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

In the matter of the application of U.S. BANK NATIONAL ASSOCIATION, et al., Petitioners, For an order, pursuant to CPLR § 7701, seeking judicial instruction.	Index No: 652382/2014 Assigned to: Friedman, J. **AFFIDAVIT OF MINGSUNG TANG IN SUPPORT OF TRIAXX'S OBJECTION**

STATE OF NEW YORK)
ss.:
COUNTY OF NEW YORK)

Mingsung Tang, being duly sworn, deposes and says:

Introduction

1. I am litigation consultant to Triaxx Prime CDO 2006-1, Ltd., Triaxx Prime CDO 2006-2, Ltd., and Triaxx Prime CDO 2007-1, Ltd. (together, "Triaxx"). I submit this affidavit summarizing evidence in support of Triaxx in the captioned Article 77 proceeding.

2. Attached hereto as Exhibit A is a summary exhibit of Triaxx's holdings among the Covered Trusts (the "Triaxx-Held Trusts"). The holdings were purchased at or about the time of issuance and had an original notional value of approximately $1.5 billion.

3. Attached hereto as Exhibit B is an excerpt from the Complaint in the case captioned *United States of America, et al. v. Bank of America Corp., et al.*, Case 1:12-cv-00361 RMC (D.D.C. filed April 4, 2012) (hereinafter, the "National Mortgage Settlement").

4. Attached hereto as Exhibit C is an excerpt of the Consent Judgment entered against JPMorgan Chase & Co. (including, with its affiliates, "JPMorgan") in the National Mortgage Settlement.

5. Attached hereto as Exhibit D is the U.S. Department of Justice's Fact Sheet on the National Mortgage Settlement.

<u>Triaxx's Investments in the Covered Trusts</u>

6. Before the financial crisis, there was a proliferation of residential mortgage-backed securities ("RMBS") backed by risky subprime, scratch and dent, second lien or adjustable-rate mortgage loans, including negative-amortizing, pay-option adjustable-rate mortgage loans ("POAs").

7. Triaxx invested in RMBS originated by JPMorgan. Triaxx invested prudently, and did not invest in risky RMBS. Triaxx invested only in super-senior classes of RMBS backed by prime, first-lien, 30-year fixed-rate mortgages.

8. Among the Covered Trusts constituting Triaxx's positions, the funds held 20,056 mortgage loans with aggregate original outstanding balance of about $9.94 billion. At October 2014, these Trusts realized about $660 million in losses, hold in excess of $455 million in delinquent loans, and hold about $1.87 billion in performing loans. *See* Exhibit E.

The Differences Among the Covered Trusts Is the Quality of the Mortgage Loan Collateral and the Differences in the <u>Representations and Warranties in the PSAs</u>

9. I have reviewed thousands of mortgage loans and hundreds of Pooling and Servicing Agreements ("PSAs") and Prospectus Supplements ("Pro Supps") for the Covered Trusts, and I can summarize them as follows: although the Covered Trusts share the same general structure, the loans that served as collateral in the Covered Trusts present significantly different levels of risk, and the representations and warranties in the PSAs differ. As a result, the Covered Trusts have different claims against JPMorgan for breach of representation and warranty ("R&W Claims"). I have not reviewed a complete set of all PSAs and Pro Supps of the

Covered Trusts, which is not readily available to the public. It is in the possession of the Petitioners and JPMorgan.

A. The Trusts Hold Different Types of Loans

10. The Covered Trusts can be categorized by the types of loans they hold:

a. Prime Fixed-Rate. Prime Trusts hold first-lien, thirty-year fixed-rate loans made to prime borrowers, whose income has been verified and who purported to have equity in their homes.

b. Prime Alt-A Fixed-Rate. Fixed-rate Alt-A Trusts also hold first-lien, thirty-year fixed-rate loans of prime quality, but an alternative ("Alt") source of documentation was used during underwriting. For example, if a borrower was self-employed and did not have a Form W-2, another document was used.

c. Subprime. These Trusts hold loans to borrowers who present a greater risk of default than prime borrowers due to their poor credit history, some of which did not require income documentation, *i.e.*, "liar loans."

d. Alt-A Pay-Option Adjustable Rate ("Alt-A POA"). A "pay option" adjustable rate loan begins with a temporary payment schedule, often based on a low "teaser" rate. After the temporary interest rate expires, the borrower can elect to pay a minimum payment that can be less than the interest-only payment. If the borrower does this, the rest of the interest is deferred and added to principal (negative amortization) until a deferral limit is reached. If the deferral limit is reached, the loan "recasts," which can result in substantial sudden increases in the borrower's payments.

e. Scratch and Dent. These Trusts hold "scratch and dent" residential mortgages that "may include mortgages that have been originated outside an originator's program guidelines in some way, or mortgages where borrowers missed payments in the past," or "loans with document defects at origination that were since rectified," or "non-prime loans that were seriously delinquent at the time of securitization." Exhibit F.

f. Second Lien. Second lien loans include second mortgages and home equity lines of credit ("HELOCs") subordinate to first mortgages.

B. The Different Types of Loans Present Different Risks

11. The different types of loans present different risks. Credit risk, the risk that a borrower will default on a loan, is greater with subprime borrowers than prime borrowers, irrespective of representation and warranty breaches. Credit risk is also greater with adjustable-rate mortgages, particularly POAs, which create "payment shock" credit risk: the risk that the borrower will be unable to make payments when the interest rate increases. By contrast, fixed-rate loans are underwritten to the full payment of principal and interest, necessitating a higher quality of borrower and thus presenting much less credit risk than with adjustable-rate or POAs.

12. Different loans also present different "security risk," the risk that the collateral for the loan (the borrower's property) will not be adequate to repay the loan in full if the borrower defaults. There is greater security risk with second lien loans, because if the property value decreases by any amount, the second mortgage may be insufficiently collateralized. If the borrower defaults, the first lien holder has a priority over any liquidation proceeds. This makes second liens sensitive to market downturns. Security risk is also greater with POAs, because the reverse amortization can increase the amount of the loan over time.

13. For all these reasons, the fact that the riskier subprime, scratch and dent, Alt-A POA, and second lien Covered Trusts have incurred greater losses than the safer prime and prime Alt-A fixed-rate Covered Trusts does not justify the assumption that losses in these Trusts give rise to valid R&W Claims. The riskier Trusts would be expected to have greater losses, given the heightened risk profile of the loans they own.

14. Exhibit G attached hereto is a summary of losses among the Covered Trusts. It graphically illustrates the inherent risk characteristics of loans, from the least risky (the Trusts holding prime Loans, with average percentage losses of 5% of original notional value) to most risky (the Trusts holding second lien loans, with average losses of 49%).

C. The Settling Certificateholders' Holdings

15. Triaxx has undertaken a review of the reported holdings of the Institutional Investors in the Covered Trusts. *See* Exhibit H. Less than half of the Institutional Investor's holdings are in prime or Alt-A prime Trusts, of which only one-third are fixed-rate. The majority of their holdings are in the risky adjustable rate (including POA), subprime, second lien and scratch and dent trusts. *See id.*

16. These types of Trusts have greater Losses than the prime and Alt-A prime Trusts, such as the Triaxx-Held Trusts. *See id.* In fact, greater losses were expected at the origination of the riskier Trusts, as shown by the fact that they paid a higher yield.

17. Certificates issued by these riskier Trusts trade at distressed prices.

18. Exhibit I attached hereto demonstrates the effect of the proposed settlement on a JPMorgan second lien Trust.

D. The Representations and Warranties Vary

19. Attached hereto as Exhibits J1-J4 are excerpts from the American Home Purchase Agreement, and PSA excerpts for JPMMT 2007-S2, BSABS 2005-AC5, and BSABS 2005-AC6 (hereinafter, the "Prime Trusts").

20. Origination fraud was a substantial risk when the loans were originated (approximately 2004-2007). *See, e.g.*, Financial Crisis Inquiry Commission Report at xxii ("One study places the losses resulting from fraud on mortgage loans made between 2005 and 2007 at $112 billion."), attached hereto as Exhibit K.

21. However, the Representations and Warranties for fraud differ widely among the Covered Trusts. *See, e.g.*, Exhibit J1 (American Home Purchase Agreement), 26, § 7.01(hh), restated in Exhibit J2 (JPMMT 2007-S2 PSA), 64, § 2.05(d)(xii) (stating that "[n]o fraud . . . with respect to the Mortgage Loan has taken place . . .").

22. In contrast, my review found that certain Subprime and Scratch and Dent Trust PSAs, such as for BSMF 2007-AR2 and BSABS 2006-SD3, respectively, contain no language concerning fraud in their representations and warranties.

23. The Prime Trusts clearly state that the "Seller . . . makes the representations and warranties contained" in the related purchase agreements, or that the Seller directly makes the representations and warranties. Exhibit J2 (JPMMT 2007-S2 PSA), 64, §§ 2.05(d)(x)-(xv); *see*, *e.g.*, Exhibit J3 (BSABS 2005-AC5 PSA), 306, § 7. In the other trusts, such as BSMF 2007-AR2, this is not always the case.

24. The Scratch and Dent Trusts disclose in their prospectuses that investors take heightened risks in purchasing their loans, while the Prime Trusts do not. *See, e.g.,* BSABS 2006-3 Prospectus Supplement, S-19, S-20 (disclosing that "approximately 17.25% of the mortgage loans" actually "were 30 days or more contractually delinquent" by cut-off date principal balance, and that the mortgage pool included impaired mortgage loans owing to "violated . . . underwriting guidelines," "missing or defective loan documentation," "previous [loan delinquency]," and/or borrowers with "credit write-offs, outstanding judgments, current or prior bankruptcies," among other reasons), attached hereto as Exhibit L.

E. <u>Triaxx's Analysis of the Loans Held by the Triaxx-Held Trusts</u>

25. On behalf of Triaxx, I have undertaken a detailed analysis of the loans in the Triaxx-Held Trusts. My analysis did not have the benefit JPMorgan's loan files, nor could it

rely upon manual re-underwriting of the loans. Rather, the analysis cross-references voluminous public and proprietary data pools external to JP Morgan and the Petitioners.

26. Attached hereto as Exhibit M is a table comparing loan modification provisions for three PSAs and one ProSupp**.** The provisions vary greatly, though even the least restrictive PSA (for JPMMT 2007-S2) permits loan modification *only if* "not materially adverse to the Certificateholders." Exhibit M.

27. Attached hereto as Exhibit N are three examples of problematic loan modifications producing conflicts of interest ("Loan Modification Examples").

28. For instance, Loan Modification Example 1 features New York property purchased in March 2007 for $835,000 and financed with a $668,000 first-lien loan from JPMorgan, along with a second lien from JPMorgan for $83,500. Exhibit N.

29. The loan was subsequently sold into the Trust, but the property went into foreclosure in April 2012. In response, JPMorgan modified the first lien in August 2013 by reducing the principal by $134,102 and the interest rate by 4.5%. The reduced principal was consequently lower than the property's market value. *Id.*

30. As of August 25, 2014, a cumulative loss of $233,037 has been posted to the Trust, whereas the second lien appears to be entirely unaltered; in contrast to the first lien, the second has no public record of modification of which I am aware or could locate. This is indicative of likely improper loan modification and a conflict of interest, to JPMorgan's benefit and the Trusts' detriment. Loan Modification Examples 2 and 3 pose similar issues for properties JPMorgan financed in California and Florida. *Id.*

31. Exhibit O graphically illustrates the security risk inherent in second lien loans.

Mingsung Tang

Sworn to before me this

3rd day of November 2014.

Helaine E. Fraser
Notary Public

HELAINE E. FRASER
Notary Public, State of New York
No. 30-6386610
Qualified in Nassau County
Commission Expires Sept. 30, 2018