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The Segregated Account of Ambac Assurance Corporation

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

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

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

NATURE OF THE ACTION

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

I. THE PARTIES

A. PLAINTIFFS

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

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

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

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

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

B. THE "BEAR STEARNS" DEFENDANTS

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

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

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

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

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

II. JURISDICTION AND VENUE

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

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

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

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

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

III. THE BEAR STEARNS MORTGAGE LOAN SECURITIZATION "MACHINE"

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

A. BEAR STEARNS CONTROLLED EVERY ASPECT OF THE SECURITIZATION PROCESS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

B. BEAR STEARNS CHURNED OUT SECURITIZATIONS BY SACRIFICING LOAN QUALITY

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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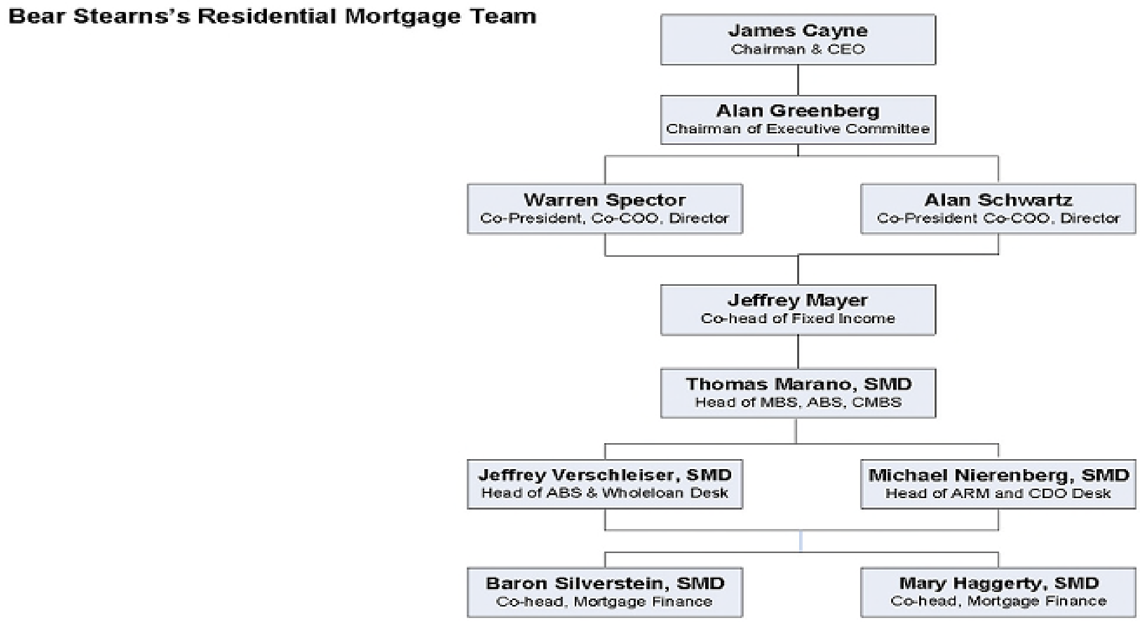
[27] Complaint ¶ 72, *Landesbank Baden-Württemberdg v. Bear, Stearns & Co. et al.*, No. 652680/2011 (N.Y. Sup. Ct. filed Jan. 27, 2012).

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

A. GREENPOINT MORTGAGE FUNDING, INC.

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

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

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

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

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

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

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

[41] Assured Complaint ¶ 105.

[42] *See generally* Assured Complaint.

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

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

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

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

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

[45] Assured Complaint ¶ 108.

[46] Assured Complaint ¶¶ 7, 109.

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

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

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

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[47] Syncora Federal Complaint ¶ 6.

[48] Assured Complaint ¶ 270.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

B. COUNTRYWIDE HOME LOANS, INC.

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

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[53] Assured Complaint ¶¶ 113-20.

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

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

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

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

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

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

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

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

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

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

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[57] Ambac-Countrywide Complaint ¶ 87.

[58] Ambac-Countrywide Complaint ¶ 87.

[59] Ambac-Countrywide Complaint ¶ 89.

[60] Ambac-Countrywide Complaint ¶ 157.

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

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

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

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

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

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

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

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

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

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

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

C. BSRM AND SOUTHSTAR

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

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

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

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

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

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

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

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

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

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

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

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

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

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

V. THE TRANSACTIONS

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

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

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

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

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

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

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

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

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

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

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

B. THE BALTA 2006-R1 TRANSACTION

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

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

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

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

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

C. THE INSURED CERTIFICATES

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

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

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

A. BEAR STEARNS SOLICITED AMBAC TO PARTICIPATE IN THE TRANSACTIONS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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