UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

14 CV 9366

Case No.

BLACKROCK BALANCED CAPITAL PORTFOLIO (FI); BLACKROCK CORE ACTIVE LIBOR FUND B; BLACKROCK CORE BOND TRUST; BLACKROCK COREALPHA BOND FUND E; BLACKROCK COREALPHA BOND MASTER PORTFOLIO; BLACKROCK COREPLUS BOND FUND B; BLACKROCK DYNAMIC HIGH INCOME – STRUCTURED CREDIT PORTFOLIO; BLACKROCK FIXED INCOME GLOBALALPHA MASTER FUND LTD.; BLACKROCK FUNDS II, INFLATION PROTECTED BOND PORTFOLIO; BLACKROCK INCOME TRUST, INC.; BLACKROCK LONG DURATION ALPHAPLUS BOND FUND; BLACKROCK MASTER TOTAL RETURN PORTFOLIO OF MASTER BOND LLC; BLACKROCK MULTI-ASSET INCOME – NON-AGENCY MBS PORTFOLIO; BLACKROCK MULTI-SECTOR INCOME TRUST; BLACKROCK STRATEGIC INCOME OPPORTUNITIES PORTFOLIO; BLACKROCK TOTAL RETURN PORTFOLIO (INS – SERIES); BLACKROCK US MORTGAGE; AST PIMCO TOTAL RETURN BOND PORTFOLIO; FIXED INCOME SHARES (SERIES R); FIXED INCOME SHARES: SERIES C; FIXED INCOME SHARES: SERIES M; LVS I LLC; LVS I SPE XIV LLC; LVS II LLC; PACIFIC BAY CDO, LTD.; PACIFIC SHORES CDO, LTD.; PCM FUND, INC.; PIMCO ABSOLUTE RETURN STRATEGY 3D OFFSHORE FUND LTD.; PIMCO ABSOLUTE RETURN STRATEGY II MASTER FUND LDC; PIMCO ABSOLUTE RETURN STRATEGY III MASTER FUND LDC; PIMCO ABSOLUTE RETURN STRATEGY IV IDF LLC; PIMCO

VERIFIED DERIVATIVE COMPLAINT AND ALTERNATIVE CLASS ACTION AGAINST HSBC BANK USA, NATIONAL ASSOCIATION FOR BREACH OF CONTRACT; VIOLATION OF THE TRUST INDENTURE ACT OF 1939; BREACH OF FIDUCIARY DUTY; BREACH OF DUTY OF INDEPENDENCE; AND NEGLIGENCE

JURY DEMAND

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Plaintiffs AEGON (as defined herein); BlackRock Funds (as defined herein); Brookfield (as defined herein); Charles Schwab & Co., Inc. ("Schwab"); Deutsche Zentral-Genossenschaftsbank AG, New York Branch, d/b/a DZ Bank AG, New York Branch ("DZ Bank"); Kore Advisors, L.P. ("Kore"); PIMCO (as defined herein); Prudential (as defined herein); Sealink Funding Limited ("Sealink"); and TIAA (as defined herein) (collectively, "Plaintiffs") by and through their undersigned attorneys, hereby bring this derivative complaint (the "Complaint") in the right of the trustee and on behalf of and for the benefit of the residential mortgage-backed securities ("RMBS") Trusts listed in Exhibit 1 ("Trusts"), against HSBC Bank USA, National Association ("HSBC" or the "Trustee"), the Trustee for the Trusts to recover losses sustained by the Trusts as a result of HSBC's wrongful conduct. Alternatively, Plaintiffs bring this action on their own behalf and on behalf of a class of all current owners of certificates in the Trusts (the "Class") to recover for the losses directly suffered by Plaintiffs and the Class as a result of HSBC's wrongful conduct.

I. NATURE AND SUMMARY OF THE ACTION

1. Defendant HSBC is a national banking association that is the Trustee for hundreds of RMBS trusts originally securitized by approximately $350 billion of residential mortgage loans. Among them are the Trusts at issue in this action: 271 private-label RMBS Trusts securitized between 2004 and 2008 collateralized with loans worth approximately $257 billion at the time of securitization. HSBC, as Trustee, is the sole gatekeeper for the protection of the Trusts and their beneficial certificateholders (the "Certificateholders"), and must at all times act in the best interests of the Trusts. As alleged herein, HSBC failed to discharge its duties and obligations to protect the Trusts. Instead, to protect its own business interests, HSBC ignored pervasive and systemic deficiencies in the underlying loan pools and the servicing of those loans

and unreasonably refused to take any action. This derivative action seeks to recover billions of dollars in damages to the Trusts caused by HSBC's abdication of responsibility.[1]

2. RMBS trusts are created to facilitate the securitization and sale of residential mortgage loans to investors. The trust's assets consist entirely of the underlying loans, and the principal and interest payments ("P&I") on the loans are "passed through" to the certificateholders. Between 2004 and 2008, a handful of large investment banks – including HSBC – dominated the RMBS market and controlled the process from beginning to end. These banks act as "sponsors" of the RMBS, acquiring the mortgage loans from originators, who often were affiliates of the sponsors or beholden to them through warehouse lending or other financial arrangements. Once the loans are originated, acquired and selected for securitization, the sponsor creates a trust where the loans are deposited for the benefit of the certificateholders. The sponsor also hand-picks the servicer, often an affiliate of the sponsor or originator, to collect payments on the loans. Finally, a select number of these same banks that originate, securitize and service RMBS also act as trustees on other sponsor's deals.

3. To ensure the quality of the RMBS and the underlying loans, the Trust documents generally include representations and warranties from the loan sellers attesting to the quality and characteristics of the mortgages as well as an agreement to cure, substitute, or repurchase mortgages that do not comply with those representations and warranties. Because the risk of non-payment or default on the loans is "passed through" to investors, other than these representations and warranties, the large investment banks and other players in the mortgage

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[1] This Complaint does not allege in any way that the Trustee was or is burdened by conflicts in connection with its negotiation, evaluation, or acceptance of any RMBS settlement, including the $8.5 billion settlement with Bank of America/Countrywide, the $4.5 billion settlement with JPMorgan, or the $1.125 billion settlement with Citibank.

securitization industry have no "skin" in the game once the RMBS are sold to certificateholders. Instead, their profits are principally derived from the spread between the cost to originate or purchase loans, how much they can sell them to investors once packaged as securities, as well as various servicing-related income. Accordingly, volume became the focus, and the quality of the loans was disregarded.

4. The fundamental role of a trustee in an RMBS securitization is to ensure that there is at least one independent party, free from any conflicting self-interest, to protect the trust corpus. Certificateholders have no access to the underlying loan files and other documents necessary to confirm compliance with the representations and warranties, cannot monitor the servicers' conduct and performance, cannot act independently to enforce the trusts' contractual rights, and must rely on the trustee to protect their interests. HSBC, as Trustee, was the sole contractual party in the Trusts' securitization process intended to be independent of the investment banks that sponsored the securitization, the lenders that originated the loans, and the servicers that were often affiliated with either the sponsors or lenders, or both. Certificateholders must rely on the Trustee to protect the rights and interests of the trusts.

5. HSBC knew that the pools of loans backing the Trusts were filled with defective mortgage loans. The abysmal performance of the Trust collateral – including spiraling defaults, delinquencies and foreclosures – is outlined on monthly remittance reports that HSBC, as Trustee, publishes and publicly files with the government. The monthly remittance reports detail how, by January 2009, the Trusts had suffered collateral losses exceeding $11.1 billion. On average, over one in every four loans in the Trusts was delinquent. Moreover, 121 Trusts had delinquency rates exceeding 33%, and 37 Trusts had delinquency rates of over 50%. By January 2011, the Trusts' total losses had increased ***four-fold*** to $47 billion, meaning that nearly 18% of

the Trusts' entire loan pool had been written off. By the start of 2010, nearly all of the securities issued by the Trusts had experienced multiple downgrades, with most reduced to "junk" status.

6. A steady stream of public disclosures has linked the abject performance of the Trusts to systemic abandonment of underwriting guidelines, and the deficient and often fraudulent securitization practices of the sponsors. Highly publicized government investigations, reports and enforcement actions; high-profile RMBS litigation by government agencies, federal banks, and institutional investors; and claims and litigation instituted by monoline insurers have repeatedly noted the "pervasive disregard" and "systemic abandonment" of underwriting guidelines in the years leading up to the financial crisis. Voluminous complaints in these proceedings detail gross misstatements in the Trust documents of key metrics concerning the quality of the underlying loan pools, including loan-to-value ratios ("LTVs"), owner occupancy status, and borrower credit scores – as well as the completeness of the loan files themselves.

7. Indeed, HSBC has admitted its knowledge of breaches of representations and warranties and "Events of Default." With this knowledge, HSBC has taken action to protect certain trusts, but only trusts that are **not** at issue herein. In fact, at the direction of certificateholders, HSBC has pursued ***over twenty*** lawsuits against Deutsche Bank and Nomura, two of the Trusts' largest sponsors, for breach of representations and warranties. In each of those actions, HSBC conducted forensic analyses of loans within the trusts, after which it concluded in court filings that the scale of the sponsor's breaches concerning loans produced by the same originators of loans in the Trusts at issue herein were ***"staggering,"*** and that the sponsors had dumped into the Trusts a "***massive number of defective loans – loans that blatantly breached [the sponsors'] representations and warranties***." In fact, HSBC regularly found breach rates ***over 80%*** and sometimes as high as ***91.5%***. As HSBC observed, the breaches included

"widespread misrepresentations of borrower income, misrepresentations of occupancy status, incorrect calculations of debt and debt-to-income ratios, improper calculations of LTV ratios, the provision of inaccurate information with respect to these loans and other breaches." As additional evidence of pervasive seller breaches, HSBC cited government investigations revealing that sponsors "***disregarded underwriting guidelines, and as a result made representations and warranties for mortgages that did not meet stated criteria in the governing documents***."

8. HSBC was further informed of pervasive and systemic deficiencies infecting the Trusts' collateral through additional "putback" initiatives. For example, in December 2011, a group of major institutional investors asked HSBC, as trustee, to investigate large numbers of ineligible mortgages in loan pools underlying dozens of JPMorgan sponsored trusts and deficient servicing of those loans. Together with similar instructions provided to four other trustees of the JPMorgan-sponsored trusts, the initiative covered more than ***$95 billion*** of RMBS issued from 2005 to 2007. Less than two years later, HSBC and the other trustees were presented with a comprehensive $4.5 billion settlement offer covering 330 JPMorgan-sponsored trusts. On August 1, 2014 and October 2, 2014, HSBC and the other trustees involved in the putback initiative ***accepted*** JPMorgan's $4.5 billion offer for the vast majority of the 330 trusts included in the offer and petitioned for ***court approval*** of the settlement. In another investor-led initiative, HSBC, as trustee, gave its ***approval*** to a $7 billion settlement covering 570 RMBS trusts sponsored by Residential Capital and its affiliates ("ResCap") from 2004 to 2008 with an original face amount of over ***$320 billion***.

9. These and other certificateholder-led initiatives sought to "putback" large quantities of loans (1) originated by many of the same lenders that also originated large

quantities of the loans sold to the Trusts, including Wells Fargo ($56.2 billion of loans sold to the Trusts), GreenPoint ($10.7 billion of loans sold to the Trusts) and Fremont ($31.5.1 billion of loans sold to the Trusts); and (2) securitized by the same investment banks and financial institutions that sponsored the Trusts, including Wells Fargo ($71.8 billion of sponsored Trusts) and Luminent Mortgage ($4.2 billion of sponsored Trusts). In addition, the initiatives identified and sought recovery of losses relating to servicing deficiencies by many of the same major servicers of loans backing the Trusts, including Wells Fargo (servicer to $231.4 billion of loans sold to the Trusts).

10. Finally, as a major player in the RMBS securitization market, HSBC learned of the industrywide servicer violations plaguing the Trusts. Indeed, many of the servicers to the Trusts have faced federal and state regulatory enforcement actions which have led to landmark settlements, including the $25 billion "National Mortgage Settlement" entered into between forty-nine state attorneys general and some of the Trusts' servicers. Notably, without receiving certificateholder approval, many of these settlement agreements effectively permit the servicers to use trust assets to finance their settlement payments for their own wrongdoing.

11. Moreover, HSBC itself was the target of government investigations and lawsuits regarding its deficient servicing operations. For example, during the fourth quarter of 2010, the Federal Reserve, the Office of the Comptroller of the Currency ("OCC"), the Federal Deposit Insurance Corporation ("FDIC"), and the Office of Thrift Supervision ("OTS") conducted on-site reviews of the adequacy of controls and governance over servicers' foreclosure processes at HSBC. The reviews uncovered significant problems in foreclosure processing at HSBC, including "critical weaknesses in [HSBC's] foreclosure governance processes, foreclosure document preparation processes, and oversight and monitoring of third-party vendors, including

foreclosure attorneys." Based on the deficiencies in the review and the risk of additional issues as a result of weak controls and processes, the Federal Reserve Board initiated formal enforcement actions requiring HSBC North America Holdings, Inc. and HSBC Finance Corporation, the corporate parent and affiliate of HSBC, to address its pattern of misconduct and negligence related to deficient practices in residential mortgage loan servicing and foreclosure processing. Ultimately, HSBC entered into a consent order with the OCC, which found that HSBC had engaged in "unsafe or unsound practices with respect to the manner in which [HSBC] handled various foreclosure and related activities."

12. Under the governing Pooling and Servicing Agreements ("PSAs"), upon HSBC's knowledge of an "Event of Default" by a servicer, HSBC is obligated to provide written notice of the default to the servicer. HSBC systematically failed, however, to provide notice to the servicers of their defaults because HSBC did not want to jeopardize its close business relationships with the servicers. Moreover, HSBC, which also acts as a servicer for billions of dollars of other RMBS, has engaged in the same improper and illicit servicing activities that plagued the Trusts. Similarly, HSBC originated billions of dollars in loans that have been securitized in other RMBS and that contain pervasive breaches of representations and warranties. Many of the same entities that act as servicers for the Trusts also service these defective HSBC-originated loans. Thus, HSBC, acting in its own self-interest, refused to provide notice to the servicers of their defaults to avoid scrutiny of its own servicing business and evade liability for its own defective loans.

13. Further, under the PSAs, within sixty to ninety days after the occurrence of an Event of Default, HSBC is obligated to transmit by mail to all Certificateholders notice of each Event of Default known to HSBC, unless the Event of Default has been cured or waived.

Although Events of Default occurred and were not – and have not been – cured or waived, HSBC has similarly failed to provide written notice to the Certificateholders of the Events of Default. HSBC has covered up the Events of Default for several self-interested reasons. Among other things, as noted above, providing notice of the servicers' default could jeopardize HSBC's close business relationships with the servicers and lead to HSBC's own potential liability in its capacity as an originator, sponsor and servicer to other RMBS trusts. Moreover, as discussed in greater detail below, had HSBC provided notice of an Event of Default, it would have greatly increased HSBC's liabilities and duties, but HSBC's compensation under the PSA would have remained the same.

14. Finally, after the Events of Default, HSBC failed to exercise its rights under the Governing Agreements as a prudent person would, under those circumstances, in the conduct of its own affairs. HSBC did nothing to protect the Trusts and Certificateholders, choosing instead to deliberately ignore the egregious Events of Default for its own benefit and to the detriment of the Trusts.

II. PARTIES

A. Plaintiffs

15. Each of the plaintiffs identified below (collectively, the "Plaintiffs") is a Certificateholder in the Trusts as identified in Exhibit 1 attached hereto. Each of the Plaintiffs was a Certificateholder of the respective Trusts at the time of the transactions of which it complains, or interests therein devolved upon it by operation of law in accordance with New York General Obligations Law § 13-107.

16. The Plaintiffs hold the economic and beneficial interest in their Certificates and are the true parties in interest. No other party has an economic or beneficial interest in the Plaintiffs' Certificates in this matter.

by 23.2%. For MANA 2007-AF1, the review showed that 35.9% of the loans had a LTV ratio greater than 100%, contrary to the represented 0%, and that the owner occupancy percentage was overstated by 22.1%.

380. Similarly, in *Prudential v. Bank of America*, No. 2:13-cv-01586 (D. N.J. Mar. 14, 2013), Prudential performed a forensic review of thirty offerings and found a "staggering" number of materially defective loans in every offerings, including one Merrill-Lynch-label offering at issue here. In MLMI 2005-WMC5, the forensic review revealed that 39.88% of the loans had at least one material defect. These material defects included, among other things, a misrepresentation of owner occupancy percentages and LTV ratios. For instance, 16.56% of the loans in MLMI 2005 WMC-1 had a LTV ratio greater than 100%, and the owner occupancy percentage was overstated by 13.17%.

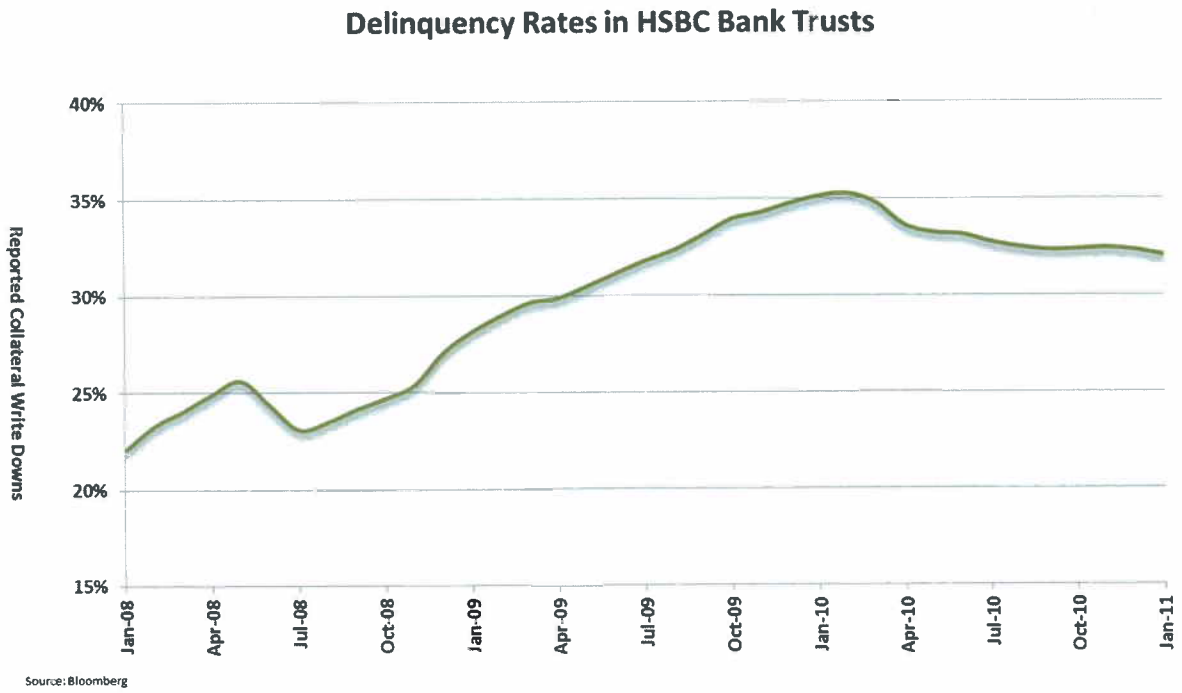
X. HSBC KNEW THAT THE TRUSTS WERE FILLED WITH DEFECTIVE LOANS

381. There is ample evidence that beginning in 2009 and by 2011, HSBC "discovered" that each of the Trusts' loan pools contained high percentages of mortgage loans that materially breached the originators' and sponsors' representations and warranties regarding their credit quality. As discussed above, since 2009, there has been a steady stream of public disclosures regarding the originators' systemic underwriting abuses and the sponsors' faulty securitization practices. However, apart from the highly publicized government investigations, reports and enforcement actions, as well as high profile RMBS litigation involving the originators and sponsors, as explained below there is a plethora of additional evidence demonstrating HSBC's and its responsible officers' knowledge that the Trusts' loan pools contained high percentages of mortgage loans that materially breached seller representations and warranties.

A. The Trusts' Poor Performance

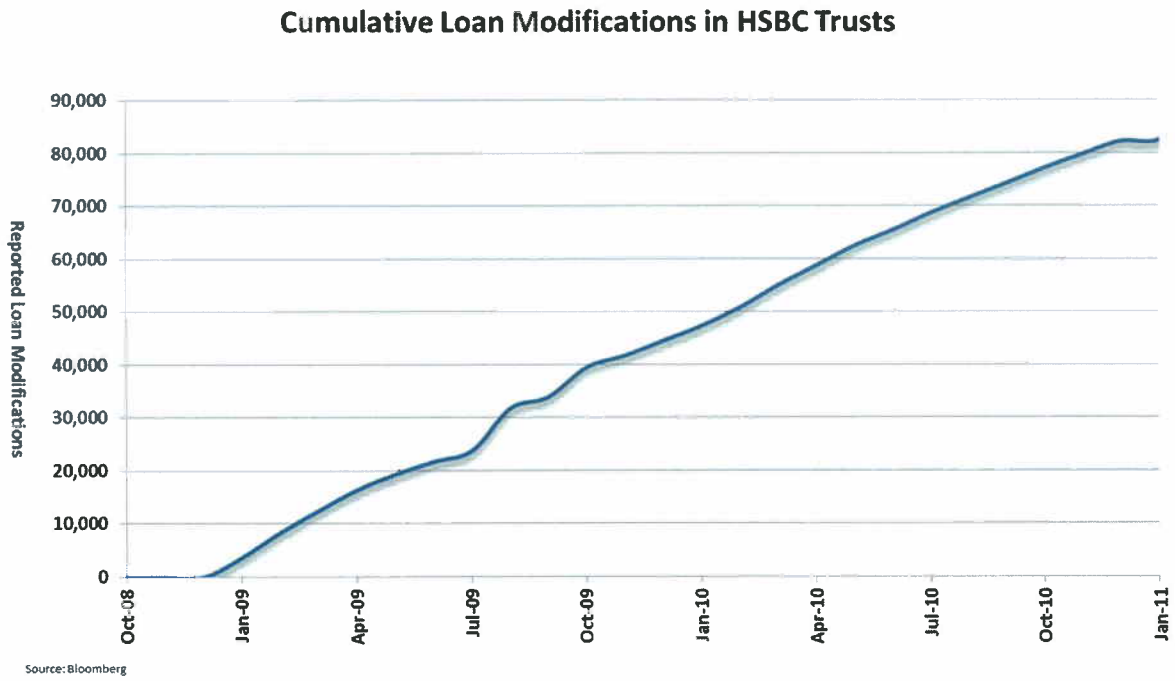
382. HSBC and its responsible officers had discovered by 2009 that the Trusts' loan pools were afflicted by severe and pervasive breaches of seller representations and warranties by virtue of the Trusts' abject performance. It was evident by January 2009, that given the extremely high mortgage loan default rates within the Trust loan pools the mortgage loans sold to the Trusts were not as the sellers had represented and warranted. For example, in January 2009, almost 75% of the Trusts had double-digit mortgage loan default rates. Over 50% of the Trusts had mortgage loan default rates is excess of 25%, with 110 of the Trusts (40%) having default rates greater than 35%. Incredibly, 37 of the Trusts (14%) had default rates in excess of 50%, while at least three Trusts had mortgage loan default rates of over 65% - nearly two of every three loans were in default.

383. These high default rates were no surprise to HSBC by January 2009. Among other things, HSBC, as Trustee, published monthly remittance reports, that were publicly filed with the SEC on Form 10-D, outlining the credit performance of the mortgage loans in the Trusts. Moreover, the delinquency rates had been steadily rising up to and through 2009. By about July 2008, the first harbingers of the violations of the representations and warranties regarding the credit quality of the loans started to appear. The Trustees' monthly reports started to show increases in the trends of loan delinquencies, and by January 2009, these trends had become pronounced.



384. HSBC was also provided regular reports regarding loan modifications granted by the servicers to borrowers that failed to timely make P&I payments on their loans to the Trusts. In general, loan modifications change the terms of the original mortgage contract agreed to by the lender and borrower, typically to ease the borrower's monthly payment obligation so the borrower may remain current and avoid default. Loan modifications often include changes to the loan's interest rate, term and/or outstanding principal. As with delinquency rates, the extent of loan modifications is indicative of breaches of representations and warranties for at least two reasons. First, escalating loan modifications correlate to misstated borrower income and creditworthiness. Second, the servicers' decisions to modify rather than foreclose on loans indicates that the underlying collateral is not adequate security to satisfy the outstanding balance because the original LTV ratio (or CLTV ratio) was not as represented because the appraised property value was misstated and additional liens encumbered the mortgaged property.

385. As indicated below, loan modifications in the Trusts dramatically increased beginning in early 2009, providing HSBC further information regarding the systemic breaches of representations and warranties in the Trusts:



B. Credit Rating Downgrades Of The Certificates Further Support The Sellers' Problems

386. At the time of securitization, all of the Trusts' senior tranches were rated "investment grade." Bond rating firms, such as Standard & Poor's, use different designations consisting of upper- and lower-case letters 'A' and 'B' to identify a bond's credit quality rating. "AAA" and "AA" (high credit quality) and "A" and "BBB" (medium credit quality) generally are considered investment grade. An investment grade rating signifies that the bond has a relatively low risk of default and are judged by the rating agencies as likely to meet payment obligations such that banks and institutional investors are permitted to invest in them. Credit ratings for bonds below investment grade designations (i.e., "BB", "B", "CCC", etc.) are considered low credit quality, and are commonly referred to as "junk bonds."

387. However, as public disclosures revealed the originators' and sponsors' systemic underwriting and securitization abuses and HSBC began reporting severe collateral losses in the performance of the mortgage loans in the Trusts, the Trusts' certificates' credit ratings were drastically downgraded. By December 31, 2009, over 75% of the senior tranches in the Trusts had been downgraded at least once. Across all Trusts, over 80% of all certificates had been downgraded by at least one ratings agency. Further, 60% of the senior certificates had been downgraded to junk bond status.

C. HSBC Discovered Widespread Seller Breaches Of Representations And Warranties In Its Capacity As Servicer

388. In addition to acting as a trustee, HSBC was among the largest mortgage loan servicer to the RMBS industry during the relevant period. Many of these loans were originated and sponsored by the same mortgage loan sellers to the Trusts, such as Option One, New Century, Countrywide, Wells Fargo and GreenPoint. In connection with servicing these loan sellers' loans, HSBC was in a front row seat to view mortgage loan sellers' abusive underwriting and securitization practices. For example, as servicer to these other RMBS trusts containing loan pools originated and securitized by the same mortgage loan sellers to the Trusts, HSBC prepared monthly reports for the trustees detailing the similarly poor performance of these loan pools. Additionally, as servicer, HSBC knew of the credit agencies' similar downgrading of these trusts as result of the poor credit quality of these same originators' and sponsors' loan pools. Further, in servicing and administrating the loans, including during the modification process, HSBC examined the loan files of mortgage loans originated and sponsored by these entities and in the process discovered systemic and pervasive breaches of representations and warranties in the loan pools.

389. Because the problems HSBC discovered regarding these common originators and sponsors in its capacity as servicer to other RMBS trusts revealed systemic and pervasive violation of underwriting and securitization guidelines, HSBC knew that these same defective underwriting and securitization practices applied to the Trusts.

D. HSBC Was Named In RMBS Litigation Involving Common Loan Sellers' Systemic Abandonment Of Underwriting Guidelines

390. HSBC's knowledge of pervasive breaches of representations and warranties by the originators and sponsors at issue herein is also demonstrated by HSBC's involvement in significant RMBS litigation in its capacity as securitization underwriter.

391. For example, on September 2, 2011, the FHFA, as conservator for Fannie Mae and Freddie Mac, filed lawsuits against seventeen of the largest financial institutions involved in the packaging, marketing and sale of RMBS that Fannie Mae and Freddie Mac purchased during the period from 2005 to 2007, including HSBC and its affiliates.[11] Fifteen of the FHFA's actions were concentrated before Southern District of New York Judge Denise L. Cote for coordinated pretrial proceedings, thereby allowing HSBC access to the pleadings and discovery in each of these cases.

392. Each of the FHFA's complaints alleged that the defendants falsely represented that the underlying mortgage loans complied with certain underwriting guidelines and standards, including representations that significantly overstated the borrowers' capacity to repay their

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[11] Complaints were filed against the following lead defendants, in alphabetical order: Ally Financial Inc. f/k/a GMAC, LLC; Bank of America Corporation; Barclays Bank PLC; Citigroup, Inc.; Countrywide Financial Corporation; Credit Suisse Holdings (USA), Inc.; Deutsche Bank AG; First Horizon National Corporation; General Electric Company; Goldman Sachs & Co.; HSBC North America Holdings, Inc.; JPMorgan Chase & Co.; Merrill Lynch & Co. / First Franklin Financial Corp.; Morgan Stanley; Nomura Holding America Inc.; The Royal Bank of Scotland Group PLC; and Société Générale.

mortgage loans and the percentage of loans secured by owner occupied properties. The FHFA further alleged that defendants materially understated the loan-to-value ratios of the underlying loans.

393. To support its allegations regarding defendants' misrepresentations regarding the credit quality and characteristics of the underlying loan collateral, the FHFA's complaints highlighted the severe delinquencies, immense collateral losses and staggering credit downgrades suffered by both the securitizations at issue in its cases and all RMBS in general of this vintage. Significantly, the FHFA's actions involved at least nineteen of Trusts at issue in this action.[12]

394. In addition, the FHFA provided highly detailed summaries of the evidence and testimony obtained through federal and state investigations, enforcement actions and reports revealing both industrywide abuses by the mortgage loan originators and sponsors during this period, and widespread breaches of representations and warranties by specific originators and sponsors in connection with RMBS trusts. These financial institutions included many of the largest mortgage loan sellers to the Trusts, such as Wells Fargo, Fremont, Lehman, GreenPoint, Countrywide, Deutsche Bank, Option One, Nomura, and Merrill Lynch.

395. Moreover, FHFA cited the results of its own forensic review of loan level data for a sampling of hundreds of thousands of mortgage loans and reunderwriting of thousands of loan files from these securitizations, including nineteen of the Trusts. The data review revealed systemic and pervasive misrepresentations regarding owner occupancy and LTV ratios in each of

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[12] These nineteen Trusts are: ACE 2005-AG1; ACE 2006-CW1; ACE 2006-FM2; ACE 2006-HE1; ACE 2006-NC2; ACE 2006-NC3; MHL 2007-1; ACE 2006-OP2; NHELI 2007-1; NHELI 2006-HE3; FHLT 2006-E; FHLT 2006-A; FHLT 2006-D; SGMS 2006-FRE1; SGMS 2006-OPT2; OOMLT 2007-HL1; FHLT 2006-C; FHLT 2005-D; and FHLT 2005-E.

the securitizations, including the Trusts at issue here and other securitizations involving the same sponsors to the Trusts, same RMBS labels, same RMBS shelves, same vintage, same loan product type, or the same originators.

396. Given the FHFA's detailed allegations and HSBC's active participation in the FHFA actions as a named defendant, HSBC and its responsible officers had actual knowledge that the Trusts' loan pools contained high percentages of loans that materially and adversely affected the Trusts and Certificateholders' interests in those loans.

397. As described in further detail below, in addition to the FHFA actions, HSBC and its affiliates have been named in several other actions alleging that originators and sponsors industrywide during the relevant period, including major originators of loans sold to the Trusts, systematically abandoned their stated underwriting guidelines. The evidence and testimony perpetuated in these actions provide further support for HSBC's knowledge of the presence of defective loans in the Trusts.

E. HSBC Received Written Notice Of Pervasive And Systemic Seller Breaches From Financial Guaranty Insurers

398. HSBC also discovered that the Trusts' loan pools contained high percentages of mortgage loans that materially breached the originators' and sponsors' representations and warranties through its involvement in financial guaranty insurer litigation involving these same originators and sponsors, in its capacity as either trustee or master servicer.

399. Financial guaranty insurers provide financial guaranty insurance for RMBS issued from many of the Trusts. Under the Governing Agreements for these insured RMBS, the mortgage loan sellers to the Trusts made numerous representations and warranties concerning quality and origination practices for the mortgage loans. The Governing Agreements for the insured RMBS also create a repurchase protocol pursuant to which the monoline insurers must

provide notice of a breach of representation and warranty to the responsible mortgage loan seller and the parties to the Governing Agreement (including the Trustee), in order to compel the responsible mortgage loan seller to repurchase loans that breach representations and warranties.

400. Monoline insurers have initiated numerous lawsuits against responsible mortgage loan sellers for breach of their representations and warranties. Prior to filing suit against the originators and/or sponsors, the monoline insurers (unlike certificateholders) were often able to obtain access to the specific loan files or conduct a forensic loan level review of the loans, which showed systemic and pervasive breaches of the representations and warranties. Plaintiffs are informed and believe that consistent with the repurchase protocol under the trusts' governing documents, HSBC was notified of these sellers' systemic and pervasive breaches of representations and warranties in either its capacity as master servicer or trustee of the other RMBS trusts.

401. The monoline insurers' findings from loan level reviews set forth both in their breach notices and subsequent publicly available lawsuits made HSBC and its responsible officers aware of the systemic violation of underwriting and related standards in the mortgage securitization industry between 2004 and 2008 vintage, as well as informed them of specific originators' and sponsors' systemic and pervasive practice of misrepresenting the credit quality and characteristics of the mortgage loans they were selling to keep the RMBS machine running.

402. For example, in *Ambac Assurance Corporation v. Nomura Credit & Capital, Inc. et al.*, Index No. 651359/2013 (N.Y. Sup. Ct. Apr. 15, 2013), Ambac, a Wisconsin-based monoline insurer, wrote insurance relating to two 2007 Nomura securitizations, consisting of adjustable-rate, first-lien mortgage loans originated by various mortgage lenders. Ambac alleged that, similar to the Nomura-label Trusts at issue here, that there were extremely high defaults

among the mortgage loans. In light of the high default rates, Ambac retained a third-party consultant that reviewed over 1,800 of the mortgage loans from these trusts and found that, in over 95% of them, one or more of Nomura's mortgage loan representations was false when made. Ambac alleged that "[t]he breaches identified evince gross malfeasance, misconduct, and negligence in connection with the origination of the loans that [Nomura] pooled, reflecting a wholesale abandonment of any attempt to gauge the ability and willingness of borrowers to repay their obligations." Ambac alleged that it "sent twelve notifications to [Nomura] and HSBC, the Trustee for both Trusts, informing them of the over 1,700 Identified Defective Loans uncovered by the forensic reunderwriting."

403. Because these monoline insurers' findings from loan level reviews set forth both in their breach notices and subsequent publicly available lawsuits reflected these common mortgage loan sellers' systemic and pervasive violation of underwriting and securitization guidelines, HSBC discovered that these same defective underwriting and securitization practices applied equally to all of the other Trusts containing loans originated and securitized by these same originators and sponsors.

F. HSBC And Its Responsible Officers Received Written Notice From Certificateholders Of Pervasive And Systemic Seller Breaches

404. HSBC, in its capacity as trustee to many Trusts at issue herein, as well as RMBS trusts that are not the subject of this action but which are secured by loans originated and sponsored by the very same entities that originated and sponsored the loans underlying the Trusts at issue herein, has repeatedly received notice from Certificateholders of pervasive and systemic violations of representations and warranties by the loan sellers. Based on the sheer volume of the defective mortgage loans identified, together with the systemic and pervasive faulty origination and securitization practices complained of in the Certificateholders' breach notices,

HSBC and its responsible officers knew that the Trusts' loan pools similarly contained high percentages of defective mortgage loans.

405. For example, on October 17, 2011, a group of major institutional mortgage investors in several dozen RMBS trusts sponsored by Citigroup or its affiliates alleged widespread violations of representations and warranties contained in the Governing Agreements for sixty-eight RMBS trusts sponsored by Citigroup from 2005 to 2008 (the "Citibank Putback Initiative"), including three of the Trusts at issue herein. The trustees for these Citigroup-sponsored trusts, which were instructed to investigate these breaches of representations and warranties, are HSBC, U.S. Bank, and Wells Fargo. On April 7, 2014, Citigroup announced that it had reached an agreement with the investor group to resolve representation and warranty repurchase claims. Under the agreement, Citigroup agreed to make a binding offer to the trustees to pay $1.125 billion to the trusts, plus certain fees and expenses. According to Citigroup's press release announcing the agreement, the sixty-eight trusts covered by the agreement issued in the aggregate $59.4 billion of RMBS "and represent all of the trusts established by Citi's legacy Securities and Banking business during 2005-2008 for which Citi affiliates made representations and warranties to the trusts." The trustees' approval of the settlement remains pending.

406. The Citibank Putback Initiative identified and seeks to compel the repurchase of large quantities of loans originated by many of the same lenders that also originated large quantities of the loans sold to the Trusts, including Wells Fargo ($56.2 billion of loans sold to the Trusts) and GreenPoint ($10.7 billion of loans sold to the Trusts). This initiative additionally identified and seeks recovery of losses relating to servicing deficiencies by many of the same major servicers of loans backing the Trusts, including Wells Fargo (original servicer to $231.4 billion of loans sold to the Trusts).

407. On December 16, 2011, a group of major institutional mortgage investors in hundreds of RMBS trusts sponsored by JPMorgan or its affiliates issued written instructions to HSBC, Wells Fargo, The Bank of New York Mellon ("HSBC"), Deutsche Bank, and U.S. Bank, as trustees, to open investigations into large numbers of ineligible mortgages in the loan pools securing those trusts and deficient servicing of those loans (the "JPMorgan Putback Initiative"). The notices covered more than $95 billion of RMBS issued by JPMorgan from 2005 to 2007, including nine trusts for which Deutsche Bank serves as trustee. Less than two years later, Wells Fargo and the other trustees were presented with a $4.5 billion settlement offer covering 330 JPMorgan-sponsored RMBS trusts. On August 1, 2014 and October 2, 2014, all of the trustees involved in the JPMorgan Putback Initiative, including HSBC, accepted JPMorgan's $4.5 billion offer for the vast majority of the 330 trusts included in the offer and petitioned the Supreme Court of the State of New York for approval of the settlement. .

408. The JPMorgan Putback Initiative identified and seeks to compel the repurchase of large quantities of loans (i) originated by many of the same lenders that also originated large quantities of the loans sold to the Trusts, including Wells Fargo ($56.2 billion of loans sold to the Trusts) and Fremont ($31.5 billion of loans sold to the Trusts); and (ii) securitized by the same investment banks and financial institutions that sponsored the Trusts, including Luminent Mortgage ($3.7 billion) and Morgan Stanley ($454 million, collectively, $4.15 billion of sponsored Trusts). In addition, the JPMorgan Putback Initiative identified and seeks recovery of losses relating to servicing deficiencies by many of the same major servicers of loans backing the Trusts, including Wells Fargo (original servicer to $231.4 billion of loans sold to the Trusts).

409. On January 5, 2012, a group of major institutional mortgage investors in several dozen RMBS trusts sponsored by Wells Fargo or its affiliates issued written instructions to

HSBC and U.S. Bank, as trustees, to open investigations into large numbers of ineligible mortgages in the loan pools securing those trusts and the deficient servicing of those loans (the "Wells Fargo Putback Initiative"). The notices covered more than $19 billion of RMBS issued by Wells Fargo from 2005 to 2007, including at least sixty of the Trusts at issue herein.

410. The Wells Fargo Putback Initiative identified and seeks to compel the repurchase of large quantities of loans (i) originated by many of the same lenders that also originated large quantities of the loans sold to the Trusts, including Wells Fargo ($56.2 billion of loans sold to the Trusts) and Deutsche Bank ($5.8 billion of loans sold to the Trusts); and (ii) securitized by the same investment banks and financial institutions that sponsored the Trusts, including Wells Fargo ($71.8 billion of sponsored Trusts). In addition, the Wells Fargo Putback Initiative identified and seeks recovery of losses relating to servicing deficiencies by many of the same major servicers of loans backing the Trusts, including Wells Fargo (original servicer to $231.4 billion of loans sold to the Trusts).

411. Similarly, on or about January 20, 2012, the FHFA provided written notice to Fernando Acebedo, a Vice President of HSBC, of Deutsche Bank's pervasive breaches of representations and warranties in its capacity as sponsor of the ACE 2006-HE2 offering. The FHFA's letter attached a schedule identifying 190 loans with specific defects and demanded that HSBC "enforce the obligation of the Sponsor to repurchase such Subject Loans" following expiration of the "90-day Repurchase Period" of the PSA because, according to the FHFA, none of the identified breaches concerning the subject loans were curable.

412. Thereafter, on or about April 26, 2012, Mr. Acebedo and Susie Moy, a Senior Vice President of HSBC again received written notice of sponsor Deutsche Bank's pervasive breach of representations and warranties. Specifically, Amherst Advisory & Management, LLC,

> knowledge of [Countrywide and other loan originators], concerning how much money they owed, how much money they made, whether and where they worked, and where they lived. A handful of instances of such inaccuracies is perhaps to be expected. Hundreds of instances of borrower dishonesty is not.

419. Similarly, between May 2012 and April 2013, HSBC, as Trustee, filed at least eight complaints against Nomura in its capacity as sponsor of eight different trusts from the NEHLI and NAA shelves due to "widespread and materially adverse breaches" of seller representations and warranties. HSBC similarly relied on forensic reviews of the loans associated with the mortgage loans held by the Trusts conducted prior to initiating suit, revealing that Nomura systemically failed to provide accurate loan level information. Specifically, HSBC's analysis showed breach rates in Nomura-label Trusts of over 80% and sometimes as high as 91.8%. HSBC asserted that with respect to Nomura's securitizations, "[u]nderwriting guidelines were brushed aside, with loan originators abandoning minimum verification procedures and therefore leaving open the possibility of even greater risks being concealed."

420. In short, the incredibly high rates of defaults cited by HSBC in support of certain putback actions demonstrates HSBC was well aware of the pervasive and systemic breaches of representations and warranties of the loans at issue here as well.

XI. THE TRUSTS SUFFERED FROM PERVASIVE SERVICER VIOLATIONS

421. In the aftermath of the financial crisis, the mortgage loan servicing industry has received increased scholarly, popular, regulatory and political attention as a result of rampant servicing abuses by private-label RMBS servicers in connection with their administration of and foreclosing on mortgage loans backing private-label RMBS.

422. Much like other private-label RMBS trusts of the same vintage, each of the Trusts suffer from ongoing Events of Default caused by the servicers' failure to observe and perform, in material respects, the covenants and agreements imposed on them by the PSAs. The servicers'

breach of their covenants is confirmed through several federal and state government investigations and published reports, well publicized news reports, and public and private enforcement actions that have described RMBS servicers' systemic and pervasive deviation from usual, customary and lawful servicing practices in their administration mortgage and, more specifically, illegal and illicit servicing activities by the same servicers who service the loans held by the Trusts.

A. The Servicers Failed To Give Notice Of Seller Breaches Of Representations And Warranties And Enforce The Sellers' Repurchase Obligations

423. As with the Trustee, the PSAs require the servicers to give prompt written notice to all parties to the PSAs of a breach of a representation or warranty made by a seller in respect of the mortgage loans that materially and adversely affects the value of any mortgage loan or the interests of the Certificateholders in any such mortgage loan, upon the servicer's discovery of such breach. Moreover, the servicers are required under the PSAs to enforce the sellers' obligation to repurchase, substitute, or cure such defective loans.

424. In many cases, the servicers are affiliates of the sellers because in connection with the sale of a loan pool, the seller secured the retention of servicing rights to loans for its servicing division. These servicers had actual knowledge of their affiliate mortgage loan sellers' abusive underwriting and securitization practices, and therefore had actual knowledge at the time of the Trusts' purchase of these loans that the sellers included high percentages of defective loans within the loan pools. These servicers failed to notify parties to the PSAs of the discovery of mortgages that were in violation of applicable representations and warranties at the time they were purchased by the Trusts, and failed to enforce the sellers' repurchase obligations, despite their awareness of loans that were in violation of representations and warranties.

425. Additionally, for the benefit of the Trusts, and pursuant to the PSAs, the sponsors acquired primary mortgage guaranty insurance ("PMI") policies for loans that had a LTV ratio in excess 80% which served as a "credit enhancement" in order to offer additional security to Certificateholders in the Trusts and to induce rating services to provide a higher credit rating for the Certificates, thereby making the Certificates more attractive to potential purchasers. In the aftermath of the financial crisis, servicers have tendered claims to mortgage insurers under the PMI policies on the Trusts' behalf on defaulted loans. The mortgage insurers have denied coverage, canceled or rescinded the mortgage insurance policies, or invoked policy exclusions for a high percentage of claims as a result of misrepresentations regarding the insured mortgage loans, including on the basis that the originator engaged in predatory lending or systemic fraud in the underwriting of the mortgage loans. After these mortgage insurance claim denials, the servicers failed to observe or perform in a material respect their covenants and/or agreements under in the PSAs by failing to notify parties to the PSAs that the mortgage loan sellers violated representations and warranties at the time they sold loans to the Trusts.. Moreover, the servicers failed to tender the defective, defaulted loans to the sellers for repurchase. Instead, the servicers charged the over-collateralized accounts for losses, causing damage to the Trusts and their Certificateholders.

426. Further, as noted above, the servicers have regularly modified mortgage loans held by the Trusts. Plaintiffs are informed and believe that in the process of modifying these mortgage loans, the servicers have discovered that specific loans breached applicable seller representations and warranties because the loan modification process involves scrutinizing the underlying origination and mortgage loan files, and any supplemental information provided by the borrower to assess the borrower's ability to pay. Thus, in the process of performing loan

modifications, the servicers had to have discovered breaches of representations and warranties regarding the characteristics of the loan, the creditworthiness of the borrower, the adequacy of the collateral and the title status of the mortgages. Nevertheless, the servicers systemically failed to notify the other parties of these breaches.

427. As also set forth above, there has been widespread public evidence of the originators' abandonment of underwriting guidelines and the sponsors' faulty securitization practices that made the servicers aware of material seller breaches representations and warranties within the Trusts loan pools. Nevertheless, the servicers have not notified the other parties to the PSAs of these seller breaches or enforced the sellers' repurchase obligations.

428. The servicers' systemic and pervasive failure to give notice of the sellers' material breaches of representations and warranties and to enforce the sellers' repurchase obligations have materially affected the rights of the Trusts and all Certificateholders under the PSAs in that they have deprived the Trusts of mortgage loans of adequate credit quality, or alternatively funds representing the "Repurchase Price" under the PSAs, with respect to each defective mortgage loan.

B. The Servicers Have Violated Their Prudent Servicing Obligations

429. The PSAs require the servicers to service and administer the mortgage loans for and on behalf of the Certificateholders, and, consistent with the PSAs: (i) in the same manner in which they service and administer similar mortgage loans for their own portfolios or for other third parties, giving due consideration to customary and usual standards of practice of prudent institutional mortgage lenders servicing similar loans; (ii) with a view to maximizing the recoveries with respect to the mortgage loans on a net-present-value basis; and (iii) without regard to, among other things, the servicers' right to receive compensation or other fees for their

services under the PSAs, their obligation to make servicing advances under the PSAs, and their ownership, servicing, or management for others of any other mortgage loans.

430. High-profile class actions against the servicers have revealed violations of prudent servicing practices. For example, in June 2012, nationwide class actions were brought on behalf of millions of homeowners against Wells Fargo, HSBC, Citibank N.A., JPMorgan Chase Bank N.A., and Bank of America N.A., alleging that mortgage borrowers were overcharged for force-placed insurance. The borrowers specifically alleged that these servicers imposed force-placed insurance policies that were far more expensive than market rates and received hundreds of millions of dollars in clandestine commissions from the insurance companies writing the policies. The servicers' practice of imposing expensive force-placed insurance increased the borrowers' monthly payments by a large amount. As a result, homeowners who were already behind in payments or were facing financial difficulties went into foreclosure. The plaintiff borrowers have also entered into several well publicized settlements with these servicers, including settlements of $300 million with JPMorgan Chase, $110 million with Citibank, $32 million with Wells Fargo, and $19.3 million with HSBC.[14] Plaintiffs are informed and believe that these servicers and each of the other servicers to the Trusts have engaged in the same violations of their prudent servicing obligations in servicing and administrating the mortgage loans for the Trusts.

431. Highly publicized government enforcement actions and settlements reached with the servicers demonstrate that the servicers have systemically and pervasively violated these

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[14] *Alfred Herrick, et al. v. JPMorgan Chase Bank N.A., et al.*, 13-21107 (S.D. Fla.), *Hall v. Bank of Am., N.A.*, 12-22700 (S.D. Fla.), *Lopez v. HSBC Bank USA N.A., et al.*, 13-21104 (S.D. Fla.), *Fladell v. Wells Fargo Bank N.A.*, 13-60721, (S.D. Fla.), and *Casey, et al. v. Citibank, N.A.*, 12-00820 (N.D.N.Y.).

prudent servicing obligations. For example, in February 2012, forty-nine state attorneys general and the federal government announced a historic $25 billion joint state-federal settlement with the country's five largest mortgage servicers and their affiliates for misconduct related to their origination and servicing of single-family residential mortgages (the "National Mortgage Settlement"): (i) Wells Fargo & Company and Wells Fargo Bank, N.A..; (ii) Bank of America Corporation, Bank of America, N.A., BAC Home Loans Servicing, LP, Countrywide Financial Corporation, Countrywide Home Loans, Inc., Countrywide Mortgage Ventures, LLC, and Countrywide Bank FSB; (iii) Citigroup Inc., Citibank, N.A., and CitiMortgage, Inc.; (iv) J.P. Morgan Chase & Company and J.P. Morgan Chase Bank, N.A.; and (v) Residential Capital, LLC, Ally Financial, Inc., and GMAC Mortgage, LLC.

432. In their corresponding complaint filed in March 2012, the state attorneys general and the federal government alleged that these servicers had engaged in unfair, deceptive, and unlawful servicing processes, including: (i) failing to timely and accurately apply payments made by borrowers and failing to maintain accurate account statements; (ii) charging excessive or improper fees for default-related services; (iii) failing to properly oversee third-party vendors involved in servicing activities on behalf of the banks; (iv) imposing force-placed insurance without properly notifying the borrowers and when borrowers already had adequate coverage; (v) providing borrowers false or misleading information in response to borrower complaints; and (vi) failing to maintain appropriate staffing, training, and quality-control systems.

433. On October 2, 2013, Attorney General Eric T. Schneiderman ("Schneiderman") announced that he was suing Wells Fargo so that a federal judge would compel the bank to honor its commitments under the 2012 National Mortgage Settlement, which includes 304 servicing standards that participating servicers are required to adhere to, and which include standards that

are intended to make it easier for homeowners to seek loan modifications. The servicing standards were incorporated into the National Mortgage Settlement to address longstanding complaints from consumers and advocates that servicers subject to the settlement, including Wells Fargo, consistently failed to provide fair and timely services to their customers. Attorney General Schneiderman announced his intention to sue Wells Fargo and Bank of America after documenting hundreds of violations of the servicing standards outlined in the National Mortgage Settlement:

> The national mortgage settlement sets out more than 300 loan-servicing standards with which the banks are to comply. However, in his warning letters to BofA and Wells Fargo, Schneiderman alleged that he had evidence from homeowners in the state that these servicers had repeatedly and persistently failed to follow basic rules like: providing written acknowledgement of receipt of a loan modification application within 3 business days; notifying the borrower of all missing documents or deficiencies in the application within 5 business days of receipt of the borrower's initial loan modification application; giving the borrower 30 days to submit missing documentation or correct a deficiency; and making a decision on a complete loan modification application within 30 days.

434. On December 20, 2010, New Jersey Administrative Director of the Courts, Judge Grant, took the extraordinary step of issuing an administrative order requiring twenty-four loan servicers and RMBS trustees to file certifications demonstrating that there were no irregularities in the handling of their foreclosure proceedings. The order was directed at, among others, Aurora, PHH, PNC (and therefore its Servicer National City) and SunTrust, all master servicers or servicers to the covered Trusts. Also on December 20, 2010, the New Jersey Superior Court Chancery Division issued an order in *In the Matter of Residential Mortgage Foreclosure Pleading and Document Irregularities*, Docket No. F-595S3N10, directing six mortgage loan lenders and servicers implicated in residential mortgage loan foreclosure irregularities to show cause why the processing of their uncontested residential foreclosure filings should not be suspended. Wells Fargo and Bank of America were two recipients of this show cause order.

435. Moreover, in June 2010, the Federal Trade Commission ("FTC") filed a civil enforcement action against Countrywide Home Loans, Inc. and BAC Home Loans Servicing, LP (f/d/b/a Countrywide Home Loans Servicing, LP), a wholly owned subsidiary of Bank of America, National Association (collectively, "Countrywide/BAC") for their "unlawful acts and practices . . . in servicing mortgage loans." *See Fed. Trade Comm'n v. Countrywide Home Loans, Inc., et al.*, No. 10-cv-4193 (C.D. Cal. June 7, 2010). In March 2008, before being acquired by Bank of America Corporation, Countrywide was ranked as the top mortgage servicer in the United States and had a servicing portfolio with a balance of approximately $1.4 trillion. In September 2009, after its acquisition of Countrywide, Bank of America was ranked as the nation's top mortgage servicer with a servicing portfolio of over $2.1 trillion. Countrywide/BAC are servicers for many of the Trusts. The FTC emphasized that many of the loans improperly serviced by Countrywide/BAC are the same "risky, high-cost loans that had been originated or funded by Defendants' parent company, Countrywide Financial Corporation . . . , and its subsidiaries . . . ."

436. According to the FTC, when borrowers fell behind on their payments, Countrywide/BAC imposed a number of default-related services (such as property inspections and foreclosure-trustee services) "by funneling the work through a panoply of Countrywide subsidiaries." In its mortgage-servicing operation, Countrywide/BAC follows a so-called "vertical integration strategy" to generate default-related fee income. Rather than obtain default-related services directly from third-party vendors and charge borrowers for the actual cost of these services, Countrywide/BAC formed subsidiaries to act as middlemen for default services. These subsidiaries exist solely to generate revenues for Countrywide/BAC and do not operate at arms-length with Countrywide/BAC. Countrywide/BAC and their subsidiaries – "[a]s a matter of

practice" – added substantial mark-ups to their actual costs for the services and then charged the borrowers the marked-up fees. The inflated fees were contrary to both prudent servicing standards and the mortgage contracts, which limit fees chargeable to the borrower to actual costs of the services and as are reasonable and appropriate to protect the noteholder's interest in the property and rights under the security instrument.

437. Countrywide/BAC similarly breached servicing standards and mortgage contracts when servicing loans for borrowers who sought to save their homes through Chapter 13 bankruptcy. According to the FTC, Countrywide/BAC made various representations to those borrowers about their mortgage loans that were false or lacked a reasonable basis, and failed to disclose to borrowers during their bankruptcy cases when fees and escrow shortages and deficiencies accrued on their loans. After the bankruptcy cases closed and borrowers no longer had the protection of the bankruptcy court, Countrywide/BAC collected those amounts, including through foreclosure actions.

438. Similarly, in December 2013, the Consumer Financial Protection Bureau ("CFPB"), authorities in forty-nine states, and the District of Columbia filed a proposed court order requiring the country's largest nonbank mortgage-loan servicer, Ocwen, and its subsidiary, Ocwen Loan Servicing, to provide $2 billion in first-lien principal reduction to underwater borrowers in order to compensate for years of systemic misconduct at every stage of the mortgage-servicing process. The Consent Order also covered two companies previously purchased by Ocwen, Litton Loan Servicing LP ("Litton") and Homeward Residential Holdings LLC (previously known as American Home Mortgage Servicing, Inc. or AHMSI). According to the CFPB and attorneys general's complaint, Ocwen violated state consumer law in a number of ways, including (i) failing to timely and accurately apply payments made by borrowers and

failing to maintain accurate account statements; charging borrowers unauthorized fees for default-related services; imposing force-placed insurance on consumers when Ocwen knew or should have known that they already had adequate home insurance coverage; and providing false or misleading information in response to consumer complaints.

439. The servicers' systemic, pervasive failure to observe their prudent servicing obligations has materially impaired the rights of the Trusts and all Certificateholders under the PSAs in that the violations have exacerbated the Trusts' losses and have fostered uncertainty as to the timely recovery of collateral.

C. The Servicers Have Violated Their Foreclosure Obligations

440. The PSAs require the servicers to use their best efforts, consistent with accepted servicing practices, to foreclose upon or otherwise comparably convert the ownership of properties securing mortgage loans that come into and continue in default and as to which no satisfactory arrangements can be made for collection of delinquent payments. Moreover, the PSAs contemplate that foreclosures and liquidations of defaulted mortgages will proceed forthwith and in accordance with applicable law, provided the documentation is in order, as a matter of fairness to all parties.

441. Highly publicized government enforcement actions and settlements reached with the servicers similarly have revealed the servicers have breached their foreclosure obligations. For example, in the fourth quarter of 2010, the Federal Reserve System, the OCC, and the OTC (collectively, the "Agencies") conducted on-site reviews of foreclosure processing at fourteen federally regulated mortgage servicers, which represented more than two-thirds of the servicing market. These servicers included Ally Bank/GMAC, Aurora, Bank of America, Citibank, EverBank, HSBC, JPMorgan Chase, MetLife, OneWest, PNC, Sovereign Bank, SunTrust, U.S. Bank, and Wells Fargo, many of which are servicers to the Trusts. In April 2011, the Agencies

issued a joint report entitled "Interagency Review of Foreclosure Policies and Practices," summarizing the findings of their reviews and providing an overview of the potential impacts associated with instances of foreclosure processing weaknesses that occurred industrywide. Notably, the Agencies' reviews found "critical weaknesses in each of the servicers' foreclosure governance processes, foreclosure document preparation processes, and oversight and monitoring of third-party vendors, including foreclosure attorneys." Based on the deficiencies identified in these reviews and the risks of additional issues as a result of weak controls and processes, the Agencies initiated formal enforcement actions against each of the fourteen servicers subject to the review to address those weaknesses and risks. The enforcement actions detailed the weaknesses at each servicer and required each servicer, among other things, to conduct a more complete review of certain aspects of foreclosure actions that occurred between January 1, 2009 and December 31, 2010.

442. The OCC found in *In the Matter of Aurora Bank FSB*, No. NE-11-16, Consent Order (U.S. Office Thrift Supervision, Apr. 13, 2011), that, in connection with certain foreclosures of loans in its residential mortgage servicing portfolio, Aurora engaged in the following unsafe or unsound practices: "(a) filed or caused to be filed in state and federal courts numerous affidavits executed by its employees or employees of third-party service providers making various assertions, such as ownership of the mortgage note and mortgage, the amount of the principal and interest due, and the fees and expenses chargeable to the borrower, in which the affiant represented that the assertions in the affidavit were made based on personal knowledge or based on a review by the affiant of the relevant books and records, when, in many cases, they were not based on such personal knowledge or review of the relevant books and records; (b) filed or caused to be filed in state and federal courts, or in local land records offices, numerous

affidavits or other mortgage-related documents that were not properly notarized, specifically that were not signed or affirmed in the presence of a notary; (c) litigated foreclosure and bankruptcy proceedings and initiated non-judicial foreclosure proceedings without always ensuring that the promissory note and mortgage document were properly endorsed or assigned and, if necessary, in the possession of the appropriate party at the appropriate time; (d) failed to devote sufficient financial, staffing and managerial resources to ensure proper administration of its foreclosure processes; (e) failed to devote to its foreclosure processes adequate oversight, internal controls, policies, and procedures, compliance risk management, internal audit, third party management, and training; and (f) failed sufficiently to oversee outside counsel and other third-party providers handling foreclosure-related services." *In the Matter of Aurora Bank FSB*, No. NE-11-16, Consent Order (U.S. Office Thrift Supervision, Apr. 13, 2011).

443. Similarly, as noted above, in March 2012, following an extensive investigation of Wells Fargo, Bank of America, Citigroup, Countrywide, J.P. Morgan Chase, Ally Financial, Inc., and GMAC Mortgage, LLC – some of the same servicers that service loans in the Trusts – the Justice Department, the Department of Housing and Urban Development, and forty-nine state attorneys general filed a complaint against these servicers and announced the $25 billion National Mortgage Settlement of the claims set forth in the complaint. In the complaint, the attorneys general and federal government alleged that these servicers had engaged in wrongful conduct related to foreclosures, including failing to properly identify the foreclosing party, charging improper fees, preparing, executing, notarizing, or presenting false and misleading documents, and engaging in robosigning.

444. Likewise, as noted above, in December 2013, following an extensive investigation of Ocwen and certain of its acquired entities, the CFPB, authorities in forty-nine

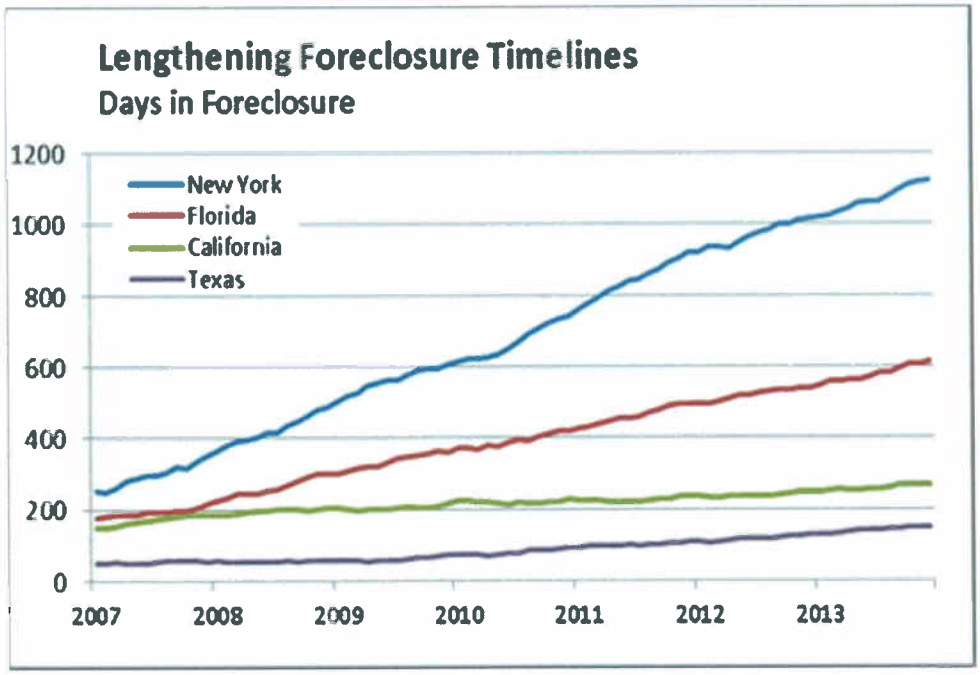
states, and the District of Columbia filed a complaint against Ocwen and announced a $2 billion settlement of the claims stated in the complaint. The CFPB's and attorneys general's complaint alleged that Ocwen engaged in the same wrongful conduct related to foreclosures described in the complaint against the servicers leading to the National Mortgage Settlement.

445. In addition, private litigation has exposed the servicers' wrongful foreclosure practices. For example, homeowners from Queens and Brooklyn, who were at risk of losing their homes to foreclosure, filed a federal class action lawsuit, charging that Aurora Loan Services, Inc. (the second largest servicer of loans in the Trusts) their mortgage servicer, has denied them access to the Obama Administration's Home Affordable Modification Program ("HAMP") for spurious reasons, and failed to provide them with notice so they may contest such denials. The lawsuit, *Edwards, et al. v. Aurora Loan Services, LLC, et al*, No. 09-cv-02100 (D.D.C. Nov. 9, 2011) was one of the first law-suits to challenge a mortgage servicer for breach of contract by failing to review mortgage loans of eligible homeowners for HAMP and to provide a procedure to contest denial.

446. Moreover, in a California class action that has survived a motion to dismiss, plaintiffs alleged that Aurora Loan Services foreclosed on homes without any notice that loan modifications were denied and without allowing borrowers access to any cure method despite promises in an agreement to do so. *Mauder, et al. v. Aurora Loan Services, LLC*, No. 10-cv-03383 (N.D. Cal. Aug. 2, 2010) Class Action Compl. ¶2.

447. Servicers have also frequently wrongfully foreclosed on properties owned by military servicemembers who were protected under the Servicemembers Civil Relief Act ("SCRA"). Based on a federal-government complaint accusing Countrywide Home Loans Servicing LP of violating the SCRA on approximately 160 properties, Countrywide agreed to

pay $20 million to the victims. *United States v. BAC Home Loans Servicing, LP F/K/A Countrywide Home Loans Servicing, LP And Any Successors In Interest*, No. 11-cv-04534 (C.D. Cal. May 26, 2011) Consent Order ¶18.



Sources: RealtyTrac, Moody's Analytics

448. The servicers have also routinely kept defaulted mortgages on their books, rather than foreclose or liquidate them. Indeed, in several states, the average days for delinquent loans in foreclosure in the Trusts have doubled or quadrupled.

449. The servicers' delay in foreclosing has allowed the servicers to charge unearned and unwarranted servicing fees, as well as unauthorized fees for default-related services, on mortgages that would have been liquidated but for the servicers' breach of their duties. For example, in the complaint that led to the National Mortgage Settlement discussed above, the federal government and forty-nine states accused Wells Fargo, Citigroup, Bank of America, J.P. Morgan Chase, Countrywide, and Ally Financial, Inc. (many of which were servicers of loans in the Trusts) of unfair and deceptive practices in the discharge of their loan servicing activities for,

among other things, "*charging excessive or improper fees for default-related services.*" *United States, et al. v. Bank of America, et al.*, No. 12-cv-0361, (D.D.C. Mar. 12, 2012) Compl. ¶51.

450. The servicers' systemic and pervasive violations of their foreclosure obligations have materially impaired the rights of the Trusts and all Certificateholders under the PSAs in that the Trusts have incurred costs of remedying procedural errors and re-filing affidavits and other foreclosure documents. The Trusts have also been forced to bear costs related to disputes over note ownership or authority to foreclose, and to allegations of procedural violations through the use of inaccurate affidavits and improper notarizations. The Trusts have further incurred losses as a result of delays or other damages caused by the weaknesses in the servicers' foreclosure processes.

D. <u>The Servicers Have Violated Their Modification Obligations</u>

451. The PSAs provide that the servicers may agree to a modification of any mortgage loan only in specified circumstances. When modifications are required to remedy predatory lending violations, the PSAs require the seller – not the Trusts or the Certificateholders – to bear the costs to cure the violations.

452. The servicers have breached the PSAs by agreeing to modify loans held in the Trusts to settle predatory lending claims made by various attorneys general against their parent companies while breaching their obligation to demand that the offending mortgage sellers (their parent companies) bear the costs of curing the violations, as well as the expenses reasonably incurred in enforcement of the sellers' obligation to cure predatory mortgages. For instance, in October 2008, Attorney Generals in eleven states announced a landmark, $8.68 billion settlement of predatory lending claims against Countrywide Home Loans, Countrywide Financial Corporation, and Full Spectrum Lending. The settlement enabled eligible subprime and pay-option mortgage borrowers whose loans were serviced by Countrywide to obtain loan

modifications valued at up to $3.4 billion worth of reduced interest payments and, for some borrowers, reduction of their principal balances.

453. The servicers have also breached the PSAs by agreeing to modify loans held in the Trusts to settle claims by various attorneys general related to the servicers' wrongful servicing and foreclosure practices. For example, in meeting their payment obligations with respect to the National Mortgage Settlement, the settling servicers received credit for writing down principal of, and providing forbearance for, mortgage loans held by the Trusts.

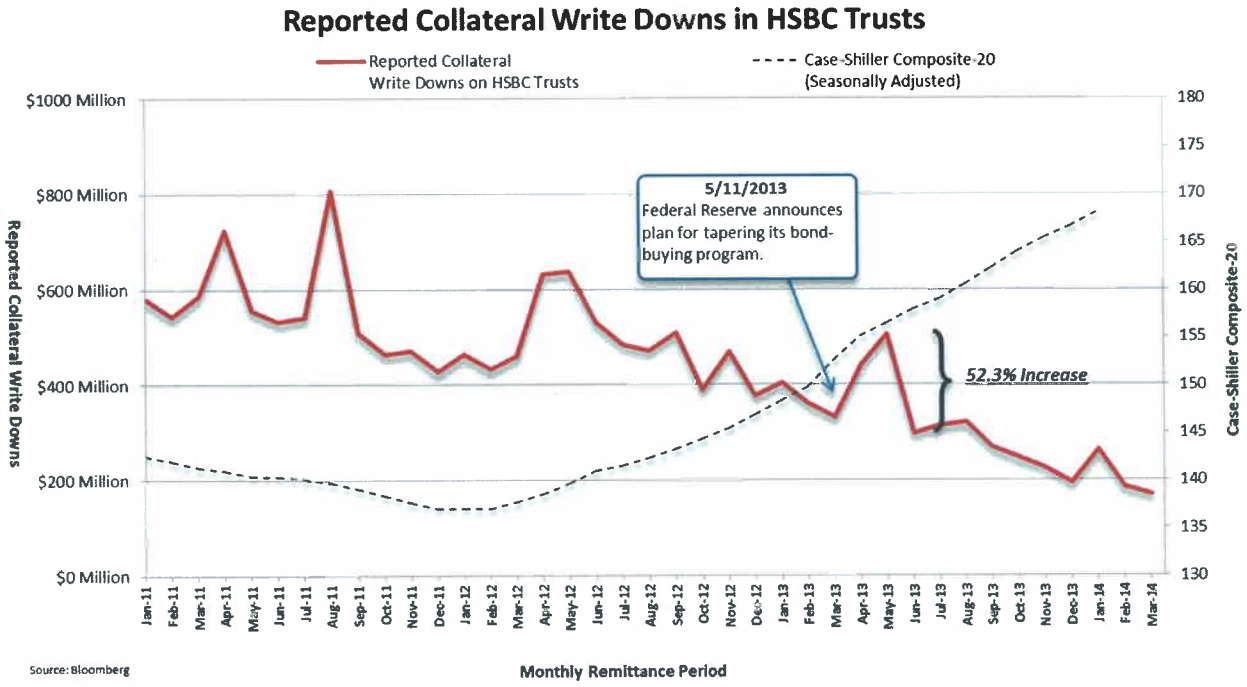
454. The servicers' violations of their loan modification obligations have materially impaired the rights of the Trusts and all Certificateholders under the PSAs in that the servicers and their parent companies have been unjustly enriched to the detriment of the Trusts and Certificateholders by using Trust collateral to settle claims that were not, and could never be, made against the Trusts.

E. The Servicers Have Abused Their Servicing Advances Obligations

455. The PSAs provide that the servicers are to advance P&I on a loan only if they determine that the advance payment is recoverable. The PSAs further provide that the servicers may only recover servicing advances that are customary, reasonable, and necessary out-of-pocket costs and expenses incurred in the servicers' performance of their servicing obligations. The servicers have abused their advancing obligations to enrich themselves to the direct detriment of the Trusts. In particular, the servicers have manipulated the "recoverable" designation to their advantage. During low-interest-rate environments, the servicers have designated severely delinquent loans as recoverable so that the loans would be kept in the Trusts' loan pools and the servicers could continue to earn their servicing fees on the loans, which exceed the relatively low cost of financing the advances on these delinquent loans. When interest rates have increased, however, the servicers have strategically switched the mortgage loans' designation from

recoverable to unrecoverable. The switch in designation enables the servicers to recoup all prior advances as a senior claim of the Trusts.

456. The servicers' manipulation of the "recoverable" designation was illustrated in the May 2013 remittance reports for many of the Trusts. Following the Federal Reserve's May 11, 2013 announcement of its plan for tapering its bond-buying program, interest rates quickly shot up. In a transparent response to the increase in the cost of financing their advances, the servicers switched the designation from recoverable to unrecoverable for an unprecedented amount of delinquent mortgage loans within the Trusts. Specifically, the servicers wrote down over $500 million in May 2013 alone, representing a 52.3% increase over the prior reporting period. The servicers' massive write downs are particularly suspicious, given that the mortgaged property values had been steadily rising for the past twelve months.



457. The Trusts and their Certificateholders are harmed by the servicers' manipulation of the "recoverable" designation because the Trusts incur more interest-rate risk exposure than expected since the servicers' recoverability designations are strategically determined as a

function of interest rates, as opposed to the value of the mortgaged property as required under the PSAs.

458. The servicers' abuse of their advancing obligations is further illustrated by their increasing use of "unrecognized forbearances." The servicers modify delinquent mortgage loans by granting forbearances to the borrowers for extended periods of time which act to reduce the principal amounts of the mortgage loans. The forbearances allow the servicers to lower their advanced principal payments on the loans. Nevertheless, the servicers do not formally write down the loan balances or make any recognition on the Trusts' accounts. Thus, the mortgage loans remain in the Trusts at full value, thereby allowing the servicers to earn full servicing fees, which are calculated as a percentage of the total principal amount of the mortgage loans in the Trusts' loan pools, although the mortgage loans are accruing interest at a lower principal amount and without the servicers having to make any advances.

459. According to a Credit Suisse study, unrecognized forbearances in the Trusts totaled approximately $500 million as of April 2013.[15] At least 207 of the Trusts had some amount of unrecognized forbearance, and at least sixteen of these Trusts had unrecognized forbearance amounts exceeding 3% of the Trust's current collateral balance:

Top 10 HSBC Trusts by Share of Current Balance Forborne

Data as of April 2013 distributions. 1st lien only

	Offering	Original Face Amount	Then Current Balance	Estimated Unrecognized Forbearance	Unrecognized Forbearance as % of Current Balance
1	ACE 2005-ASP1	$522,792,584	$83,970,442	$5,686,594	6.77%
2	CARR 2007-HE1	$384,437,480	$202,752,212	$11,696,292	5.77%
3	SGMS 2006-OPT2	$813,345,795	$288,207,543	$16,565,071	5.75%
4	FHLT 2005-E	$2,118,037,100	$396,548,706	$21,765,981	5.49%

[15] Credit Suisse estimates that, as of April 2013, unrecognized forbearances on non-agency RMBS deals issued after 2000 (first lien only) totaled around $8.3 billion.

5	OOMLT 2007-HL1	$794,245,622	$282,177,982	$13,454,146	4.77%
6	ACE 2006-OP2	$892,105,501	$257,437,651	$11,692,666	4.54%
7	LUM 2006-7	$792,898,000	$275,844,227	$11,903,090	4.32%
8	ACE 2006-ASP3	$728,556,220	$161,977,644	$6,329,960	3.91%
9	ACE 2006-OP1	$1,107,055,226	$274,204,859	$10,572,114	3.86%
10	SARM 2007-9	$532,007,422	$207,725,380	$7,673,050	3.69%

Source: Credit Suisse, Loan Performance

460. The servicers' pervasive use of unrecognized forbearances harms the Trusts and their Certificateholders since the Trusts pay higher servicing fees to the servicers and are not informed in a timely manner about impairments to mortgage loans in the underlying loan pools.

461. Despite the requirement that servicing advances were to be incurred only for reasonable and necessary out-of-pocket costs, the servicers instead utilized affiliated vendors – which marked up their charges to a level 100% or more above the market price – to provide services related to the preservation, restoration, and protection of mortgaged property, in a fraudulent, unauthorized, and deceptive effort to supplement their servicing income.

XII. HSBC HAS KNOWN OF SERVICER VIOLATIONS PLAGUING THE TRUSTS

462. There is ample evidence that, beginning in early 2009 and continuing to the present, HSBC and its responsible officers have known of the above described widespread and severe failures on the part of the servicers to observe or perform in material respects their obligations under the PSAs. Preliminarily, as discussed above, since 2009 and continuing to the present there has been a steady stream of public disclosures regarding the servicers' violations. Nevertheless, apart from the highly publicized government investigations, reports and enforcement actions, as well as high profile litigation involving the servicers, as explained below there is a host of additional evidence demonstrating HSBC and its responsible officers' knowledge that the servicers have materially breached their contractual obligations.

A. HSBC Itself Was Involved In Government Enforcement Actions And Litigation Stemming From The Servicers' Violations

463. HSBC and its responsible officers knew of the servicers' improper servicing practices because, as described in greater detail below, HSBC and its affiliates, in their capacity as servicers to other RMBS trusts, were targets together with many of the servicers for the Trusts in highly publicized governmental investigations, prosecutions and settlements. For example, along with thirteen other of the nation's largest servicers, the Agencies similarly found deficiencies in HSBC's servicing and foreclosure processes. Accordingly, the Agencies brought a formal enforcement action against HSBC, and HSBC participated in a joint settlement including Aurora, Bank of America, Citibank, Goldman Sachs, HSBC, JPMorgan Chase, MetLife Bank, Morgan Stanley, PNC, Sovereign, SunTrust, and U.S. Bank. HSBC's involvement in such proceedings would have made it acutely aware of the deficiencies of each of the other servicers subject to these actions.

464. HSBC and its responsible officers also knew of the servicers' improper servicing practices through its involvement in litigation highlighting servicing failures, such as in judicial foreclosure proceedings exposing the servicers' failure to correct irregularities in the chain of title. *See Davenport v. HSBC Bank USA*, 739 N.W.2d 383, 385 (Mich. Ct. App. 2007) (holding that the foreclosure must be vacated when the bank "did not yet own the indebtedness that it sought to foreclose"); *HSBC Bank U.S.A. Nat'l Ass'n v. Miller*, 889 N.Y.S.2d 430, 433 (Sup. Ct. 2009) (holding that a mortgagee's assignee lacked standing to foreclose because the mortgagee did not hold the promissory note at the time the complaint was filed); and *Pasillas v. HSBC Bank USA*, 255 P.3d 1281 (Nev. 2011) (holding that non-judicial foreclosures could not proceed under the Nevada foreclosure-mediation statue when a party seeking foreclosure was neither the holder of the note nor the assignee beneficiary of the deed of trust).

465. Similarly, in *HSBC Bank USA v. Palladino*, 2011 Ill. App. 2d No. 08-CH-4548, the court reversed summary judgment, noting that, "there are genuine issues of material fact with respect to whether there was an assignment of the mortgage and note from Fremont to HSBC Bank." HSBC was also unsuccessful in a foreclosure action in New York state court where the judge found that the "continuation of this action by plaintiff HSBC, with its false statements of fact, the use of robosigners, and the disingenuous affirmation of Mr. Cassara, appears to be frivolous . . . . It is clear that the instant motion for an order of reference "is completely without merit in law" and "asserts material factual statements that are false." *HSBC Bank USA, N.A. v. Taher*, 32 Misc. 3d. 1208(A), 932 N.Y.S. 2d 760 (N.Y. Sup. Ct. Kings Co. 2011).

466. Finally, in *HSBC Bank USA v. Beirne*, 212-Ohio-1386 (Ohio App. Ct. 9th Dist. Mar. 30, 2012), summary judgment granted in favor of HSBC was reversed. "In the affidavit which was attached to the supplement to the motion for summary judgment, Mr. Spradling averred that HSBC had been assigned the loan on June 5, 2009, and that '[a] true and correct copy of the Assignment was attached to the Complaint filed by HSBC.' However, a review of the complaint and the exhibits attached thereto reveals that there was no evidence that the note had been assigned to HSBC. Moreover, an assignment dated June 5, 2009, could not have been attached to the complaint which was filed on May 11, 2009." *Id.*

467. These and other public enforcement actions and private litigation highlighting the servicers' improper servicing practices were well known throughout the RMBS industry, including by HSBC and the other principal financial crisis-era trustees. For example, in October 2010 Deutsche Bank – which serves as trustee for more than 1,000 RMBS trusts – issued a notice to all RMBS certificateholders in trusts for which Deutsche Bank served as trustee confirming Deutsche Bank's awareness of ongoing government investigations into improper

servicing practices. Deutsche Bank's notice acknowledged that it had been "widely reported in the news media" that "several major U.S. loan servicers" had "suspended certain foreclosures in some or all states" due to allegations and investigations regarding "defects in foreclosure practices, procedures and/or documentation." Also in October 2010, Deutsche Bank sent an "urgent and time sensitive" memorandum to all servicers of mortgage loans included in any RMBS trust for which Deutsche Bank acts as trustee. In the memorandum, Deutsche Bank discussed "an urgent issue requiring your [the servicers] immediate attention" – specifically, the same "serious . . . defects in foreclosure practices, procedures and/or documentation" discussed in Deutsche Bank's notice to certificateholders. The memorandum referred to the expansive scope of the reported servicer deficiencies, and admitted that foreclosure abuses such as the execution and filing by servicers or their agents of documents containing untrue assertions of fact "would constitute a breach of that Servicer's obligations under the [PSAs] and applicable law."

B. HSBC And Its Responsible Officers Received Written Notice From Certificateholders Of Pervasive And Systemic Servicer Breaches

468. In its capacity as trustee to other RMBS trusts that are not the subject of this action, HSBC and its responsible officers received written notice from certificateholders of the same systemic servicing violations described above perpetrated by the very same servicers for the Trusts. Based on the systemic and pervasive practices complained of in the certificateholders' breach notices, HSBC and its responsible officers knew that the servicers were engaged in the same wrongful conduct in connection with their servicing of the loans for the Trusts.

469. For example, on December 16, 2011, investors provided notice to HSBC and four other RMBS trustees of, among other things, master servicer violations by JPMorgan Chase and JPMorgan Chase predecessor entities (Bear Stearns and WaMu) in connection with $95 billion of

RMBS issued by various affiliates of JPMorgan Chase from 243 trusts issued between 2005 and 2007 under the BALTA, BSABS, BSARM, BSMF, CFLX, CHASE, JPALT, JPMAC, JPMMT, PRIME, SACCO, SAMI, WAMU, and WMALT labels. The investors demanded that HSBC open an investigation of ineligible mortgages and deficient servicing of these loans. The December 16, 2011 notice put HSBC on notice of systemic deficient servicing practices by JPMorgan Chase and its affiliates, some of the largest servicers for the Trusts. Indeed, as discussed above, this same investor group reached an agreement with JPMorgan Chase that calls for the payment of $4.5 billion in cash to the 330 trusts issued under these JPMorgan Chase RMBS labels to settle mortgage repurchase and servicing claims, as well as for the implementation of substantial servicing changes to mortgage loans in the covered trusts to rectify the pervasive servicing deficiencies by JPMorgan and its affiliates. On August 1, 2014 and October 2, 2014, all of the trustees involved in the JPMorgan Putback Initiative – including HSBC – accepted JPMorgan's $4.5 billion offer for the vast majority of the 330 trusts included in the offer and petitioned the Supreme Court of the State of New York for approval of the settlement.

470. As noted above, on January 5, 2012, a group of investors provided notice to HSBC and U.S. Bank, as Trustees, of mortgage loans in breach of seller representations and warranties in pools securing over $19 billion of RMBS issued by various affiliates of Wells Fargo in forty-eight trusts from the WFALT, WFMBS, and WMLT shelves ("January 5, 2012 Notice"). In addition to advising HSBC of ineligible loans, the investor group issued instructions to HSBC to open an investigation into deficient servicing of those loans. On September 9, 2012, that same group issued notice to Wells Fargo, identifying specific servicing covenants in PSAs that Wells Fargo have failed to perform. The September 9, 2012 letter alleges that each of these

failures has materially affected the rights of the Certificateholders and constitutes an ongoing Event of Default in the servicer's performance under the relevant PSAs. Plaintiffs are informed and believe that HSBC received a copy of the September 9, 2012 letter.

471. Despite HSBC's actual notice of widespread loan defaults and breaches, as the two examples above illustrate, HSBC failed to act in accordance with its obligations under the Governing Agreements and TIA to enforce the originators' and sponsors' obligations to cure, substitute or repurchase defective mortgage loans.

C. HSBC Had Knowledge Of The Servicers' Failures Through The Monthly Servicer And Remittance Reports

472. HSBC and its responsible officers also knew of the servicers' improper servicing practices through the servicers' servicing reports and the monthly remittance reports HSBC itself published. These reports detailed the Trusts' increasing loan modifications, staggering losses, and write-downs due to the poor credit quality of the loans, but did not reflect the servicers' actions to enforce the sellers' repurchase obligations. The reports similarly reflected the servicers' abuse of servicing advances.

XIII. HSBC FAILED TO DISCHARGE ITS CRITICAL PRE- AND POST-DEFAULT DUTIES

473. Despite HSBC's knowledge of the Trusts' high default rates and poor performance, breaches of representations and warranties made by the originators, sellers, depositors, and sponsors, and servicer violations, HSBC failed to perform its duties as Trustee to protect the Trusts and Certificateholders.

A. Failure To Enforce The Trusts' Repurchase Rights

474. As set forth above, beginning in 2009 and continuing to the present, HSBC and its responsible officers discovered the Trusts contained loans that materially breached the sellers'

representations and warranties, which adversely affected the value of those mortgage loans and the Trusts' and Certificateholders' interests in those mortgage loans. HSBC further knew that the servicers had failed to take appropriate steps to enforce the sellers' obligations to cure, replace or repurchase the affected loans, and that the failure on the part of the servicers to take appropriate steps against the sellers was material.

475. HSBC breached its contractual and statutory duties under TIA and was negligent by failing to (i) provide notice to the servicers and/or the responsible sellers upon its discovery of these breaches, and (ii) take any action to enforce the sellers' repurchase of the defective mortgage loans.

B. Failure To Provide Notice
To The Servicers Of Events Of Defaults

476. As set forth above, beginning in 2009 and continuing to the present, HSBC and its responsible officers knew of failures on the part of the servicers to observe or perform in material respects their covenants or agreements in the PSAs, including the servicers' (i) failure to give notice to the other parties of seller breaches of representations and warranties upon discovery thereof and enforce the sellers' repurchase obligations; (ii) violations of prudent servicing obligations; (iii) violations of foreclosure obligations; (iv) violations of modification obligations; and (v) improper servicing advances. These breaches by the servicers constituted "Events of Defaults" as defined by the PSAs. HSBC knew that these servicers' breaches were material.

477. HSBC breached its contractual and statutory duties under TIA and was negligent by failing to provide notice to the servicers of these Events of Defaults or terminating the servicers.

C. Failure To Act Prudently Subsequent To The Uncured Events Of Defaults

478. As set forth above the Events of Default occurred, remained uncured for the requisite period of time and are continuing. Consequently, under the PSAs, HSBC had and continues to have the obligation to exercise the rights and powers vested in it by the PSAs, and to use the same degree of care and skill in its exercise as a prudent person would exercise or use under the circumstances in the conduct of such person's own affairs.

479. A prudent person would have taken action to protect the Trusts and its Certificateholders from the known seller breaches of representations and warranties by exercising all of its rights under the PSAs to enforce the sellers' repurchase obligations, including timely conducting an investigation to determine all of the materially breaching mortgage loans and suing the sellers for specific performance to compel their repurchase of those loans. HSBC breached its contractual, statutory and fiduciary duties and was negligent by failing to act prudently and taking these actions.

480. A prudent person would have also taken action to protect the Trusts and its Certificateholders from the known servicer violations by exercising all of its rights under the PSAs to enforce the servicers' prudent servicing obligations, including ensuring that all Events of Defaults were cured, terminating the servicers, substituting itself in as the substitute servicer or replacing the servicers, and enforcing the servicers obligations to reimburse the Trusts for losses caused as a result of their breaches through suit if necessary. HSBC breached its contractual, statutory and fiduciary duties and was negligent by failing to act prudently and taking these actions.

sellers and extensive servicer violations, including with respect to deficient loans sold by solvent responsible parties. Proper notice would have enabled Certificateholders to, among other things, determine whether to take independent or collective action to protect their interests against such breaches of representations and warranties, including against solvent responsible parties and others engaged in abusive securitization practices.

488. Finally, HSBC has taken certain actions on behalf of the Trusts and Certificateholders in isolated bankruptcies of sponsors or originators by submitting proofs of claim in the bankruptcy proceedings. For example, HSBC submitted proofs of claim in the bankruptcy of ResCap in 2013. However, HSBC did so because such action enabled HSBC to create the appearance of enforcement, but required only minimal effort or expense from HSBC with little legal risk, while simultaneously providing a vehicle for HSBC to seek broad liability releases and exculpation. Indeed, the broad settlement reached in the ResCap bankruptcy covering 570 trusts was the product of a hard-fought initiative led by certificateholders—not the trustees that ultimately approved the deal and benefitted from its releases and other provisions. Submitting claims also created no business risk to HSBC because the seller's failure meant that HSBC could selectively enforce the Trusts' repurchase rights without fear of losing valuable repeat business, alienating new sources of business, or provoking claims in response against HSBC for its own liability as a seller for other RMBS.

XV. HSBC FAILED TO PROTECT THE TRUSTS DUE TO ITS CONFLICTS OF INTEREST

489. HSBC failed and unreasonably refused to discharge its critical pre- and post-default duties owed to the Trusts and all Certificateholders because acting to diligently protect the interests of the Trusts would have conflicted with its own interests.

A. HSBC Was Economically Beholden To The Mortgage Loan Sellers

490. Trustees are selected by the sponsor, which is often an affiliate of the servicer. While HSBC was charged with representing the interests of the Trusts and all Certificateholders, it was economically beholden to the sponsors. Indeed, HSBC had close, repeat business relationships with most, if not all, of the sponsors for the Trusts. For example, HSBC received over 30% of its private-label residential mortgage securitization trusteeship appointments from just two banks: Wells Fargo and Lehman, based on the cumulative original face value of the offerings. And, the entirety of these banks' servicing business was conducted by their respective affiliates: Wells Fargo Bank (100%) and Aurora Loan Services Inc. (100%). Accordingly, HSBC was incentivized to not require servicers to take necessary action because these servicers were affiliated with the sponsors that provided valuable trustee appointments. In short, HSBC failed to protect the Trusts because it did not want to risk losing significant business from these sponsors.

B. HSBC Was Engaged In The Same Wrongful Servicing Activities

491. HSBC failed and unreasonably refused to take action to protect the Trusts and Certificateholders against seller breaches and servicer violations because it would have exposed that HSBC itself was engaged in the same servicing misconduct in its role as servicer for other RMBS trusts.

492. As noted above, during the fourth quarter of 2010, the Federal Reserve, the OCC, the FDIC, and the OTS conducted on-site reviews of the adequacy of controls and governance over servicers' foreclosure processes at HSBC. The reviews uncovered significant problems in foreclosure processing at HSBC, including "critical weaknesses in [HSBC's] foreclosure

governance processes, foreclosure document preparation processes, and oversight and monitoring of third-party vendors, including foreclosure attorneys."[16]

493. On April 13, 2011, based on the deficiencies in the review and the risk of additional issues as a result of weak controls and processes, the Federal Reserve Board initiated formal enforcement actions against HSBC North America Holdings, Inc. and HSBC Finance Corporation, the corporate parent and affiliate of HSBC, respectively, requiring them to address HSBC's pattern of misconduct and negligence related to deficient practices in residential mortgage loan servicing and foreclosure processing.[17] According to the Federal Reserve Board's press release, "[t]hese deficiencies represent significant and pervasive compliance failures and unsafe and unsound practices at [HSBC]." The enforcement action required HSBC to remediate deficiencies in its residential mortgage loan servicing and foreclosure processing practices.

494. As part of the enforcement action, HSBC North America Holdings, Inc. and HSBC Finance Corporation entered into a consent order with the Federal Reserve Board, which found that the HSBC Mortgage Servicing Companies had engaged in "unsafe or unsound practices in residential mortgage servicing and in the Bank's initiation and handling of foreclosure proceedings."

495. In addition, the OCC entered into consent orders with HSBC and several other servicers, including HSBC and Aurora (the "OCC Consent Orders"). In the OCC Consent Order with HSBC, the government found, among other things, that beginning in 2009 HSBC filed false

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[16] Interagency Review of Foreclosure Policies and Practices (Apr. 2011), *available at* http://www.federalreserve.gov/boarddocs/rptcongress/interagency_review_foreclosures_20110413.pdf.

[17] The nine other institutions targeted by the Federal Reserve Board's enforcement actions were Bank of America Corporation; Citigroup Inc.; Ally Financial Inc.; JPMorgan Chase & Co.; MetLife, Inc.; The PNC Financial Services Group, Inc.; SunTrust Banks, Inc.; U.S. Bancorp., and Wells Fargo & Company.

or otherwise defective affidavits in connection with foreclosure proceedings and failed to exercise adequate oversight, internal controls, policies, and procedures, compliance risk management, internal audit, third party management, and training for its foreclosure-related services. The enforcement action required extensive fixes to HSBC's mortgage servicing and foreclosure processes. The order also required HSBC to retain independent consultants to conduct a comprehensive review of foreclosure activity by these servicers in 2009 and 2010.

496. On January 18, 2013, HSBC settled with the Federal Reserve and the OCC and agreed to provide $249 million to end the case-by-case review of HSBC's servicing practices. HSBC agreed to pay $96 million to eligible borrowers who lost their homes to foreclosure in 2009 and 2010 and to provide $153 million in other assistance, including loan modifications and forgiveness of deficiency judgments, to settle the Federal Reserve and OCC's charges in connection with the unsafe and unsound mortgage servicing and foreclosure practices.

497. Likewise, several consumer suits have revealed HSBC's pattern and practice of imposing improper servicing fees on borrower, including *Lopez v. HSBC Bank USA N.A., et al.*, No. 13-cv-21104 (S.D. Fla. Mar. 28, 2013), where HSBC was forced to pay $32 million to settle borrower claims for imposing force-placed property insurance on borrowers at inflated rates.

498. Due to the fact that HSBC itself was engaging in the same illicit and improper acts as the servicers for the Trusts, HSBC failed to enforce the servicer violations, or even alert the Certificateholders to the servicers' misconduct.

C. HSBC Originated And Sponsored Defective Loans

499. HSBC was also a leading sponsor of private-label mortgage-backed securities and securitized hundreds of millions of dollars of loans that breached applicable representations and warranties. HSBC, a principal subsidiary of HSBC, sponsored thirty-five RMBS offerings under

the HASC, HALO and, HFCHC labels that were collateralized by a total of over $27 billion in certificates issued from trusts ("HSBC-Sponsored Trusts"). Many of the same entities that acted as sellers through their affiliate companies acted in the capacity as servicer or trustee for the HSBC-Sponsored Trusts, including HSBC.

500. Many of the underlying residential mortgage loans for HSBC-Sponsored Trusts were originated and serviced by HSBC affiliates. In addition, HSBC acquired loans for its securitizations from mortgage originators that later became known as some of the worst in the industry, including First Franklin, Option One, New Century, WMC, and Countrywide, among others. As a mortgage loan seller, both as an originator and sponsor, HSBC made representations and warranties to the HSBC-Sponsored Trusts regarding the quality and characteristics of the mortgage loans.

501. Widespread public evidence demonstrates pervasive violations of seller representations and warranties in the HSBC-Sponsored Trusts. For example, a comprehensive loan level analysis of various HSBC-Sponsored Trusts conducted by the FHFA revealed that up to 13.26% of mortgage loans in the HSBC-Sponsored Trusts breached owner occupancy representations and warranties, and that up to 39.51% of mortgage loans in the HSBC-Sponsored Trusts breached certain LTV representations and warranties. *FHFA v. HSBC N. Am. Holdings, Inc. et al.*, No. 1:11-cv-06189 (S.D.N.Y Sept. 2, 2011) Compl. at ¶¶96, 100. Other securities suits have similarly demonstrated that significant numbers of mortgage loans sold into the HSBC-Sponsored Trusts breached representations and warranties. *See, e.g.*, *Deutsche Bank Nat'l Trust Co. v. HSBC Bank USA, N.A.*, Index No. 652001/2013 (N.Y. Sup. Ct. Nov. 12, 2013) (finding that approximately 45% of the loans analyzed were determined to be in breach of one or more representations and warranties). In addition, there is widespread evidence of deficient

underwriting practices by the third party originators that supplied loans for the HSBC-Sponsored Trusts.

502. Accordingly, because HSBC itself faced enormous repurchase liability for billions of dollars of loans it originated, sponsored and sold to the HSBC-Sponsored Trusts in breach of representations and warranties, HSBC failed and unreasonably refused to take any action against the sellers for the Trusts, or even notify the Certificateholders of servicer misconduct.

D. HSBC Refused To Discharge Its Duties In Order To Preserve Profits

503. HSBC was also conflicted because discharging its critical pre- and post-default duties owed to the Trusts and the Certificateholders would have necessarily diminished profits. Specifically, such conduct would have directly impaired HSBC's profits by increasing costs and expenses while revenue remained unchanged. Indeed, rather than act pursuant to its proscribed contractual, statutory, and common law duties, HSBC failed and unreasonably refused to enforce the sellers' repurchase obligations and servicers' prudent servicing requirements in order to avoid the associated transactional costs of exercising the Trusts' rights against these entities – or provoke the servicers to shine the light on HSBC's own wrongful conduct.

504. For example, prior to a "default" under the TIA or an "Event of Default" under the PSAs, HSBC had minimal ministerial duties to perform.[18] Following a default under the TIA or Event of Default under the PSAs, however, HSBC's obligations expand such that it must act as a prudent person. This requirement carries with it significant and more costly responsibilities, including seeking direction from the certificateholders regarding the appropriate actions it should take on behalf of the trusts. However, fulfilling these greater duties increases costs while

[18] New York common law still imposed certain non-waivable duties on HSBC both before and after a "default" under the TIA or an "Event of Default" under the PSAs.

HSBC's compensation under the PSAs – a fixed fee rate based on the unpaid principal balance of the trust (typically less than one basis point) – would remain unchanged.

505. Additionally, the occurrence of an Event of Default could lead to the termination of the master servicer, which would have profound financial implications on HSBC. If the master servicer were terminated, HSBC would have to retain a successor master servicer or substitute itself in as the master servicer. The compensation that HSBC or the successor master servicer could obtain would be heavily restricted. For example, typical – and more lucrative – servicing income, such as float, excess spread, and ancillary fees are prohibited for a successor master servicer under the PSAs. Nevertheless, HSBC or the successor master servicer would be required to hold regulatory capital against the servicing rights.

506. Further, the occurrence of a default under the TIA or an Event of Default under the PSAs requires HSBC to provide notice of these defaults to the certificateholders. In addition to alerting certificateholders to seller and servicer violations, the default notice would expose HSBC's negligence in carrying out its ministerial duties, including its failure to receive, process, maintain and hold all or part of the mortgage loan files as required under the PSAs. Consequently, HSBC's providing notice to the certificateholders of defaults could lead to potential liability or its removal as trustee of the Trusts.

507. Accordingly, the increased duties, costs, and liability risks associated with enforcing the Trusts' rights against seller and servicer violations would make HSBC's trusteeships less profitable and possibly unprofitable. For these reasons, HSBC failed and unreasonably refused to enforce the Trusts' rights against the sellers and servicers.

XVI. CAUSATION

508. HSBC's failure and unreasonable refusal to enforce the Trusts' rights against the sellers and servicers, and its violations of its other contractual, statutory, fiduciary and