

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

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 :  
 AMBAC ASSURANCE CORPORATION and :  
 THE SEGREGATED ACCOUNT OF AMBAC :  
 ASSURANCE CORPORATION, :  
 :  
 Plaintiffs, :  
 :  
 - against - :  
 :  
 COUNTRYWIDE HOME LOANS, INC., :  
 COUNTRYWIDE SECURITIES CORP., :  
 COUNTRYWIDE FINANCIAL CORP. (n.k.a. :  
 Bank of America Home Loans), and BANK OF :  
 AMERICA CORP., :  
 :  
 Defendants. :  
 :  
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Index No. \_\_\_\_\_  
Date purchased: \_\_\_\_\_

**SUMMONS**

To the above named Defendants:

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

Venue in New York County is proper pursuant to CPLR §§ 501 and 503. The bases of venue are Plaintiff Ambac Assurance Corporation's and several defendants' residence in New York County, *see* CPLR §§ 503(a), (c), and a contractual provision, *see* CPLR § 501.

Dated: New York, New York  
September 28, 2010

PATTERSON BELKNAP WEBB & TYLER LLP



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SUPREME COURT OF THE STATE OF NEW YORK  
NEW YORK COUNTY

\_\_\_\_\_)  
AMBAC ASSURANCE CORPORATION and THE )  
SEGREGATED ACCOUNT OF AMBAC )  
ASSURANCE CORPORATION, )  
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Plaintiffs, )  
v. )  
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COUNTRYWIDE HOME LOANS, INC., )  
COUNTRYWIDE SECURITIES CORP., )  
COUNTRYWIDE FINANCIAL CORP. (n.k.a. )  
Bank of America Home Loans), and BANK OF )  
AMERICA CORP., )  
 )  
Defendants. )  
\_\_\_\_\_)

Index No. \_\_\_\_\_

**COMPLAINT**

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

## NATURE OF THE ACTION

1. Countrywide<sup>1</sup> emerged as the number-one mortgage lender in the country over the last decade as it fueled the inflation of the housing market bubble. Now that the bubble has burst, the secret of Countrywide's short-term success—and long-term demise—has become clear: Countrywide became the country's number-one mortgage lender by abandoning its underwriting standards and condoning fraud by its employees, business partners, and many of its borrowers.

2. Beginning in 2003, Countrywide rapidly grew its lending business by “securitizing” the majority of the loans it originated. To effectuate a securitization, Countrywide first aggregated thousands of its mortgage loans into one or more “pools.” It then sold these pools of loans to a trust that it created for the securitization transaction. The trust, in turn, issued securities—certificates or notes—that were to be paid down from the cash flow from the pooled mortgage loans. Countrywide issued these securities in numerous classes with differing priorities of claims to the mortgage loan cash flows. To enhance their marketability, Countrywide contracted with monoline insurers to issue financial guaranty insurance policies that guaranteed payments due on certain classes of the securities. Securitization allowed Countrywide to vastly increase the number of loans it could make and the fees it could earn by providing a ready means to sell loans it originated.

3. Countrywide's ability to execute these securitizations hinged on its assurances that it was a prudent lender that stood behind the loans it originated: The investors who purchased the securities and the insurers that guaranteed payments to investors relied on

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<sup>1</sup> References to the conduct of “Countrywide” encompass Countrywide Financial, Countrywide Home (as its most prominent lending subsidiary), and Countrywide Securities unless made in the context of agreements entered into in connection with the Transactions that are the subject of this action, in which case references to “Countrywide” mean Countrywide Home.

Countrywide's representations concerning its mortgage lending business and mortgage loans, including Countrywide's assurances that it engaged in proper and prudent loan origination, including "underwriting" (*i.e.*, the process of assessing a borrower's ability to repay the mortgage loan and the value of the mortgaged property as collateral).

4. Because Countrywide was the nation's leading mortgage originator, its many public pronouncements that its underwriting practices were the industry's gold standard carried significant weight. Countrywide repeatedly asserted that the loans in its portfolio, from which the loans in the transactions at issue were drawn, were originated pursuant to Countrywide's strict underwriting standards that allowed "exceptions" only if compensating factors were present. But what Countrywide concealed is that, contrary to its representations, approval of "exceptions" became the rule. Countrywide failed to disclose that its business model was premised on the perpetual origination and refinancing of loans to borrowers who did not have the ability to make the required payments.

5. Countrywide was able to mask its practices and duplicity while residential real estate prices continued to inflate because borrowers could flip properties they could not afford in the first instance and Countrywide could refinance its borrowers out of bad loans into even larger bad loans. But in late 2007, when the real estate market collapsed, Countrywide could no longer conceal its systemic underwriting abuses and misrepresentations.

6. The magnitude of Countrywide's malfeasance has now come to light from the mouths of its own executives and the pages of its own internal documents. Myriad recent legal actions contain particularized allegations regarding Countrywide's wholesale underwriting misconduct, appraisal fraud, and predatory lending practices. As a federal district court concluded in denying Countrywide's motion to dismiss a shareholders' derivative suit, former

Countrywide employees credibly “tell what is essentially the same story—a rampant disregard for underwriting standards.”<sup>2</sup>

7. This lawsuit arises out of twelve Countrywide-sponsored residential mortgage-backed securitization transactions that closed between 2004 and 2006. Nine of these transactions involve securitization of home equity lines of credit (“HELOCs”) secured by second-lien mortgages (each a “Transaction,” and collectively, the “HELOC Transactions”). In such a HELOC, the borrower’s equity in the property (*i.e.*, the value of the property that exceeds the amount of the first-lien debt) collateralizes a specific line of credit that may be drawn down by the borrower. The HELOC Transactions are: (1) CWABS Revolving Home Equity Loan Trust, Series (“CWABS”) 2004-K; (2) CWABS 2004-L; (3) CWABS 2004-M; (4) CWABS 2004-N; (5) CWABS 2004-O; (6) CWABS 2004-T; (7) CWHEQ Revolving Home Equity Loan Trust, Series (“CWHEQ”) 2005-F; (8) CWHEQ 2006-B; and (9) CWHEQ 2006-C. The remaining three transactions involve securitization of closed-end second-lien mortgage loans (“CES”), which are also collateralized by the borrower’s remaining equity, but the loan is for a fixed amount (each a “Transaction” and, collectively, the “CES Transactions”). The CES Transactions are: (1) CWHEQ 2006-S1; (2) CWHEQ 2006-S4; and (3) CWHEQ 2006-S6. The HELOC Transactions and the CES Transactions are collectively referred to as the “Transactions.” In the aggregate, these twelve Transactions contain over 268,000 loans, which serve as collateral for a total of approximately \$16.7 billion in securities. Certain classes of these securities are insured by Ambac, a monoline insurance company.

8. Countrywide induced Ambac to issue financial guaranty insurance policies (the “Policies”), covering the payments due on the securities issued in the Transactions, by

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<sup>2</sup> See *In re Countrywide Fin. Corp. Derivative Litig.*, 554 F. Supp. 2d 1044, 1059 (C.D. Cal. 2008).

making (i) fraudulent representations and omissions directly to Ambac in advance of the closing of the Transactions, and (ii) express representations and warranties in the parties' agreements. Under its irrevocable Policies, Ambac guaranteed that it would cover certain payments to purchasers of the securities regardless of whether Countrywide's representations proved false and the mortgage loans did not generate the anticipated cash flow.

9. Countrywide fraudulently induced Ambac to issue the Policies by providing Ambac materially false and misleading information concerning, among other things, (i) the characteristics of the loans pooled for the Transactions, and (ii) the underwriting guidelines Countrywide purportedly followed and the due diligence it purportedly conducted to ensure the veracity of the represented characteristics and that the loans were made to borrowers who had the ability to make their payments when due.

10. Countrywide also induced Ambac to issue its Policies by entering into agreements with Ambac wherein Countrywide made two types of representations and warranties: (i) "transaction-level" representations and warranties concerning the accuracy of all of the information it provided to Ambac, including information about Countrywide's mortgage lending practices in general, its financial information, and characteristics of the pools of mortgage loans it securitized; and (ii) "loan-level" representations and warranties concerning the quality and attributes of each of the individual mortgage loans that Countrywide pooled for the Transactions. Both types of representations and warranties were critical to Ambac's assessment of the risk of insuring the securities issued in the Transactions, and both were fundamentally false.

11. Countrywide's extra-contractual and contractual representations were false and misleading, as reflected by the performance of the securitized collateral. Over the last two years, the loans in the Transactions have defaulted at extraordinary rates. To date, over 35,000

loans with an aggregate principal balance (as of the date of default or charge-off) of more than \$1.95 billion have defaulted or have been charged-off. As a result, Ambac has been forced to make more than \$466 million in claim payments.

12. Faced with this remarkably poor loan performance, Ambac reviewed the loan origination files of the defaulted loans for conformance with Countrywide's loan-level representations and warranties. Ambac has to date reviewed a total of 6,533 loans across the twelve Transactions. Of these, 6,362 loans (or over 97% of the loans reviewed) with an aggregate initial principal balance of approximately \$658 million materially breached Countrywide's loan-level representations and warranties. Among other breaches, Countrywide's loans did not bear the represented attributes or conform to Countrywide's own underwriting guidelines, and in many cases were made to borrowers with little or no ability to repay their loans.

13. Pursuant to the parties' agreements, Ambac demanded that Countrywide cure the breaches or substitute or repurchase the breaching loans. That is, the parties' agreements gave Ambac, among other non-exclusive and cumulative remedies, the right to demand that Countrywide cure breaches, or substitute or repurchase loans with breaches that materially and adversely affected the value of the loan or Ambac's interest in the loan. Despite Ambac's detailed documentation of the loan-level breaches, and in utter disregard of its contractual obligations, Countrywide refused to do so.

14. Countrywide instead implemented a delay-and-defer strategy, refusing to comply with its repurchase obligations, and requiring Ambac to engage in protracted deliberations regarding the breaches on a loan-by-loan basis prior to repurchasing even the *de minimis* loans Countrywide has repurchased to date. Only then did Countrywide concede the

existence of breaches that were detailed and evident at the outset. Through this unilaterally imposed and burdensome process (designed, overseen and closely controlled by Bank of America executives)—not called for or allowed by the parties’ agreements—Countrywide has addressed only a fraction of the breaching loans, and thus has frustrated and compounded the harm resulting from its initial breach of the repurchase or cure protocol. The parties’ agreements require Countrywide to address non-conforming loans within specified time frames in recognition of Ambac’s obligation under its Policies to make payments attributable to shortfalls due to those breaching loans. Ambac has thus paid hundreds of millions of dollars in claims, but has been deprived of the benefit of the bargain by Countrywide’s ongoing refusal to timely comply with its obligations to repurchase or cure the non-conforming loans, thereby causing and continuing to cause Plaintiffs significant harm.

15. Plaintiffs are entitled to redress for Countrywide’s massive fraud and pervasive and material breaches, including damages sufficient to place Ambac in the same position it would have been in had it never insured the Transactions.

### **THE PARTIES**

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

17. 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").

18. The Commissioner is the court-appointed Rehabilitator of the Segregated Account. In addition, the Wisconsin court appointed the Deputy Commissioner of Insurance as the Special Deputy Rehabilitator of the Segregated Account.

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

20. Defendant Countrywide Home is a New York corporation with its principal executive offices in Calabasas, California. Countrywide Home is a wholly owned subsidiary of Countrywide Financial.

21. Defendant Countrywide Securities, a wholly owned subsidiary of Countrywide Financial, is a Delaware corporation with its executive offices in Calabasas, California and New York, New York. Countrywide Securities is or was a registered broker-dealer and underwrites offerings of mortgage-backed securities. Countrywide Securities acted as an underwriter for each of the Transactions.

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

and belief, in April 2009, Countrywide Financial changed its name to Bank of America Home Loans.

23. Defendant Bank of America is a Delaware corporation with its principal executive offices in Charlotte, North Carolina. The three Countrywide entities involved with the Transactions—Countrywide Home, Countrywide Securities, and Countrywide Financial—became wholly owned subsidiaries of Bank of America following the merger of Countrywide Financial into a Bank of America subsidiary on July 1, 2008 and, on information and belief, Bank of America is a successor-in-interest to Countrywide’s liabilities.<sup>3</sup> Moreover, Bank of America actively participated in the frustration of Ambac’s loan-level repurchase or cure remedy by adopting and directing a strategy to delay-and-defer any recovery afforded thereunder.

#### **JURISDICTION AND VENUE**

24. This Court has original jurisdiction over this action pursuant to N.Y. C.P.L.R. 301. Countrywide Home, Countrywide Securities, Countrywide Financial, and Bank of America are registered or licensed to do business within New York and have agreed to the jurisdiction of this Court within the State over matters arising out of their activities within the State. Each has offices and regularly transacts business within the State. Each participated in negotiations and other activities within the State that led to the Transactions that give rise to the claims in this complaint, and the Transactions themselves occurred within the State.

25. In addition, this Court has personal jurisdiction over Countrywide Home pursuant to a forum selection clause in the Insurance and Indemnity Agreements (“I&I Agreements”) between the parties for each Transaction. Specifically, Section 6.05(a) of each

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<sup>3</sup> A California federal court recently noted that “Countrywide’s remaining operations and employees have been transferred to Bank of America, and Bank of America ceased using the Countrywide name in April 2009.” *Securities and Exchange Commission v. Mozilo*, No. 09-CV-3994, slip op. at 3 n.2 (C.D. Cal. Sept. 16, 2010).

I&I Agreement provides as follows:

The parties hereto hereby irrevocably submit to the non-exclusive jurisdiction of . . . any court in the State of New York located in the City and County of New York . . . in any action, suit or proceeding brought against it and to or in connection with any of the Operative Documents [defined below], the Policy or the Transaction or for recognition or enforcement of any judgment, and the parties hereto hereby irrevocably and unconditionally agree that all claims in respect of any such action or proceeding may be heard or determined in such New York state court. . . .<sup>4</sup>

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

27. Venue is also proper in this judicial district under the forum selection clause cited in paragraph 25.

### **FACTUAL ALLEGATIONS**

#### **A. The Rise and Fall of Countrywide**

28. Countrywide's principal business is or was residential mortgage banking. Countrywide Financial, Countrywide Home, and Countrywide Securities each had a role in Countrywide's securitizations. Countrywide Financial directed the activities of Countrywide Home and Countrywide Securities, its wholly owned subsidiaries. Upon information and belief, after the merger in July 2008, Bank of America became the successor-in-interest to Countrywide and directed its activities.

29. During the middle of the prior decade, Countrywide Financial was America's largest mortgage lender, and Countrywide Home—its principal mortgage lending subsidiary—accounted for the majority of its loan originations. The most prolific loan origination growth in Countrywide's forty-year history occurred after 2002: from 2002 to 2006,

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<sup>4</sup> The Operative Documents for the HELOC Transactions are substantively identical for purposes of this Complaint. The same is true for the Operative Documents for the CES Transactions. The Complaint excerpts only Operative Documents from the CWHEQ 2005-F Transaction (which are similar to the Operative Documents for the remaining HELOC Transactions) and the CWHEQ 2006-S1 Transaction (which are similar to the Operative Documents for the remaining CES Transactions).

Countrywide Home's total mortgage loan originations grew from over \$242 billion to over \$421 billion and its pre-tax profit grew by more than 210%. Overall, during this period Countrywide Financial's mortgage loan originations grew from over \$251 billion to over \$468 billion and its pre-tax profit increased by more than 300%.

30. Countrywide increased its mortgage loan originations by secretly abandoning sound underwriting practices and its own internal underwriting guidelines. Countrywide implemented an internal policy to make loans regardless of the borrowers' ability to repay, and allowed the borrowers to avoid defaults by serially refinancing their loans based on inflated property valuations. This *secret* policy was in direct contravention of Countrywide's stated policy against making loans based solely on the equity in the collateral property.<sup>5</sup>

31. Countrywide could mask these abuses while the real estate bubble expanded. But when the market collapsed, Countrywide could no longer refinance unfit borrowers into new loans and borrowers no longer could flip the underlying properties to avoid defaults. Thus, its scheme came to an end, and the depth of Countrywide's misconduct was revealed.

32. As a consequence of Countrywide's lending practices, billions of dollars worth of Countrywide mortgage loans have defaulted since late 2007, and billions more are expected to default. This has inflicted massive damage on all investors with direct and indirect interests in Countrywide-originated loans, as well as the global financial system.

## **B. Countrywide's Secret Growth Strategy**

33. Countrywide grew its mortgage loan originations after 2002 by underwriting loans under standards that differed diametrically from Countrywide's public

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<sup>5</sup> See, e.g., Countrywide Technical Manual, dated Mar. 15, 2005, at 4 ("No loan will be approved based solely on the equity available in the collateral property.").

characterization of its mortgage lending practices and its own underwriting guidelines.

**1. Countrywide's Facade**

34. Before 2003, Countrywide made primarily traditional first-lien loans to highly creditworthy individuals. At that time, Countrywide's market share was thirteen percent. In 2003, however, Countrywide's Chief Executive Officer, Angelo Mozilo, implemented an aggressive growth strategy, calling for Countrywide to capture an unprecedented thirty percent 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."

35. At the same time, Countrywide and Mozilo assured the market that Countrywide's focus on growth would not come at the expense of loan quality:

- During a January 2004 analyst conference call, Mozilo stated that "going for 30% mortgage share here is totally unrelated to quality of loans we go after . . . . There will be no compromise in that as we grow market share."
- On a March 15, 2005 analyst conference call, Mozilo again represented that "under no circumstances will Countrywide ever sacrifice sound lending and margins for the sake of getting to that 30% market share."
- In a July 26, 2005 earnings call, Mozilo claimed that he was "not aware of any change of substance in [Countrywide's] underwriting policies" and that Countrywide had not "taken any steps to reduce the quality of its underwriting regimen."
- At an investor forum in 2006, Mozilo boasted of Countrywide's position as an industry leader and a role model, stating: "We take seriously the role as responsible lender for all of our constituencies . . . . To help protect our bondholder customers, we engage in prudent underwriting guidelines."

36. Similarly in its filings with the Securities and Exchange Commission ("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.

37. For example, in its Annual Report filed with the SEC for 2006 (Form 10-K), Countrywide represented that it ensured compliance with its underwriting standards through various control procedures:

We help to ensure that our origination standards are met by employing accomplished and seasoned management, underwriters and processors and through the extensive use of technology. We also employ proprietary underwriting systems in our loan origination process that improve the consistency of underwriting standards, assess collateral adequacy and help to prevent fraud, while at the same time increasing productivity.

We supplement our loan origination standards and procedures with a post-funding quality control process. Our Quality Control Department is responsible for completing loan audits that may consist of a re-verification of loan documentation, an underwriting and appraisal review, and if necessary, a fraud investigation. We also employ a pre- and post-funding proprietary loan performance evaluation system. This system helps to identify fraud and poor performance of individuals and business entities associated with the origination of our loans. The combination of this system and our audit results allows us to evaluate and measure adherence to prescribed underwriting guidelines and compliance with laws and regulations.<sup>6</sup>

38. Countrywide made similar statements in the offering documents for the securities like those at issue in this case, including documents that Countrywide provided to Ambac to induce Ambac to do business with Countrywide. In the Prospectus Supplements filed with the SEC for each Transaction, for example, Countrywide purported to describe the (i) underwriting procedures it utilized for origination of loans, (ii) material characteristics of the loans included in the securitizations, and (iii) material risks relating to investing in the securities.

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<sup>6</sup> Countrywide Financial, Annual Report for Fiscal Year 2006 (Form 10-K), at 100-01 (March 1, 2007). Countrywide’s Form 10-Ks for fiscal years 2005 and 2004 contain representations that are substantively identical. *See* Countrywide Financial, Annual Report for Fiscal Year 2005 (Form 10-K), at 93 (March 1, 2006); Countrywide Financial, Annual Report for Fiscal Year 2004 (Form 10-K), at 75 (March 15, 2005).

39. The Prospectus Supplements for the Transactions describe Countrywide’s underwriting process as follows:

The underwriting process is intended to assess the applicant’s credit standing and repayment ability, and the value and adequacy of the real property security as collateral for the proposed loan. Exceptions to the sponsor’s underwriting guidelines will be made 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.<sup>7</sup>

....

Full appraisals are generally performed on all home equity loans. These appraisals are determined on the basis of a sponsor-approved, independent third-party, fee-based appraisal completed on forms approved by Fannie Mae or Freddie Mac.<sup>8</sup>

40. The Prospectus Supplements also describe characteristics of the loans in the loan pools, including the purported maximum “debt-to-income ratio” (“DTI”)—an important metric for assessing a borrower’s ability to repay:

The “*debt-to-income ratio*” is the ratio of the borrower’s total monthly credit obligations (assuming the mortgage loan interest rate is based on the applicable fully indexed interest rate) to the borrower’s gross monthly income. Based on this, the maximum monthly debt-to-income ratio is 45%. . . .<sup>9</sup>

41. In addition to describing the characteristics of the loan pools for the particular transactions, the Prospectus Supplements purport to describe risk factors associated with investing in the securities. But in describing these generic risk factors, Countrywide

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<sup>7</sup> CWHEQ 2005-F Prospectus Supplement at S-23; CWHEQ 2006-S1 Prospectus Supplement at S-30.

<sup>8</sup> CWHEQ 2005-F Prospectus Supplement at S-23. The Prospectus Supplements for the CES Transactions provide that “[f]ull appraisals are generally performed on all closed-end second lien mortgage loans that at origination had a loan amount greater than \$100,000. These appraisals are determined on the basis of a sponsor-approved, independent third-party, fee-based appraisal completed on forms approved by Fannie Mae or Freddie Mac.” See CWHEQ 2006-S1 Prospectus Supplement at S-31.

<sup>9</sup> CWHEQ 2005-F Prospectus Supplement at S-24. The Prospectus Supplements for the CES Transactions are substantively identical. See CWHEQ 2006-S1 Prospectus Supplement at S-31.

omitted a key risk that it knew materially and adversely affected the value of its mortgage-backed securities: The risk that its undisclosed strategy had resulted in securitized pools replete with loans made to borrowers with little or no ability to repay.

42. At the same time Countrywide was falsely representing the rigor of its underwriting practices to investors in public statements and SEC filings, it was making false representations to Ambac in face-to-face due diligence meetings between the companies' executives at Countrywide's Calabasas headquarters. At these due diligence meetings—which took place, among other times, in July 2004, November 2004, September 2005, and February 2006—Countrywide executives briefed Ambac executives on Countrywide's underwriting and other loan origination practices, appraisal practices, underwriting quality control, and legal and regulatory compliance.

43. At these meetings, Countrywide executives touted the rigor of Countrywide's loan origination practices and underwriting standards. For example, an internal Ambac memorandum concerning its credit decision on the CWHEQ 2006-B Transaction states:

In September of 2005, Ambac performed a full operational due diligence for Countrywide's origination and credit practices. In February 2nd [sic], 2006, [Ambac employees] Jeff Nabi, along with Rick Persaud and Ervin Pilku performed a follow-up operational due diligence on Countrywide. The purpose of the meeting was to discuss in more details [sic] the origination and securitization practices for second-lien HELOCS and Option Arms. The results of the meeting were positive highlighting [of] CFC's [Countrywide Financial Corporation's] conservative credit approach in origination volume and quality of corporate controls.

Countrywide's underwriting process assesses the applicant's credit standing and repayment ability, as well as the value and adequacy of the property. Exceptions to their underwriting guidelines are made only by senior officers when compensating factors are present. These factors include employment stability, favorable credit history, equity in the property, and the nature of the underlying mortgage.

## 2. *Countrywide's Actual Strategy*

44. Contrary to Countrywide's representations to the market and to Ambac concerning its mortgage lending business, Countrywide pursued its ambitious growth target by engaging in undisclosed, imprudent and unlawful lending practices that contravened its own stated policies. This wrongful conduct is cataloged in recent public and private actions against Countrywide.

45. Recently, 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.<sup>10</sup> 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."<sup>11</sup> 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."<sup>12</sup>

46. On September 17, 2010, the U.S. District Court for the Central District of California denied defendants' motion for summary judgment in the SEC's action, citing to hundreds of pages of internal Countrywide documents and depositions of Countrywide employees that showed Countrywide failed to disclose material information and risks associated

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<sup>10</sup> *SEC v. Mozilo*, No. 09-CV-3994 (C.D. Cal. 2009).

<sup>11</sup> Complaint ¶ 6, *SEC v. Mozilo*, No. 09-CV-3994 (C.D. Cal. filed, June 4, 2009).

<sup>12</sup> Complaint ¶ 7, *SEC v. Mozilo*, No. 09-CV-3994 (C.D. Cal. filed, June 4, 2009).

with its loans and origination practices.

47. 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.<sup>13</sup> These particular allegations, admissions, documents and rulings demonstrate that Countrywide drove loan origination growth by shifting to loan products with greater risk of default, while (i) abandoning the very underwriting policies it purportedly implemented to control for that risk, (ii) inflating borrowers' income on loan

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<sup>13</sup> See, e.g., *In re Countrywide Fin. Corp. Derivative Litig.*, Lead Case No. 07-CV-06293 (C.D. Cal. 2007) (class action by Countrywide shareholders for violations of the federal securities laws); *In re Countrywide Fin. Corp. Derivative Litig.*, Lead Case No. 07-CV-06293 (C.D. Cal. 2007) (derivative action by Countrywide shareholders against former Countrywide officers and directors for breach of fiduciary duties, gross mismanagement, corporate waste, insider trading, and violations of federal securities laws); *Argent Classic Convertible Arbitrage Fund v. Countrywide Fin. Corp.*, No. 07-07097 (C.D. Cal. 2007) (class action by Countrywide debt holders alleging violations of federal securities laws and California law); *Amalgamated Bank v. Countrywide Fin. Corp.*, No. 08/603425 (N.Y. Sup. Ct. 2008) (action by a bank that invested in four portfolios of HELOCs from Countrywide for fraudulent inducement and breach of contract); *Federal Home Loan Bank of Seattle v. Countrywide Sec. Corp.*, No. 10-CV-148 (W.D. Wash. 2008) (alleging that the offer and sale of Countrywide-originated loans was made pursuant to untrue statements or omissions of material facts); *Federal Home Loan Bank of San Francisco v. Credit Suisse Securities (USA) LLC*, No. CGC 10-497840 (Cal. Super. Ct. 2010) (same); *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, Index No. 08/602825 (N.Y. Sup. Ct. 2008) (action by financial guaranty insurer alleging fraud, negligent misrepresentation, and breach of contract in connection with Countrywide securitizations it insured); *Syncora Guarantee Inc. v. Countrywide Home Loans, Inc.*, Index No. 09-650042 (N.Y. Sup. Ct. 2009) (same); *MBIA Ins. Corp. v. Bank of America Corp.*, No. BC417572 (Cal. Super. Ct. 2009) (same); *Financial Guaranty Ins. Co. v. Countrywide Home Loans, Inc.*, Index No. 090650736 (N.Y. Sup. Ct. 2009) (same); *Capitol West Appraisals, LLC v. Countrywide Fin. Corp.*, No. 08-CV-1520 (W.D. Wash. 2008) (class action by real estate appraisers alleging that Countrywide violated the federal Racketeer Influenced and Corrupt Organizations Act by illegally obtaining favorable appraisals); *Alston v. Countrywide Fin. Corp.*, 585 F.3d 753 (3d Cir. 2009) (alleging that Countrywide violated federal law and engaged in a kickback scheme when it required certain borrowers to obtain insurance from particular primary insurance companies, which then obtained reinsurance from Countrywide's affiliates); *Zachary v. Countrywide Fin. Corp.*, No. 08-CV-00214 (S.D. Tex. 2008) (action by a former Countrywide executive alleging he was wrongfully discharged for refusing to engage in illegal lending practices); *United Guaranty Residential Ins. Co. of N. Carolina v. Countrywide Fin. Corp.*, No. 09-CV-203 (M.D.N.C. 2009) (action by primary mortgage insurer alleging that Countrywide misrepresented loan attributes and its underwriting practices); *Republic Mortgage Ins. Co. v. Countrywide Fin. Corp.*, Index No. 09-603915 (N.Y. Sup. Ct. 2009) (same); *Old Republic Ins. Co. v. Countrywide Bank FSB*, No. 2008-CH-47501 (Illinois Cir. Ct. 2008) (same). See also *People of the State of California v. Countrywide Fin. Corp.*, No. LC081846 (Cal. Super. Ct. 2008); *State of Connecticut v. Countrywide Fin. Corp.*, (Ct. Superior Ct. 2008); *Office of the Attorney General, Department of Legal Affairs, State of Florida v. Countrywide Fin. Corp.*, No. 08-30105 (Fl. Cir. Ct. 2008); *People of the State of Illinois v. Countrywide Fin. Corp.*, No. 08CH22994 (Ill. Cir. Ct. 2008); *State of Indiana v. Countrywide Fin. Corp.*, Cause No. 76C01-0808-PL-0652 (Ind. Cir. Ct. 2008); *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).

applications, (iii) fostering fraudulent appraisals, and (iv) engaging in predatory lending.

(a) **Shift to Riskier Products**

48. Starting in 2003, Countrywide shifted its origination strategy from making fixed-rate loans to creditworthy borrowers to making risky adjustable rate loans to marginal borrowers. As a result, Countrywide increased both the size and risk of its mortgage loan portfolio. Countrywide's revised strategy included offering existing loan products to classes of borrowers they were neither designed nor appropriate for.

49. For example, Countrywide expanded its use of reduced documentation or "low-doc" loans, such as those included in the Transactions at issue in this lawsuit. 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.<sup>14</sup> But the limited income verification associated with these loans "does not eliminate the need to analyze and evaluate the [b]orrower'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 [b]orrower's occupation and credit information."<sup>15</sup>

50. 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."<sup>16</sup> But in response to the call to increase volume, Countrywide funneled into these programs borrowers of the type that its own guidelines prohibited—borrowers who could not qualify for loans under full-documentation programs

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<sup>14</sup> Countrywide Technical Manual, Introduction: 0.2.3 (last revised June 5, 2006).

<sup>15</sup> Countrywide Technical Manual, Introduction: 0.2.3 (last revised June 5, 2006).

<sup>16</sup> Countrywide Technical Manual, Introduction: 0.2.3 (last revised June 5, 2006).

because they did not have the necessary income or financial strength.

51. As a former Regional Vice President of Countrywide alleged in his wrongful termination lawsuit, Countrywide condoned the practice of approving borrowers for reduced-documentation loans after Countrywide determined that the borrowers could not qualify for loans based on the income reflected on their W-2 forms or tax returns<sup>17</sup>—a practice that is specifically prohibited by Countrywide’s Technical Manual.<sup>18</sup> Because these loans did not require corroborating documentation, Countrywide employees simply “stated” on the loan application the income that Countrywide’s guidelines required to make the loan.<sup>19</sup>

52. Indeed, former Countrywide wholesaler John Sipes has stated that underwriters at Countrywide’s Santa Monica and Beverly Hills branches often shredded borrowers’ tax documents to destroy proof of the borrowers’ incomes and extend larger loans than the borrowers could afford—another practice that is prohibited by Countrywide’s own guidelines.<sup>20</sup> Because Countrywide told borrowers that there would not be any inquiry into the truth of their stated income, Countrywide employees referred to these products as “liar loans.”<sup>21</sup>

53. The SEC’s complaint against Mozilo illustrates that Countrywide executives knew and did not disclose that Countrywide’s use of reduced documentation loans

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<sup>17</sup> Complaint ¶¶ 11-12, *Zachary v. Countrywide Financial Corp. d/b/a Countrywide Home Loans Inc.*, No. 08-CV-214 (S.D. Tex. 2008).

<sup>18</sup> Countrywide Technical Manual, Part 0, Chapter 2, Section 3 (last revised July 13, 2005) (“If a loan was declined as a full/alternatively documented loan it may not be eligible for any stated or no income documentation program.”).

<sup>19</sup> Zachary repeated these allegation in an interview with NBC news. *See* Lisa Myers, *Countrywide Whistleblower Reports ‘Liar Loans’: Former Regional Manager Sues Mortgage Company for Wrongful Termination*, Nightly News With Brian Williams, July 1, 2008, available at [http://www.msnbc.msn.com/id/25465130/ns/nightly\\_news\\_with\\_brian\\_williams/](http://www.msnbc.msn.com/id/25465130/ns/nightly_news_with_brian_williams/).

<sup>20</sup> Countrywide Technical Manual, Part 0, Chapter 2, Section 3 (last revised July 13, 2005) (“Income verification cannot be removed from a loan file.”).

<sup>21</sup> Mara Der Hovanesian, *Who Crossed the Line on the Street?*, BUSINESS WEEK, Nov. 13, 2008, available at [http://www.businessweek.com/magazine/content/08\\_47/b4109075640944.htm](http://www.businessweek.com/magazine/content/08_47/b4109075640944.htm).

was fraught with risk. The complaint contains the following allegations about Countrywide's senior executives' knowledge of the rampant misrepresentation of income associated with reduced-documentation loans:

- 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.<sup>22</sup>
- At an April 6, 2005 meeting of Countrywide's credit risk committee its chief risk officer, John P. McMurray reported that the risk of default associated with HELOCS had doubled over the past year, mainly due to the prevalence of reduced documentation in those loans.<sup>23</sup>
- At a June 28, 2005 meeting, Countrywide's credit risk management department reported to Countrywide's credit risk committee on evidence of borrowers misrepresenting their income and occupation on reduced documentation loan applications.<sup>24</sup>
- Mozilo and Sambol knew by June 2006 that a significant percentage of borrowers who were taking out stated income loans were engaged in mortgage fraud. On June 2, 2006, Sambol received an e-mail reporting on the results of a control audit conducted by Countrywide Bank that showed that 50% of the stated income loans audited by the bank showed a variance in income from the borrowers' IRS filings of greater than 10%. Of those, 69% had an income variance of greater than 50%.<sup>25</sup>

54. A second illustration of Countrywide's shift to riskier uses of traditional products is its expanded issuance of CESs and HELOCs, types of loans included in the

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<sup>22</sup> Complaint ¶ 35, *SEC v. Mozilo*, No. 09-CV-3994 (C.D. Cal. 2009).

<sup>23</sup> Complaint ¶ 36, *SEC v. Mozilo*, No. 09-CV-3994 (C.D. Cal. 2009).

<sup>24</sup> Complaint ¶ 37, *SEC v. Mozilo*, No. 09-CV-3994 (C.D. Cal. 2009).

<sup>25</sup> Complaint ¶ 40, *SEC v. Mozilo*, No. 09-CV-3994 (C.D. Cal. 2009).

Transactions.<sup>26</sup> Countrywide historically extended HELOCs to creditworthy borrowers for consumer expenses like home renovations or college tuition. Countrywide, however, covertly began to issue HELOCs to borrowers to purchase properties they could not otherwise afford. As detailed in the shareholder complaint against Countrywide, “if a broker convinced a borrower to take out a HELOC in addition to a mortgage loan—which was commonplace in [Countrywide’s] sales of so-called 80/20 loans—the broker received an extra 0.25% commission.”<sup>27</sup> This new use of HELOCs was especially perilous because HELOCs—as well as CESs—sit in the first loss position. Upon a default and foreclosure, the lender receives proceeds from the foreclosure sale only after the first lien holder is paid in full. Accordingly, it is critical that the lender carefully evaluate the ability of the borrower to repay the loan and the value of the underlying property as collateral. Countrywide did neither.

55. Rather, Countrywide disregarded sound underwriting practices in pursuit of volume. As a result, Countrywide increased the quantity of HELOCs it extended more than four-fold from 2002 to 2006, from over \$11 billion in 2002 to over \$47 billion in 2006.

**(b) Abandonment of Sound Underwriting Practices**

56. As it increased the risk of its mortgage loan portfolio, Countrywide turned its back on the underwriting philosophy outlined in its own Technical Manual.

57. According to the Technical Manual, it was Countrywide’s policy to originate “investment quality loans,” defined as “one that is made to a borrower from whom

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<sup>26</sup> Countrywide’s increasing origination of “pay-option” adjustable rate mortgages, which allow borrowers to choose among four payment options, also reflects its increasing appetite for riskier mortgage products. The California federal court found that not only were these products riskier, but Countrywide covertly originated them “on a reduced documentation basis” when its executives wrote to each other that “there was evidence that borrowers were lying about their income in the loan application.” *SEC v. Mozilo*, No. 09-CV-3994, slip op. at 6 (C.D. Cal. Sept. 16, 2010).

<sup>27</sup> Second Consolidated Class Action Complaint ¶ 258, *In re Countrywide Fin. Corp. Sec. Litig.*, Lead Case No. 07-CV-05295 (C.D. Cal. filed, Jan. 6, 2009).

timely payment of debt can be expected, is adequately secured by real property, and is originated in accordance with Countrywide's Technical Manual and Loan Program Guides."<sup>28</sup>

58. Consistent with its stated aim of producing investment quality loans, the Countrywide Technical Manual contains a lengthy discussion of borrower fraud:

When a fraudulent loan is submitted to Countrywide, we are at risk no matter when the fraud is detected. Regardless of whether the fraud was committed for profit or just for someone to be able to purchase a home, it is fraud. The investor to whom we sell a fraudulent loan can require that we repurchase the loan even if fraud occurred months or years earlier. In the majority of cases, Countrywide suffers a monetary loss since the perpetrators of the fraud have disappeared or, if caught, rarely have the financial ability to reimburse the Company.<sup>29</sup>

59. The Technical Manual instructs Countrywide underwriters to consider the following guidelines when reviewing a loan application:

- Capacity to pay – What is the gross income, debt ratio, and disposable income?
- Credit – What is the history of mortgage credit, consumer credit, and public records?
- Common Sense – Does the loan benefit the borrower. Does the entire loan package make sense and meet the borrower's objectives?
- Current situation – Does the borrower show the ability and willingness to repay the loan at this time?
- Collateral – What is the property type, condition, and marketability?<sup>30</sup>

60. Notwithstanding the cautious tone of Countrywide's Technical Manual, in practice Countrywide encouraged the flouting of its underwriting guidelines and allowed the

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<sup>28</sup> Countrywide Technical Manual, Part 0, Chapter 2, Section 1 (last revised Sept. 29, 2005).

<sup>29</sup> Countrywide Technical Manual, Introduction – Loan Fraud: 0.6 (last revised Sept. 27, 2004).

<sup>30</sup> Countrywide Technical Manual, Introduction: 0.1 (last revised Mar. 15, 2005).

circumvention of the very controls it represented it had implemented to control for such risk.

Moreover, as the California federal court recently found, Countrywide's executives knew well—

but did not disclose—that Countrywide's guidelines were the most aggressive in the industry:

- Countrywide's Chief Risk Officer, John McMurray, explained in his deposition, that Countrywide mixed and matched guidelines from various lenders in the industry, which resulted in Countrywide's guidelines being a composite of the most aggressive guidelines in the industry: "And so, . . . if you match one lender on—on one—on certain guidelines or for certain products and then you match a separate lender on a different product or a different set of guidelines, then in my view the composite of that—of that two-step match would be more—would be more aggressive than either one of those competitor reference points viewed in isolation." McMurray repeatedly explained his view and the risks of the matching strategy to others within Countrywide, including Sambol.
- Moreover, in addition to demonstrating that Defendants were aware of the facts which made their statements misleading, the SEC has presented evidence that Sambol and Sieracki knew that Countrywide's Chief Risk Officer John McMurray firmly believed that Countrywide should include greater credit risk disclosures in its SEC filings. "For example, in January 2007, McMurray sent an e-mail to Sieracki outlining 'why delinquencies will increase and the impact this increase will have on [Countrywide's] financial results,' and specifically pointed out 'widened guidelines' as one of the principal reasons."
- In a June 24, 2005 e-mail, Countrywide's Chief Risk Officer John McMurray explained to Sambol that "because the matching process includes comparisons to a variety of lenders, our [guidelines] will be a composite of the outer boundaries across multiple lenders. For example, First Franklin is used as a comparison for some guidelines where they are more aggressive (e.g., high LTV/CLTV) and not used where they are less aggressive (e.g. stated doc loans). As a result, our composite guides are likely among the most aggressive in the industry."
- On November 2, 2006, Sambol was again made aware of McMurray's concern that when Countrywide's matching strategy was "done across lenders, across products and across

guidelines, the composite set of guidelines will be the most aggressive credit in the market.”

- In a February 11, 2007 e-mail, McMurray advised Sambol that he doubted Countrywide’s composite matching strategy “would play well with regulators, investors, rating agencies, etc. To some, this approach might seem like we’ve simply ceded our risk standards and balance sheet to whoever has the most liberal guidelines.”
- On May 25, 2006, the chairman of the board of Countrywide Bank reported that he had spoken to Sambol regarding pay option loans: “Spoke with sambol. He believes historical payoption performance trends can help disclose problems but are not sufficient/capable of providing comfort. Sambol is concerned about payment shock at recast and inability to absorb increased payments thru income or refi (due to low equity). So Sambol believes high cltv loans with no mi, particularly those with high dti are risky. Maybe also those with low ficos. If the loans are in markets that have slowed the risk is exacerbated. He wants us to propose a strawman action plan. For example, for those segments in the markets that have stopped appreciating, sell the most recent production and stop portfolioing cltv greater than 80 and high dti loans. For markets that are expected to continue to appreciate, monitor and maybe stop portfolioing high cltv and dti loans.”<sup>31</sup>

61. Countrywide’s executives knew—and kept it a secret—that the quality of loans originated by Countrywide was deteriorating, and would continue to worsen. For instance, on September 1, 2004, Mozilo wrote an e-mail to other Countrywide executives, Stan Kurland and Keith McLaughlin, in which he stated: “As I look at production trends . . . at Countrywide . . . , there is 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.”<sup>32</sup>

62. To the public and the participants in its securitizations, Countrywide

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<sup>31</sup> *SEC v. Mozilo*, No. 09-CV-3994, slip op. at 20-21 (C.D. Cal. Sept. 16, 2010) (citation omitted).

<sup>32</sup> SEC’s Statement of Genuine Issues of Material Fact in Opposition to Defendants’ Motions for Summary Judgment ¶ 221, *SEC v. Mozilo*, No. 09-CV-3994 (C.D. Cal. Aug. 16, 2010).

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 most senior executives.

63. Countrywide claimed that it made exceptions to CLUES only 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 loans, the system “referred” the loan applications for “manual” underwriting to what Countrywide termed its “Exception Processing System,” which was nothing more than a protocol designed to secure approval for virtually every loan regardless of the borrower’s ability to repay the loan.

64. The Exception Processing System was a process by which loans rejected by CLUES were routed to individual underwriters, their branch managers, and ultimately the so-called “Structured Loan Desk” until the application reached an officer with sufficient authority to override the stated guidelines and approve the loan. Based in Plano, Texas, the Structured Loan Desk was created for the very purpose of approving loans based on exceptions that plainly did not qualify under Countrywide’s underwriting guidelines touted to the outside world. The California federal court, in denying Countrywide executives’ motion for summary judgment, explained the criteria used by Countrywide’s Structured Lending Desk in approving loans:

According to the testimony of the Managing Director of Countrywide Home Loans’ Secondary Marketing Division, once the loan was referred to Countrywide’s Secondary Markets Structured Lending Desk, *the sole criterion used for approving the loan was whether or not the loan could be sold into the secondary market.* As a result of this process, a significant percentage

(typically in excess of 20%) of Countrywide's loans were issued as exceptions to its official underwriting guidelines. As reported in one Corporate Credit Risk Committee meeting, one third of the loans referred from CLUES missed "major guidelines" and another one third missed "minor" guidelines. In light of this evidence, a reasonable jury could conclude that Countrywide all but abandoned managing credit risk through its underwriting guidelines, that Countrywide would originate any loan it could sell, and therefore that the statements regarding the quality of Countrywide's underwriting and loan production were misleading.<sup>33</sup>

65. Through the Exception Processing System, Countrywide approved thousands of loans per week that were made to borrowers who could not repay the loans. In fact, as recited in the SEC's complaint, from early 2006 Countrywide used as "compensating factors" variables that had already been assessed by Countrywide's automated underwriting systems. Countrywide's underwriting manuals were amended to explicitly prohibit this practice in mid-2007.<sup>34</sup>

66. Countrywide's internal documents and its employees' admissions demonstrate that under management's direction, approval of "exceptions" was the rule—regardless of the risk associated with the loan—and in contravention of its own policy that exceptions could be considered and approved only in moderation.<sup>35</sup>

67. For example, an internal Countrywide presentation created by former Countrywide President and Chief Operating Officer, David Sambol, submitted in a criminal prosecution of a former Countrywide loan officer, listed the following objectives for the Exception Processing System:

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<sup>33</sup> *SEC v. Mozilo*, No. 09-CV-3994, slip op. at 11-12 (C.D. Cal. Sept. 16, 2010) (citation omitted) (emphasis added).

<sup>34</sup> Complaint ¶ 13, *SEC v. Mozilo*, No. 09-CV-3994 (C.D. Cal. 2009).

<sup>35</sup> Countrywide Technical Manual, Part 0, Chapter 2, Section 10 (last revised August 17, 2005) ("Exceptions must be considered and approved in moderation.").

- Approve *virtually every borrower and loan profile* with pricing add-on when necessary.
- Identify alternative program to meet borrower needs.
- Process and price exceptions on standard products for high-risk products.
- Process exceptions for:
  - Credit Scores
  - LTV (loan-to-value) amount
  - Cash out amounts
  - Property types<sup>36</sup>

Former Countrywide loan officer, Kourosh Partow, told an interviewer for Dateline NBC that if a borrower had a pulse, Countrywide would give the borrower a loan.<sup>37</sup>

68. The SEC’s complaint against Mozilo reflects that Sambol and other Countrywide executives were aware that Countrywide’s abuse of the exception process had increased the risk of loans originated by Countrywide. It alleges that on May 22, 2005, Countrywide’s chief risk officer warned Sambol that loans approved on an exception basis were significantly more likely to default: “The main issue is to make sure everyone’s aware that we will see higher default rates.”<sup>38</sup> Sambol was also informed that as a result of the higher rates of default on loans originated pursuant to exceptions, third-parties to whom Countrywide has managed to sell the credit risk associated with these loans will seek repurchase or indemnification from Countrywide for their losses.<sup>39</sup> Discovery of Countrywide’s documents in the SEC’s lawsuit shows that about a month later, on June 28, 2005, Countrywide’s Corporate Credit Risk Committee received a presentation informing Countrywide executives that a third of the loans referred from CLUES miss major guidelines and another third miss minor guidelines.

<sup>36</sup> See *United States v. Partow*, No. 06-CR-00104 (HRH) (D. Alaska 2006) (emphasis added).

<sup>37</sup> Dateline NBC: Inside the Financial Fiasco (NBC television broadcast Mar. 27, 2009).

<sup>38</sup> Complaint ¶ 54, *SEC v. Mozilo*, No. 09-CV-3994 (C.D. Cal. 2009).

<sup>39</sup> SEC’s Statement of Genuine Issues of Material Fact in Opposition to Defendants’ Motions for Summary Judgment ¶ 288, *SEC v. Mozilo*, No. 09-CV-3994 (C.D. Cal. Aug. 16, 2010).

The presentation informed the committee that loans over \$650,000 that were originated under exceptions were performing 2.8 times *worse* than similar loans underwritten within the guidelines.<sup>40</sup>

69. In denying Countrywide executives' motions for summary judgment, the California federal court pointed to additional evidence indicating that Countrywide's executives "were aware that Countrywide routinely ignored its underwriting guidelines":

- As early as May 22, 2005, Countrywide's Chief Risk Officer John McMurray sent an e-mail alerting Sambol to the risks of Countrywide's exception policy. McMurray stated that "exceptions are generally done at terms even more aggressive than our guidelines," and "[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 and reconfirm where we're comfortable and change where we're not." Additionally, he warned that increased defaults would cause repurchase and indemnification requests to rise and the performance of Countrywide-issued mortgage-backed securities in the secondary market to deteriorate.
- On June 28, 2005, Sieracki attended a Corporate Credit Risk Committee meeting, in which he was informed that 1/3 of the loans which were referred from CLUES violated "major" underwriting guidelines and 1/3 violated "minor" guidelines. At that same June 28, 2005 meeting, Sieracki learned that Countrywide was originating non-owner occupied loans with 95% combined loan to value ratios, which were exceptions to Countrywide's underwriting guidelines. Countrywide's chief operating officer opined that Countrywide "appear[ed] to have unacceptable risk on [its] balance sheet" from these loans.
- Mozilo was acutely aware of the breakdown in Countrywide's procedures and the lack of compliance with Countrywide's underwriting guidelines as a result of HSBC's demand that Countrywide "buy-back" many of the "80/20" loans that it had purchased. . . . On April 13, 2006, Mozilo sent another e-mail to Sieracki and Sambol, stating that he had "personally

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<sup>40</sup> SEC's Statement of Genuine Issues of Material Fact in Opposition to Defendants' Motions for Summary Judgment ¶ 289, *SEC v. Mozilo*, No. 09-CV-3994 (C.D. Cal. Aug. 16, 2010).

observed a serious lack of compliance with our origination system as it relates to documentation and generally a deterioration in the quality of loans originated versus the pricing of those loan[s]. In my conversations with Sambol he calls the 100% subprime seconds as the ‘milk’ of the business. Frankly I consider that product line to be the poison of ours.”

- At a March 12, 2007 Corporate Credit Risk Committee meeting, attended by Sambol and Sieracki, Risk Management reported that 12% of the loans reviewed through Countrywide’s internal quality control process were rated severely unsatisfactory or high risk, and that one of the principal causes for such a rating was that loans had debt-to-income, loan to value, or FICO scores outside Countrywide’s underwriting guidelines.
- On May 29, 2007, Sambol and Sieracki attended a Credit Risk Committee Meeting, during which they were informed that even as Countrywide had been purportedly tightening guidelines, “loans continue[d] to be originated outside guidelines” primarily via the Secondary Structured Lending Desk without “formal guidance or governance surrounding Secondary SLD approvals.” The presentation also included a recommendation from the credit management department that two divisions “cease to grant exceptions where no major competitor is offering the guideline.”<sup>41</sup>

70. Countrywide’s admission of its secret, rampant, and unjustified use of the exceptions process is further corroborated by the particularized allegations in a lawsuit by another financial guarantor—*Financial Guaranty Insurance Company v. Countrywide Home Loans, Inc.*<sup>42</sup> Plaintiff in this lawsuit states that at two separate meetings between the parties at Countrywide’s headquarters on April 24, 2007 and December 13, 2007, Countrywide admitted “that it had, apparently since sometime in 2006, undertaken a deliberate practice to routinely make increased exceptions to and expansion of its underwriting guidelines . . . .”<sup>43</sup> According to

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<sup>41</sup> *SEC v. Mozilo*, No. 09-CV-3994, slip op. at 19-20 (C.D. Cal. Sept. 16, 2010) (citation omitted).

<sup>42</sup> No. 09-650736 (N.Y. Sup. Ct. 2009).

<sup>43</sup> Complaint, ¶¶ 158, 163, *Financial Guaranty Insurance Company v. Countrywide Home Loans, Inc.*, No. 09-650736 (N.Y. Sup. Ct. filed, Dec. 11, 2009).

Countrywide, “[t]he reason . . . for these undisclosed exceptions and expansion of the guidelines was to try to retain [its] existing share of the mortgage origination market.”<sup>44</sup> Countrywide also informed plaintiff that it had discovered borrower misrepresentation, speculation, and fraud at an increasing rate in 2006, which it admitted “had been a significant factor in the underperformance of the 2006 securitized HELOC portfolios.”<sup>45</sup>

71. In recent lawsuits, Countrywide employees have confirmed the prevalence of these practices. One former Countrywide employee—quoted in a class action complaint filed by Countrywide debt holders, *Argent Classic Convertible Arbitrage Fund v. Countrywide Financial Corp.*<sup>46</sup>—stated that Countrywide routinely approved loans through the Exception Processing System that violated its underwriting guidelines. And another former Countrywide employee—a former Assistant Vice President of Risk Management with Countrywide’s Structured Loan Desk in Plano, Texas and an underwriter from 2004 until 2006 responsible for evaluating credit risk—stated that Countrywide’s management “encouraged more and more loans” to be processed through the Exception Processing System beginning in 2004. During 2006, Countrywide processed between 15,000 and 20,000 loans a month through the Exception Processing System.<sup>47</sup>

72. Similarly, in a wrongful dismissal lawsuit against Countrywide—*Zachary v. Countrywide Financial Corp. d/b/a Countrywide Home Loans Inc.*<sup>48</sup>—former Countrywide

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<sup>44</sup> Complaint, ¶¶ 158, 163, *Financial Guaranty Insurance Company v. Countrywide Home Loans, Inc.*, No. 09-650736 (N.Y. Sup. Ct. filed, Dec. 11, 2009).

<sup>45</sup> Complaint, ¶¶ 158, 163, *Financial Guaranty Insurance Company v. Countrywide Home Loans, Inc.*, No. 09-650736 (N.Y. Sup. Ct. filed, Dec. 11, 2009).

<sup>46</sup> No. 07-CV-07097 (C.D. Cal. 2007).

<sup>47</sup> Third Amended Class Action Complaint, ¶¶ 592-93, *Argent Classic Convertible Arbitrage Fund v. Countrywide Fin. Corp.*, No. 07-CV-07097 (C.D. Cal. filed, Dec. 3, 2008).

<sup>48</sup> No. 08-CV-00214 (S.D. Tex. 2008).

Regional Vice President Mark Zachary alleged that Countrywide regularly approved stated income or reduced-documentation loans for applicants who Countrywide had previously refused a loan under its full-documentation loan program. In fact, Countrywide’s loan officers would assist applicants in switching from full-documentation loans to reduced-documentation loans. Zachary alleges that Countrywide discharged him because he refused to engage in this activity.

73. Zachary’s allegations, and those of many other former Countrywide employees, are also featured in a shareholders derivative complaint.<sup>49</sup> In denying Countrywide’s motion to dismiss that complaint, the court highlighted Countrywide’s dramatic loosening of its underwriting standards in branches across the United States.<sup>50</sup> Specifically, the court held that the “numerous confidential witnesses support a strong inference of a Company-wide culture that, at every level, emphasized increased loan origination volume in derogation of underwriting standards.”<sup>51</sup> In drawing this inference, the court noted that the allegations of misconduct came from Countrywide employees (i) located throughout the United States, (ii) in varying levels of the Countrywide hierarchy (including underwriters, senior underwriters, senior loan officers, vice presidents, auditors, and external consultants), and (iii) employed at varying times.<sup>52</sup> In the court’s words, these witnesses “tell what is essentially the same story—a rampant disregard for underwriting standards—from markedly different angles.”<sup>53</sup>

74. The court’s holding was supported by references to, among other things, the particular allegations of a longtime Countrywide executive who stated “that particularly risky

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<sup>49</sup> See Consolidated Shareholder Derivative and Class Action Complaint, *In re Countrywide Fin. Corp. Derivative Litigation*, Lead Case No. 07-CV-06293 (C.D. Cal. 2007).

<sup>50</sup> See *In re Countrywide Fin. Corp. Derivative Litig.*, 554 F. Supp. 2d 1044, 1058 (C.D. Cal. 2008).

<sup>51</sup> *In re Countrywide Fin. Corp. Derivative Litig.*, 554 F. Supp. 2d 1044, 1058 (C.D. Cal. 2008).

<sup>52</sup> *In re Countrywide Fin. Corp. Derivative Litig.*, 554 F. Supp. 2d 1044, 1058-59 (C.D. Cal. 2008).

<sup>53</sup> *In re Countrywide Fin. Corp. Derivative Litig.*, 554 F. Supp. 2d 1044, 1059 (C.D. Cal. 2008).

loans that were routed out of the normal underwriting process (because they violated underwriting standards) were in fact regularly being approved” with the knowledge of former Countrywide President and Chief Operating Officer David Sambol.<sup>54</sup> The court similarly noted that “underwriters at various levels and offices attested to egregious instances of underwriting, involving, for example, previously declined loans that would ‘come back to life’ when new information qualifying the applicants would ‘miraculously appear,’ and loans that were provided pursuant to borrowers’ patently ridiculous ‘stated incomes.’”<sup>55</sup>

75. The complaint in a shareholder class action, *In re Countrywide Financial Corporation Securities Litigation*, contains allegations that echo those in the derivative and SEC’s complaints. It alleges, based on statements from a loan underwriter in Countrywide’s Consumer Markets Division, 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.”<sup>56</sup>

76. 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 so departed from its public

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<sup>54</sup> *In re Countrywide Fin. Corp. Derivative Litig.*, 554 F. Supp. 2d 1044, 1059 (C.D. Cal. 2008) (citing Derivative Complaint ¶ 163).

<sup>55</sup> *In re Countrywide Fin. Corp. Derivative Litig.*, 554 F. Supp. 2d 1044, 1058 (C.D. Cal. 2008) (citing Derivative Complaint ¶ 147).

<sup>56</sup> Second Consolidated Class Action Complaint ¶ 180, *In re Countrywide Fin. Corp. Sec. Litig.*, Lead Case No. 07-CV-05295 (C.D. Cal. filed, Jan. 6, 2009).

statements that even ‘high quality’ became materially false or misleading.”<sup>57</sup> Countrywide recently agreed to settle this lawsuit by paying \$600 million.<sup>58</sup>

77. To make matters worse, while lowering its underwriting standards, Countrywide pressured its underwriters to increase the volume of loan approvals. According to the Illinois Attorney General, Countrywide directed its underwriters to approve and process purchase files in 24 hours and refinance files in 48 to 72 hours. One Countrywide underwriter stated that, for a period of time, Countrywide required her to underwrite 25 loan files a day during the week and 25 to 35 loan application files over the weekend.<sup>59</sup>

(c) **Inflated Borrower Income**

78. Countrywide’s malfeasance did not end with the abrogation of the very underwriting guidelines it represented it maintained. Countrywide affirmatively and covertly inflated the stated incomes of borrowers on loan applications in the documentation for the loans that fueled its securitizations. This misconduct is particularized in the recent filings against Countrywide.

79. Former Countrywide Regional Vice President Mark Zachary’s complaint also describes an instance where a Countrywide loan officer inflated an applicant’s income on a loan application without the applicant’s knowledge. According to Zachary, the customer sent an e-mail to Countrywide stating: “I was told that my loan had been turned over to Countrywide’s internal fraud department for review because a loan officer increased my income figures without authorization in order to get me approved for a stated income loan. I was told by several people

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<sup>57</sup> *In re Countrywide Fin. Corp. Sec. Litig.*, 588 F. Supp. 2d 1132, 1144 (C.D. Cal. 2008).

<sup>58</sup> Chad Bray, *N.Y. Funds Reach Settlement with Countrywide*, KPMG, Wall St. J., May 7, 2010.

<sup>59</sup> Complaint ¶ 89, *People of the State of Illinois v. Countrywide Fin. Corp.*, No. 08CH22994 (Ill. Cir. Ct.).

at Countrywide that this was done just to get me qualified and that nobody would check on it.”<sup>60</sup>

80. 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 on July 25, 2007. Ms. Sweet stated that when she reviewed her loan application after her loan had closed, she

discovered several things [she] 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.

81. These individual cases of inflated borrower income are not isolated incidents. Instead, they are the product of Countrywide’s corporate culture, as former Countrywide employees have made clear in related litigations.

82. For example, the complaint in *In re Countrywide Financial Corp. Derivative Litigation* alleges, based on statements from a compliance officer who worked at Countrywide from 2001 to mid-2007, an external home loan consultant who worked at Countrywide from 2000 to 2007 and was responsible for originating prime loans for the residential market, and a former senior loan officer from Countrywide’s Consumer Markets division in Atlanta Georgia, that Countrywide’s no documentation loan process lacked independent verification and was openly abused.<sup>61</sup>

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<sup>60</sup> Second Amended Complaint ¶ 17, *Zachary v. Countrywide Fin. Corp.*, No. 08-CV-214 (S.D. Tex. filed Apr. 9, 2008).

<sup>61</sup> Consolidated Shareholder Derivative and Class Action Complaint ¶ 154, *In re Countrywide Fin. Corp. Derivative Litig.*, No. 07-CV-6293 (C.D. Cal. Feb. 15, 2008).

83. The second consolidated class action complaint in *In re Countrywide Financial Corporation Securities Litigation* alleges, based on statements from a corporate-level Senior Vice President involved in financial reporting and analysis until 2007, that it was generally known at Countrywide that “there was a lot of lying going on” in connection with stated income and stated asset loans.<sup>62</sup>

84. And in an NBC News report, one former Countrywide loan officer said that he had seen Countrywide supervisors stand by and watch as loan officers repeatedly entered fictitious income figures into Countrywide’s system until it approved the borrower for a loan. A borrower stated in the same report that a Countrywide loan officer advised her to double her salary when completing her loan application.<sup>63</sup>

85. Further, as discovery in the SEC’s lawsuit has shown, Countrywide’s executives were aware of, but failed to disclose, internal findings that representations of incomes on stated loan applications were overwhelmingly inflated. For instance, an internal Countrywide document reported results of an audit of Countrywide Bank’s reduced documentation loans for the 10-month period ending on April 30, 2006. For the purposes of this audit, Countrywide Bank executed IRS Forms 4506, which were submitted by borrowers with their loan applications, and compared the income stated on the loans applications with the income reported to the IRS. The audit showed that 50.3% of the Forms 4506s executed revealed an income variance between the loan application and IRS records of 10% or more. Of those, 69% had an

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<sup>62</sup> Second Consolidated Class Action Complaint ¶ 155, *In re Countrywide Fin. Corp. Sec. Litig.*, Lead Case No. 07-CV-05295 (C.D. Cal. filed, Jan. 6, 2009).

<sup>63</sup> 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/](http://www.msnbc.com/id/25465130/ns/nightly_news/).

income variance of greater than 50%.<sup>64</sup> This led Countrywide’s “management to conclude that somewhere between 30 and 40% of the loans held for investment at Countrywide Bank had materially misstated income, and therefore misstated debt to income ratios.”<sup>65</sup> Countrywide did not disclose these facts to either Ambac or the investing public.

**(d) Fraudulent Appraisals**

86. Countrywide also adopted an unlawful practice of systematically overstating another key metric used to assess the risk of mortgage loans: the appraised value of the mortgaged property. 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.”<sup>66</sup>

87. In *Capitol West Appraisals, LLC v. Countrywide Financial Corp.*,<sup>67</sup> *Clark v. Countrywide Home Loans, Inc.*,<sup>68</sup> and *Johnson v. KB Home*<sup>69</sup>—putative class actions filed on behalf of real estate appraisers and homeowners nationwide—the plaintiffs allege that Countrywide engaged in widespread appraisal-related misconduct by inflating the value of properties in order to support the loans that it wished to make. Plaintiffs in *Clark* allege that Countrywide often required the borrower to have the property appraised by its affiliates,

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<sup>64</sup> SEC’s Statement of Genuine Issues of Material Fact in Opposition to Defendants’ Motions for Summary Judgment ¶ 427-28, *SEC v. Mozilo*, No. 09-CV-3994 (C.D. Cal. Aug. 16, 2010).

<sup>65</sup> SEC’s Opposition to Joint Memorandum of Points and Authorities in Support of Defendants Motion for Summary Judgment and Adjudication at 8, *SEC v. Mozilo*, No. 09-CV-3994 (C.D. Cal. Aug. 16, 2010).

<sup>66</sup> Countrywide Conventional Technical Manual, Part 8, Chapter 6, Section 3, Subsection 02 (effective date June 21, 2000).

<sup>67</sup> No. 08-CV-1520 (W.D. Wash. 2008).

<sup>68</sup> No. 09-CV-0036 (W.D. Wash. 2009).

<sup>69</sup> No. 09-CV-972 (D. Ariz. 2009).

LandSafe, Inc. and LandSafe Appraisal Services, Inc.<sup>70</sup> This way, Countrywide was able to control the appraisal process and influence and inflate the appraised values assigned to properties on which it was lending.<sup>71</sup> Plaintiffs in these lawsuits allege that this conduct violated federal law requiring appraisals prepared by an in-house or “staff appraiser” at a bank—as opposed to an independent contractor—to “be independent of the lending, investment, and collection functions and not involved, except as an appraiser, in the federally related transactions, and have no direct or indirect interest, financial or otherwise, in the property.”<sup>72</sup> Further, Countrywide “engaged in a practice of pressuring and intimidating appraisers into using appraisal techniques that meet Countrywide’s business objectives even if the use of such appraisal technique is improper and in violation of industry standards.”<sup>73</sup> Countrywide allegedly black-listed appraisers who did not provide appraisal reports consistent with Countrywide’s expectations.

88. The allegations in *Capitol West Appraisals, Clark, and Johnson* are consistent with the allegations of former Countrywide Regional Vice President Mark Zachary, who alleges that Countrywide loan officers were permitted to discard appraisals that did not support loan transactions in favor of appraisals by replacement appraisers that would support a qualifying loan-to-value ratio. Indeed, Zachary’s lawsuit details systematic appraisal fraud perpetrated by Countrywide with the knowledge and acquiescence of Countrywide executives. Specifically, Zachary alleges that an appraiser known to Countrywide executives was strongly encouraged to inflate the appraised value of homes by as much as six percent to allow the homeowners to “roll up” all closing costs. As Zachary noted, this conduct misled the buyer and

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<sup>70</sup> Complaint at 1, *Clark v. Countrywide Home Loans, Inc.*, No. 09-CV-0036 (W.D. Wash. 2009).

<sup>71</sup> Complaint at 1, *Clark v. Countrywide Home Loans, Inc.*, No. 09-CV-0036 (W.D. Wash. 2009).

<sup>72</sup> 12 C.F.R. § 34.45.

<sup>73</sup> Second Amended Class Action Complaint at 1, *Capitol West Appraisals, LLC v. Countrywide Fin. Corp.*, No. 08-CV-1520 (W.D. Wash. 2008).

the secondary mortgage market by overstating the value of the property securing the mortgage note. Zachary alleges that Countrywide executives rebuffed his persistent overtures to address this issue.

**(d) Predatory Lending**

89. Further still, Countrywide 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 and related Countrywide practices were the subject of consumer protection actions by the Attorneys General of California, Connecticut, Florida, Illinois, Indiana, and West Virginia.

90. 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 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; and (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.<sup>74</sup>

91. The California Attorney General made the following allegations about Countrywide’s practices relating to HELOCs:

- Countrywide misrepresented the terms of HELOCs, including without limitation by failing to inform the borrower that he or she would not have access to credit because he or she was receiving a full draw or that the monthly payment on the HELOC was interest only and the borrower would therefore not be able to draw additional funds on the HELOC at a later date.
- Countrywide misrepresented or obfuscated the payment shock that borrowers would experience after the interest only period on the HELOCs ended. Countrywide’s Call Center received large numbers of calls from borrowers complaining that they did not understand that the payments on their full-draw HELOCs would only cover interest, or that the interest rates on their HELOCs would adjust and increase.<sup>75</sup>

92. Connecticut’s complaint against Countrywide echoes the same allegations.

It states that Countrywide

made loans 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 circumvented [Countrywide’s] own purported rules and procedures by referring a consumer, whose fully documented application for a HELOC had been rejected due to insufficient income by [Countrywide], to another of [Countrywide’s] retail locations so she could apply for, and ultimately receive, a HELOC; the consumer was then required to draw down the entire balance of the HELOC at [the] time of closing despite her expectation that she

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<sup>74</sup> First Amended Complaint ¶ 21, *People of the State of California v. Countrywide Fin. Corp.*, No. LC081846 (Cal. Super. Ct. 2008).

<sup>75</sup> First Amended Complaint ¶¶ 134-35, *People of the State of California v. Countrywide Fin. Corp.*, No. LC081846 (Cal. Super. Ct. 2008).

would draw against the HELOC only as needed.<sup>76</sup>

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

- 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 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, or the meaning of a prepayment penalty, 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.<sup>77</sup>

94. Indiana's complaint also describes two cases in which Countrywide representatives misled borrowers about the duration of the 1.75% introductory rate. In one case, Countrywide led the borrower to believe that the introductory rate would last for five years instead of just one. In the other, Countrywide 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.<sup>78</sup>

95. 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

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<sup>76</sup> Complaint ¶ 16, *State of Connecticut v. Countrywide Fin. Corp.*, No. 09-CV-4042969 S (Ct. Super. Ct. 2008).

<sup>77</sup> Complaint ¶¶ 9-11, *State of Indiana v. Countrywide Fin. Corp.*, No. 76C01-0808-PL-0652 (Ind. Cir. Ct. 2008).

<sup>78</sup> Complaint ¶¶ 13-14, *State of Indiana v. Countrywide Fin. Corp.*, No. 76C01-0808-PL-0652 (Ind. Cir. Ct. 2008).

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.”<sup>79</sup>

96. 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. If consumers did question these loans or terms, they were simply told they could refinance later.”<sup>80</sup>

97. In October 2008, Bank of America settled these and other state attorney general lawsuits on behalf of Countrywide by, among other things, agreeing to provide \$8.4 billion in direct loan assistance to affected borrowers. The settlement is the largest ever settlement in a predatory lending case, dwarfing the \$484 million paid by Household Finance Corporation in 2002 to resolve claims relating to deceptive real estate lending practices. Bank of America spokesperson James E. Mahoney stated that Bank of America has “put our own leadership in charge of Countrywide and have committed to a very different set of business practices going forward.”<sup>81</sup>

### **C. Countrywide Executes the Transactions as Part of its Growth Strategy**

98. Countrywide’s growth strategy depended on securitizing the mortgage

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<sup>79</sup> Complaint ¶¶ 231-69, *People of the State of Illinois v. Countrywide Fin. Corp.*, No. 08CH22994 (Ill. Cir. Ct. 2008).

<sup>80</sup> Complaint ¶ 30, *State of West Virginia ex rel. Darrell V. McGraw, Jr., Attorney General v. Countrywide Fin. Corp.*, No. 08-C-268 (W. Va. Cir. Ct. 2008).

<sup>81</sup> The direct assistance Bank of America agreed to provide included its commitment to modify loans in securitized loan pools. That commitment is being challenged by investors in the affected securitizations as outside the scope of Countrywide’s authority to implement without investor approval and potentially detrimental to the investors’ financial interests. *See Greenwich Financial Services Distressed Mortgage Fund 3, LLC v. Countrywide Fin. Corp.*, No. 08/650474 (N.Y. Sup. Ct. 2008). Accordingly, it remains to be seen whether Bank of America and Countrywide entered into these commitments in good faith, or whether Bank of America sought to limit its own liability with other people’s money.

loans it originated, which Countrywide did in record numbers. These securitizations provided capital to make new loans, greatly increasing Countrywide's profits through loan origination fees and servicing fees on the massive number of loans it was able to originate.

99. Twelve of these securitizations are at issue in this action: (1) CWABS 2004-K; (2) CWABS 2004-L; (3) CWABS 2004-M; (4) CWABS 2004-N; (5) CWABS 2004-O; (6) CWABS 2004-T; (7) CWHEQ 2005-F; (8) CWHEQ 2006-B; (9) CWHEQ 2006-C; (10) CWHEQ 2006-S1; (11) CWHEQ 2006-S4; and (12) CWHEQ 2006-S6.

100. For each of the twelve Transactions, Countrywide Home or one of its affiliates originated the underlying residential mortgage loans and then conveyed pools of these loans to a depositor, also a Countrywide entity, in exchange for cash. The depositor in turn conveyed these pools to Countrywide-created trusts, which used the loans as collateral for securities that would be sold to investors. The trusts worked with the underwriters, including Countrywide Securities, to market and sell the securities to investors. The securities represent an interest in the pools of the underlying loans, and, therefore, the right to participate in the cashflows (in the form of payments of interest and principal) generated by the pools of mortgages.

101. Countrywide's ability to effectuate its securitizations—including the Transactions—depended on its ability to instill confidence in investors about the soundness of the securities. Countrywide did this (i) by touting the quality of its lending practices, and (ii) contracting with financial guaranty insurers like Ambac to guarantee the payments on certain classes of the securities.

102. Countrywide induced Ambac to issue its Policies by making (i) fraudulent representations and omissions in advance of the closing of the Transactions, and (ii) express

representations and warranties in the parties' agreements.

**D. Countrywide Fraudulently Induces Ambac to Issue its Policies**

103. To induce Ambac to issue its Policies, Countrywide made numerous false and misleading statements directly to Ambac and omitted material facts about the quality of Countrywide's loan origination procedures and the collateral underlying the Transactions.

104. First, Countrywide made regular presentations to Ambac employees at meetings held at Countrywide's headquarters, including those in July 2004, November 2004, September 2005, and February 2006. As discussed above, and as contemporaneously documented in Ambac's internal memoranda, at these meetings Countrywide touted its "conservative approach to origination volume and quality of corporate controls," and encouraged Ambac to rely, and was aware that Ambac in fact relied, on information that Countrywide provided at these meetings.

105. Second, Countrywide provided Ambac with draft Prospectus Supplements to induce Ambac to insure certain classes of securities issued in the Transactions. These Prospectus Supplements contained false and misleading statements concerning the quality of Countrywide's loan origination procedures and, in particular, failed to disclose that Countrywide had adopted a practice of making loans to borrowers who had little or no ability to repay their loans.

106. Third, Countrywide sent to Ambac mortgage loan "tapes" for the Transactions. The tapes were 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 properties as collateral. Countrywide intended Ambac to rely, and Ambac did rely, on the information from the loan

tapes to analyze the risks of and pricing for the proposed Transactions. Countrywide knew or should have known—in view of its abandonment of sound underwriting practices and its knowledge of pervasive fraud—that the information on the mortgage loan tapes was materially false and misleading.

107. Fourth, Countrywide provided Ambac with “due diligence” reports purportedly conducted to prevent defective loans from entering the Transactions. For example, on December 23, 2004, Ruben Avilez, Senior Vice President of Countrywide Securities, conveyed to Ambac a summary of the loan-level re-underwriting for the CWABS 2005-T Transaction that its consultant had purportedly conducted to ensure the quality of the loans and their conformance to Countrywide’s representations and warranties. According to Countrywide, its consultants selected a random and adverse sample of the loans proposed for the securitization to assess the attributes of the pool as a whole. Countrywide represented (i) that its consultants re-underwrote the loans to assess the reasonableness of the borrowers and Countrywide’s own representations and to ensure that underwriting decisions were prudent and reasonable, and (ii) that Countrywide overrode its underwriters’ findings of non-conforming loans only where there purportedly were strong compensating factors. Neither representation was true. What Countrywide failed to disclose, as revealed by Ambac’s subsequent re-underwriting, was that its consultants were “rubber stamping” its determinations and fabricating compensating factors to approve loans for the Transaction.

108. Fifth, Countrywide arranged for the rating agencies, Standard & Poor’s and Moody’s, to issue “shadow ratings” in advance of Ambac’s submission of its bid for the Transactions. The ratings represented the agencies’ expectations of the performance of the securities to be issued—before accounting for any financial guaranty insurance. The rating

agencies used mortgage loan data provided by Countrywide to model the expected performance of the collateral that backed the securities the agencies rated. Countrywide intended Ambac to rely, and Ambac did rely, on these ratings and take comfort in the agencies' analyses of the expected performance of the insured securities. But Countrywide knew that the mortgage-data-dependent ratings constituted "garbage-in-garbage-out" and were false and misleading.

109. In addition to the direct representations and omissions made in advance of the closing of the Transactions, Countrywide induced Ambac to issue its Policies by committing to provide Ambac express contractual representations and warranties concerning its business and the mortgage loans in the Transactions.

110. Ambac reasonably relied to its detriment on Countrywide's false and misleading representations, which were designed to fraudulently induce Ambac to enter into each Transaction. Ambac's reasonable reliance on Countrywide's representations was contemporaneously documented in the internal memoranda Ambac prepared to obtain internal approval for each of the Transactions. For instance, the memorandum for the CWHEQ 2005-F Transaction notes that Countrywide's "underwriting and origination strategy is to target primarily 'A' quality borrowers. All approval processes are centralized and any exception to its underwriting guidelines is reviewed and determined by only authorized underwriters."

111. As the largest originator and securitizer of residential mortgage loans, Countrywide had leverage to dictate many terms of its securitizations. Because its scheme depended on the concealment of its actual growth strategy, Countrywide used its market power to guard against the possibility that its counterparties, including Ambac, would get a peek behind the curtain at the actual lending practices or attributes of the loans Countrywide originated. Most significantly, Countrywide dictated that the Transaction participants—including Ambac and the

rating agencies—accept Countrywide’s representations concerning its lending practices and its disclosures about the specific loans proposed for inclusion in the Transactions. Indeed, Countrywide even mandated that its own broker-dealer affiliate Countrywide Securities direct the purported due diligence file review of a small sample of the proposed loans, and then provided the results of that “diligence” to Ambac. Countrywide’s protocols thus ensured it was the sole source of information concerning its lending practices and the securitized loans.

112. Lacking the accurate depiction of Countrywide’s practices and perspective, Ambac’s reliance on Countrywide’s representations was reasonable and consistent with the industry practice and the parties’ bargain. 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 and were not fraudulently procured. Ambac as the 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.

113. 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, as a bond insurer, Ambac never owned the loans or the loan files, and was several steps removed from the borrowers to whom the loans were made 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.

114. This risk allocation arrangement enabled each party to conduct the appropriate due diligence *consistent and commensurate with* the risk they bore. Countrywide purported to adhere to its conservative underwriting guidelines and conduct further quality control review of the loans after origination. Ambac, in turn, (i) conducted on-site reviews of Countrywide's operations, (ii) secured and evaluated Countrywide's representations concerning its origination and quality control, (iii) conducted extensive modeling of its exposure to interest rate and other market variables using the mortgage loan data represented as true by Countrywide, (iv) assessed the adequacy of Countrywide's wherewithal to stand behind its representations and warranties, (v) analyzed the represented performance of Countryside's prior securitizations, and (vi) secured from Countrywide its commitment to provide representations and warranties concerning, among other things, the veracity of the mortgage loan data Countrywide provided and the origination practices followed.

115. 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 Operative Documents, particularly within the limited time frame (*i.e.*, just days) afforded to provide a bid in response to

Countrywide's solicitation. Accordingly, Ambac could not properly design or price, and therefore would not have offered, its Policies absent Countrywide's explicit agreement to bear the loss if the information Countrywide provided proved to be false or misleading.

116. Accordingly, Countrywide accepted the risks that its broad and extensive representations were false, while Ambac accepted the risk that mortgage loans that conformed to Countrywide's representations and warranties would not perform as expected.

**E. Countrywide Provides Representations and Warranties to Induce Ambac into the Transactions**

117. The representations and warranties designed to induce Ambac to enter the Transactions were included in a series of documents Countrywide executed to effectuate the Transactions.

***1. The Transaction Documents***

118. The Transactions are governed by a set of documents that provide for, among other things, (i) the sale of the mortgages by Countrywide Home to a Countrywide-affiliated special purpose vehicle; (ii) the servicing of those mortgages by Countrywide Home or another Countrywide entity; and (iii) the rights of the purchasers of mortgage-backed securities ("Noteholders").

119. The rights and obligations of the parties for the HELOC Transactions are governed by Mortgage Loan Purchase Agreements ("MLPA"), Sale and Servicing Agreements ("SSA"), and Trust Indentures. For the CES Transactions, the rights and obligations of the parties are governed primarily by Pooling and Servicing Agreements ("PSA"). For each Transaction, Countrywide and Ambac also entered into an I&I Agreement which provided the terms for the issuance of a financial guaranty policy by Ambac to the trust for the benefit of the Noteholders. Collectively, for each Transaction, these documents—along with other documents

executed by the parties at the time of the closing of each Transaction—are referred to as the “Operative Documents.”

**(a) HELOC Transactions**

120. As the Sponsor in the nine HELOC Transactions, Countrywide Home securitized more than 219,200 HELOCs that served as collateral for the issuance of \$13.75 billion in publicly offered securities. One HELOC Transaction—CWHEQ 2005-F—is described in greater detail below. This Transaction provides a representative example of the rights and obligations of the parties under all of the HELOC Transactions.

121. As the Sponsor in the CWHEQ 2005-F Transaction, Countrywide Home securitized more than 36,800 HELOCs that served as collateral for the issuance of \$2.7 billion in publicly offered Class 1-A and Class 2-A Notes.

122. On August 25, 2005, Garrett Galati of Countrywide sent to Ambac by e-mail a request for bids to issue the financial guaranty insurance policy for the CWHEQ 2005-F Transaction—the request included a loan tape for the Transaction. On or about September 13, 2005, Ambac submitted a bid for the CWHEQ 2005-F Transaction, and Countrywide awarded the CWHEQ 2005-F Transaction to Ambac.

123. The CWHEQ 2005-F Transaction closed on September 29, 2005 and was effectuated through the following series of agreements executed by Countrywide and its affiliates (the “CWHEQ 2005-F Operative Documents”).

124. First, Countrywide Home and its affiliate (Park Monaco Inc.), acting as Sellers, sold and assigned their interest in the HELOCs owned by them to an affiliate, CWHEQ, Inc., pursuant to an MLPA dated September 29, 2005 (the “CWHEQ 2005-F MLPA”).<sup>82</sup>

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<sup>82</sup> The parties to the MLPAs for the CWABS 2004-K (dated September 29, 2004), CWABS 2004-L (dated September 29, 2004), CWABS 2004-M (dated September 29, 2004), CWABS 2004-N (dated

125. Second, CWHEQ, Inc. sold its interest in the mortgage loans, and assigned all of its rights under the CWHEQ 2005-F MLPA to the CWHEQ Revolving Home Equity Loan Trust, Series 2005-F (the “CWHEQ 2005-F Trust”) pursuant to an SSA dated September 29, 2005 (the “CWHEQ 2005-F SSA”).<sup>83</sup> Pursuant to an Indenture, dated September 29, 2005 (the “CWHEQ 2005-F Indenture”),<sup>84</sup> the CWHEQ 2005-F Trust then issued the Class 1-A and Class 2-A Notes, which were underwritten and marketed to investors by another Countrywide affiliate, Countrywide Securities, by means of a Prospectus Supplement, dated September 27, 2005.<sup>85</sup>

126. Third, Countrywide Home, in its capacities as Sponsor and Master Servicer, entered into an I&I Agreement with Ambac, dated September 29, 2005 (the “CWHEQ 2005-F I&I Agreement”).<sup>86</sup> Under the CWHEQ 2005-F I&I Agreement, Ambac agreed to issue

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September 29, 2004), CWABS 2004-O (dated September 29, 2004), and CWABS 2004-T (dated December 23, 2004) Transactions are Countrywide Home (as Seller) and CWABS, Inc. (as Purchaser). The parties to the MLPAs for the CWHEQ 2006-B (dated March 29, 2006) and CWHEQ 2006-C (dated March 30, 2006) Transactions are Countrywide Home (as Seller), Park Monaco Inc. (as Seller), and CWHEQ, Inc. (as Purchaser).

<sup>83</sup> The parties to the SSAs for the CWABS 2004-K (dated September 29, 2004), CWABS 2004-L (dated September 29, 2004), CWABS 2004-M (dated September 29, 2004), CWABS 2004-N (dated September 29, 2004), CWABS 2004-O (dated September 29, 2004), and CWABS 2004-T (dated December 23, 2004) Transactions are CWABS, Inc. (as Depositor), Countrywide Home (as Sponsor and Master Servicer), the trust set up by Countrywide for the respective Transaction, and JPMorgan Chase Bank (as Indenture Trustee). The parties to the SSAs for the CWHEQ 2006-B (dated March 29, 2006), and CWHEQ 2006-C (dated March 30, 2006) Transactions are CWHEQ (as Depositor), Countrywide Home (as Sponsor and Master Servicer), the trust set up by Countrywide for the respective Transaction, and JPMorgan Chase Bank, N.A. (as Indenture Trustee).

<sup>84</sup> The Indentures for the CWABS 2004-K, CWABS 2004-L, CWABS 2004-M, and CWABS 2004-N Transactions are dated September 29, 2004; the Indenture for the CWABS 2004-O Transaction is dated September 30, 2004; the Indenture for the CWABS 2004-T Transaction is dated December 23, 2004; the Indenture for the CWHEQ 2006-B Transaction is dated March 29, 2006; and the Indenture for the CWHEQ 2006-C Transaction is dated March 30, 2006.

<sup>85</sup> The Prospectus Supplements for the CWABS 2004-K, CWABS 2004-L, CWABS 2004-M, CWABS 2004-N, and CWABS 2004-O Transactions are dated September 27, 2004; the Prospectus Supplement for the CWABS 2004-T Transaction is dated December 20, 2004; the Prospectus Supplements for the CWHEQ 2006-B and CWHEQ 2006-C Transactions are dated March 28, 2006.

<sup>86</sup> The I&I Agreements for the CWABS 2004-K, CWABS 2004-L, CWABS 2004-M, and CWABS 2004-N Transactions are dated September 29, 2004; the I&I Agreement for the CWABS 2004-O Transaction is dated September 30, 2004; the I&I Agreement for the CWABS 2004-T Transaction is dated December

a financial guaranty insurance policy for the Class 1-A and Class 2-A Notes in exchange for a premium and the representations, warranties, covenants, rights, and remedies afforded by the CWHEQ 2005-F I&I Agreement and other Operative Documents for the CWHEQ 2005-F Transaction.

127. Finally, relying on the representations and warranties, covenants, rights, and remedies afforded by the CWHEQ 2005-F I&I Agreement, CWHEQ 2005-F MLPA, CWHEQ 2005-F SSA, and CWHEQ 2005-F Indenture, Ambac issued a financial guaranty insurance policy—Certificate Guaranty Insurance Policy No. AB0925BE (the “CWHEQ 2005-F Policy”).<sup>87</sup> Under the CWHEQ 2005-F Policy, Ambac agreed to insure certain payments of interest and principal with respect to the Class 1-A and Class 2-A Notes.<sup>88</sup>

128. For the remaining HELOC Transactions, the following chart summarizes the dates when Countrywide disseminated the mortgage loan tape to Ambac via e-mail and when the closing took place:

<b>Transaction</b>	<b>Date Loan Tape Disseminated</b>	<b>Countrywide Employee Disseminating the Loan Tape</b>	<b>Closing Date</b>
CWABS 2004-K	September 9, 2004	David Anderson	September 29, 2004
CWABS 2004-L	September 15, 2004	David Anderson	September 29, 2004
CWABS 2004-M	September 22, 2004	David Anderson	September 29, 2004
CWABS 2004-N	September 22, 2004	David Anderson	September 29, 2004
CWABS 2004-O	September 25, 2004	Jon Coleman	September 30, 2004
CWABS 2004-T	December 6, 2004	David Anderson	December 23, 2004
CWHEQ 2006-B	March 7, 2006	Garrett Galati	March 29, 2006
CWHEQ 2006-C	March 14, 2006	Garrett Galati	March 30, 2006

23, 2004; the I&I Agreement for the CWHEQ 2006-B Transaction is dated March 29, 2006; and the I&I Agreement for the CWHEQ 2006-C Transaction is dated March 30, 2006.

<sup>87</sup> The Certificate Guaranty Insurance Policies for the remaining HELOC Transactions are as follows: CWABS 2004-K (AB0798BE); CWABS 2004-L (AB0809BE); CWABS 2004-M (AB0810BE); CWABS 2004-N (AB00811BE); CWABS 2004-O (AB0813BE); CWABS 2004-T (AB0849BE); CWHEQ 2006-B (AB0979BE); and CWHEQ 2006-C (AB0985BE).

<sup>88</sup> For the remaining HELOC Transactions, Ambac agreed to insure certain payments of interest and principal with respect to the Class 1-A and 2-A Notes for each of the Transactions.

(b) **CES Transactions**

129. As the Sponsor in the CES Transactions, Countrywide Home securitized more than 48,800 loans that served as collateral for the issuance of approximately \$2.96 billion in publicly offered securities. One CES Transaction—CWHEQ 2006-S1—is described in greater detail below. This Transaction provides a representative example of the rights and obligations of the parties under all of the CES Transactions.

130. The CWHEQ 2006-S1 Transaction involved the securitization by Countrywide Home of more than 13,900 CES mortgage loans. These loans served as collateral for the issuance of \$860 million in publicly offered Class A-1, Class A-2, Class A-3, Class A-4, Class A-5, Class A-10, and Class A-R Certificates.

131. In or about March 2006, Countrywide sent to Ambac by e-mail a request for bids to issue the financial guaranty insurance policy for the CWHEQ 2006-S1 Transaction—the request included a loan tape for the Transaction. By letter dated March 23, 2006, Ambac submitted a bid for the CWHEQ 2006-S1 Transaction, and Countrywide awarded the CWHEQ 2006-S1 Transaction to Ambac.

132. The CWHEQ 2006-S1 Transaction closed on March 30, 2006 and was effectuated through the following series of agreements executed by Countrywide and its affiliates (the “CWHEQ 2006-S1 Operative Documents”).

133. First, Countrywide Home and its affiliates (Park Granada LLC, Park Monaco Inc., and Park Sienna LLC), acting as Sellers, conveyed their entire interest in a pool of mortgage loans to CWHEQ, Inc., pursuant to a PSA dated March 1, 2006 (the “CWHEQ 2006-S1 PSA”).<sup>89</sup> Pursuant to the CWHEQ 2006-S1 PSA, CWHEQ, Inc. conveyed its rights in the

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<sup>89</sup> The parties to the PSAs for the CWHEQ 2006-S4 (dated August 1, 2006) and CWHEQ 2006-S6 (dated September 1, 2006) Transactions are: CWHEQ, Inc. (as Depositor); Countrywide Home (as Seller); Park

pool of mortgage loans to a trustee, for the benefit of holders of Class A-1, Class A-2, Class A-3, Class A-4, Class A-5, Class A-IO, and Class A-R Certificates, which were issued pursuant to the CWHEQ 2006-S1 PSA and underwritten and marketed to investors by Countrywide Securities by a Prospectus Supplement, dated March 29, 2006.<sup>90</sup>

134. Then, Countrywide Home, in its capacities as Sponsor, Seller, and Master Servicer, entered into an I&I Agreement with Ambac, dated March 30, 2006 (the “CWHEQ 2006-S1 I&I Agreement”).<sup>91</sup> Under the CWHEQ 2006-S1 I&I Agreement, Ambac agreed to issue a financial guaranty insurance policy for the Class A Certificates in exchange for a premium and the representations, warranties, covenants, rights, and remedies afforded by the CWHEQ 2006-S1 I&I Agreement and the CWHEQ 2006-S1 PSA.

135. Finally, relying on the representations and warranties, covenants, rights, and remedies afforded by the CWHEQ 2006-S1 I&I Agreement and CWHEQ 2006-S1 PSA, Ambac issued Certificate Guaranty Insurance Policy No. AB0984BE (the “CWHEQ 2006-S1 Policy”).<sup>92</sup> Under the CWHEQ 2006-S1 Policy, Ambac agreed to insure certain payments of interest and principal with respect to the Class A Certificates.<sup>93</sup>

136. For the remaining CES Transactions, the following chart summarizes the dates when Countrywide disseminated the mortgage loan tape to Ambac via e-mail and when the closing took place:

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Granada LLC (as Seller); Park Monaco Inc. (as Seller); Park Sienna LLC (as Seller); Countrywide Home Loans Servicing LP (as Master Servicer); and The Bank of New York (as Trustee).

<sup>90</sup> The Prospectus Supplement for the CWHEQ 2006-S4 Transaction is dated September 7, 2006, and the Prospectus Supplement for the CWHEQ 2006-S6 Transaction is dated September 28, 2006.

<sup>91</sup> The I&I Agreement for the CWHEQ 2006-S4 Transaction is dated September 8, 2006, and the I&I Agreement for the CWHEQ 2006-S6 Transaction is dated September 29, 2006.

<sup>92</sup> The Certificate Guaranty Insurance Policies for the remaining CES Transactions are as follows: CWHEQ 2006-S4 (AB1023BE); and CWHEQ 2006-S6 (AB1031BE).

<sup>93</sup> For the remaining CES Transactions, Ambac agreed to insure certain payments of interest and principal with respect to the Class A Certificates for each of the Transactions.

<b>Transaction</b>	<b>Date Loan Tape Disseminated</b>	<b>Countrywide Employee Disseminating the Loan Tape</b>	<b>Closing Date</b>
CWHEQ 2006-S4	July 31, 2006	Garret Galati	September 8, 2006
CWHEQ 2006-S6	September 15, 2006	Garret Galati	September 29, 2006

## **2. Countrywide's Representations and Warranties**

137. In the foregoing transaction documents, Countrywide made two types of representations and warranties to Ambac. First, in the l&l Agreements, Countrywide made representations and warranties to Ambac concerning the accuracy of all information it provided to Ambac, including data on the mortgage loan tapes for each of the Transactions, information about Countrywide's mortgage lending practices in general, its financial information, and its inventory of second-lien loans as a whole. These comprehensive "transaction-level" representations conveyed that Countrywide was a prudent, responsible, and financially sound mortgage lender and that the loans in the Transactions were drawn from a larger pool of Countrywide originated loans that, as a whole, conformed to Countrywide's touted underwriting standards, and that any non-conforming loans were the exception, not the rule. And they provided assurance that Countrywide had not engaged in wholesale, rampant misconduct resulting in a portfolio replete with defective loans, which is a risk that Ambac could not model or accept.

138. Second, Countrywide made extensive "loan-level" representations and warranties to Ambac pertaining to the individual mortgage loans that Countrywide selected and pooled for the Transactions. Countrywide agreed to cure the breach, repurchase, or substitute any loan that did not conform to one or more of these specific and numerous representations and warranties. The loan-level representations and warranties remedy thus afforded Ambac with a means of addressing anomalous—but not pervasive—non-conforming loans in the securitized pools. Moreover, so long as the volume of non-conforming loans was immaterial, Ambac could

evaluate and price the risk of the pools of loans *bearing the represented and warranted attributes with the knowledge and understanding that any aberrant, non-conforming loan would be addressed by Countrywide through the repurchase protocol.*

139. Ambac would not have entered into the Transactions had it known that Countrywide had materially and pervasively breached either set of the representations and warranties it made to Ambac.

(a) **Countrywide's Transaction-Level Representations and Warranties**

140. The transaction-level representations and warranties Countrywide made to Ambac are found in the I&I Agreements, and include the following:

- *Financial Statements.* The Financial Statements of CFC [Countrywide Financial], copies of which have been furnished to [Ambac], (i) are, as of the dates and for the periods referred to therein, complete and correct in all material respects, (ii) present fairly the financial condition and results of operations of CFC as of the dates and for the periods indicated and (iii) have been prepared in accordance with generally accepted accounting principles consistently applied, except as noted therein . . . . Since the date of the most recent Financial Statements, there has been no Material Adverse Change in respect of Countrywide, the Master Servicer or the Depositor or, to the best knowledge of Countrywide [Home], CFC.<sup>94</sup>
- *Accuracy of Information.* Neither the Operative Documents nor other material information relating to the Mortgage Loans, the operations of Countrywide, the Issuer or the Depositor or the financial condition of Countrywide, the Issuer or the Depositor (collectively, the “Documents”), as amended, supplemented or superseded, furnished to [Ambac] in writing or in electronic form by Countrywide, the Issuer or the Depositor contains any statement of material fact which was untrue or misleading in any material respect when made. Each of Countrywide, the Issuer and the Depositor has no knowledge of any circumstances that could reasonably be expected to cause a Material Adverse Change with respect to Countrywide, the Issuer or the Depositor. Since the furnishing of the

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<sup>94</sup> CWHEQ 2005-F I&I Agreement § 2.01(g); CWHEQ 2006-S1 I&I Agreement § 2.01(g).

Documents, there has been no change nor any development or event involving a prospective change known to Countrywide, the Issuer or the Depositor that would render any of the Documents untrue or misleading in any material respect.<sup>95</sup>

- *Compliance with Securities Laws.* The offer of the Notes complies or shall comply in all material respects with all requirements of law, including all registration and reporting requirements of applicable securities laws. Without limiting the foregoing, the Offering Document does not contain any untrue statement of material fact and does not omit to state a material fact necessary to make the statements made therein, in light of the circumstances under which they were made, not misleading; . . . .<sup>96</sup>

141. As demonstrated by the plain language of these representations and warranties, Countrywide attested to, among other things, the truth and completeness of the written and electronic documentation that Countrywide provided to Ambac about Countrywide's mortgage lending business and Countrywide's pools of second-lien loans as a whole, which included (i) Countrywide's "Financial Statements," (ii) "other material information relating to the Mortgage Loans [and] the operations of Countrywide," and (iii) the "Offering Documents," *i.e.*, the Prospectuses and Prospectus Supplements.

142. As discussed above, in its Prospectus Supplements Countrywide extolled the quality of its underwriting practices, and its financial statements contained Countrywide's assessment of the value of its mortgage loan portfolio and the residual interests Countrywide maintained in its securitizations.

143. Countrywide thus sought to convey to Ambac that it could be confident that Countrywide's loan portfolio, from which the loans in the Transactions were drawn, was

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<sup>95</sup> CWHEQ 2005-F I&I Agreement § 2.01(j). The CES Transactions contain a similar provision. *See* CWHEQ 2006-S1 I&I Agreement § 2.01(j).

<sup>96</sup> CWHEQ 2005-F I&I Agreement § 2.01(k). The CES Transactions contain a similar provision. *See* CWHEQ 2006-S1 I&I Agreement § 2.01(k).

originated pursuant to sound and prudent underwriting practices and not replete with poorly originated and fraudulent loans, and that Countrywide had the ability and financial wherewithal to meet its contractual commitments. These were basic assumptions of the parties' bargains. Ambac would not have entered into the Transactions had Countrywide not stood behind its mortgage lending business and accepted the risk of loss in the event that its representations and warranties proved false or misleading.

144. Reflecting the broad scope and significance of these representations and warranties, the I&I Agreements explicitly state that Ambac may pursue any remedy "existing at law or in equity" in the event of a breach by Countrywide.<sup>97</sup> The I&I Agreements also provide that Ambac may pursue express contractual remedies, and that any and all remedies are cumulative and not exclusive.<sup>98</sup>

145. And consistently, the express contractual remedies afforded to Ambac are broad. Under the I&I Agreements, for example, Ambac is entitled to indemnification for claim payments made as a result of Countrywide's breaches of these representations and warranties.<sup>99</sup> And Ambac is entitled to recover any expenses, plus interest, incurred in protecting, preserving and enforcing its rights and remedies.<sup>100</sup>

**(b) Countrywide's Loan-Level Representations and Warranties**

146. Countrywide's extensive representations and warranties pertaining to the specific mortgage loans it pooled for the Transactions are set forth in the MLPAs and SSAs for the HELOC Transactions and the PSAs for the CES Transactions, incorporated by reference in

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<sup>97</sup> CWHEQ 2005-F I&I Agreement §§ 5.01 – 5.02; CWHEQ 2006-S1 I&I Agreement §§ 5.01 – 5.02.

<sup>98</sup> CWHEQ 2005-F I&I Agreement §§ 5.01 – 5.02; CWHEQ 2006-S1 I&I Agreement §§ 5.01 – 5.02.

<sup>99</sup> CWHEQ 2005-F I&I Agreement § 3.04(a); CWHEQ 2006-S1 I&I Agreement § 3.04(a).

<sup>100</sup> CWHEQ 2005-F I&I Agreement §§ 3.03(c) and (d); CWHEQ 2006-S1 I&I Agreement §§ 3.03(c) and (d).

the I&I Agreements, and include the following:

- As of the Closing Date, the information in the Mortgage Loan Schedule for the Initial Mortgage Loans is correct in all material respects. . . .<sup>101</sup>
- As of the Closing Date with respect to the Initial Mortgage Loans . . . the Mortgage File for each Mortgage Loan contains each of the documents specified to be included in it.<sup>102</sup>
- At origination, each Mortgage Loan and the related Mortgage Note complied in all material respects with applicable local, state, and federal laws, including all applicable predatory and abusive lending laws, usury, truth-in-lending, real estate settlement procedures, consumer credit protection, equal credit opportunity, or disclosure laws applicable to the Mortgage Loan, and the servicing practices used by the Master Servicer with respect to each Mortgage Loan have been consistent with the practices and the degree of skill and care the Master Servicer exercises in servicing for itself loans that it owns that are comparable to the Mortgage Loans.<sup>103</sup>
- As of the Closing Date with respect to the Initial Mortgage Loans . . . , the Combined Loan-to-Value Ratio for each Mortgage Loan in each loan group was not in excess of the percentage specified in the Adoption Annex.<sup>104</sup>
- As of the Closing Date with respect to the Initial Mortgage Loans . . . , no selection procedure reasonably believed to be

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<sup>101</sup> CWHEQ 2005-F MLPA § 3.02(a)(4). The CES Transactions contain a similar representation and warranty: “The information set forth on Exhibit F-1 [*i.e.*, schedules of Mortgage Loans] hereto with respect to each Initial Mortgage Loan is true and correct in all material respects as of the Closing Date.” See CWHEQ 2006-S1 PSAs§ 2.03(b)(7).

<sup>102</sup> CWHEQ 2005-F MLPA § 3.02(a)(13). The CES Transactions do not contain this representation and warranty.

<sup>103</sup> CWHEQ 2005-F MLPA § 3.02(a)(14). The CES Transactions contain a similar representation and warranty: “Each Mortgage Loan, at the time it was originated and as of the Closing Date or the related Subsequent Transfer Date, as applicable, complied in all material respects with applicable local, state and federal laws, including, but not limited to, all predatory and abusive lending laws.” See CWHEQ 2006-S1 PSA § 2.03(b)(57).

<sup>104</sup> CWHEQ 2005-F MLPA § 3.02(a)(19). The Adoption Annex for the MLPAs specifies a Combined Loan-to-Value Ratio of 100%. The CES Transactions contain a similar representation and warranty: “No Mortgage Loan had a Combined Loan-to-Value Ratio at origination in excess of 100.00%.” See CWHEQ 2006-S1 PSA 2.03(b)(10).

adverse to the interests of the Transferor, the Noteholders, or [Ambac] was used in selecting the Mortgage Loans.<sup>105</sup>

- As of the Closing Date with respect to the Initial Mortgage Loans . . . , no default exists under any applicable Mortgage Note or applicable Mortgage Loan and no event that, with the passage of time or with notice and the expiration of any grace or cure period, would constitute a default under any applicable Mortgage Note or applicable Mortgage Loan has occurred and been waived.<sup>106</sup>
- As of the Closing Date with respect to the Initial Mortgage Loans . . . , each Mortgage Loan was originated in accordance with the Sponsor's underwriting guidelines and the Sponsor had no knowledge of any fact that would have caused a reasonable originator of mortgage loans to conclude on the date of origination of each Mortgage Loan that each such Mortgage Loan would not be paid in full when due.<sup>107</sup>
- Before the approval of the Mortgage Loan application, an appraisal of the related Mortgaged Property was obtained from a qualified appraiser, duly appointed by the Sponsor, who had no interest, direct or indirect, in the Mortgaged Property or in any loan secured by the Mortgaged Property, and whose

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<sup>105</sup> CWHEQ 2005-F MLPA § 3.02(a)(20). The CES Transactions contain a similar representation and warranty: "The Mortgage Loans were selected from among the outstanding one- to four-family mortgage loans in the applicable Seller's portfolio at the Closing Date as to which the representations and warranties made as to the Mortgage Loans set forth in this Section 2.03(b) . . . can be made. No selection was made in a manner that would adversely affect the interests of [Noteholders] or [Ambac]." *See* CWHEQ 2006-S1 PSA § 2.03(b)(49).

<sup>106</sup> CWHEQ 2005-F MLPA § 3.02(a)(36). The CES Transactions contain a similar representation and warranty: "There is no material monetary default existing under any Mortgage or the related Mortgage Note and, to the best of CHL's [Countrywide Home Loans, Inc.'s] knowledge, there is no material event that, with the passage of time or with notice and the expiration of any grace or cure period, would constitute a default, breach, violation or event of acceleration under the Mortgage or the related Mortgage Note; and no Seller has waived any default, breach, violation or event of acceleration." *See* CWHEQ 2006-S1 PSA § 2.03(b)(40).

<sup>107</sup> CWHEQ 2005-F MLPA § 3.02(a)(37). The CES Transactions contain a similar representation and warranty: "The Mortgage Loans originated by CHL were underwritten in all material respects in accordance with CHL's underwriting guidelines for closed-end second lien mortgage loans or, with respect to Mortgage Loans purchased by CHL were underwritten in all material respects in accordance with customary and prudent underwriting guidelines generally used by originators of closed-end second lien mortgage loans." *See* CWHEQ 2006-S1 PSA § 2.03(b)(45).

compensation is not affected by the approval or disapproval of the Mortgage Loan.<sup>108</sup>

- The Initial Mortgage Loans, individually and in the aggregate, conform in all material respects to their descriptions in the Prospectus Supplement.<sup>109</sup>

147. In short, Countrywide expressly represented and warranted the key attributes of each loan it conveyed to the Trusts. The MLPAs for the HELOC Transactions also provide that these “Agreement[s] shall bind and inure to the benefit of and be enforceable by . . . [Ambac].”<sup>110</sup>

148. Countrywide further extended the loan-level representations and warranties directly to Ambac by reference in a representation and warranty in the I&I Agreements, which states:

*Operative Documents.* Each of the representations and warranties of Countrywide . . . contained in the applicable Operative Documents and the Underwriting Agreement is true and correct in all material respects and . . . Countrywide . . . hereby makes each such representation and warranty to, and for the benefit of, [Ambac] as if the same were set forth in full herein . . .<sup>111</sup>

149. This representation and warranty also provides that, in the event any loan is found to have breached these loan-level representations and warranties, Ambac is entitled to enforce the remedy provided by the SSAs in the HELOC Transactions and the PSAs in the CES

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<sup>108</sup> CWHEQ 2005-F MLPA § 3.02(a)(52). The CES Transactions contain a similar representation and warranty: “Prior to the approval of the Mortgage Loan application, an appraisal of the related Mortgaged Property was obtained from a qualified appraiser, duly appointed by the originator, who had no interest, direct or indirect, in the Mortgaged Property or in any loan made on the security thereof, and whose compensation is not affected by the approval or disapproval of the Mortgage Loan; such appraisal is in a form acceptable to Fannie Mae and Freddie Mac.” See CWHEQ 2006-S1 PSA § 2.03(b)(46).

<sup>109</sup> CWHEQ 2005-F MLPA § 3.02(a)(57). The CES Transactions contain a similar representation and warranty. See CWHEQ 2006-S1 PSA § 2.03(b)(52).

<sup>110</sup> CWHEQ 2005-F MLPA § 7.07.

<sup>111</sup> CWHEQ 2005-F I&I Agreement § 2.01(l); CWHEQ 2006-S1 I&I Agreement § 2.01(l).

Transactions.<sup>112</sup> The SSAs provide that upon discovery or receipt of notice of a breach of any of the MLPA loan-level representations and warranties, Countrywide must notify Ambac of the breach and cure the breach, repurchase the non-conforming loan, or substitute another equivalent loan in its place;<sup>113</sup> the PSAs provide that “upon discovery” or receipt of notice of a breach of any of the loan-level representations, Countrywide must cure the breach, repurchase the non-conforming loan, or substitute another equivalent loan in its place.<sup>114</sup> This loan-level repurchase remedy was intended to address the aberrant defective loan that may have evaded Countrywide’s purportedly rigorous underwriting standards and quality controls. It was not intended as an alternative to Countrywide’s compliance with its representations and warranties and, indeed, is inadequate to address pervasive breaches of those representations and warranties.

150. Further, the SSAs specifically provide that Countrywide is required to cure, substitute, or repurchase a non-conforming loan even if it was not aware of the facts constituting the breach of the applicable representation and warranty: “If the substance of any representation and warranty . . . made to the best of [Countrywide’s] knowledge or as to which [Countrywide] has no knowledge is inaccurate and the inaccuracy materially and adversely affects the interest of the Trust, the Noteholders, or [Ambac] . . . then, *notwithstanding that [Countrywide] did not know the substance of the representation and warranty was inaccurate at the time the representation or warranty was made*, the inaccuracy shall be a breach of the applicable representation or warranty.”<sup>115</sup> The SSAs also specifically provide that “[Ambac] is a

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<sup>112</sup> CWHEQ 2005-F I&I Agreement § 2.01(l); CWHEQ 2006-S1 I&I Agreement § 2.01(l).

<sup>113</sup> CWHEQ 2005-F SSA § 2.04(c).

<sup>114</sup> CWHEQ 2006-S1 PSA § 2.03(e).

<sup>115</sup> CWHEQ 2005-F SSA § 2.04(b) (emphasis added).

third party beneficiary of th[ese] Agreement[s].”<sup>116</sup>

151. The I&I Agreements provide that Ambac is a third-party beneficiary of the underlying Operative Documents, with all rights afforded thereunder, and incorporate and restate for the benefit of Ambac all of the representations, warranties, and covenants Countrywide made in the Operative Documents.

152. The I&I Agreements also mandate that Countrywide reimburse Ambac for any payment (plus interest) that Ambac makes under its Policies as a result of Countrywide’s failure to comply with its obligation to repurchase, cure, or substitute a loan.<sup>117</sup>

#### **F. Countrywide’s Fraud Is Revealed**

153. With the collapse of the residential real estate market in late 2007, Countrywide could no longer conceal its policy and practice of systematically originating loans to borrowers who could not repay them. Ambac and the public became aware of what Countrywide knew all along: that Countrywide’s loan portfolios were replete with poorly originated loans that were likely to default.

##### ***1. Fraud demonstrated by particularized allegations***

154. As detailed in the pleadings in the actions referenced 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 the exception the rule;

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<sup>116</sup> CWHEQ 2005-F SSA § 8.06.

<sup>117</sup> CWHEQ 2005-F I&I Agreement § 3.03(b); CWHEQ 2006-S1 I&I Agreement § 3.03(b).

- 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 refinance every several months and thereby manipulating its static pool loss data to artificially improve performance;
- pressuring of appraisers to inflate values of appraised properties or risk being blacklisted;
- engaging in abusive and predatory lending in violation of state consumer protection statutes; and
- failing to implement controls to guard against, or even actively condoning and facilitating, borrower, broker, and employee fraud on a massive scale.

**2. *Countrywide fraud is corroborated by the Transactions' performance***

155. The abysmal performance of the loans included in the Transactions corroborates the falsity of Countrywide's representations about the quality of its underwriting. As reflected in the following table, the Transactions have experienced cumulative losses of more than \$1.4 billion in the aggregate:<sup>118</sup>

<b>Transaction</b>	<b>Cumulative Losses</b>
CWABS 2004-K	\$45,284,150.89
CWABS 2004-L	\$27,500,934.54
CWABS 2004-M	\$27,900,571.78
CWABS 2004-N	\$27,890,603.20
CWABS 2004-O	\$48,215,579.86
CWABS 2004-T	\$87,181,781.20
CWHEQ 2005-F	\$213,867,170.74
CWHEQ 2006-B	\$218,989,613.64
CWHEQ 2006-C	\$265,718,099.71

<sup>118</sup> As of September 15, 2010 for the HELOC Transactions and September 25, 2010 for the CES Transactions.

CWHEQ 2006-S1	\$81,486,625.37
CWHEQ 2006-S4	\$200,346,474.28
CWHEQ 2006-S6	\$184,007,387.98
<b>Total</b>	<b>\$1,428,388,993.19</b>

As of August 30, 2010, Ambac has made claim payments to cover these losses of more than \$466 million.

**3. *Countrywide's fraud is demonstrated by Ambac's re-underwriting***

156. The falsity of Countrywide's representations about the quality of its loan underwriting and the attributes of the loans included in the Transactions is further corroborated by Ambac's loan-level re-underwriting of the securitized loans. When the Transactions' performance first began to deteriorate, Ambac reviewed the loan origination files provided for the loans securitized in the Transactions. Countrywide only provided Ambac with files for loans which had defaulted. To date, 6,533 loan files have been reviewed. Of those, a remarkable over 97% contained evidence of one or, in most cases, more than one of the following defects:

- fraud, primarily involving misrepresentation of the borrower's income, assets, employment, or intent to occupy the property as the borrower's residence (rather than as an investment), and subsequent failure to so occupy the property;
- failure by the borrower to accurately disclose his or her liabilities, including multiple other mortgage loans taken out to purchase additional investment property;
- appraisals that do not support the claimed value of the property;
- pervasive violations of Countrywide's own underwriting guidelines, including loans made to borrowers (i) who made unreasonable claims as to their income, (ii) with multiple, unverified social-security numbers, (iii) with debt-to-income and loan-to-value ratios above the allowed maximums, or (v) with relationships to the lender or other non-arm's-length relationships; and
- inappropriately and deceptively high levels of loans approved on an

“exception” basis both within Countrywide’s automated underwriting system (CLUES) and outside it, in numerous cases in violation of underwriting guidelines supplied and represented by Countrywide as being applicable to the loans in question, which purportedly limited the use of “exceptions” to only those instances in which compensating factors warranted approval.

157. These defects demonstrate that Countrywide’s representations about the quality of its underwriting practices and the key attributes of the loans were false when made.

#### **G. Countrywide’s Pervasive Breaches of Its Representations and Warranties**

158. Each of the defects described above that were identified through Ambac’s re-underwriting efforts constitute a breach of one or more of Countrywide’s loan-level representations and warranties that materially and adversely affects Ambac’s interest in the applicable loan. And the prevalence of the breaches in the loans Ambac has reviewed constitutes, in the aggregate, a material breach of Countrywide’s broader, transaction-level representations and warranties about the absence of material misstatements or omissions in the information provided to Ambac regarding Countrywide’s mortgage lending practices, and, consequently, constitutes a material breach of the I&I Agreements as a whole.

159. Ambac’s allegations demonstrate the pervasive and material breaches of Countrywide’s representations and warranties in the I&I Agreements pertaining to the accuracy of information it provided to Ambac, including information about its mortgage lending business (including the specific statements about its underwriting practices in its Prospectus Supplements).

160. They also demonstrate that Countrywide breached its representation and warranty concerning the accuracy of its financial statements. That is, in its efforts to conceal its underwriting improprieties, Countrywide materially understated its allowance for loan losses and loan repurchase obligations and materially overstated the value of its residual interests. In doing

so, Countrywide deprived Ambac of the benefit of an early warning sign about Countrywide's financial health, its ability to perform its obligations under the Operative Documents, and the value it placed on the loans it originated.

**H. Countrywide Compounds its Breaches by Frustrating the Loan-Level Contractual Remedy**

161. In April 2008, Ambac sought from Countrywide access to documents related to the Transactions, to which it is entitled under Section 2.02 of the I&I Agreements, to assess Countrywide's compliance with its representations and warranties. Rather than comply with its contractual commitments, Countrywide erected one obstacle after another to hinder the production of the requested documentation. Indeed, after delaying over five months, in late September 2008, Countrywide then weakly represented that the data would be sent *if* Countrywide could locate a computer hard drive onto which the files could be copied. When nothing was forthcoming, Ambac was forced to serve Countrywide with formal notice of breach of the I&I Agreements. Only thereafter did Countrywide provide the requested data to Ambac.

162. Ambac was then able to conduct the re-underwriting analyses which demonstrated that the defaulting loans were replete with breaches of Countrywide's representations and warranties. In December 2008, Ambac began providing Countrywide with formal notices of breach in accordance with the terms of the Operative Documents together with the analyses that specifically identified breaches of Countrywide's loan-level representations and warranties and requested that Countrywide comply with its obligations to repurchase or cure non-conforming loans.

163. To date, Ambac has notified Countrywide of breaches of representations and warranties with respect to 5,734 loans. Countrywide has agreed to repurchase only 460 of the loans identified.

164. Countrywide's deliberate frustration of the repurchase remedy further compounds the harm to Ambac. By what amounts to virtually a wholesale rejection of Ambac's repurchase, cure, or substitution demands, Countrywide has made clear that it does not intend to honor in any meaningful way its obligation to repurchase or cure the non-conforming loans.

165. Instead of timely complying with Ambac's repurchase requests, Countrywide has executed a delay-and-defer strategy, refusing to comply with the overwhelming majority of its repurchase obligations. From the outset, Countrywide unilaterally imposed extra-contractual conditions on its repurchase of loans with evident breaches on a loan-by-loan basis. Under the direction and with the participation of Bank of America, Countrywide demanded that Ambac engage in protracted, multi-step reviews and negotiations of the detailed breaches. In the meantime, Ambac has paid extraordinary sums to cover amounts due to the insured investors as a result of the staggering numbers of defaulted loans.

166. Countrywide's conduct demonstrates that it has not complied with, and does not intend to honor in any meaningful or timely manner, its obligations to repurchase, cure or substitute non-conforming loans. Rather, Countrywide's actions—at all times at the direction of Bank of America—have compounded the harm resulting from its origination and sale of the defective loans into the Transactions by frustration of the repurchase-cure-or-substitute protocol. Upon information and belief, Bank of America's delay-and-defer strategy in responding to Ambac's repurchase demands is designed to avoid recognizing in its financial statements the extraordinary off-balance sheet liability attributable to Countrywide's contractual obligations.

#### **I. Plaintiffs are Entitled to Relief**

167. Ambac would not have participated in the Transactions and issued its Policies had it known of Countrywide's fraud *or* pervasive and material breaches of its

representations and warranties. Countrywide’s pervasive misrepresentations and breaches pierce the very heart—and amount to a total repudiation—of the bargain struck by the parties. The loan portfolios Countrywide sold into the Transactions did not have the attributes or bear any resemblance to what Countrywide represented and warranted would be transferred. Countrywide’s deliberate frustration of the loan-level contractual remedy further compounds the harm from its breaches.

168. Despite repeated attempts by Ambac to address Countrywide’s breaches, Countrywide, at Bank of America’s direction, has continued to delay, without offering any meaningful resolution. In the meantime, Ambac has incurred significant harm, and is incurring significant harm, as a consequence of Countrywide’s malfeasance, including the payment of over \$466 million in claim payments to date, lost-opportunity costs on those amounts and the reserves Ambac must maintain relating to the future anticipated claims on the Transactions.

**J. As Countrywide’s Successor, Bank of America is Vicariously Liable for Countrywide’s Actions**

169. As Countrywide’s successor in liability, Bank of America is jointly and severally liable for any and all damages resulting to Plaintiffs from the wrongful actions of Countrywide. Bank of America itself has acknowledged that its acquisition of all of Countrywide’s assets through an all-stock transaction on July 1, 2008 was a “merger.”<sup>119</sup> In a July 2008 press release, Barbara Desoer, identified as the head of the “combined mortgage, home equity and insurance businesses” of Bank of America and Countrywide, said: “Now we begin to

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<sup>119</sup> Bank of America, Annual Report for Fiscal Year 2008 (Form 10-K), at 100-01 (Mar. 9, 2009) (“On July 1, 2008, we acquired Countrywide through its merger with a subsidiary of the Corporation in exchange for stock with a value of \$4.2 billion. Under the terms of the agreement, Countrywide shareholders received 0.1822 of a share of Bank of America Corporation common stock in exchange for each share of Countrywide common stock. The acquisition of Countrywide significantly improved our mortgage originating and servicing capabilities, making us a leading mortgage originator and servicer.”).

combine the two companies and prepare to introduce our new name and way of operating.”<sup>120</sup>

According to Bank of America, it “anticipates substantial cost savings from combining the two companies,” from eliminating employment positions, and from reducing overlapping technology, vendor and marketing expenses.<sup>121</sup> Desoer added that “the company is expected to benefit by leveraging its broad product set to deepen relationships with existing Countrywide customers.”<sup>122</sup>

Desoer was also interviewed for the May 2009 issue of *Housing Wire*, which reported that “[o]ne of the assets [Bank of America] acquired with Countrywide was a vast technology platform for originating and servicing loans, and Desoer says that the bank will be migrating some aspects of BofA’s mortgage operations over to Countrywide’s platforms.” Desoer was quoted as saying, “[w]e’re done with defining the target, and we’re in the middle of doing the development work to prepare us to be able to do the conversion of the part of the portfolio going to the legacy Countrywide platforms.” Mozilo stated in another press release that “the combination of Countrywide and Bank of America will create one of the most powerful mortgage franchises in the world.”<sup>123</sup> And in its 2008 Annual Report, Bank of America confirmed that by acquiring Countrywide it became the “No. 1 provider of both mortgage originations and servicing” and “as a combined company,” it would be recognized as a “responsible lender who is committed to helping our customers become successful homeowners.”<sup>124</sup>

170. Bank of America has reported to the SEC that on November 7, 2008,

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<sup>120</sup> Bank of America, *Bank of America Completes Countrywide Financial Purchase*, July 1, 2008, available at <http://newsroom.bankofamerica.com/index.php?s=43&item=8202>.

<sup>121</sup> Bank of America, *Bank of America Completes Countrywide Financial Purchase*, July 1, 2008, available at <http://newsroom.bankofamerica.com/index.php?s=43&item=8202>.

<sup>122</sup> Bank of America, *Bank of America Completes Countrywide Financial Purchase*, July 1, 2008, available at <http://newsroom.bankofamerica.com/index.php?s=43&item=8202>.

<sup>123</sup> Bank of America, *Bank of America Agrees to Purchase Countrywide Financial Corp.*, Jan. 11, 2008, available at <http://newsroom.bankofamerica.com/index.php?s=43&item=7956>.

<sup>124</sup> Bank of America, *2008 Annual Report*, Mar. 9, 2009, at 14, available at [http://media.corporate-ir.net/media\\_files/irol/71/71595/reports/2008\\_AR.pdf](http://media.corporate-ir.net/media_files/irol/71/71595/reports/2008_AR.pdf) (emphasis added).

Countrywide Financial and Countrywide Home “transferred substantially all of their assets and operations to [Bank of America].”<sup>125</sup> This transfer of assets was “in connection with the integration of Countrywide Financial Corporation . . . with [Bank of America’s] other businesses and operations.”<sup>126</sup> A California federal court recently found that since the merger, “Countrywide’s remaining operations and employees have been transferred to Bank of America, and Bank of America ceased using the Countrywide name in April 2009.”<sup>127</sup> And the New York Supreme Court has denied the defendants’ motion to dismiss another monoline insurer’s successor and vicarious liability claim against Bank of America.<sup>128</sup> Countrywide also ceased submitting filings to the SEC, which are now submitted as part of Bank of America’s filings. Further, Bank of America has taken responsibility for Countrywide’s pre-merger liabilities, including restructuring hundreds of thousands of loans created and serviced by Countrywide.

171. A spokesperson for Bank of America confirmed: “We bought the company and all of its assets and liabilities.”<sup>129</sup> Similarly, a January 23, 2009 New York Times article quoted Kenneth D. Lewis (who at the time was Bank of America’s Chairman and CEO), acknowledging that Bank of America had factored Countrywide’s liabilities into the price it paid to acquire Countrywide: “We looked at every aspect of the deal, from their assets to potential lawsuits and we think we have a price that is a good price.”

172. Consistent with its assumption of Countrywide’s liabilities, on October 6,

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<sup>125</sup> Bank of America Corporation, Current Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (Form 8-K), Item 8.01 (Nov. 10, 2008).

<sup>126</sup> Bank of America Corporation, Current Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (Form 8-K), Item 8.01 (Nov. 10, 2008).

<sup>127</sup> *SEC v. Mozilo*, No. 09-CV-3994, slip op. at 3 n.2 (C.D. Cal. Sept. 16, 2010).

<sup>128</sup> *MBIA Ins. Corp. v. Countrywide Home Loans, Inc. et al.*, Index No. 602825-08, slip op. (N.Y. Sup. Ct. April 27, 2010).

<sup>129</sup> Amy Miller, *Countrywide in Crosshairs as Mortgage Crisis Fuels Litigation*, CORPORATE COUNSEL, Feb. 22, 2008.

2008, Bank of America settled lawsuits brought against Countrywide by state Attorneys General by agreeing to loan modifications for 390,000 borrowers, an agreement valued up to \$8.4 billion. Bank of America also agreed to pay \$150 million to help Countrywide customers who were already in or were at serious risk of foreclosure, and an additional \$70 million to help Countrywide customers who had already lost their homes to make the transition to other living arrangements. In 2008, Bank of America restructured 300,000 home loans of which 87% had been originated or serviced by Countrywide. In announcing that its loan modification program known as the National Homeowners Retention Program (“NHRP”) will now have a “principal forgiveness” component, Bank of America noted that it “developed and launched the NHRP . . . to provide assistance to Countrywide borrowers.”<sup>130</sup> Further, under the I&I Agreements for each of the Transactions, Countrywide is defined to include its “successors and assigns.”<sup>131</sup>

173. Upon information and belief, Bank of America has been operating Countrywide Home effectively as a mere division of Bank of America. To that end, on April 27, 2009, Bank of America announced that “[t]he Countrywide brand has been retired.” Bank of America advised that it is operating the Countrywide home loan and mortgage business as a “division” named Bank of America Home Loans, which “represents the combined operations of Bank of America’s mortgage and home equity business and Countrywide Home Loans.”<sup>132</sup> The Bank of America Home Loans division is headquartered at Countrywide’s offices in Calabasas,

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<sup>130</sup> Bank of America, *Bank of America Introduces Earned Principal Forgiveness Among Enhancements to Its National Homeownership Retention Program*, March 24, 2010, available at <http://newsroom.bankofamerica.com/index.php?s=43&item=8662>.

<sup>131</sup> CWHEQ 2005-F I&I Agreement § 1.01 (“‘Countrywide’ means Countrywide Home . . . , as a Seller under the [MLPA], as Administrator under the Administration Agreement and as a Master Servicer under the [SSA], and any successor thereto under any such agreement.”); CWHEQ 2006-S1 I&I Agreement § 1.01 (“Countrywide means Countrywide Home . . . , as a Seller under the [PSA], and any successor thereto under such agreement.”).

<sup>132</sup> Bank of America, *Bank of America Responds to Consumer Desire for Increased Transparency in Home Loan Process with Tools that Clarify Mortgage Terms and Foster Informed Homeownership*, April 27, 2009, available at: <http://newsroom.bankofamerica.com/index.php?s=43&item=8440>.

California. Further, Bank of America's website states that "Countrywide customers . . . have access to Bank of America's 6,100 banking centers."<sup>133</sup> Countrywide's former website redirects customers to Bank of America's website.

174. Reflecting, among other things, the continuation in interests between the corporate entities, and Bank of America's assumption of Countrywide's obligations, among other things, Bank of America employees have been directing and controlling the policies and procedures that account for Countrywide's ongoing refusal to repurchase the vast majority of the defective mortgage loans for which Ambac has demanded repurchase, cure, or substitution, and Bank of America representatives have taken the lead role in discussions with Ambac regarding Ambac's repurchase demands.

#### **FIRST CAUSE OF ACTION**

##### **(Fraudulent Inducement Against Countrywide Financial, Countrywide Home, and Countrywide Securities)**

175. Plaintiffs re-allege and incorporate by reference paragraphs 1 through 174 of this Complaint.

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

177. As a corporate parent, Countrywide Financial directed the activities of Countrywide Home and Countrywide Securities. Countrywide Financial and Countrywide Home were responsible for selecting the mortgage loans for the Transactions. Countrywide Home was responsible for transferring the mortgage loans into the trusts, and entering into agreements with the trusts, Ambac, and other parties. As part of its fraudulent scheme,

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<sup>133</sup> Bank of America, *Bank of America Responds to Consumer Desire for Increased Transparency in Home Loan Process with Tools that Clarify Mortgage Terms and Foster Informed Homeownership*, April 27, 2009, available at <http://newsroom.bankofamerica.com/index.php?s=43&item=8440>.

Countrywide needed, and fraudulently induced Ambac to provide, credit enhancement to improve the marketability of the notes and certificates issued in connection with each of the Transactions. Countrywide Securities, a broker-dealer, was responsible for off-loading the risks associated with the mortgage loans originated by Countrywide Home, and underwriting and managing the offering of the notes and certificates issued in connection the Transactions to buyers in the secondary market. Countrywide Securities marketed the notes and certificates by fraudulently representing that the mortgage loans had been originated consistent with Countrywide's traditional underwriting standards, and the strength of Countrywide's reputation for conservative lending practices and high quality loans.

178. Countrywide made materially false statements and omitted material facts with the intent to defraud Ambac through pre-contractual communications between Ambac and Countrywide officers. Absent Countrywide's fraudulent inducement, Ambac never would have entered into the I&I Agreements or issued the Policies.

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

180. Countrywide, knowingly and with the intent to defraud, delivered to Ambac materially false and misleading documents, including loan tapes, Operative Documents, 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.

181. Ambac reasonably relied on Countrywide's statements and omissions

when it entered into the I&I Agreements and issued its Policies.

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

183. 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.

184. Because Countrywide committed these acts and omissions maliciously, wantonly, oppressively, and with the knowledge that they would affect the general public—which they have—Plaintiffs are entitled to punitive damages.

### **SECOND CAUSE OF ACTION**

#### **(Material Breach of Each of the I&I Agreements Against Countrywide Home)**

185. Plaintiffs re-allege and incorporate by reference paragraphs 1 through 184 of this Complaint.

186. Countrywide induced Ambac to enter into the I&I Agreements and to issue its Policies by making extensive, express contractual representations and warranties concerning Countrywide's operations and loan origination practices and the loans that Countrywide caused to be sold to the Trusts, and by agreeing to broad remedies for breaches of those representations and warranties.

187. Countrywide's representations and warranties, its covenants, and the broad remedial provisions it afforded in the I&I Agreements were material to Ambac's decision to insure each of the Transactions, and Ambac was induced thereby to enter into each I&I Agreement and perform its obligations thereunder.

188. The I&I Agreement in each Transaction is a valid and binding agreement between Ambac and Countrywide.

189. Ambac has performed all of its obligations under the I&I Agreements.

190. Countrywide has materially breached the I&I Agreements.

191. Plaintiffs have been damaged and will continue to be damaged in an amount to be determined at trial.

### **THIRD CAUSE OF ACTION**

#### **(Breach of Representations and Warranties Against Countrywide Home)**

192. Plaintiffs re-allege and incorporate by reference paragraphs 1 through 191 of this Complaint.

193. Countrywide has materially breached its representations and warranties under Section 2.01 of the I&I Agreements, including the loan-level representations in the MLPAs and PSAs incorporated by reference in the I&I Agreements.

194. Plaintiffs have been damaged and will continue to be damaged in an amount to be determined at trial.

### **FOURTH CAUSE OF ACTION**

#### **(Breach of Repurchase, Cure, or Substitution Obligation Against Countrywide Home)**

195. Plaintiffs re-allege and incorporate by reference paragraphs 1 through 194 of this Complaint.

196. Countrywide has materially breached its obligations under Sections 2.04 and 2.07 of the SSAs, Section 2.03 of the PSAs, and Section 2.02(a) of the I&I Agreements by refusing to repurchase, cure, or provide substitutes for the vast majority of the loans that breached Countrywide's representations and warranties and with respect to which notice of

breach has been provided by Ambac to Countrywide.

197. Plaintiffs have been damaged and will continue to be damaged in an amount to be determined at trial.

#### **FIFTH CAUSE OF ACTION**

##### **(Indemnification Against Countrywide Home)**

198. Plaintiffs re-allege and incorporate by reference paragraphs 1 through 197 of this Complaint.

199. Pursuant to Section 3.04(a) of the I&I Agreements, Ambac is entitled to be indemnified by Countrywide for all claims, losses, and liabilities of any nature arising out of or relating to, among other things, the breach by Countrywide of any of its representations, warranties or covenants contained in any of the Operative Documents, the misfeasance, malfeasance, or gross negligence of Countrywide arising from or relating to the Operative Documents related to any Transaction; the violation by Countrywide of any applicable law or any untrue statement or alleged untrue statement of a material fact or material omission contained in the Offering Documents.

200. Countrywide has breached numerous representations, warranties, and covenants contained in the Operative Documents, has committed negligence and/or malfeasance relating to the Operative Documents, and has materially misstated or failed to disclose material facts in its Offering Documents, all of which has caused Ambac to pay claims and incur losses, costs, and expenses, and Plaintiffs will continue to pay claims and incur losses, costs, and expenses as a result of Countrywide's conduct.

#### **SIXTH CAUSE OF ACTION**

##### **(Reimbursement for Claims Paid and Attorneys' Fees and Costs Against Countrywide Home)**

201. Plaintiffs re-allege and incorporate by reference paragraphs 1 through 200 of this Complaint.

202. Pursuant to Section 3.03(b) of the I&I Agreements, Countrywide agreed to reimburse Ambac for any and all charges, fees, costs, and expenses paid or incurred in connection with, among other things, enforcing, defending, or preserving Ambac's rights under the Operative Documents and those arising as a result of Countrywide's failure to substitute for or deposit an amount in respect of any defective mortgage loan as required pursuant to Section 3.02 of the MLPAs, Sections 2.04 and 2.07 of the SSAs, or Section 2.03 of the PSAs.

203. Ambac has incurred numerous expenses, including attorneys' fees and expert fees, in order to enforce, defend, and preserve its rights under the relevant agreements, and has made hundreds of millions of dollars in claim payments under the Policies as a result of Countrywide's failure to repurchase, cure, or substitute defective mortgage loans as required by the Operative Documents for the Transactions.

#### **SEVENTH CAUSE OF ACTION**

##### **(Successor and Vicarious Liability Against Bank of America)**

204. Plaintiffs re-allege and incorporate by reference paragraphs 1 through 203 of this Complaint.

205. Bank of America is jointly and severally liable for any and all damages resulting from the wrongful actions of Countrywide because it is the successor in liability to all of the three Countrywide defendants.

206. On July 1, 2008, Bank of America acquired Countrywide Financial and the other Countrywide Defendants through an all-stock transaction. Bank of America has described the transaction as a merger, and is actively incorporating Countrywide's mortgage business into Bank of America.

207. On April 27, 2009, Bank of America announced that “[t]he Countrywide brand has been retired. Instead, Bank of America will operate its home loan and mortgage business through a new division named Bank of America Home Loans, which “represents the combined operations of Bank of America’s mortgage and home equity business and Countrywide Home Loans.” The integration of Countrywide into Bank of America was to be completed by the end of 2009. According to press reports, Bank of America Home Loans will operate out of Countrywide’s offices in Calabasas, California.

208. On November 7, 2008, Countrywide Financial and Countrywide Home “transferred substantially all of their assets and operations to [Bank of America].” This transfer of assets was “in connection with the integration of Countrywide Financial Corporation . . . with [Bank of America’s] other businesses and operations.”

209. Bank of America has also taken responsibility for Countrywide’s pre-merger liabilities, including restructuring hundreds of thousands of loans created and serviced by Countrywide. As a spokesperson for Bank of America admitted: “We bought the company and all of its assets and liabilities.”

210. Moreover, in each of the I&I Agreements, Countrywide is defined to include its “successors and assigns.” Because Bank of America has merged with Countrywide Financial, and acquired substantially all of the assets of all Countrywide Financial, Countrywide Home, and Countrywide Securities, it is the successor in liability to Countrywide, and is jointly and severally or otherwise vicariously liable for the wrongful conduct, of Countrywide Financial, Countrywide Home, and Countrywide Securities.

### **PRAYER FOR RELIEF**

**WHEREFORE**, Plaintiffs respectfully pray for the following relief:

- A. For an award of all legal, equitable, and punitive damages, to be proven at trial, against Countrywide and Bank of America for Countrywide's fraudulent inducement of Ambac's participation in the Transactions and issuance of its Policies;
- B. For an award of legal, equitable and any other damages to be proven at trial, for Countrywide's and Bank of America's pervasive and material breaches of their representations and warranties, and contractual repurchase, cure, or substitution obligations, constituting material breaches of the I&I Agreements and frustration of the parties' bargains;
- C. For an order compelling Countrywide and Bank of America to comply with their obligations under Section 3.02 of the MLPAs, Sections 2.04 and 2.07 of the SSAs, and Section 2.03 of the PSAs, to repurchase, cure, or substitute the loans that breach Countrywide's representations and warranties;
- D. For an order of indemnification for the claim payments and other losses and expenses Plaintiffs have paid or will pay in the future under the Policies pursuant to Section 3.04(a) of the I&I Agreements;
- E. For an order awarding reimbursement of claim payments that Plaintiffs have made or will make as a result of Countrywide's and Bank of America's failure to repurchase, cure, or substitute breaching loans and Plaintiffs' attorneys' fees, and other costs and expenses incurred in enforcing, defending, or preserving their rights under the Operative Documents, pursuant to Section 3.03(b) of the I&I Agreements, and interest thereon pursuant to Section 3.03(c) of the I&I Agreements;
- F. For an order of prejudgment interest; and
- G. For an Order awarding Plaintiffs such other and further relief as the Court deems just and proper.

### **JURY DEMAND**

Plaintiffs demands a trial by jury for all issues so triable as a matter of right.

Dated: New York, New York  
September 28, 2010

Respectfully submitted,

PATTERSON BELKNAP WEBB & TYLER LLP



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