100 INTRODUCTORY FACTS ABOUT MORTGAGE SECURITIZATION

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1. Most mortgages in the U.S. are owned by trusts.

2. The trusts are often referred to as "RMBS" trusts, an acronym standing for "residential mortgage-backed securities."

3. The total U.S. mortgage debt is between $12 and $14 trillion. Of this, approximately $8 trillion was owned by trusts in 2008.

Why is it important to learn about mortgage securitization?

Reason #1: Most of the foreclosures filed in the U.S. in the last 5 years were filed by mortgage-backed trusts. Most of the foreclosures filed in the next 5 years will be filed by mortgage-backed trusts.

4. The trusts are made up of a bundle or pool of mortgages (often 5,000 – 8,000 mortgages per trust). The loans are almost always subprime loans. The value of the mortgages in each trust is usually between $500,000 and $2 billion.

5. Individual mortgages got packaged into RMBS Trusts; these RMBS trusts got bundled, sliced and sold as CDOs – collateralized debt obligations.

6. The mortgage loans in each pool – or RMBS Trust – usually include both first lien and second lien loans, and fixed-rate and adjustable rate loans.

7. There are different "layers" within each pile of loans, representing different qualities of loans. It is not unusual for each pile to have as many as 20 different layers – these layers are sometimes called classes or "tranches."

8. Certificates are issued to investors to represent the purchase – so investors are often called "certificate holders."

9. There are often minimum investment requirements – such as "Offered certificates must be purchased in minimum total investments of $100,000 per class."

10. The loans are selected for each pool by a particular date, often called the "closing date" of the trust. Some trusts include a schedule or listing of all of the loans in the trust by the closing date. While a trust may substitute loans into the pool after the closing date, there are restrictions on such substitutions.

11. The pool of loans is described in a "prospectus" – a printed document that describes the business enterprise that is distributed to prospective buyers, investors and participants (similar to the glossy brochure distributed by new car dealers describing the features of the car."

12. Many representations (promises) are made to the potential buyers regarding the loans in each pool in both the prospectus and the Pooling and Servicing Agreement (described more fully below). The following, for example, are taken from the prospectus for Soundview Home Loan Trust 2006-OPT2:

Mortgage Loans with Prepayment Charges:

74.60%

Fixed-Rate Mortgage Loans:

15.61%

Second lien Mortgage Loans:

4.18%

Interest Only Mortgage Loans:

16.94%

Range of Remaining Term to Stated Maturities:

116–360 Months

Weighted Average Remaining Term to Stated Maturity:

357 Months

Range of Original Principal Balances:

$15,000–$1,620,000

Average Original Principal Balance:

$201,215

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Range of Current Mortgage Rates:

5.350%–14.30%

Weighted Average Credit Score of the Mortgage Loans:

622

Weighted Average Current Mortgage Rate:

8.49%

Weighted Average Gross Margin of the Adjustable-Rate Mortgage Loans:

6.50%

Weighted Average Maximum Mortgage Rate of the Adjustable-Rate Mortgage Loans:

14.43%

Weighted Average Minimum Mortgage Rate of the Adjustable-Rate Mortgage Loans:

8.42%

Weighted Average Initial Rate Adjustment Cap of the Adjustable-Rate Mortgage Loans:

2.99%

Weighted Average Periodic Rate Adjustment Cap of the Adjustable-Rate Mortgage Loans:

1.00%

Weighted Average Months Until Next Adjustment Date for the Adjustable-Rate Mortgage Loans:

25 Months

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Geographic Concentration in Excess of 5%:

California:

26.02%

Florida:

11.81%

New York:

10.90%

New Jersey:

5.80%

Massachusetts:

5.10%

SOME OF THE LAWS INVOLVED IN RMBS TRUSTS

13. In 1960 the government enacted the Real Estate Investment Trust Act of 1960. This act allowed the creation of the real estate investment trusts (REIT) to encourage real estate investment.

14. In 1984 the government passed the Secondary Mortgage Market Enhancement Act (SMMEA) to improve the marketability of REITS.

15. The Tax Reform Act of 1986 allowed the creation of the tax-free Real Estate Mortgage Investment Conduit (REMIC) special purpose vehicle for the express purpose of issuing pass-through investments.

16. The Tax Reform Act significantly contributed to the savings and loan crisis of the 1980s and 1990s that resulted in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), which changed the regulation of the savings and loan industry and encouraged loan origination.

17. Investors invest in a pool of mortgage loans. As homeowners pay of the underlying mortgage loans, the investors receive payments of interest and principal. These payments are usually made monthly or quarterly.

18. There are special tax rules that apply to these trusts. Because the money coming in to the trusts is passed through to investors, the trusts are not required to pay tax on the money that flows into the trusts (the mortgage payments from homeowners). Investors pay tax when they receive their return on the investments.

19. RMBS Trusts are securities; the Securities and Exchange Commission regulate mortgage-backed trusts.

20. On January 7, 2005, the SEC published Regulation AB, a final rule to codify requirements for the registration, disclosure and reporting for all publicly registered asset-backed securities including mortgage-

backed securities. Regulation AB consists of 24 “Items” relating to the operation and reporting requirements for mortgage-backed trusts. There have been numerous revisions to Regulation AB.

21. RMBS Trusts also have special tax consequences; the IRS also regulates RMBS Trusts.

22. The majority of mortgage securities were issued by the U.S. government, by the Government National Mortgage Association (Ginnie Mae) or by government-sponsored entities (GSEs) such as the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). These entities also very often guarantee some or all of the loans in RMBS trusts.

23. The vast majority of the RMBS trusts were created between 2004 and 2008.

24. The revenue from the trusts are predicted (but not guaranteed) to last for 25 – 30 years.

25. Servicers are paid by monthly fees from the trusts usually by a formula – for example: “Servicer will be paid a monthly fee equal to one-twelfth of 0.30% multiplied by the Aggregate Principal Balance of the mortgage loans as of the first day of the related due period for the first 10 due periods…0.65% for all due periods thereafter.”

26. The Servicer may purchase all of the loans and any REO properties and “retire the certificates” (end the payments) when the total loan balance equal or is less than 10% of the original loan balance.

27. Typical representations made to investors:

- the credit scores for at least 5,000 of the 7,500 loans in the trust will be above 600;
- at least 7,000 of the 7,500 loans will not mature for at least 355 months;
- at least 5,500 of the loans are for single-family detached homes;
- at least 6,500 of the 7,500 loans will have been made to homeowners who will use the homes as their primary residence;
- the average combined loan-to-value ratio of the loans was 77% (the loan was made for only 77% of the value of the home);
- at least 5,000 of the 7,500 loans were full documentation loans;
- the current mortgage rates for at least 70% of the loans were between 7% and 10%.

28. Servicers also are responsible for issuing periodic reports to investors advising of the performance of the loans in the trust (investor reports).

29. Mortgage loans were classified as follows:

1. full documentation;
2. stated income documentation;

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3. no documentation;
4. lite documentation;
5. business bank statements.

30. Some of the major producers of RMBS Trusts from 2004-2007 included:

- Lehman Brothers
- Morgan Stanley
- Credit Suisse
- Merrill Lynch
- Deutsche Bank
- Goldman Sachs
- Bear Stearns
- JPMorgan
- CitiGroup
- Barclays

31. The names of trusts often contain short-hand information regarding that particular trust. GSAMP Trust 2006-S3, for example, stands for Goldman Sachs Alternative Mortgage Products Trust, created in 2006. Other examples:

CWALT is shorthand for Countrywide Alternative Loan Trust.

CWABS is shorthand for Countrywide Asset-Backed Securities.

Other trusts have friendly names such as Harborview or Soundview.

32. The three biggest mortgage companies in the U.S. in 2005 were:

- American Home Mortgage in Melville, NY
- Countrywide Mortgage in Calabasas, CA
- Option One Mortgage Corporation in Irvine, CA

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Almost all of these loans were bundled into RMBS trusts. Other mortgage companies that were major producers of mortgages for RMBS trusts included:

- Ameriquest Mortgage, a/k/a Long Beach Mortgage Company
- Citi Residential Lending
- Dietech (owned by GMAC)
- Fairbanks Capital
- Fremont Investment & Loan
- GMAC Financial
- New Century Mortgage Company
- NovaStar Financial

This is a very short list – there were many, many other big lenders.

33. There are 5 major groups involved in securitization: originators, depositors, sponsors, master servicers and trustees.

34. The companies that make the loans, the mortgagee, are known as the ORIGINATORS in the securitization process.

35. Loan originators often sold the loans to depositors the very same day that these loans were made or within just a few days of the closing date of the loan.

36. Loan originators very often did not lend their own money to the homeowner/borrower. The originators were often financed by “warehouse lenders.” These warehouse lenders were financial institution that extended a line of credit to the originator to fund a mortgage. The loan typically lasted from the time it was originated until it was sold into the securitization market.

37. The companies that select the loans from the various mortgage companies and sell the loans to the trusts are called the Depositors.

38. The companies that direct the creation of the trusts are called the Sponsors.

39. The companies that are responsible for continuing to collect payments on the loans, notifying delinquent mortgagees, foreclosing on collateral (if any), performing data processing functions, preparing periodic reports to investors and Rating Agencies and taking other actions are called the servicers. The Servicer is often also an affiliate of the Originator. Servicing is often the most lucrative role in securitization.

40. The companies (banks) that operate the trust after it is created are called the Trustees. Duties of the trustee for an ABS transaction typically include:

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- Receiving and releasing assets
- Receiving data and collections from servicers
- Remitting funds
- Distributing reports to investors

Trustees have the authority – but typically are not required – to take action to enforce breaches of representations and warranties.

41. Approximately eight big banks serve or served as Trustees for the majority of trusts: Bank of America, Bank of New York Mellon, Citibank, Deutsche Bank National Trust Company, GMAC/Ally, HSBC Bank, JP Morgan Chase and Wells Fargo.

42. Bank of New York Mellon is the world's largest custody bank, with $26 Trillion in assets under custody and administration. (Reuters, February 16, 2012, "U.S. SEC pressures BNY Mellon for better disclosure.")

43. Trustees do not keep the mortgage documents themselves – they hire other banks to serve as Document Custodians. Example: Wells Fargo serves as Document Custodian for most of the Deutsche Bank trusts.

44. In most trusts, a bank other than the Trustee Bank or the Document Custodian Bank, serves as Master Servicer. The operation of most trusts, therefore, involves three banks, serving in different roles.

45. Trustees frequently change, in part due to bank failures and mergers.

46. Each trust has a set of rules, set forth in a document called the Pooling and Servicing Agreement or PSA. A PSA, or similar agreement, is the governing document of a securitization transaction. Such an agreement sets forth the relationship among the parties and the assets, including, for example, the capital structure of the transaction, the eligibility criteria for the assets, the manner in which cash flows from those assets are to be distributed to note holders, and the definitions for an event of default.

Why is it important to learn about mortgage securitization?

Reason #2: The major investors in RMBS Trusts are pension funds, banks, insurance companies and state and local governments. The fate of the economy is inextricably tied to the fate of mortgage-backed trusts.

47. The PSA for every trust includes many provisions regarding the loan documents that the trust must obtain and safeguard in a "mortgage file." These documents almost always include the promissory note, endorsed in blank or to the trust, the mortgage, an assignment of mortgage to the trust and a title insurance policy.

48. Mortgage-backed trusts include the following or equivalent language regarding Assignments: "Assignments of the Mortgage Loans to the Trustee (or its nominee) will not be recorded in any jurisdiction, but will be delivered to the Trustee in recordable form, so that they can be recorded in the event recordation is necessary in connection with the servicing of a Mortgage Loan."

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49. The SEC is the major source of information about a particular trust. Information usually available from the SEC about each trust includes the Prospectus, the Pooling and Servicing Agreement, and Annual Reports.

50. Each Prospectus and PSA includes promises to investors about the quality of the loans and the loan documentation. These promises are called Representations and Warranties.

51. Key representations and warranties concern origination, servicing, underwriting standards, due diligence, and related documentation. The PSA usually limits the rights of investors to sue for breaches of these representations and warranties. The Depositor typically makes representations and warranties to the Trustee in the PSA in which mortgage loans are conveyed.

52. Investors and insurance companies began to file major lawsuits against trust creators in 2009.

53. The most common claims against the creators of trusts include the following:

Failure to disclose risks such as failure to disclose loans in default at time of closing;

Disregard of underwriting guidelines such as disregard of LTV guidelines, or debt-to-income ratios; and

Failure to conduct due diligence such as representing that due diligence was performed when it was not.

54. The PSAs usually include anti-lawsuit provisions that limit the circumstances under which a lawsuit may be filed against the trust creators. Example:

Greenwich Fin. Svcs. Distressed Mortgage Fund 3, LLC, et al. v. Countrywide Fin. Corp. (NY Supreme Court, Oct. 2010).

Complaint was dismissed because plaintiffs did not comply with anti-suit provision that required certificate-holders to (1) make a demand upon the Trustee on behalf of 25 percent of the certificate holders, (2) offer Trustee proper indemnity, and (3) wait 60 days for Trustee to commence lawsuit.

55. Examples of major lawsuits against trust creators include the following:

MBIA v. Morgan Stanley (New York State Court May 26, 2011)

MBIA alleged that it was defrauded into insuring mortgage loans, and presented evidence that 97% of the loans in a sample did not meet stated underwriting criteria.

The court found that plaintiff adequately pled “material and pervasive non- compliance with the Seller’s underwriting Guide and the mortgage loan representations.”

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Boilermakers Nat'l Annuity Trust Fund v. WAMU Mortgage Pass-Through Certificates, Series AR1 (W.D. Wash. Sept. 28, 2010)

Plaintiff alleged that defendant failed to disclose that mortgage loans were not originated in accordance with underwriting guidelines, resulting in violations of the Securities Act of 1933.

The court found that Plaintiff had adequately pled facts suggesting that underwriting standards were abandoned.

Syncora Guarantee Inc. v. EMC Mortgage Corp. (S.D.N.Y. March 25, 2011)

Syncora, which provided a financial guarantee to investors in RMBS, filed a lawsuit seeking to require EMC (the seller of the mortgages underlying the RMBS) to repurchase the loans on a pool-wide basis.

Syncora alleged that a sample of 400 mortgage loans had 85% breaches. Syncora also demanded that EMC cure breaches in 1300 loans; EMC acknowledged only 20 breaching loans.

56. RMBS Trusts have ratings, like many other securities.

57. Allegations have been made that the trust creators manipulated the ratings.

China Development Industrial Bank v. Morgan Stanley & Co. (Sup. Ct. N.Y. Feb 25, 2011).

CDIB alleged that Morgan Stanley manipulated the rating agencies' models.

In denying Morgan Stanley's motion to dismiss, the court noted that the alleged corruption of the ratings process "could not have been discovered by any degree of due diligence or analysis performed by the most sophisticated of investors."

58. Some lawsuits have focused on the undisclosed involvement of "short" parties in the loan selection process:

SEC v. Goldman Sachs & Co. (S.D.N.Y. decision June 10, 2011)

The court declined to dismiss federal securities fraud claims against Goldman employee (Tourre) based on Goldman's alleged failure to disclose to CDO investors that a hedge fund strongly influenced collateral selection while it was it was "shorting" the CDO.

SEC v. J.P. Morgan Securities LLC (S.D.N.Y. complaint June 21, 2011)

The SEC simultaneously sued and settled with JPM for $153.6 million. The SEC alleged in its complaint that JPM arranged and sold a CDO to investors while representing "that the investment portfolio of [the CDO]

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was selected by the [CDO's collateral manger]" but failed to disclose that a hedge fund with a $600 million short interest in the CDO "played a significant role in the portfolio selection process."

59. At least one lawsuit by investors has focused in part upon the trusts' failure to obtain and keep the original loan documents as promised to investors.

Oklahoma Police Pension and Retirement System v. U.S. Bank National Association (S.D.N.Y. complaint Nov., 2008)

60. Courts may pay strict attention to the many disclaimers in the Prospectuses and the PSAs.

Plumbers' Union Local No. 12 Pension Fund, et al. v. Nomura Asset Acceptance Corporation (D.Ma. complaint Jan. 31, 2008)

With respect to the plaintiffs' allegations concerning the mortgage originators' underwriting standards, District of Massachusetts Judge Richard G. Stearns found that the offering documents contained a "fusillade of cautionary statements" that "abound with warnings about the potential perils." Judge Stearns noted that plaintiffs' contention that they were not "on notice" of those perils "begs credulity." (This was reversed, in part, on appeal.)

61. Regulation of RMBS Trusts by the SEC was done almost solely on the honor system. The trusts prepared reports and filed these with the SEC, and almost no verification of these reports was done by the SEC.

62. The trusts were continually down-graded by the rating agencies.

63. Current investigations by the Federal Task Force co-chaired by New York Attorney General Eric Schneiderman are focusing on whether there were criminal violations in the packaging of these loans, and criminal acts by servicers relating to foreclosures by the trusts

64. Many of the people now responsible for investigating the creation and operation of trusts were previously involved in the creation and operation of these trusts. Example: Robert Khuzami, Director of Enforcement for the SEC, was previously General Counsel for the Americas for Deutsche Bank from 2004-2009. Khuzami thus supervised Greg Lippman, a senior trader at Deutsche, who helped create and fuel the market for mortgage-backed securities.

65. Greg Lippman was perhaps the most famous of all traders who made tens of millions of dollars betting AGAINST the continued strong performance of the U.S. housing market. He has been singled out for his misconduct in Congressional reports. He is known for being brash, crass and unscrupulous.

Why is it important to learn about mortgage securitization?

Reason #3: The RMBS Trusts now own more homes in most counties than any other property owner.

66. The majority of trusts have less than 40% of performing loans remaining in the trusts. This means that most trusts will stop producing income for investors about 20 years sooner than expected.

67. A study of 37 trusts from three popular series of trusts, American Home Mortgage Assets Trusts, American Home Mortgage Investment Trusts and Soundview Home Loan Trusts, showed the following:

Of the 37 trusts, 18 had 25% or less of performing loans remaining.

Of the 37 trusts, 8 had 26% – 30% of performing loans remaining.

Of the 37 trusts, 11 had 31% – 38% of performing loans remaining.

There were a combined total of 228,203 loans in these trusts at inception.

As of November, 2011, there were a combined total of 51,798 (22.7%) performing loans in these trusts.

The combined collateral value of the loans in these trusts at inception was over $61 Billion: $61,441,128,225.

Of the 37 trusts, Soundview Home Loan Trust 2007-OPT5 had the highest percentage of performing loans remaining in the trust: 38%. American Home Mortgage Assets Trust 2005-2 had the lowest percentage of performing loans remaining in the trust: 10.5%.

THE INVESTORS IN MORTGAGE-BACKED TRUSTS

68. Investment banks invested heavily in mortgage-backed securities. Example: Merrill Lynch reported on January 17, 2008, an $8.6 billion net loss from write-downs on its subprime investments.

69. Pension fund managers, public and private, invested heavily in mortgage-backed securities. Ohio's former Attorney General Richard Cordray filed 8 major lawsuits, and to date has recovered over $2 billion for Ohio pension funds.

70. Insurance companies were major investors in RMBS trusts. The National Association of Insurance Commissioners recently estimated that insurance companies have investments of half a trillion dollars in mortgage-backed securities.

71. Local governments, counties and municipalities invested heavily in mortgage-backed securities.

LIES TOLD TO INVESTORS

72. The information in the prospectuses and the PSAs was often false. The average credit scores of borrowers in the loan pool were much lower than represented. There were many more "no documentation" or "stated income" loans than disclosed. There were much fewer "full documentation" loans than disclosed.

73. The information about the loan to value ratios was often also falsely stated. Home values were inflated during appraisals to make it appear that there was a much higher homeowner investment/equity in the home.

INACCURATE/FALSE INFORMATION IN INVESTOR REPORTS

74. The investor reports often contain inaccurate and false information about the loans in the trust.

75. The status of the loans is often wrongly reported in the investor reports. Loans may be reported as delinquent, in foreclosure, in bankruptcy, or trustee-owned when the records of the clerk of the court indicate a different status for these same loans.

76. The investor reports often do not disclose that a loan/home has been sold to a new buyer through short sale or foreclosure auction.

TRUSTS AND FORECLOSURES

77. Most trustees and trust servicers refuse to modify trust-owned loans and instead foreclose whenever a loan is 90-days delinquent.

78. Most trustees use high volume, low quality law firms ("foreclosure mills") to foreclose.

79. The law firms used by the trusts are often dictated by a list of "approved" law firms selected by FANNIE and FREDDIE.

80. According to a New York Times report in October, 2011, Fannie Mae learned as early as 2003 of extensive foreclosure abuses among the law firms it had hired to remove troubled borrowers from their homes. Fannie Mae did little to correct the firms' practices.

81. Fannie Mae and Freddie Mac approved law firms included some of the worst of the worst such as New York's Steven Baum law firm (where employees at a firm Halloween party dressed as homeless people) or Florida's Law Offices of David Stern where employees signed tens of thousands of documents to use as proof in their own foreclosure cases.

82. Fannie Maw and Freddie Mac gave incentives to law firms for the speed of foreclosures, with a pervasive disregard for legal requirements and honest practices.

83. Fannie and Freddie auditors may have themselves received incentives from the law firms they hired including expensive tickets to sporting events and elaborate restaurant meals to give law firms advance notice of audits and the files that would be audited.

84. In hundreds of thousands of other cases, the servicers for trusts used an outside vendor, Lender Processing Services (LPS), to handle their foreclosures.

85. LPS maintains a network of lawyers similar to the Fannie Mae and Freddie Mac approved lawyer vendor list. LPS has been accused by bankruptcy trustees and private litigants of requiring participating lawyers to kick-back fees to LPS from foreclosures.

86. The servicers often run-up costs when a loan in a trust goes in to foreclosure by greatly over-insuring the property, and adding monthly maintenance fees (often for services not performed) and appraisal fees. All of these fees are subtracted from any money that eventually goes to the investors after the foreclosure is complete and the property is resold.

TRUSTS, MORTGAGE LOAN DOCUMENTATION & OTHER ABUSES

87. In foreclosures, many trusts use(d) law firms and process servers that have been discredited because of fraudulent documents.

88. Although all states require that the homeowner by served with foreclosure documents at the start of the foreclosure, certain process serving companies often used by trusts engage in a practice known as “sewer service” where the homeowners are never actually served with the papers. (The term refers to foreclosure documents left in the sewers in front of homes.)

89. In many other foreclosures by trusts, the process server has falsely stated that the homeowner was not in active duty military service when the homeowner was actually a service member on active duty service in Iraq or Afghanistan.

90. Renters were also never told about a pending foreclosure of the home they were renting, although such notice and opportunity to be heard was required in almost every state. This home deterioration was so extreme that some municipalities filed lawsuits against trustees accusing trustees of being slumlords. This widespread failure to protect the homes (the trust assets) further drove down neighborhood home values, further deteriorating the value of the loans/homes in the trust.

91. Sales of foreclosed properties were often held without complying with state laws requiring advertising such sales so that the maximum price could be obtained for the homes, lessening any loss to investors.

92. Vacant homes were not protected or maintained, causing extreme loss of value of the homes as they were often looted and vandalized.

93. Many trusts never obtained the mortgage documents that were supposed to have been in the mortgage file kept by the document custodian. Endorsed notes and mortgage assignments were often missing from the mortgage files kept by the Document Custodian for the trusts.

94. In the case of many loans that were supposed to haven been registered with the Mortgage Electronic Registration Systems (“MERS”), showing the trust as the owner of the loan and mortgage, no such registration was made and the loan remained registered in the name of the loan originator.

95. Where loan documents were missing, many trusts concealed the missing documents problem, or missing MERS registration problem, by filing “replacement” documentation with the county registers of deeds and clerks of the courts.

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96. In possibly thousands of cases, the ownership by the trust is never disclosed. The foreclosure is brought in the name of the originator even though the loan was only owned by the originator for a few hours, days or weeks.

97. In the case of MERS, many trusts changed the ownership of mortgages on the MERS registry to falsely reflect that the Trust acquired the mortgage at or about the time that the loan defaulted.

98. In possibly thousands of cases, the endorsements on notes have been falsified showing an endorsement in blank or an endorsement to the trusts when no such endorsement was ever obtained from the loan originator.

99. In hundreds of thousands of foreclosure cases nationwide, false fraudulent and often forged mortgage assignments to trusts were prepared and filed solely to give the trusts a legal advantage in the foreclosure litigation.

100. A major investigation of the abuses in mortgage securitization was announced in the 2012 State of the Union address.

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