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

ALLSTATE INSURANCE COMPANY, ALLSTATE LIFE INSURANCE COMPANY, ALLSTATE BANK (F/K/A ALLSTATE FEDERAL SAVINGS BANK), AND KENNETT CAPITAL, INC.

Plaintiffs,

-against-

CREDIT SUISSE SECURITIES (USA) LLC, CREDIT SUISSE FIRST BOSTON MORTGAGE SECURITIES CORP., ASSET BACKED SECURITIES CORPORATION, AND DLJ MORTGAGE CAPITAL, INC.,

Defendants.

Index No.

SUMMONS

TO: CREDIT SUISSE SECURITIES (USA) LLC
Attn: Litigation Department
Eleven Madison Avenue
New York, New York 10010

CREDIT SUISSE FIRST BOSTON MORTGAGE SECURITIES CORP.
Attn: Litigation Department
Eleven Madison Avenue
New York, New York 10010

ASSET BACKED SECURITIES CORPORATION
Attn: Litigation Department
Eleven Madison Avenue
New York, New York 10010

DLJ MORTGAGE CAPITAL, INC.
Attn: Litigation Department
Eleven Madison Avenue
New York, New York 10010

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

Plaintiffs designate New York County as the place of trial. The basis of the venue designated is that Defendants do business in or derive substantial revenue from activities carried out in this County. Almost all activity pertaining to the securitization of the mortgage loans at issue occurred in this County, including the underwriting, negotiating, drafting and signing of the operative agreements, the formation of the trusts, the compilation of offering materials, and the marketing of the Offering Materials.

DATED: New York, New York
February 28, 2011

QUINN EMANUEL URQUHART & SULLIVAN, LLP

By: David Brockett

Daniel L. Brockett
David D. Burnett
51 Madison Avenue, 22nd Floor
New York, New York 10010-1601
Telephone: (212) 849-7000
Fax: (212) 849-7100
danbrockett@quinnemanuel.com
daveburnett@quinnemanuel.com

Of Counsel: (pro hac vice applications forthcoming where applicable)

D. M. Rawlings
Richard A. Schirtzer (NY Bar No. 1992841)
865 South Figueroa Street, 10th Floor
Los Angeles, California, 90017
Telephone: (213) 443-3000
Fax: (213) 443-3100
chiprawlings@quinnemanuel.com
richardschirtzer@quinnemanuel.com

David J. Ruderman
Alexander B. Binder
50 California Street, 22nd Floor
San Francisco, California 94111
Telephone: (415) 875-6600
Facsimile: (415) 875-6700
davidruderman@quinnemanuel.com
alexbinder@quinnemanuel.com

Attorneys for Plaintiffs Allstate Insurance Company, Allstate Life Insurance Company, Allstate Bank, and Kennett Capital, Inc.

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

ALLSTATE INSURANCE COMPANY, ALLSTATE LIFE INSURANCE COMPANY, ALLSTATE BANK (F/K/A ALLSTATE FEDERAL SAVINGS BANK), AND KENNETT CAPITAL, INC. Plaintiffs, -against- CREDIT SUISSE SECURITIES (USA) LLC, CREDIT SUISSE FIRST BOSTON MORTGAGE SECURITIES CORP., ASSET BACKED SECURITIES CORPORATION, AND DLJ MORTGAGE CAPITAL, INC, Defendants.	Index No. **COMPLAINT**

Plaintiffs Allstate Insurance Company, Allstate Life Insurance Company, Allstate Bank (f/k/a Allstate Federal Savings Bank), and Kennett Capital, Inc. (collectively, "Allstate"), by and through their attorneys, bring this action against Credit Suisse Securities (USA) LLC, Credit Suisse First Boston Mortgage Securities Corp., Asset Backed Securities Corporation, and DLJ Mortgage Capital, Inc., (collectively "Defendants" or "Credit Suisse Defendants"), and allege as follows:

NATURE OF ACTION

1. This action arises out of the Defendants' fraudulent sale of residential mortgage-backed securities (the "Certificates") to Allstate. Whereas Allstate was made to believe it was buying highly-rated, safe securities backed by pools of loans with specifically represented risk profiles, the Defendants in fact knew the pool included a toxic mix of loans that had been given to borrowers who could not afford the properties, and thus were highly likely to default.

2. The Defendants made numerous material misrepresentations and omissions regarding the riskiness and credit quality of the Certificates in registration statements, prospectuses, prospectus supplements, term sheets, and other written materials (both herein and in the Exhibits, the "Offering Materials"). For example:

(i) ***Underwriting guidelines.*** The Offering Materials each represented that a particular, reasonable, underwriting process was followed to ensure that only loans that the borrower could repay would be included in the pool underlying the Certificates (the "Mortgage Loans"). In fact, the Defendants knew that the loans did not meet the disclosed guidelines. Based on data compiled from third-party due diligence firms, the federal Financial Crisis Inquiry Commission ("FCIC") noted in its January 2011 report:

> The Commission concludes that firms securitizing mortgages failed to perform adequate due diligence on the mortgages they purchased and at time knowingly waived compliance with underwriting standards. **Potential investors were not**

> **fully informed or were misled** about the poor quality of the mortgages contained in some mortgage-related securities. **These problems appear to be significant.**

(FCIC Report at 187 (emphasis added).)

(ii) ***Percentage of Known Non-Conforming Loans.*** The Defendants fraudulently omitted to inform Allstate that due diligence conducted by third-party firms, and by the Defendants themselves, had identified numerous, specific loans that did not conform to the underwriting guidelines of the originators. Nor did they disclose that many of those very same loans had been "waived" into the collateral pools underlying the Certificates despite not having any purported "compensating" factors. Data recently made available from one of the largest due diligence firms – which worked for Credit Suisse – confirms this was occurring on a staggering scale. This not only confirms the results of Allstate's analysis of the loans at issue, but also confirms the Defendants' knowledge of those underwriting violations.

(iii) ***Owner Occupancy Statistics*****.** The Offering Materials made specific representations regarding the percentage of borrowers who would be occupying the property being mortgaged – a key risk characteristic given that borrowers are less likely to walk away from properties they live in, as compared to properties being used as a vacation home or as an investment. Analytical tools recently made available to investors confirm that in truth, a far greater percentage of the loans underlying Allstate's Certificates than represented by Defendants were given to borrowers who did not live in the homes that secured the mortgages in question.

(iv) ***Loan-to-Value Ratios*****.** The Offering Materials represented that the loans had specific loan-to-value ("LTV") and combined loan-to-value ("CLTV") ratios. The LTV and CLTV represent the size of the borrower's obligations as compared to the value of the property being used as collateral. The CLTV is the LTV after all loans are considered, not just the first mortgage. These are additional key risk metrics, because they represent the equity "cushion" that borrowers have, and the likelihood of repayment to lenders upon foreclosure. Analytical tools recently made available to investors confirm that in truth Defendants' Offering Materials vastly overstated the value of the collateral being included in the loan pools, and hid additional liens that had been placed on the properties.

(v) ***Purpose and Use of Exceptions.*** The Offering Materials represented that loans which did not meet certain criteria were approved as "exceptions" only on the basis of countervailing features of the borrowers' risk profiles that "made up" for negative aspects of the risk profile. In fact, "exceptions" were not based on legitimate compensating factors and instead were used as a way to increase loan volume by circumventing the applicable underwriting guidelines. Based on a loan-level review of the loan files, Defendants (directly and through their representatives) knew of these significant departures from the underwriting guidelines at the same time when Defendants were concealing the problems from Allstate.

(vi) ***Credit Ratings.*** The Offering Materials represented that the Certificates had specific investment-grade credit ratings. Defendants fed the same misrepresentations found in the Offering Materials to the ratings agencies in an attempt to manufacture predetermined ratings. The rating agencies relied on this inaccurate loan information when rating the Certificates. Defendants' misconduct in withholding accurate information from the rating agencies not only rendered false Defendants' representations about how the ratings process really functioned, but also assured that the ratings themselves in no way reflected the actual risk underlying the Certificates.

(vii) ***Credit Enhancement Features.*** The Offering Materials represented that the Certificates had certain "credit enhancements" that Defendants were using to improve the likelihood that holders of such certificates would receive regular principal and interest payments thereon. “Credit enhancements” are features designed to reduce the risk of loss to investors in the senior tranches of certificates. These features can include overcollateralization (*i.e.*, the value of the collateral underlying the certificates is greater than the principal balance of the certificates) the subordination in right of payment of junior certificates to senior certificates, the establishment of reserve accounts, a mortgage pool insurance policy, an interest-rate swap agreement, or a combination of such features. The level of credit enhancement utilized for each offering was to be correlated to the risk associated with the underlying loan pool. However, due to the pervasive underwriting deficiencies that rendered the Mortgage Loans far riskier and less valuable than disclosed, and because the credit enhancements themselves depended on the quality of those Mortgage Loans, the credit enhancements described in the Offering Materials were never adequate to protect certificate holders from loss. As a result, the purported “credit enhancements” were really no protection at all.

3. Allstate purchased over $231 million in the Defendants’ mortgage-backed securities in reliance on these and the other misrepresentations and omissions. Allstate purchased the Certificates directly from Credit Suisse First Boston Corporation, the predecessor to Defendant Credit Suisse Securities (USA) LLC. The purchases are further detailed in the exhibits to this Complaint, which are all incorporated as if set forth fully herein.

Transaction	Total Investment
ARMT 2005-6A, A22	$3,526,279
ARMT 2007-1, 5A4	$19,935,897
CSMC 2006-8, 3A1	$19,902,325
CSMC 2007-3, 4A6	$27,166,666
CSMC 2007-5, 1A10	$7,184,435
HEMT 2005-5, A1A	$45,460,000
HEMT 2005-5, A1F2	$17,641,262
HEMT 2006-2, 1A1	$24,992,167
HEMT 2006-2, 2A1	$25,000,000
TBW 2006-4, A4	$30,113,015

ABSC 2006-HE5, A1	$11,077,791
Total	**$231,999,837**

4. Allstate invested in the Certificates as part of a broader plan to invest in a diverse array of carefully underwritten, mortgage-backed securities. Allstate typically purchased senior classes of mortgage-backed securities (i.e., those rated AAA/Aaa or AA/Aa by the rating agencies Standard & Poor's and Moody's Investors Service). Allstate purchased the Certificates to generate income and total return through safe investments. Allstate also purchased these securities with the expectation that the investments could be – and indeed some would be and were – purchased and sold on the secondary market.

5. The systemic (but hidden) abandonment of the disclosed underwriting guidelines led to soaring default rates in the mortgage loans underlying the Certificates, resulting in a drastic drop in the value of the Certificates. For instance, despite the fact that nearly all of the of the Certificates started out with AAA ratings – the same rating given to treasury bills backed by the full faith and credit of the United States government – none are rated as investment-grade securities by at least one of the three major credit rating agencies as of the time of this Complaint. With the underlying loans performing so poorly, the value of Allstate's Certificates has plummeted, causing Allstate to incur significant losses. These losses were not caused by the downturn in the U.S. housing market, but by the Defendants' faulty underwriting.

PARTIES

6. ***The Plaintiffs.*** Plaintiff Allstate Insurance Company is an insurance company formed under the laws of, and domiciled in, the State of Illinois, with its principal place of business in Northbrook, Illinois. It sells property and casualty insurance. Allstate Insurance Company is licensed to do business in New York and writes insurance policies to New York residents. Allstate Insurance Company is a wholly owned subsidiary of Allstate Insurance

Holdings, LLC, which is a Delaware limited liability company. Allstate Insurance Holdings, LLC is a wholly owned subsidiary of The Allstate Corporation, which is a Delaware corporation.

7. Plaintiff Allstate Life Insurance Company is an insurance company formed under the laws of, and domiciled in, the State of Illinois, with its principal place of business in Northbrook, Illinois. It sells life insurance and annuity products. Allstate Life Insurance Company is a wholly owned subsidiary of Allstate Insurance Company.

8. Plaintiff Allstate Bank (formerly known as Allstate Federal Savings Bank) is a federally-chartered thrift institution that provides retail bank products and services. Its registered office is in Northbrook, Illinois. It is wholly owned by The Allstate Corporation.

9. Plaintiff Kennett Capital, Inc. is a Delaware corporation and an indirect, wholly owned subsidiary of The Allstate Corporation.

10. ***The Defendants.*** All of the Defendants in this action are part of the same corporate family, and acted together to control the entire process in the creation of the Certificates at issue here, from loan origination, to mortgage pooling, to securities underwriting, to sale to Allstate.

11. ***Seller/Sponsor Defendant.*** Defendant DLJ Mortgage Capital, Inc. ("DLJ Mortgage Capital") is a Delaware corporation with its principal place of business in New York, New York. It is a wholly owned, indirect subsidiary of Credit Suisse Holdings (USA), Inc., and it is primarily engaged in the purchase of mortgage loans. DLJ Mortgage Capital acted as the Seller or Sponsor (or both) for all the offerings of mortgage-backed securities at issue in this case. It also originated some of the Mortgage Loans underlying ARMT 2005-6A, ARMT 2007-1, CSMC 2006-8, CMSC 2007-3, and CSMC 2007-5, and acquired other Mortgage Loans underlying the Certificates from third-party originators.

12. ***Underwriter Defendant.*** Defendant Credit Suisse Securities (USA) LLC, formerly known as Credit Suisse First Boston LLC, is a Delaware limited liability company with its principal place of business in New York, New York. It is primarily engaged in the business of investment banking and is a wholly owned, indirect subsidiary of Credit Suisse Holdings (USA), Inc. It, or its predecessor, acted as the underwriter for the Certificates as issue here.

13. ***Depositor Defendants.*** The Depositors are issuers of the Certificates within the meaning of Section 2(a)(4) of the 1933 Act, 15 U.S.C. § 77b(a)(4), and Section 11(a) of the 1933 Act, 15 U.S.C. § 77k(a).

14. Defendant Credit Suisse First Boston Mortgage Securities Corp. is a Delaware corporation with its principal place of business in New York, New York. It was the Registrant for certain Registration Statements filed with the SEC, and an issuer of ARMT 2005-6A, ARMT 2007-1, CSMC 2006-8, CSMC 2007-3, CSMC 2007-5, HEMT 2005-5, and TBW 2006-4. It is a wholly owned, indirect subsidiary of Credit Suisse Holdings (USA), Inc.

15. Defendant Asset Backed Securities Corporation is a Delaware corporation with its principal place of business in New York, New York. It was the Registrant for certain Registration Statements filed with the SEC, and an issuer of ABSC 2006-HE5 and HEMT 2006-2. It is a wholly owned, indirect subsidiary of Credit Suisse Holdings (USA), Inc.

16. ***Relevant Non-Parties.*** Select Portfolio Servicing, Inc. ("SPS") is a Utah corporation whose principal place of business is Salt Lake City, Utah. It is an indirect, wholly owned subsidiary of Credit Suisse Holdings (USA), Inc. and is primarily engaged in the servicing of mortgage loans. SPS acted as servicer for certain of the loans securitized in the following trusts: ARMT 2005-6A, ARMT 2007-1, CSMC 2007-3, CSMC 2007-5, and HEMT 2005-5.

17. Credit Suisse Financial Corporation ("CSFC") is a Delaware corporation with its principal place of business in Princeton, New Jersey. It is engaged in the business of, among other things, the origination of mortgage loans. It is a wholly owned, indirect subsidiary of Credit Suisse Holdings (USA), Inc. CSFC originated a portion of the loans securitized in the following trusts: ARMT 2007-1, CSMC 2007-3, CSMC 2007-5, and HEMT 2006-2.

18. Credit Suisse Group AG is a Swiss company whose share are publicly traded on the Swiss Stock Exchange. It is the parent company of Credit Suisse Holdings (USA), Inc.

19. Credit Suisse Holdings (USA), Inc. is a Delaware corporation with its principal place of business in New York, New York. It is the direct or indirect parent corporation of DLJ Mortgage Capital, Inc., Credit Suisse Securities (USA) LLC, Select Portfolio Servicing, Inc., Credit Suisse Financial Corporation, and Credit Suisse First Boston Mortgage Securities Corp.

20. Each security acquired by Allstate from a Credit Suisse-affiliated entity was issued by a trust. The issuing trusts (collectively, the "Trusts") are identified in Exhibit A, along with other details regarding Allstate's purchases. The following issuing trusts are common-law trusts formed under the laws of the state of New York: ARMT 2007-1, CSMC 2006-8, CSMC 2007-3, CSMC 2007-5, HEMT 2005-5, and TBW 2006-4. The Trusts are managed by trustees. The trustees for the Trusts were U.S. Bank N.A. and Wells Fargo Bank N.A.

21. At all relevant times, the Defendants committed the acts, caused or directed others to commit the acts, or permitted others to commit the acts alleged in this Complaint. Any allegations about acts of the corporate Defendants means that those acts were committed through their officers, directors, employees, agents, and/or representatives while those individuals were acting within the actual or implied scope of their authority.

JURISDICTION AND VENUE

22. Jurisdiction of this Court is founded upon CPLR §§ 301 and 302.

23. All of the Defendants do business in or derive substantial revenue from activities carried out in New York. Almost all activity pertaining to the securitization of the mortgage loans at issue occurred in New York, including the underwriting, negotiating, drafting and signing of the operative agreements, the formation of the trusts, the compilation of offering materials, and the marketing of the Offering Materials.

24. Venue is proper in this County pursuant to CPLR §§ 503(a).

BACKGROUND

A. The Mechanics of Mortgage Securitization

25. Mortgage pass-through securities or certificates represent interests in a pool of mortgage loans; the securities are "shares" in the pool that are sold to investors. The pass-through securities entitle the holder to payments from the pool of mortgages. Although the structure and underlying collateral may vary by offering, the basic principle of pass-through securities remains the same: the cash flow from the pool of mortgages is "passed through" to the securities holders when payments are made by the underlying mortgage borrowers.

26. The initial step in creating a mortgage pass-through security is the acquisition by a "depositor" of an inventory of loans from a "sponsor" or "seller," which either originates the loans or acquires the loans from other mortgage originators. This "sponsor" of a mortgage-backed security ("MBS") was often a Wall Street investment bank, like Credit Suisse.

27. In many cases, Credit Suisse would provide a "warehouse" loan to the loan originator, with the warehouse line providing the money that was loaned to the ultimate borrower. These warehouse lines gave Credit Suisse the inside track on acquiring the loans that were generated using Credit Suisse funds. The process of implementing the warehouse loan also provided Credit Suisse with detailed information about the loans being made using its money,

including the right to access the loan files and other detailed information about the underwriting process for the loans in question.

28. Upon acquisition, the depositor transfers, or deposits, the acquired pool of loans to an "issuing trust."

29. The depositor then securitizes the pool of loans in the issuing trust so that the rights to the cash flows from the pool can be sold to investors. The securitization transactions are structured such that the risk of loss is divided among different levels of investment, or "tranches." Tranches consist of multiple series of related securities offered as part of the same offering, each with a different level of risk and reward. Any losses on the underlying loans – whether due to default, delinquency, or otherwise – are generally applied in reverse order of seniority. As such, the most senior tranches of pass-through securities receive the highest credit ratings. Junior tranches, being less insulated from risk, typically obtain lower credit ratings, but offer greater potential returns.

30. Once the tranches are established, the issuing trust passes the securities or certificates back to the depositor, who becomes the issuer of the securities. The depositor then passes the securities to one or more underwriters, who offer and sell the securities to investors in exchange for cash that is passed back to the depositor, minus any fees owed to the underwriters.

31. The underwriters, often Wall Street banks (and in this case, Credit Suisse), play a critical role in the securitization process by purchasing the securities from the issuing trust through a depositor and then selling them to investors. Significantly, the underwriters provide the information that potential investors like Allstate use to decide whether to purchase the securities.

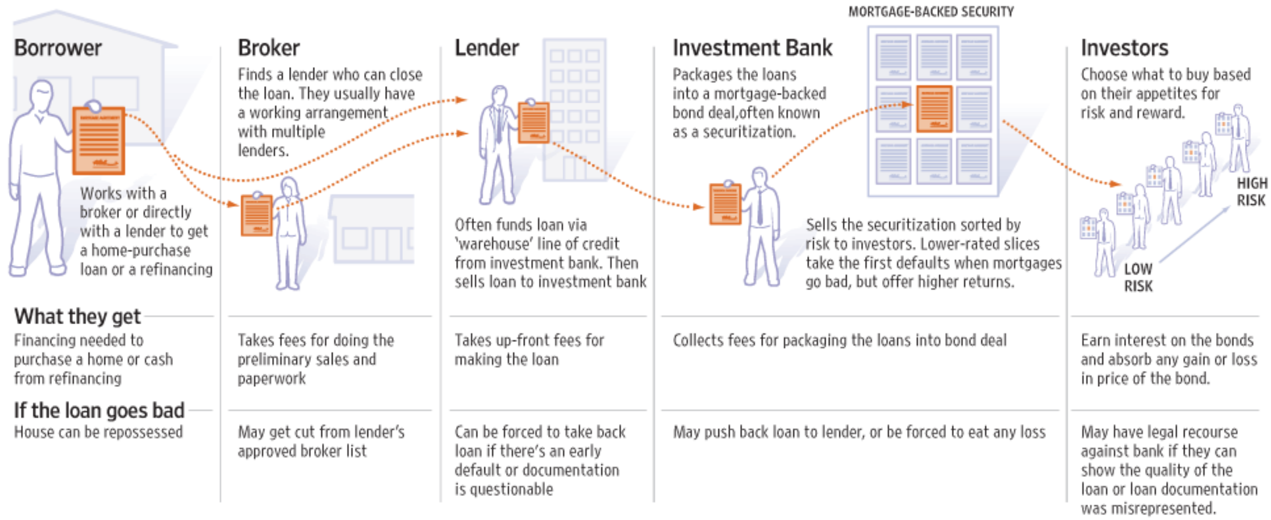
32. Because the cash flow from the loans in the collateral pool of a securitization is the source of payments to holders of the securities issued by the trust, the credit quality of the securities depends upon the credit quality of the loans in the collateral pool. The most important information about the credit quality of the loans is contained in the "loan files" that the mortgage originator develops while making the loans.

33. For residential mortgage loans, each loan file normally contains documents including the borrower's application for the loan; verification of the borrower's income, assets, and employment; references; credit reports on the borrower; an appraisal of the property that will secure the loan and provide the basis for measures of credit quality, such as loan-to-value ratios; and a statement of the occupancy status of the property. The loan file also typically contains the record of the investigation by the loan originator of the documents and information provided by the borrower, as well as the detailed notes of the underwriter setting forth the rationale for the making of each loan. Investors like Allstate were not given access to the loan files and they must rely on the representations made by the sponsors and underwriters in the Offering Materials.

34. The collateral pool for each securitization usually includes thousands of loans. Instead of having each potential investor reviewing all of these loan files, the underwriters are generally responsible for gathering, verifying, and presenting to potential investors accurate and complete information about the credit quality and characteristics of the loans that are deposited into the issuing trust. In accordance with industry standards, this involves performing due diligence on the loan pool and the originators to ensure the representations being made to investors are accurate. Investors, like Allstate, rely on the offering materials to correctly describe the quality and nature of the loans that form the security for their investments.

35. The *Wall Street Journal* has summarized the securitization process as follows:

Follow the Mortgage What happens to your mortgage after you sign on the dotted line



Source: WSJ Reporting

B. Securitization of Mortgage Loans: The Traditional Model

36. Traditionally, mortgage originators financed their mortgage business through customer deposits, retained ownership of the loans they originated, and directly received the mortgage payment streams. When an originator held a mortgage through the term of the loan, the originator also bore the risk of loss if the borrower defaulted and the value of the collateral was insufficient to repay the loan. As a result, the originator had a strong economic incentive to verify the borrower's creditworthiness through prudent underwriting and to obtain an accurate appraisal of the value of the underlying property before making the mortgage loan.

37. Mortgage loan securitization, however, shifted the traditional "originate to hold" model to an "originate to distribute" model, in which originators sell residential mortgages and transfer credit risk to investors through the issuance and sale of residential mortgage backed securities ("RMBS"). Under the new model, originators no longer hold the mortgage loans to maturity. Instead, by selling the mortgages to trusts, which provide their securities to investors, the originators obtain the funds to make more loans. Securitization also enables originators to earn most of their income from transaction and loan-servicing fees, rather than from the spread

between interest rates paid on deposits and interest rates received on mortgage loans, as in the traditional model. Thus, securitization gives originators an incentive to increase the number of mortgages they issue regardless of credit quality. However, contractual terms, adherence to solid underwriting standards, and good business practices obligate originators to underwrite loans in accordance with their stated policies and to obtain accurate appraisals of the mortgaged properties.

38. At the time, most mortgage securitizations were conducted through the major Government Sponsored Enterprises (the "Agencies"), *i.e.*, the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac"), and the Government National Mortgage Association ("Ginnie Mae"). The Agencies purchased loans from originators and securitized the loans. These Agency securitizations had high credit quality because the Agencies required the underlying loans to be originated in accordance with strict underwriting guidelines. Most non-Agency mortgage securitizations during this period also had relatively high credit quality because they typically complied with the Agencies' underwriting standards.

C. The Systemic Violation Of Underwriting And Appraisal Standards In The Mortgage Securitization Industry

39. During the 1980s and 1990s, the mortgage securitization business grew rapidly, making it possible for mortgage originators to make more loans than would have been possible using only the traditional primary source of funds from deposits. Originators during that period generally made loans in accordance with their stated underwriting and appraisal standards and provided accurate information about the loans, borrowers, and mortgaged properties to the Wall Street banks that securitized the loans. In turn, the Wall Street banks provided accurate information about the loans, borrowers, and properties to RMBS investors.

40. Unbeknown to investors, the game fundamentally changed in the early 2000s. While both originators and Wall Street banks, through the 1990s, played by the rules and complied with their obligations to underwrite loans responsibly and provide accurate information to RMBS investors, this ceased to be the case in the following decade. The history of this market collapse was investigated by the FCIC, which "reviewed millions of pages of documents, interviewed more than 700 witnesses, and held 19 days of public hearings in New York, Washington, D.C., and communities across the country." The FCIC issued a report in January 2011 that described the crisis:

> [I]t was the collapse of the housing bubble –fueled by low interest rates, easy and available credit, scant regulation, and toxic mortgages – that was the spark that ignited a string of events, which led to a full-blown crises in the fall of 2008. Trillions of dollars in risky mortgages had become embedded throughout the financial system, as mortgage-related securities were packaged, repackaged, and sold to investors around the world.

(FCIC Report at xvi.)

41. With interest rates at historic lows and pushing down the profits of traditional lending and even securitization through Fannie Mae or Freddie Mac, Wall Street banks looked for new ways to increase fees. Banks began to focus on creating products outside the traditional lending guidelines and expanding the number of borrowers who could purportedly qualify for loans, while also charging those borrowers much higher fees than they would have paid on conforming loan terms. As a result, the number of loans that were riskier than those that could be securitized through Fannie Mae or Freddie Mac skyrocketed. For instance, according to an April 7, 2010 report by the FCIC, loans that did not conform with Fannie Mae and Freddie Mac guidelines grew from around $670 billion in 2004 to over $2 trillion in 2006.

42. Such an enormous rise in mortgage volume over a short period of time created problems with loan funding capital and risk allocation. As the FCIC put it: "[U]nder the radar,

the lending and financial services industry had mutated." (FCIC Report at 7.) It found that "[s]ecuritization and subprime origination grew hand in hand," as "[t]he nonprime mortgage securitization process created a pipeline through which risky mortgages were conveyed and sold throughout the financial system. The pipeline was essential to the origination of the burgeoning numbers of high-risk mortgages." (FCIC Report at 70, 125.)

43. In other words, the shift away from non-traditional loans sparked a growing focus on the "originate and distribute" model. What has now become clear is that the risk of non-payment was transferred to investors, and the only remaining incentive for originators, underwriters, and others in the securitization chain was to pump out as many loans as possible, the more exotic (and thus the more lucrative), the better – as long as they could be sold. Originators and securitizers were willing to abandon sound underwriting practices because they routinely offloaded the risk onto investors like Allstate by misrepresenting the resulting loans to ensure their marketability. As the FCIC concluded: "The originate-to-distribute model undermined responsibility and accountability for the long-term viability of the mortgages and mortgage-related securities and contributed to the poor quality of mortgage loans." (FCIC Report at 125.)

44. The underwriters of the offerings and originators of the underlying mortgage loans make large amounts of money from the fees and other transaction revenues that are connected with their efforts in creating and selling mortgage-backed securities. Although these fees and revenues are often stated in terms of "basis points" (each of which is only 1/100 of 1%), a few basis points can amount to millions of dollars in the context of large transactions. In this connection, from 2000 through 2008, Wall Street banks had learned that they could earn much more from originating and selling the products of securitizations than they could make by simply

making loans and selling them. They found that the origination and sale of mortgage-backed securities was a goldmine for the entities that were able to control a significant share of the market for mortgage-backed securities.

45. Because the underlying loans were on non-traditional terms, banks could offer investors higher rates of return on the securitized pools, even as the deal's structure (such as, for instance, including "extra" mortgage loans in the collateral pool) purportedly made the investments safe. Unknown to investors like Allstate, however, the securities were much riskier than disclosed because Defendants misrepresented many aspects of the mortgage loans.

46. For instance, Defendants (a) overstated how many loans were owner-occupied (owner-occupied properties have lower risks), (b) understated the loan pools' average loan-to-value ratios (suggesting the borrowers had more of an equity "cushion" than they did), (c) misrepresented their abandonment of standard underwriting practices, (d) misrepresented the amount of verification of the borrower's assets and income that had been done (understating the risk that the borrower could not actually afford the monthly payments), (e) failed to disclose that they were pushing exotic loans on borrowers who did not understand or need them, and (f) omitted to inform investors such as Allstate that high numbers of defective loans were "waived" into the mortgage pools by the underwriters (making representations regarding the quality of the underwriting process even more misleading).

47. Each misrepresentation and omission created an additional, hidden layer of risk well beyond that known to be associated with an "adjustable rate mortgage" or a "home equity loan" in the abstract. Since the payment streams from borrowers ultimately fund payments to investors, if enough loans in the pool default, investors will not be paid the interest returns promised and may even lose their principal. The market value of the certificates also decreases

as the perceived risk of the underlying mortgage pool increases. As such, any representation bearing on the riskiness of the underlying mortgage loans was material to investors, including Allstate. In short, by misrepresenting the true risk profile of the underlying loan pools, Defendants defrauded investors like Allstate into accepting the risks created by their shoddy lending and underwriting practices.

D. The Defendants Were an Integrated Vertical Operation Controlling Every Aspect of the Securitization Process

48. The Defendants and their affiliates controlled, and thus had actual knowledge of or were reckless as to the truth about, every aspect of the securitization process, from loan origination through sale to Allstate. Defendants controlled and/or facilitated every aspect of originating and servicing the underlying Mortgage Loans, providing them with unique and special knowledge regarding the characteristics of the Mortgage Loans and the quality of the underwriting and servicing practices. The Defendants also acquired and pooled the mortgage loans, created the securities, and marketed and sold the Certificates at issue using purported disclosures that were wrongful and fraudulent.

49. Many of the Mortgage Loans were originated or acquired by the Defendants' affiliates. Six of the seven deals at issue contained a significant number of loans originated by DLJ Mortgage Capital and/or Credit Suisse Financial (as can be seen on the chart below). According to the Offering Materials, such affiliated originators were often the single largest source of Mortgage Loans. The other Certificates were backed by loans originated by nonbank mortgage lenders that received substantial lines of credit from Credit Suisse (the so-called "warehouse lender") to finance the loan origination. These mortgage lenders then sold defendant the loans shortly after origination to repay the line of credit. Some of the originators that were identified are included below:

Transaction	Originator(s)	% of Origination/ Acquisition
ARMT 2005-6A, A22	DLJ Mortgage Capital, Inc.	100%
ARMT 2007-1, 5A4	DLJ Mortgage Capital, Inc.	24.60% (Groups 1-4) 32.74% (Group 5)
	Countrywide Home Loans Inc.	20.94% (Groups 1-4)
	Credit Suisse Financial Corp.	12.59% (Group 1-4) 35.80% (Group 5)
CSMC 2006-8, 3A1	DLJ Mortgage Capital, Inc.	31.36%
	Countrywide Home Loans Inc.	25.15%
CSMC 2007-3, 4A6	Countrywide Home Loans, Inc.	33.69% (Group 1) 53.00% (Groups 2-4)
	DLJ Mortgage Capital, Inc.	26.92% (Group 1) 10.56% (Groups 2-4)
	Credit Suisse Financial Corp.	13.80% (Group 1)
CSMC 2007-5, 1A10	DLJ Mortgage Capital, Inc.	39.89% (Group 1)
	Countrywide Home Loans, Inc.	12.95% (Group 1)
HEMT 2006-2, 1A1 & 2A1	Credit Suisse Financial Corp.	11.43% (Group 1)
ABSC 2006-HE5, A1	Option One Mortgage Corp.	100%

50. Defendants or their affiliates acted as the sponsor, seller, and servicer for the loans underlying the securities. DLJ Mortgage Capital was sponsor or seller (or both) for all the Certificates. Defendants first obtained the Mortgage Loans from originators or sellers, including from its affiliates, as described above. Defendants then pooled the Mortgage Loans in the securitizations and sold, transferred, or otherwise conveyed title to those loans to the Depositor pursuant to Pooling and Servicing Agreements, which are governed by New York law. The Pooling and Servicing Agreements also established Defendants or their affiliates as servicer or special servicer of nearly all the Mortgage Loans underlying each security. SPS acted as servicer for certain of the loans securitized in ARMT 2005-6A, ARMT 2007-1, CSMC 2007-3, CSMC 2007-5, and HEMT 2005-5.

51. Credit Suisse Securities (USA), LLC or its predecessor, Credit Suisse First Boston LLC, was the underwriter for all of the securities marketed and sold to Allstate. In that

role, it had responsibility for underwriting and managing the securitizations' sale of Certificates to Allstate and other investors, including screening the Mortgage Loans for compliance with the Defendants' underwriting guidelines. Indeed, because of its position as owner or warehouse lender to the loan originators, Defendants were in a unique position to know the precise nature of the underwriting being done, and the actual level of risk presented by the particular loans that were being included in the various loan pools for the securities.

52. Credit Suisse First Boston Mortgage Securities Corp. and Asset Backed Securities Corp. were the Depositors for the offerings. The Depositors purchased the Mortgage Loans, including large amounts of the Mortgage Loans from Defendants' affiliates, pursuant to the Pooling and Servicing Agreements, which are governed by New York law. The depositor then sold, transferred, or otherwise conveyed the Mortgage Loans to the Trustees, which held the Mortgage Loans in the Trusts for the benefit of Allstate and other Certificate holders. The depositor then issued the Certificates, which represent interests in the Mortgage Loans held by the trusts, to Allstate and other investors. The depositor, the sponsor/seller and underwriter marketed and sold the Certificates to investors such as Allstate.

53. Defendants' involvement in and control over each aspect of the securitization process provided them with unique and special knowledge and expertise regarding the application of any purported standards or procedures for originating, acquiring, underwriting, and servicing the Mortgage Loans, as well as the loan characteristics of the loan pools securing each Certificate at issue.

ALLEGATIONS REGARDING PARTICULAR CERTIFICATES

I. THE OFFERING MATERIALS CONTAINED UNTRUE STATEMENTS OF MATERIAL FACT AND OMISSIONS ABOUT THE MORTGAGE ORIGINATORS' UNDERWRITING STANDARDS AND PRACTICES, AND MATERIAL CHARACTERISTICS OF THE MORTGAGE LOAN POOLS

A. Defendants' Misrepresentations Regarding Underwriting Standards and Practices

54. The Offering Materials associated with each of Allstate's Certificates describe underwriting guidelines purportedly employed by the lenders or underwriters to evaluate the loans. The stated goal of the guidelines was "to evaluate the borrower's credit standing and repayment ability and/or the value and adequacy of the related property as collateral." (CSMC Prospectus dated August 28, 2006, at 30.)

55. The underwriting process used to originate the pools of mortgage loans underlying Allstate's Certificates was material to Allstate because, as discussed above, the quality of loans in the pool determines the risk of the certificates backed by those loans. If a reasonable underwriting process was not actually followed, the chances that the loans had riskier features than Defendants claimed would greatly increase, making the entire loan pool much riskier. A systemic underwriting failure would decrease the reliability of *all* the information investors have about the loans, and thus would significantly increase the perceived and actual risk to investors while materially decreasing the value of the Certificates.

56. The Offering Materials all represented that the Mortgage Loans had been originated according to a consistent underwriting program. For example, the Offering Materials for ARMT 2007-1 stated: "The mortgage loans were originated or acquired generally in accordance with the underwriting guidelines described in this prospectus supplement."

57. The Offering Materials also represented the underwriting process followed by the initial originators in granting the loans. For example, the Prospectus Supplements for ARMT 2007-1 and CSMC 2006-8, both of which had many loans generated by Countrywide, state:

> Countrywide Home Loans' underwriting standards are applied in accordance with applicable federal and state laws and regulations. As part of its evaluation of potential borrowers, Countrywide Home Loans generally requires a description of income. . . . Self-employed prospective borrowers generally are required to submit relevant portions of their federal tax returns for the past two years . . .
>
> Countrywide Home Loans' underwriting standards are applied by or on behalf of Countrywide Home Loans to evaluate the prospective borrower's credit standing and repayment ability and the value and adequacy of the mortgaged property as collateral. Under those standards, a prospective borrower must generally demonstrate that the ratio of the borrower's monthly housing expenses (including principal and interest on the proposed mortgage loan and, as applicable, the related monthly portion of property taxes, hazard insurance and mortgage insurance) to the borrower's monthly gross income and the ratio of total monthly debt to the monthly gross income (the "debt-to-income" ratios) are within acceptable limits . . . . In addition to meeting the debt-to-income ratio guidelines, each prospective borrower is required to have sufficient cash resources to pay the down payment and closing costs. Exceptions to Countrywide Home Loans' underwriting guidelines may be made if compensating factors are demonstrated by a prospective borrower.

58. The Offering Materials for these offerings also represent that Countrywide required and relied upon independent, industry-standard appraisals to determine the adequacy of the underlying collateral:

> Except with respect to the mortgage loans originated pursuant to its Streamlined Documentation Program, whose values were confirmed with a Fannie Mae proprietary automated valuation model, Countrywide Home Loans obtains appraisals from independent appraisers or appraisal services for properties that are to secure mortgage loans. The appraisers inspect and appraise the proposed mortgaged property and verify that the property is in acceptable condition. Following each appraisal, the appraiser prepares a report which includes a market data analysis based on

> recent sales of comparable homes in the area and, when deemed appropriate, a replacement cost analysis based on the current cost of constructing a similar home. All appraisals are required to conform to Fannie Mae or Freddie Mac appraisal standards then in effect.

59. The Offering Materials for each Certificate contain substantially similar, if not identical, statements of material fact concerning the underwriting standards and practices that were applied to the Mortgage Loans. These statements are excerpted in Exhibits C-K.

60. These representations were false. The mortgage loans underlying Allstate's Certificates did not comply with the underwriting standards the Offering Materials described because those standards were systemically ignored. In originating or acquiring the loans, the originators – including DLJ Mortgage Capital, CSFC, and Countrywide – ignored borrowers' actual repayment ability and the value and adequacy of mortgaged property that was used as collateral. Systematic, bulk exceptions to underwriting standards were granted without proper compensating factors. Defendants intentionally failed to inform investors that they were systematically abusing the "exceptions" process in order to further circumvent their purported underwriting standards.

61. That the loans were systematically generated without regard to the stated underwriting guidelines is confirmed by Allstate's loan-level analysis of the Mortgage Loans at issue here, statistics regarding the Defendants' "waiver" of guidelines made public by the FCIC's investigation, the collateral pool's sudden and dismal performance, a review of the Defendants' loan files by their own insurer, and other facts set forth more fully below.

B. <u>Defendants' Misrepresentations Regarding Due Diligence Results</u>

62. Defendants' representations regarding the underwriting process would be understood by any reasonable investor, including Allstate, to mean that non-compliant loans would not be included in the mortgage pools. Indeed, Defendants' underwriting disclosures

would be pointless if read to mean only that the some (but not all) of a pool of loans met the given standards, but the Defendants approved all the loans together for securitization, including those that failed the applicable standards.

63. The Defendants, however, did not disclose that: (1) many of the loan pools were subject to review by Defendants and/or third-party due diligence firms; (2) Defendants were informed from those loan-level review processes that a substantial percentage of loans in the collateral pools were defective; (3) the Defendants nonetheless had waived the defects as to a substantial percentage of these loans; (4) the Defendants had instead used the due diligence reports to negotiate a lower price for the loan pools, while retaining the toxic loans for inclusion in the loan pools; and (5) Defendants improperly failed to adjust their investigations (such as by increasing their sampling size or refusing to continue to work with problem originators) given the high number of non-conforming loans the due diligence process had in fact identified.

64. That Defendants were including loans that their due diligence procedures had flagged as being defective has been confirmed by the recent release of documents from the Defendants' third-party underwriter, Clayton Holdings, and other facts set forth below.

65. Defendants' failure to disclose that high numbers of loans had been rejected by the due diligence process, and yet "waived" into the collateral pools anyway, was a fraudulent omission, and rendered the underwriting disclosures even more misleading.

C. Defendants' Misrepresentations Regarding Owner-Occupancy Statistics

66. Owner-occupancy statistics were material to Allstate because high owner-occupancy rates should have made the Certificates safer investments than certificates backed by second homes or investment properties. Homeowners who reside in mortgaged properties are less likely to default than owners who purchase homes as investments or vacation homes.

67. The Offering Materials for each Certificate contain detailed statistics regarding the mortgage loans in the collateral pools, including their reported owner-occupancy characteristics. For example, in the Offering Materials for CSMC 2007-5, it was claimed that of the 2,351 mortgage loans in the relevant sub-pool backing Allstate's certificates, 1,956 were purportedly secured by owner-occupied properties. Likewise, the Offering Materials for TBW 2006-4 represent that 1,377 out of the 1,738 loans in the aggregate pool were secured by the borrower's primary residence. These statistical representations of fact are further excerpted in Exhibits C-K.

68. These representations were false. In truth, a much lower percentage of the loans were owner-occupied. Occupancy was being misrepresented first to get the borrower approved for the loan, then being misrepresented to investors to get the loan sold. This is confirmed not only by industry statistics showing widespread fraud in this area, but by a loan-level analysis of the specific Mortgage Loans at issue here, and other facts set forth below.

D. Defendants' Misrepresentations Regarding Loan-to-Value and Combined Loan-to-Value Ratios

69. The loan-to-value ("LTV") ratio is the ratio of a mortgage loan's original principal balance to the appraised value of the mortgaged property. The related Combined LTV ("CLTV") takes into account other liens on the property (such as "second" mortgage and home equity loans). These ratios were material to Allstate and other investors because higher ratios are correlated with a higher risk of default. A borrower with a small equity position in a property has less to lose if he or she defaults on the loan. There is also a greater likelihood that a foreclosure will result in a loss for the lender if the borrower fully leveraged the property. These are common metrics for analysts and investors to evaluate the price and risk of mortgage-backed securities.

70. The Offering Materials for each Certificate contain detailed statistics regarding these ratios for the mortgage loans in the relevant collateral pools. The Offering Materials for each Certificate contain the same type of factual representations concerning the LTV and CLTV ratios of the underlying mortgage pools. For example, the Offering Materials for TBW 2006-4 represent that the weighted-average LTV ratio at origination of the aggregate loan pool backing Allstate's Certificates was 77.53%. And the Offering Materials for ARMT 2007-1 represented that no loans had a LTV ratio greater than 100%. These representations are excerpted in Exhibits C-K.

71. These representations were false. The underlying data was being manipulated in order to get loans approved, making the LTV and CLTV ratios baseless. Defendants did not genuinely believe the appraisal values used in these statistics because they knew that the property values were being artificially inflated in order to increase the amount of money that could be given to a borrower. The Defendants had access to detailed information about the borrowers and about all the loans the borrowers were receiving. The CLTV ratios also omitted the effect of additional liens on the underlying properties, rendering them even further from the truth. Defendants also misleadingly omitted that the disclosed statistics were baseless and that the appraisers were systematically pressured to inflate their appraisals. Thus, Defendants knew that the LTV and CLTV ratios were false. This is confirmed not only by testimony showing widespread appraisal fraud, but by a loan-level analysis of the specific Mortgage Loans at issue here, and other facts set forth below.

E. Defendants' Misrepresentations Regarding the Sufficiency of the Borrower's Income

72. The ratio of a borrower's debt to his or her income was material to Allstate because it represents a borrower's ability to afford the mortgage payments at issue, and thus implicates the likelihood of default.

73. The Offering Materials for CSMC 2007-3 represent that: (a) mortgagors were generally required to furnish information regarding "assets, liabilities, income (except as described below), credit history, employment history and personal information, and furnished an authorization to apply for a credit report which summarizes the mortgagor's credit history with local merchants and lenders and any record of bankruptcy"; and (b) based on all of this data, it was purportedly determined "whether the prospective mortgagor has sufficient monthly income available to meet the prospective mortgagor's monthly obligations on the proposed loan and other expenses related to the residence, such as property taxes, hazard and primary mortgage insurance and, if applicable, maintenance, and other financial obligations and monthly living expenses." The Offering Materials for each Certificate contain the same type of factual representations concerning the underwriter's evaluation of the prospective borrower's ability to repay a mortgage loan, and debt-to-income ratios in the underlying loan pool. These representations are excerpted in Exhibits C-K.

74. These representations were false. The abandonment of sound underwriting practices facilitated the widespread falsification of these statistics within the Offering Materials. This abandonment is evidenced by all the facts set forth below, including Allstate's statistical analysis into the loans at issue here, and a review of Defendants' loan files conducted by their own insurer. In reality, the borrowers' claimed income was regularly inflated, such that the true debt-to-income ratios were materially higher than they were represented to be.

75. Defendants knew that the borrower income information was unreliable, through its loan-level review process and its close (and often intimate) relationship with the loan originators. Defendants also knew that employment history and other reliable methods of confirming income were being systematically ignored. They knew this because the loan files consistently were without any confirmation whatsoever with respect to borrower income.

F. <u>Defendants' Misrepresentations Regarding Credit Ratings</u>

76. Each tranche of the Allstate Certificates received a credit rating indicating the rating agencies' view of its risk profile. The initial ratings given to the Certificates were generally AAA, or the highest available investment rating. The ratings were material to reasonable investors, including Allstate, because the ratings provided additional assurances that investors would receive the expected interest and principal payments. The Certificates would have been unmarketable to investors like Allstate and would not have been issued but for the provision of these ratings, as almost every prospectus stated that it was "a condition to the issuance of the offered certificates" that they receive certain, specified ratings from the rating agencies. (*See, e.g.*, CSMC 2007-5 Prospectus Supplement dated July 31, 2007, at S-151.)

77. The Offering Materials represented that the rating agencies conducted an analysis designed to assess the likelihood of delinquencies and defaults in the underlying mortgage pools and issued ratings accordingly. For example, the Offering Materials for ARMT 2005-6A represent:

> The ratings on mortgage pass-through certificates address the likelihood of the receipt by certificateholders of all distributions on the underlying mortgage loans to which such certificateholders are entitled. The rating process addresses the structural and legal aspects associated with such certificates, including the nature of the underlying mortgage loans.

78. Each prospectus supplement also provides the ratings for each class of certificate issued, based on ratings analyses done by two or three ratings agencies.

79. The Offering Materials for each Certificate contain the same type of factual representations concerning the rating agencies' evaluation of the Certificates and the significance of the ratings assigned by them. These representations are excerpted in Exhibits C-K.

80. These representations were false. The ratings given to the Certificates by the major credit rating agencies were based on the loan profiles fed to the agencies by Defendants. But as above and expounded upon below, most (if not all) of the key components of that data were false. As such, Defendants essentially pre-determined the ratings by "feeding garbage" into the ratings system. This rendered misleading Defendants' representations concerning the ratings and their significance, because Defendants failed to disclose that the ratings would be based entirely on unreliable information provided by Defendants themselves, and therefore would not reflect the true credit risk associated with the Certificates.

81. Indeed, the allegations of fraud that have surrounded Defendants' conduct at issue here have received the attention of the government. According to a May 13, 2010 *Reuters* news article, the New York Attorney General is conducting "an investigation into whether eight banks, including [Credit Suisse], misled rating agencies with regard to mortgage-derivative deals."

82. As set forth in Section II, the credit ratings of the offerings at issue have plummeted as the true quality of the collateral pools and the true nature of Defendants' misconduct have been revealed, and as the ratings agencies have obtained more accurate information regarding the offerings at issue.

G. <u>Defendants' Misrepresentations Regarding Credit Enhancements</u>

83. Credit enhancement represents the amount of "cushion" or protection from loss exhibited by a given security. This cushion is intended to improve the likelihood that holders of

highly-rated certificates receive the interest and principal they expect. The level of credit enhancement offered is based on the make-up of the loans in the underlying collateral pool. Riskier pools necessarily need higher levels of credit enhancement to ensure payment to senior certificate holders. Credit enhancements for a given trust also impact the overall credit rating a given tranche of certificates receives. The level of credit enhancement for the Certificates was material to Allstate because it represented the protection purportedly afforded from loss.

84. The Offering Materials for each of the Certificates describe the credit enhancements applicable to the certificates. For example, the Offering Materials for TBW 2006-4 represented that "[f]ive classes of subordinate certificates, which provide credit enhancement for the senior certificates and each class of subordinate certificates" would be issued, and that "[t]his subordination is intended to enhance the likelihood of regular receipt by holders of Certificates having a higher priority of payment of the full amount of interest and principal distributable thereon."

85. The Offering Materials for each Certificate contain substantially similar, if not identical, statements of material fact concerning the protection afforded by credit enhancements. These statements are excerpted in Exhibits C-K.

86. The representations regarding the purported credit enhancements were untrue and misleading. All of the purported "enhancements" depended on or derived from the false representations regarding the quality of the Mortgage Loans underlying the Certificates. Highly risky, misrepresented loans piled on top of other highly risky, misrepresented loans is not a true "enhancement."

H. Defendants' Misrepresentations Regarding Underwriting Exceptions

87. Whether Defendants and those from which Defendants were purchasing their loans were making case-by-case (rather than bulk) exceptions to the otherwise-applicable

underwriting guidelines was material to Allstate. A disclosed guideline is irrelevant – and indeed misleading – from a risk-analysis perspective if large numbers of loans were peremptorily excused from those guidelines.

88. Defendants represented that they and those making the loans being included in their loan pools made case-by-case exceptions to the disclosed underwriting standards based on compensating factors that increased the quality of the loan application. For example, the Offering Materials for CSMC 2007-3 represent: "Certain exceptions to the underwriting standards described herein are made in the event that compensating factors are demonstrated by a prospective borrower." Similarly, the Offering Materials state that "[e]xceptions to Countrywide Home Loans' underwriting guidelines may be made if compensating factors are demonstrated by a prospective borrower."

89. The Offering Materials for each Certificate contain the same type of factual representations concerning the use of underwriting exceptions, used on a case-by-case basis, to originate the underlying loans in the mortgage pools. These representations are excerpted in Exhibits C-K.

90. These representations were false and misleading because loans had been granted outside of the stated guidelines, without regard to whether there were any purported "countervailing features" justifying a lending or underwriting exception. This is evidenced by, among other things, the high number of Credit Suisse loans identified by the third-party due diligence firm Clayton Holdings that both failed the given underwriting guidelines and that did not show any "countervailing features." It is also confirmed by a review of Defendants' own loan files, conducted by their own insurer, and other facts set forth below.

II. EVIDENCE THAT ALL OF DEFENDANTS' REPRESENTATIONS WERE UNTRUE AND MISLEADING

A. High Default Rates and Plummeting Credit Ratings Themselves Evidence the Loans Were Not Properly Underwritten

91. The drastic rise in default rates on the mortgage loans underlying Allstate's Certificates is cogent evidence of faulty underwriting. The Certificates were supposed to be long-term, stable investments, yet they have already experienced payment problems significantly beyond what was expected for loan pools that were properly underwritten and which contained loans that actually had the characteristics Defendants' Offering Materials claim. For instance, **31% of the loans in the collateral pool for HEMT 2006-2 have already been written off for a loss**. Similarly, **30% of the loans for ARMT 2007-1, and 29% of the loans for HEMT 2005-5 have already been written off for a loss**.

92. The data also shows that these high rates of loans that require being written off at a loss will continue to skyrocket. The following chart sets forth how many of what loans still remain in the pool are themselves delinquent in their payments:

Transaction	Percent of Remaining Pool Currently Delinquent
ARMT 2005-6A	41.20%
ARMT 2007-1	43.03%
CSMC 2006-8	18.45%
CSMC 2007-3	29.92%
CSMC 2007-5	24.14%
HEMT 2005-5	19.31%
HEMT 2006-2	17.84%
TBW 2006-4	47.79%

93. Not only have Allstate's Certificates experienced extraordinary rates of delinquency, their ratings have significantly deteriorated. Most of Allstate's Certificates initially received the highest possible ratings – S&P's AAA rating or its equivalent from the other rating

agencies. According to S&P's website: "An obligation rated 'AAA' has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is extremely strong." Moody's similarly describes its highest rating, Aaa, as meaning that the investment is "judged to be of the highest quality, with minimal credit risk." This is the same rating typically given to bonds backed by the full faith and credit of the U.S. government, such as treasury bills. Historically, an AAA-rated security had an expected loss rate of less than 0.05%.

94. Because of the systemic abandonment of underwriting standards and the resulting inclusion of toxic, highly risky Mortgage Loans in the collateral pool backing the Certificates, the majority of Allstate's Certificates have been downgraded from the highest possible ratings to "junk-bond" ratings. Any instrument rated lower than BBB (or Baa for ratings provided by Moody's) is considered below investment-grade or a junk bond.

95. Currently, **all but one** of the Certificates are rated as non-investment grade by at least two of the three ratings agencies which originally provided their ratings. Indeed, **all** of the Certificates have fallen to "junk-bond" status according to at least one rating agency. Significant downgrades on these Certificates did not take place until mid-2008 or later.

96. As above, the mortgage loans underlying Allstate's Certificates have experienced unprecedented rates of delinquencies and defaults. Other studies have corroborated this result, and confirmed the common-sense conclusion that this type of performance is itself evidence of underwriting abandonment.

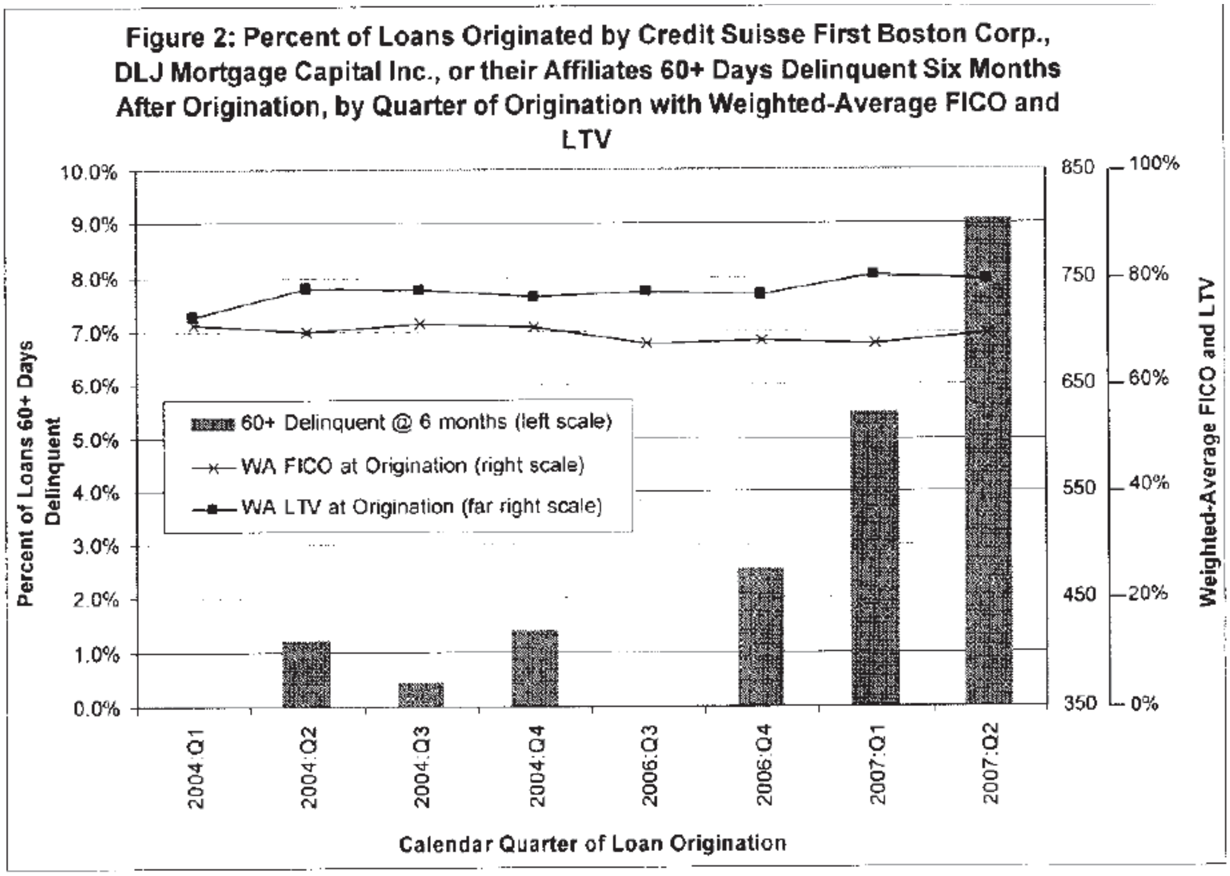
97. Defaults are usually caused by a large and unexpected disruption to a borrower's income. In a properly-underwritten pool of loans, one would not expect to see a large spike of defaults occurring shortly after origination, because it is unlikely that many borrowers would all

incur a sudden and unexpected change to their payment ability so soon after purchasing a home. However, when borrowers are put in loan products they cannot actually afford, they quickly and predictably fall behind on their payments.

98. In an extensive empirical study of mortgage loans made and sold into securitizations during this period, economists at the University of Michigan and elsewhere found that the high rates of delinquency and default were not caused primarily by a deterioration in credit characteristics of the loans that were expressly embodied in underwriting standards and disclosed to investors. Instead, the study found that the high rates in delinquency were caused by deterioration in credit characteristics that were not disclosed to investors.

99. Similarly, a study conducted by the F.B.I. has also linked the rate of delinquencies to widespread misrepresentations in the underwriting of loans. The F.B.I. investigated three million residential mortgages, and found that between 30% and 70% of early payment defaults were linked to significant misrepresentations in the original loan applications. Loans containing egregious misrepresentations were **five times** more likely to default in the first six months than loans that did not.

100. These studies have found that the number of loans relating to Credit Suisse First Boston Corp., DLJ Mortgage Capital, or their affiliates that suffered from a particular performance problem – 60 or more days delinquent as of six months after origination – skyrocketed beginning in mid-2006, *i.e.*, around the time many of the mortgage loans at issue here were being originated and securitized. The data also shows that this drastic change did not occur because of a change in the claimed FICO or LTV scores:



101. The fact that studies conducted by others show a spike in early payment problems in Defendants' loans, despite the fact that key characteristics of the loan pools were supposedly not changing, is powerful evidence that the Defendants were systematically abandoning their underwriting standards in purchasing, creating, and characterizing those loans, while representing that the risk characteristics had not changed.

102. As above, Allstate's analysis shows the Mortgage Loans at issue here have experienced similarly dismal performance. These studies confirm that this performance is strong evidence that they were improperly underwritten, and that they did not have the credit risk characteristics that were claimed in Defendants' Offering Materials. The defaults and related drop in value thus are due to Defendants' wrongdoing, and not because of the general change in economic conditions.

B. <u>Loan-Level Evidence that Borrowers Did Not Actually Occupy the Mortgaged Properties as Represented</u>

103. According to a January 2011 *Business Week* report, loan files often misrepresented the owner-occupancy status of the mortgaged properties. The study, which looked at a loan's history for 16 months before labeling it "misreported," found that 23% of mortgages that were securitized as being "owner occupied" were either never moved into or were quickly vacated by the borrower.

104. Allstate need not rely purely on such industry-wide studies to support its allegation that the Mortgage Loans here were misrepresented, however. Using techniques and methodologies that only recently became available, Allstate conducted loan-level analyses on more than eleven thousand mortgage loans underlying its Certificates, across eight of the offerings at issue to test the Defendants' representations on a loan-level basis.

105. For each offering, Allstate attempted to analyze 800 defaulted loans and 800 randomly-sampled loans from within the collateral pool. This sample size is more than sufficient to provide statistically-significant data to demonstrate the degree of misrepresentation of the Mortgage Loans' characteristics. Analyzing data for each Mortgage Loan in each Offering would have been cost-prohibitive and unnecessary. Statistical sampling is an accepted method of establishing reliable conclusions about broader data sets, and is routinely used by courts, government agencies, and private businesses. As the size of a sample increases, the reliability of its estimations of the total population's characteristics increase as well. Experts in RMBS cases have found that a sample size of just 400 loans can provide statistically significant data, regardless of the size of the actual loan pool, because it is unlikely that so large a sample would yield results vastly different from results for the entire population.

106. To determine whether a given borrower actually occupied the property as claimed, Allstate investigated tax information for the sampled loans. One would expect that a borrower residing at a property would have the tax bills sent to that address, and would take all applicable tax exemptions available to residents of that property. If a borrower had his or her tax records sent to another address, that is good evidence that that borrower was not actually residing at the mortgaged property. If a borrower declined to make certain tax exemption elections that depend on the borrower living at the property, that also is strong evidence the borrower was living elsewhere.

107. A review of credit records was also conducted. One would expect that people have bills sent to their primary address. If a borrower was telling creditors to send bills to another address, even six months after buying the property, it is good evidence the borrower was living elsewhere.

108. A review of property records was also conducted. It is less likely that a borrower lives in any one property if in fact that borrower owns multiple properties. It is even less likely the borrower resides at the mortgaged property if a concurrently-owned separate property did not have its own tax bills sent to the property included in the mortgage pool.

109. A review of other lien records was also conducted. If the property was subject to additional liens but those materials were sent elsewhere, that is good evidence the borrower was not living at the mortgaged property. If the other lien involved a conflicting declaration of residency, that too would be good evidence that the borrower did not live in the subject property.

110. The results of Allstate's loan-level analysis of true owner-occupancy rates on the Mortgage Loans underlying its Certificates are set forth below and are further detailed in Exhibits C-K. Failing multiple of the above tests is strong evidence the borrower did not in fact

reside at the mortgaged properties. These statistics thus show that, despite the Defendants' representations, a much higher percentage of borrowers did not occupy the mortgaged properties:

Asset	Percentage of Owner-Occupied Properties in Prospectus	Actual Percentage of Owner-Occupied Properties	Prospectus Overstatement
ARMT 2005-6A	67.3%	55.3%	12.07%
ARMT 2007-1	75.2%	60.3%	14.88%
CSMC 2006-8	77.9%	65.0%	12.85%
CSMC 2007-3	76.5%	64.1%	12.38%
CSMC 2007-5	73.7%	62.8%	10.91%
HEMT 2005-5	87.2%	76.0%	11.15%
HEMT 2006-2	87.1%	77.5%	9.61%
TBW 2006-4	79.2%	60.3%	14.88%

111. The facts alleged in this Complaint show the Defendants' problems were systemic, and such is confirmed by the consistency of the results set forth above. Allstate tested thousands of Defendants' loans, across multiple offerings. The transaction that was not tested, ABSC 2006-HE5, involved primarily the same parties and nearly identical disclosures; moreover, both the underlying loans and the certificates themselves were generated around the same time according to the same purported processes. As such, on information and belief, the Offering Materials for the offering that Allstate was not yet able to test on a loan-level basis also misrepresented the owner-occupancy information at approximately the same material rate as seen in the large sample of Certificates discussed above.

C. Loan-Level, Independent Evidence that the Loan-to-Value and Combined Loan-to-Value Ratios Were Misstated

112. Using techniques and methodologies that only recently became available, Allstate had a sample of the property underlying eight of the offerings at issue valued by an industry-standard automated valuation model ("AVM"). AVMs are routinely used in the industry, at the present time (as they were not available for use during the time when Allstate

was making its investments), as a way of valuing properties during prequalification, origination, portfolio review, and servicing. AVMs have become so ubiquitous that their testing and use is specifically outlined in regulatory guidance, and is discussed in the Dodd-Frank Act. AVMs rely upon similar data as appraisers – primarily county assessor records, tax rolls, and data on comparable properties. AVMs produce independent, statistically-derived valuation estimates by applying modeling techniques to this data. The AVM that Allstate used incorporates a database of 500 million mortgage transactions covering zip codes that represent more than 97% of the homes, occupied by more than 99% of the population, in the United States. Independent testing services have determined that this AVM is the most accurate of all such models.

113. The results of this analysis for each Certificate in the tested offerings is set forth in the Exhibits. Applying the AVM to the available data for the loans underlying these Certificates shows that the value used by the Defendants in the represented LTVs and CLTVs were materially and consistently inflated. This caused the disclosed ratios to be lower than they really were, i.e., the owners were represented to have more of an equity "cushion" than they really did.

114. The offerings had recalculated LTV ratios that were significantly higher than those represented in the Offering Materials. This overvaluation affected numerous statistics in the Offering Materials. For instance, the Offering Materials made representations about the percentage of loans that had LTV ratios of 80% or higher. However, the AVM indicates that a much higher percentage of the loans than represented had LTV ratios of 80% or higher, as shown in the chart below. (Two of the transactions tested, HEMT 2005-5 and HEMT 2006-2, only contained representations regarding CLTV ratios, and thus are discussed further below.)

Asset	Percentage of Loans Represented to Have LTVs of 80% or Greater	Actual Percentage of Loans With LTVs of 80% or Greater	Prospectus Understatement of Percent of Loans With High LTVs
ARMT 2005-6A	7.59%	52.82%	45.23%
ARMT 2007-1	4.56%	64.77%	60.21%
CSMC 2006-8	0.75%	37.73%	36.98%
CSMC 2007-3	10.12%	63.20%	53.08%
CSMC 2007-5	42.19%	75.20%	33.00%
TBW 2006-4	9.03%	70.04%	61.46%

115. The Offering Materials also represent that none of the mortgage loans in the subject loan pools had LTV ratios greater than 90%. LTV ratios in excess of 90% provide the lender little value cushion to protect against borrower default and loss upon foreclosure.

Asset	Percentage of Loans Represented to Have LTVs of 90% or Greater	Actual Percentage of Loans With LTVs of 90% or Greater	Prospectus Understatement of Percent of Loans With Very High LTVs
ARMT 2005-6A	1.90%	21.58%	19.68%
ARMT 2007-1	2.38%	32.65%	30.27%
CSMC 2006-8	0.27%	15.98%	15.71%
CSMC 2007-3	5.60%	35.50%	29.91%
CSMC 2007-5	27.59%	48.27%	20.67%
TBW 2006-4	4.26%	33.30%	29.04%

116. The Offering Materials also represent that there were **no** mortgage loans in the subject loan pools that had LTV ratios greater than 100%. Instead, Allstate's analysis found that a substantial number of the mortgage loans had LTV ratios greater than 100%. Indeed, one transaction actually had over **30%** of the underlying loans with an LTV ratio greater than 100%. An LTV ratio that is greater than 100% means the size of the loan is greater than the value of the property. (This is known as being "under water," where a borrower owes more on the property than it is worth.) Loans with an LTV ratio over 100% afford the lender no equity cushion and leave the lender with inadequate collateral from the outset of the loan. Despite Defendants' representations, Allstate's analysis found as follows:

Asset	Percentage of Loans Represented to Have LTVs Greater than 100%	Actual Percentage of Loans With LTVs Greater than 100%	Prospectus Understatement of Percent of Loans Already Underwater
ARMT 2005-6A	0.00%	8.16%	8.16%
ARMT 2007-1	0.00%	15.48%	15.48%
CSMC 2006-8	0.00%	8.24%	8.24%
CSMC 2007-3	0.00%	18.49%	18.49%
CSMC 2007-5	0.00%	31.51%	31.51%
TBW 2006-4	0.00%	14.81%	14.81%

117. Allstate also analyzed the weighted average LTV ratio of the mortgage loans in each pool and found that these too were overstated, as follows:

Asset	Represented Weighted Average LTV	Actual Weighted Average LTV	Prospectus Understatement
ARMT 2005-6A	74.66%	81.37%	6.71%
ARMT 2007-1	75.63%	87.34%	11.71%
CSMC 2006-8	66.33%	77.83%	11.50%
CSMC 2007-3	73.29%	86.44%	13.15%
CSMC 2007-5	82.66%	93.57	10.91%
TBW 2006-4	77.53%	89.18%	11.65%

118. Some Offering Materials included representations for the CLTV ratio as well as the LTV ratios. Others, particularly for those deals with a large number of second-lien loans, included *only* the CLTV statistics of the underlying loans. This is because those statistics should take into account the total value of the liens on the property. Again, like with the LTV statistics, these Offering Materials represent that there were **no** mortgage loans in the subject loan pools with CLTV ratios greater than 100%. Instead, Allstate's analysis found that these Offering Materials grossly misrepresented the number of loans that had CLTV ratios higher than 100%:

Asset	Percentage of Loans Represented to Have CLTVs Greater than 100%	Actual Percentage of Loans With CLTVs Greater than 100%	Prospectus Understatement of Percent of Loans Already Underwater
ARMT 2007-1	0.00%	46.62%	46.62%

Asset	Percentage of Loans Represented to Have CLTVs Greater than 100%	Actual Percentage of Loans With CLTVs Greater than 100%	Prospectus Understatement of Percent of Loans Already Underwater
HEMT 2005-5	0.00%	62.27%	62.27%
HEMT 2006-2	0.00%	65.92%	65.92%

119. Allstate also analyzed the weighted average CLTV ratio of the mortgage loans in these pools and found that these too were overstated, as follows:

Asset	Represented Weighted Average CLTV	Actual Weighted Average CLTV	Prospectus Understatement
HEMT 2005-5	95.52%	107.85%	12.33%
HEMT 2006-2	91.74%	108.84%	17.10%

(The Offering Materials for ARMT 2007-1 did not contain representations regarding the weighted-average CLTV.)

120. The facts alleged in this Complaint show the Defendants' problems were systemic, and such is confirmed by the consistency of the results set forth above. Allstate tested thousands of Defendants' loans, across multiple offerings. The transaction that was not tested, ABSC 2006-HE5, involved primarily the same parties and nearly identical disclosures; moreover, both the underlying loans and the certificates themselves were generated around the same time according to the same purported processes. As such, on information and belief, the Offering Materials for the offering that Allstate was not yet able to test on a loan-level basis also misrepresented these statistics at approximately the same material rate as seen in the large sample of Certificates discussed above.

D. <u>Documentary and Testimonial Evidence that Defendants' Due Diligence Flagged Many Problem Loans That Were "Waived In" Anyway</u>

121. The Defendants wore multiple hats in connection with the Offerings at issue here, acting in various capacities including sponsor and underwriter of the offered securities. In their

overlapping capacities, the Defendants were responsible for purchasing large blocks of mortgage loans from third-party originators, repackaging those loans into securities, and selling the newly-created securities to investors like Allstate. In addition, in some cases, Defendants provided the warehouse lines of credit for certain of their loan originators. As a lender, Defendants provided underwriting standards into their loan documentation and engaged in a careful review of the loans being made with their loan funds. Defendants were thus intimately aware of what was being done with their warehouse lines as to those loan originators who were borrowing from them.

122. In connection with their purchase of the Mortgage Loans from the loan originators, and consistent with industry practice, the Defendants performed due diligence to determine the quality of the loans they were purchasing.

123. Specifically, on information and belief, the Defendants operated quality assurance and risk management departments tasked with discovering whether the loans met the Defendants' own standards. Defendants conducted due diligence on the loans included in each offering to ensure compliance with Credit Suisse-created or approved underwriting guidelines. Defendants' analysis involved the individualized review of thousands of loans in each Mortgage Pool. To make this determination, the Defendants employed a team of underwriters who reviewed a sample of the purchased loans to confirm that they both conformed with the representations made by the originators and complied with the Defendants' own credit policies.

124. On information and belief, the Defendants' own due diligence revealed that a significant percentage of loans failed to meet the applicable underwriting standards, yet were included the securitization pools anyway. This is evidenced by the Defendants' actions when it happened to outsource its due diligence obligations, and other facts set forth herein.

125. Defendants sometimes relied on outside firms to conduct the requisite due diligence. One of the largest such firms is Clayton Holdings. As the FCIC put it (at 166): "Because of the volume of loans examined by Clayton during the housing boom, the firm had a unique inside view of the underwriting standards that originators were actually applying – and that securitizers were willing to accept."

126. For each loan pool they were hired to review, Clayton checked for: (1) adherence to seller-credit underwriting guidelines and client-risk tolerances; (2) compliance with federal, state and local regulatory laws; and (3) the integrity of electronic loan data provided by the seller to the prospective buyer. This review was commonly referred to as a "credit and compliance review." Contract underwriters reviewed the loan files, compared tape data with hard copy or scanned file data to verify loan information, identified discrepancies in key data points, and graded loans based on seller guidelines and client tolerances. This included answering such questions as whether the "loans meet the underwriting guidelines," "comply with federal and state laws, notably predatory-lending laws and truth-in-lending requirements," and "were the reported property values accurate." (FCIC Report at 166.) It also "critically" analyzed whether, to the extent a loan was deficient, there were any "compensating factors." (*Id.*)

127. Clayton generated regular reports for Defendants and the loan seller that summarized Clayton's review findings, including summaries of the loan files that were outside the relevant underwriting standards. Once Clayton identified such problems, the seller had the option to attempt to cure them by providing missing documentation or otherwise explaining to Clayton why a loan complied with the underwriting standards. If additional information was provided, Clayton re-graded the loan. Once this process was complete, Clayton provided the underwriters and sponsors with final reports.

128. Clayton gave loans one of three grades – Grade 3 loans "failed to meet guidelines and were not approved," while Grade 1 loans "met guidelines." Tellingly, only 54% of the nearly one-million loans reviewed by Clayton Holdings "met guidelines," a number that its former president admitted indicated "there [was] a quality control issue in the factory" for mortgage-backed securities.

129. Recently released internal Clayton documents show that, contrary to Defendants' representations, a startlingly high percentage of loans reviewed by Clayton for Credit Suisse were defective, but were nonetheless included by the Defendants in loan pools sold to Allstate and other investors. **According to an internal Clayton "Trending Report" made public in September 2010, Clayton found that 32% of the 56,300 loans that it reviewed for Defendants received the worst possible grade, i.e., they failed to conform to standards.**

130. With such a high failure rate, the proper response would be to reject the pool outright, and seriously investigate whether that originator could be considered a trusted source of loans in the future. Even assuming Defendants incredibly believed a 32% failure rate could be chalked up to 'sampling error' (due to the fact that Clayton Holdings did not review every loan in a pool), the proper response would be to increase the sample size to test that hypothesis.

131. Defendants did neither. They not only continued to work with problematic originators, but, rather than expanding the sample size to truly investigate the problems, they simply ignored the red flags Clayton's results showed. **According to Clayton's "Trending Report," Credit Suisse "waived in" to its pools one third of those toxic loans that Clayton had identified as being outside the guidelines.** Given the 32% failure rate to begin with, this waiver rate means that the data from that Defendants' own due diligence firm shows that

approximately 11% of the loans that actually made it into Defendants' collateral pools had seriously failed the applicable guidelines and were not subject to any compensating factors.

132. These numbers show that Defendants regularly securitized large numbers of defective, toxic loans, including in all of Defendants' offerings at issue here, contrary to Defendants' representations to investors like Allstate.

133. On information and belief, Defendants were similarly informed by its internal and third-party due diligence of the high number of problematic Mortgage Loans at issue here, and wrongfully waived high numbers of those loans into the loan pools underlying the mortgage-backed securities purchased by Allstate.

134. The hidden "waiver" of rejected loans that were not subject to any compensating factors was a fraudulent omission and rendered Defendants' disclosures regarding their underwriting and due diligence processes even more misleading. As the FCIC report concluded:

> [M]any prospectuses indicated that the loans in the pool either met guidelines outright or had compensating factors, even though Clayton's records show that only a portion of the loans were sampled, and that of those that were sampled, a substantial percentage of Grade 3 loans were waived in.
>
> . . . .
>
> [O]ne could reasonably expect [the untested loans] to have many of the same deficiencies, at the same rate, as the sampled loans. **Prospectuses for the ultimate investors in the mortgage-backed securities did not contain this information, or information on how few of the loans were reviewed, raising the question of whether the disclosures were materially misleading, in violation of the securities laws.**

(FCIC Report at 167, 170 (emphasis added).)

E. <u>A Review by the Defendants' Own Insurer Evidences the Mechanics and Breadth of Defendants' Abandonment</u>

135. MBIA Insurance Corporation ("MBIA") had access to some of the complete loan files for certain of Defendants' securitizations – including files from the same series of offerings at issue here, the HEMT shelf. Its analyses were made public only in December 2009. MBIA's findings demonstrate that the essential characteristics of the Mortgage Loans underlying the Certificates sold to Allstate were misrepresented, and that the problems in the Defendants' underwriting practices were systemic.

136. MBIA is a New York-based monoline insurer that wrote insurance on HEMT 2007-1. MBIA conducted an investigation into certain loan files after it was asked to make payments on its insurance policies. (Allstate, as an investor, does not have access to such files.) HEMT 2007-1 was serviced by SPS, the same servicer on many of Allstate's investments. DLJ Mortgage Capital, sponsor of HEMT 2007-1, was the seller, or sponsor of all the Certificates at issue here, and the originator for some as well. HEMT 2007-1 came from the same series of offerings as certain offerings at issue here, that is, MBIA analyzed HEMT 200**7-1**, while Allstate purchased certificates in HEMT 200**5-5** and HEMT 200**6-2**. For the offerings MBIA analyzed, the parties, type of collateral, structure, timing, and disclosures made all were substantially similar, if not identical, to those present here. MBIA's analysis is also probative of problems underlying Allstate's Certificates because the Defendants' problems were systemic.

137. In carrying out its review of the approximately 1,386 Credit Suisse defaulted loan files, MBIA found that **87% of the defaulted or delinquent loans in those securitizations contained breaches of DLJ Mortgage Capital's representations and warranties**. These findings demonstrated "a complete abandonment of applicable guidelines and prudent practices such that the loans were (i) made to numerous borrowers who were not eligible for the reduced

documentation loan programs through which their loans were made, and (ii) originated in a manner that systematically ignored the borrowers' inability to repay the loans." Moreover, "the rampant and obvious nature of the breaches confirms that Credit Suisse made intentional misrepresentations concerning its mortgage loans and the due diligence that Credit Suisse purported to perform regarding the quality of those loans."

138. Below is just a small sample of the problems MBIA found:

- pervasive violations of the originators' actual underwriting standards, and prudent and customary origination and underwriting practices, including (1) qualifying borrowers under reduced documentation programs who were ineligible for those programs; (ii) systemic failure to conduct the required income-reasonableness analysis for stated income loans, resulting in the rampant origination of loans to borrowers who made unreasonable claims as to their income and (iii) lending to borrowers with debt-to-income and loan-to-value ratios above the allowed maximums;

- rampant fraud, primarily involving misrepresentation of the borrowers income, assets, employment, or intent to occupy the property as the borrowers' residence (rather than as an investment), and subsequent failure to so occupy the property; and

- failure by the borrower to accurately disclose his or her liabilities including multiple other mortgage loans taken out to purchase additional investment property.

139. On information and belief, all of these findings apply to all of the Certificates at issue here. Because it is just an investor, Allstate does not currently have the same access to the loan files that the Defendants' insurer was given. However, MBIA's findings are consistent with, and confirmed by, Allstate's statistical analyses discussed above. Further, as above, for the offerings MBIA analyzed, the parties, structure, timing, and disclosures made all were substantially similar to those present here.

F. <u>Further Documentary and Testimonial Evidence That the Unaffiliated Originators Were Also Generating Loans Outside the Disclosed Underwriting Guidelines</u>

140. Many of the mortgage loans underlying Defendants' offerings at issue here were originated by Defendants' affiliates. However, other loans were originated by unaffiliated third-party lenders. Many were originated by Countrywide Home Loans, Inc. ("Countrywide") or Option One Mortgage Corp. ("Option One").

141. As discussed above the results of Allstate's loan-level analysis show significant deviations in important loan characteristics, such as owner-occupancy rates and LTV ratios, from the representations in the Offering Materials for each of Defendants' offerings. For each offering, including each offering that contained loans originated by third-party originators, Defendants greatly overstated the percentage of underlying loans that were secured by owner-occupied properties and vastly understated that LTV ratios of the loans in the mortgage pools. This uniform statistical deviation is, by itself, powerful evidence that the third-party originators of loans in Defendants' offerings failed to adhere to their stated underwriting guidelines.

142. Moreover, as noted above, the startling levels of loan defaults and delinquencies across all of Defendants' offerings provides further compelling evidence these third-party originators systemically deviated from their underwriting guidelines.

143. Recently uncovered documents, testimony, and analyses confirm that representations made about the third-party originators' adherence to underwriting standards were false, and that the third-party originators were infected by the same underwriting problems as Defendants' affiliated originators.

(1) Countrywide

144. Countrywide originated approximately 20.94% of the 1,514 mortgage loans in Groups 1-4 in the ARMT 2007-1 offering, 25.15% of the 1,468 mortgage loans in the CSMC

2006-8 offering, 33.69% of the 3,038 mortgage loan in Group 1 and 53.00% of the 1,168 mortgage loans in Groups 2-4 in the CSMC 2007-3 offering, and 20.36% of the 1,580 mortgage loans in Group 1 in the CSMC 2007-5 offering.

145. The Offering Materials contain material misstatements and omissions related to Countrywide's underwriting standards because, as described herein: (1) Countrywide systematically disregarded its underwriting standards and granted exceptions in the absence of compensating factors; and (2) appraisals on properties originated by Countrywide were routinely inflated because appraisers knew that if they appraised under certain levels they would not be hired again. Thus, the appraisals were inherently unreliable and there was little to support the value and adequacy of the mortgaged property.

146. During the relevant period, Countrywide was the single largest U.S. mortgage lender and one of the largest subprime lenders. Recent government investigations and their accompanying public release of internal documents have revealed Countrywide's widespread departure from its stated loan origination underwriting guidelines throughout the relevant period.

147. Countrywide's remarkable growth from 2003 to 2007 was fueled by its unbridled pursuit of increasing mortgage loan origination volume, regardless of borrowers' qualifications or ability to repay. During a conference call with analysts in 2003, co-founder Angelo Mozilo stated that his goal for Countrywide was to "dominate" the mortgage market and "to get our market share to the ultimate 30% by 2006, 2007." Accomplishing Mozilo's goal of a 30% market share required Countrywide to systematically depart from its credit risk and underwriting standards.

148. In order to meet its volume and market share goals, Countrywide employed a policy of matching any product that a competitor was willing to offer. A former finance

executive at Countrywide explained that: "To the extent more than 5 percent of the [mortgage] market was originating a particular product, any new alternative mortgage product, then Countrywide would originate it . . . . [I]t's the proverbial race to the bottom."

149. Countrywide's internal documents and communications, recently made public by the SEC, show that this "matching" strategy led to systemic underwriting failures that implicated all of the loans originated by Countrywide during the relevant period including, on information and belief, the loans underlying Allstate's Certificates. A recently-disclosed June 2005 document shows that John McMurray, Countrywide's Chief Risk Officer, warned that, "as a consequence of [Countrywide's] strategy to have the widest product line in the industry, we are clearly out on the 'frontier' in many areas," adding that the "frontier" had "high expected default rates and losses." He further warned that because of the "matching" strategy, Countrywide's underwriting guidelines "will be a composite of the outer boundaries across multiple lenders," and that the resulting "composite guides [sic] are likely among the most aggressive in the industry."

150. The recently-released results of a 2006 internal Countrywide audit corroborate Mr. McMurray's concerns. Among the findings were that "approximately 40% of the Bank's reduced documentation loans . . . could potentially have income overstated by more than 10% and a significant percent of those loans would have income overstated by 50% or more." Mr. McMurray asserted that it is "obviously the case" that "perhaps many" of these overstatements were the result of misrepresentations.

151. Around the same time, according to the SEC, Countrywide made internal disclosures at a credit meeting that one-third of the loans referred out of Countrywide's automated underwriting system violated "major" underwriting guidelines, 23% of the subprime

first-lien loans were generated as "exceptions," and that "exception" loans were performing 2.8 times worse than loans written within guidelines. That the loans approved by exceptions were performing so much worse than other similar loans is itself strong evidence that the "exceptions" were not being granted based on any purported countervailing circumstances in the borrowers' credit profile.

152. Another recently-disclosed internal Countrywide review showed that 23% of the subprime loans originated by Countrywide in 2006 were generated as exceptions, even taking into account "all guidelines, published and not published, approved and not yet approved." This study occurred during the same period in which loans were being generated and included in Allstate's Certificates. As a result of the study, Countrywide Managing Director of Risk Management concluded that "[t]he results speak towards our inability to adequately impose and monitor controls on production operations."

153. In a recently-uncovered May 7, 2007 letter to the OTS, Countrywide candidly admitted: "Specifically looking at originations in the fourth quarter of 2006, we know that almost 60% of the borrowers who obtained subprime hybrid ARMs [from Countrywide] would not have qualified at the fully indexed rate." Countrywide also admitted that "almost 25% of the borrowers would not have qualified for any other [Countrywide] product." In other words, Countrywide was shuffling borrowers to exotic products because the borrowers could not afford anything else, making those loans all the riskier. Moreover, when a borrower did not qualify for a conventional loan, Countrywide's loan officers would often steer the borrower into riskier loans that did not require documentation, so-called "liar loans."

154. In addition, Countrywide regularly engaged appraisers that were affiliated with Countrywide, including appraisal businesses that were owned or controlled by Countrywide,

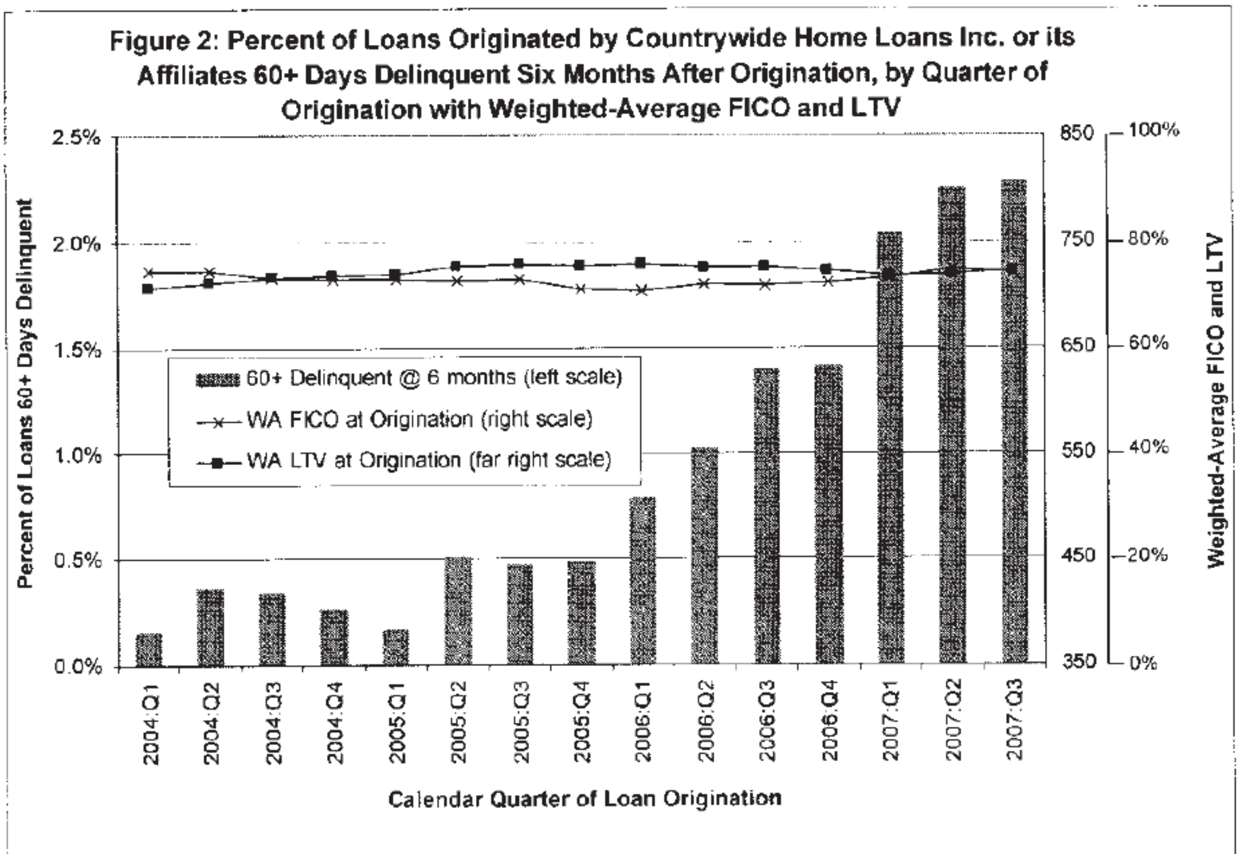
rather than the purported independent appraisals that it represented were used. This created a conflict of interest. As originator and securitizer of the loans, Countrywide had an incentive to inflate the value of properties because doing so would result in lower LTV ratios. A lower LTV ratio would allow a loan to be approved when it otherwise would not be, and would appear less risky to Allstate and other investors. In practice, Countrywide's appraisals were not intended to determine the adequacy of the collateral in the event of a default, but rather to ensure that a large volume of mortgages were rapidly originated, underwritten and securitized, without regard to the value of the collateral.

155. According to Capitol West Appraisals, LLC, a company that has provided real estate appraisals to mortgage brokers and lenders since 2005, Countrywide engaged in a pattern and practice of pressuring even non-affiliated real estate appraisers to artificially increase appraised values for properties underlying mortgages Countrywide originated. Capitol West stated that Countrywide officers sought to pressure it to increase appraised values for three separate loan transactions. When Capitol West refused to vary the appraised values from what it independently determined was appropriate, Countrywide retaliated by blacklisting it.

156. Because Countrywide was one of the nation's largest mortgage lenders, a substantial portion of any mortgage broker's loans was submitted to Countrywide. Because a broker could not rule out that Countrywide would be the ultimate lender, and because mortgage brokers knew from the blacklist that a field review would be required if a blacklisted appraiser were chosen, with the likely result that a mortgage would not be issued with that appraisal, and that its mortgage applicant would have to incur the cost of retaining another appraiser, such a broker had a strong incentive to refrain from using a blacklisted appraiser. By these means,

Countrywide systematically and deliberately enlisted appraisers in its scheme to inflate appraisals and issue low-quality, extremely risky loans.

157. Finally, as above, studies have been conducted that compare the presence of early payment defaults in certain vintages of loans, as compared to the purported credit qualities of those loans. These studies confirm that Countrywide's underwriting standards were being increasingly, but secretly, ignored during the period it was originating the Mortgage Loans at it provided to Allstate's collateral pools:



158. As Countrywide's abandonment was systemic and occurring at the same time as the loans underlying Allstate's Certificates were originated by Countrywide, on information and belief the same underwriting and origination failures occurred with respect to the Countrywide loans underlying Allstate's Certificates ARMT 2007-1, CSMC 2006-8, CSMC 2007-3, and

CSMC 2007-5. This is further confirmed by Allstate's statistical analysis of the loans at issue here, as discussed above.

(2) Option One

159. Option One originated 100% of the mortgage loans underlying the ABSC 2006-HE5 offering. The statements in the Offering Materials related to Option One's underwriting standards were false and misleading because Option One: (1) systematically failed to follow its stated underwriting standards; (2) allowed pervasive exceptions to its stated underwriting standards in the absence of compensating factors; (3) disregarded credit quality in favor of generating increased loan volume; and (4) violated its stated appraisal standards and in many instances materially inflated the values of the underlying mortgage properties in the loan origination and underwriting process.

160. Option One was a national mortgage lender formerly owned by H&R Block, Inc., until its assets were sold to American Home Mortgage Servicing, Inc. in April 2008. Option One was the sixth worst mortgage originator, by number of foreclosures as of March 22, 2010, according to the OCC's "Ten Worst in the Ten Worst" list.

161. On information and belief, Option One routinely violated its stated standards for underwriting and appraisals. For example, Option One did the following:

- It was Option One's practice that if an underwriter denied a loan and an account executive complained, the loan was escalated to the branch manager and the loan would be pushed through;
- Option One knowingly approved stated income loans that contained falsified income information, and the majority of stated income loans contained falsified income information;
- Option One's main driver was income, not accuracy in the underwriting process;
- Option One account executives and managers did not seek to reduce risk because Option One shifted the mortgages to investors; and

- Option One was motivated to violate its underwriting and appraisal standards in order to increase the volume of loans it could sell to Wall Street Banks to be securitized.

162. On information and belief, it was Option One's practice that if an underwriter questioned the appraised value, the account executive and branch manager would override the underwriter's objection. In addition, when underwriters objected to loans because of flawed appraisals, the loan officer would complain to the branch manager, who would complain to the Appraisals Department at headquarters in Irvine, California, and on up the chain until the loan was given the green light.

163. The Attorney General for the Commonwealth of Massachusetts has investigated Option One, and its past and present parent companies, for their unfair and deceptive origination and servicing of mortgage loans. She determined that Option One increasingly disregarded underwriting standards, created incentives for loan officers and brokers to disregard the interests of the borrowers and steer them into high-cost loans, and originated thousands of loans that Option One knew or should have known the borrowers would be unable to pay. This was all in an effort to increase loan origination volume, so as to profit from the practice of packaging and selling the vast majority of Option One's residential subprime loans to the secondary market. She has also determined that Option One's agents and brokers frequently overstated an applicant's income and/or ability to pay, and inflated the appraised value of the applicant's home, and that Option One avoided implementing reasonable measures that would have prevented or limited these fraudulent practices.

164. Based on Allstate's loan-level review of the misrepresented statistics, as well as the plummetting performance of the related collateral pools, and other facts set forth herein, on information and belief the Mortgage Loans underlying Allstate's Certificates here that were provided by Option One suffered from these same defects.

III. THE DEFENDANTS KNEW THEIR REPRESENTATIONS WERE FALSE

A. The Statistical Evidence Is Itself Persuasive Evidence Defendants Knew or Recklessly Disregarded the Falsity of Their Representations

165. As discussed above, all of Allstate's Certificates have significantly underperformed, and an analysis of the underlying loans shows seriously misrepresented owner-occupancy, LTV, and CLTV statistics. For instance, Allstate's loan-level analysis shows that Defendants frequently overstated the percentage of loans secured by owner-occupied properties in a given mortgage pool by more than 10%. Because borrowers are less likely to "walk away" from properties they live in, Defendants' repeated overstatements concerning owner occupancy materially misrepresented the risk profiles of each of the offerings at issue here.

166. Allstate's loan-level analysis also revealed that Defendants consistently understated the percentage of loans underlying the mortgage pools with high LTV ratios, sometimes by **more than 60%**. Even more strikingly, Defendants uniformly represented that none of the loans have LTV ratios greater than 100%, yet Allstate's analysis revealed that a substantial percentage of loans – up to **31% –** in each of Defendants' offerings were already "underwater." This meant that many of the borrowers had no equity cushion to protect against borrower default, and in fact guaranteed a loss upon foreclosure.

167. The remarkable default and delinquency rates, understated LTV and CLTV ratios, and overstated owner occupancy statistics are not only evidence that the Mortgage Loans underlying the Offerings were defective. They are themselves strong evidence that the Defendants knew the Mortgage Loans underlying the Offerings were grossly defective when they made contrary representations to Allstate. Simply put, through their detailed loan-level reviews of the loans that were security for their warehouse lines and of the loans they were purchasing, the Defendants could not have pooled these Mortgage Loans without knowing that,

contrary to their representations, the loans were widely defective. Indeed, the Defendants' own insurer found, in reviewing the actual loan files (which, as an investor, Allstate does not have access to) that the "rampant and obvious nature of the breaches confirms that Credit Suisse made intentional misrepresentations concerning its mortgage loans and the due diligence that Credit Suisse purported to perform regarding the quality of those loans."

168. That the Mortgage Loans could have made it to the securitization market without the Defendants' knowledge of their problems is made all the less improbable by the fact that the Defendants' affiliates originated many of the loans in-house. This vertical integration between originators and issuers heightened the already-perverse incentives created by the move to the "originate and distribute" business model. The originator, secure with a pipeline to the market, would have even more incentive to loosen its guidelines. Those responsible for the securitization, focused on volume, would push them to do so even more. And once the loans were issued, they would have significant incentives to ignore problem loans because rejecting a loan would saddle an affiliated company with a toxic loan. This process gave Defendants yet another source of actual knowledge of the falsity of the representations they made to Allstate. As it was often affiliated entities that generated the loans in the first place, Defendants had a direct window into the lax practices that led to the creation of the toxic pools of loans from the outset.

169. Even where the Defendants purchased loans, they had direct sources of knowledge of the misrepresented quality of the loans. As purchasers of the loans, the Defendants had extensive business relationships with the originators (even the unaffiliated ones), had access to the originators' personnel and internal information and conducted due diligence into the originators through their own personnel and third-party loan review firms. This access

was even more pronounced, in the case of third-party mortgage lenders, when Defendants were the warehouse lenders or those originators.

170. The significance of Defendants' systemic underwriting problems is magnified when one considers the size of Defendants' operations. It is inconceivable that problems on the scale at issue here, occurring within one of the world's largest and most sophisticated finance entities, could be anything but the result of knowing or reckless conduct with regard to the true risk profiles of the mortgage loans underlying Defendants' securitizations.

B. <u>Evidence From Third-Party Due Diligence Firms Demonstrates That Defendants Knew Defective Loans Were Being Securitized</u>

171. Not only *must* the Defendants have know that the Mortgage Loans were widely defective; they *did* know. As previously described, the Defendants engaged in their own due diligence review of the Mortgage Loans to determine whether the loans both conformed with the representations made by the originators and complied with the Defendants' own credit policies. This review would necessarily have revealed the pervasive deficiencies in the Mortgage Loans at issue here.

172. In fact, upon information and belief, the defendant's own due diligence review revealed that a high percentage of the Mortgage Loans underlying Allstate's Certificates were deficient – both because the loans failed to conform to the originator's stated underwriting standards, and because the loans failed to meet the Defendants' own credit standards. Yet the Defendants routinely included these deficient loans in loan pools underlying the Offerings.

173. That the Mortgage Loans were actually defective is evidenced by Allstate's loan-level analysis, and other facts set forth above. That those problems were caught by the due diligence process, yet knowingly given "waivers," is evidenced by, among other things, the Defendants' reaction to loans being rejected by the due diligence process when it happened to

involve a third-party due diligence firm who later released their statistical information to the government. Specifically, the Defendants hired the third-party due diligence firm Clayton Holdings to review mortgage loans and determine whether the loans at issue "[met] the underwriting guidelines" and "compl[ied] with federal and state laws, notably predatory-lending laws and truth-in-lending requirements," and whether "the reported property values [were] accurate."

174. As described above, Defendants were informed that 32% of the loans reviewed by Clayton on Defendants' behalf had been rejected as they "failed to meet guidelines." These findings were typically provided to the Defendants in a **daily** report that summarized Clayton's review and included summaries of the deficient loan files. As above, with such a high failure rate, the proper response would be to reject the pool outright, or at a minimum to hold that pool to higher scrutiny (with, for instance, expanded sampling techniques).

175. Instead, despite receiving this daily and specific evidence that a significant percentage of the loans it was buying were defective, the Defendants provided waivers for **33%** of those rejected loans.

176. According to the September 2010 testimony of Clayton's Vice President Vicky Beal, the third-party due diligence firms' "exception reports" were provided not just to the underwriter, but also to the sponsors. On information and belief, then, the Defendants here, through their numerous roles of underwriter, sponsor, and affiliated originator, were made fully aware **on a daily basis** that a significant percentage of the Mortgage Loans here failed to meet the stated underwriting guidelines, but were being included in the pools underlying Allstate's Certificates anyway by way of Defendants' "waiver" process.

C. **Evidence That the Defendants Leveraged Their Unique Knowledge To Increase Their Own Profits**

177. The Defendants apparently never took steps to address the systemic weakness in the loan pools or with the originators it was dealing with. As above, rather than insisting on different loans, refusing to do business with problematic originators, or expanding their statistical tests to see if the rejects were anomalies, the Defendants "waived in" a third of the faulty loans. Even more damning, rather than mitigate the risks to investors such as Allstate by removing problematic loans or refusing to do business with problematic originators, Credit Suisse leveraged its unique knowledge to its own advantage.

178. Defendants were incentivized to allow the rejected mortgages to remain in the securitizations because (1) mortgage originators would not invite a bank that consistently kicked out large numbers of loans to future auctions; and (2) the securitization became smaller as loans were kicked out, thus decreasing the underwriting fee.

179. Further, according to the September 2010 testimony before the Federal Crisis Inquiry Commission by Clayton's former president, D. Keith Johnson, **the investment banks would use the exception reports simply to force a lower price.** In other words, rather than reject defective loans from collateral pools, or cease doing business with consistently failing originators, **the Defendants would instead use the Clayton Holdings data simply to insist on a lower price from the loan originators, leaving more room for their own profits when the problem loans were hidden in securitization pools.**

D. **Evidence of Defendants' Influence Over the Appraisal Process Demonstrates That Defendants Knew the Appraisals Were Falsely Inflated**

180. On information and belief, Defendants used their economic leverage over appraisers to make the appraised values fit the loan they wanted to approve, rather than to fit the

true value of the property. This further establishes that they knew the LTV and CLTV statistics were false.

181. That all the misstatements go heavily in one direction – seriously inflated property values leading to materially understated LTV and CLTV statistics – is itself persuasive evidence that the inaccuracies revealed by Allstate's recent analysis were not mere errors or differences of opinion, but conscious misrepresentations. For instance, as discussed above, Defendants severely understated the percentage of loans in the mortgage pools that had high LTV ratios. In ARMT 2007-1, the Offering Materials represented that only 4.56% of the loans had an LTV ratio greater than 80%. In fact, however, 64.77% of the loans had an LTV ratio greater than 80% – an **understatement of 60.21%**. Similarly, the TBW 2006-4 Offering Materials represented that 9.03% of the underlying loans had an LTV ratio greater than 80%, whereas 70.04% did – an **understatement of 61.46%**. Similar material misrepresentations are made throughout Defendant's Offering Materials.

182. That the Defendants did not generally believe these wildly misstated statistics is further confirmed by Congressional testimony and other statements made by those in the industry about the widespread corruption in the appraisal processes during all times relevant to this Complaint.

183. For instance, Richard Bitner, a former executive of a subprime lender for fifteen years, testified in April 2010 that "the appraisal process [was] highly susceptible to manipulation," and that the rise in property values was in part due to "the subprime industry's acceptance of overvalued appraisals." Similarly, Patricia Lindsay, a former wholesale lender, testified in April 2010 that in her experience appraisers were "often times pressured into coming in 'at value,'" i.e., at least the amount needed for the loan to be approved. The appraisers

"fearing" their "future business and their livelihoods" would choose properties "that would help support the needed value rather than finding the best comparables to come up with the most accurate value."

184. And Jim Amorin, President of the Appraisal Institute, testified in April 2009 that "in many cases, appraisers are ordered or severely pressured to doctor their reports to convey a particular, higher value for a property, or else never see work from those parties again . . . [T]oo often state licensed and certified appraisers are forced into making a 'Hobson's Choice.'"

185. The FCIC's January 2011 report recounts (at 91) the similar testimony of Dennis J. Black, an appraiser with twenty-four years of experience who held continuing education services across the country. "He heard complaints from appraisers that they had been pressured to ignore missing kitchens, damaged walls, and inoperable mechanical systems. Black told the FCIC, 'The story I have heard most often is the client saying he could not use the appraisal because the value was [not] what they needed.' The client would hire somebody else."

IV. ALLSTATE'S DETRIMENTAL RELIANCE AND DAMAGES

186. In making the investments, Allstate relied upon the Defendants' representations and assurances regarding the quality of the mortgage collateral underlying the Certificates, including the quality of their underwriting processes. Allstate received, reviewed, and relied upon the Offering Materials, which described in detail the Mortgage Loans underlying each offering.

187. In purchasing the Certificates, Allstate justifiably relied on the Defendants' false representations and omissions of material fact detailed above, including the misstatements and omissions in the Offering Materials. These representations materially altered the total mix of information upon which Allstate made its purchasing decisions.

188. But for the misrepresentations and omissions in the Offering Materials, Allstate would not have purchased or acquired the Certificates as it ultimately did, because those representations and omissions were material to its decision to acquire the Certificates, as described above.

189. The false and misleading statements of material facts and omissions of material facts in the Offering Materials directly caused Allstate damage, because the Certificates were in fact far riskier than the Defendants described them to be. The loans underlying the Certificates experienced default and delinquency at extraordinarily high rates due to the abandonment of the disclosed underwriting guidelines. Allstate's losses on the Certificates have been much greater than they would have been if the loans were as Defendants described them to be.

190. For example, the fact that the loans were not secured by owner-occupied properties at their claimed rate made them more prone to default. Owners who do not occupy their properties are more likely to default on their loans, which made the Certificates poorer investments, accelerated the Certificates' decline in value, and greatly worsened Allstate's losses. Because the value of a security is contingent upon the prospect of future cash flows, the increased, previously-undisclosed risk means the Certificates are less valuable than Certificates that had the attributes presented in the Offering Materials.

191. There are several potential ways of valuing a mortgage-backed security. One of the potential ways that lower value can be measured, and part of the evidence that Allstate has been damaged, can be found in secondary-market pricing. Though the market may have temporarily "seized up" during the financial crisis, it has since recovered and there was and is a functioning secondary market for mortgage-backed securities such as the Certificates here. Numerous brokers are active in, and have trading desks specifically dedicated to, the secondary

market for RMBS, including without limitation Credit Suisse itself, Barclays, Bank of America, Citigroup, Deutsche Bank, Goldman Sachs, Royal Bank of Scotland, J.P. Morgan, Nomura, and Morgan Stanley.

192. According to data provided to the FCIC, between May 2007 and November 2008 Goldman Sachs alone bought and sold $17 billion worth of RMBS cash securities, and $32 billion worth of credit default swaps linked to RMBS securities, representing a total of 7,000 trades. These figures demonstrate the liquidity in the secondary market for RMBS.

193. Indeed, Allstate has already sold some of these Certificates on the secondary market. That they were sold at a significant loss evidences the fact that the Certificates did not carry the value that the securities would have had if they were backed by mortgage loans with the quality represented in the Offering Materials.

194. Allstate has incurred substantial losses in market value on the Certificates. Further, the income and principal payments that Allstate received have been less than Allstate expected under the “waterfall” provisions of the securitizations. Even in the context of the real estate crisis, the Certificates would have held most, if not all, of their value had the securities underlying the loans been as represented by the Defendants in the Offering Materials. This decreased value is evidenced collectively by, but need not be measured solely by, among other things: (a) the high rates of default and delinquency of the Mortgage Loans; (b) the Certificates’ plummeting credit ratings; and (c) lower-than-expected past and current income streams from the Certificates.

195. The disclosure of fundamental irregularities in the Defendants’ underwriting practices and increased risk regarding future cash flow has also led to a substantial decline in market value of the Certificates. Allstate purchased the Certificates not only for their income

stream, but held them on a "available for sale" basis, with the expectation that some of Allstate's RMBS portfolio could and would be sold on the existing secondary market. Some of these Certificates have already been sold on the secondary market. Allstate thus viewed market value as a critical aspect of the Certificates' value when purchasing them. Allstate incurred substantial losses on the Certificates due to both lower-than-expected income streams and a drastic decline in market value attributable to the misrepresentations. Those misrepresentations, when discovered, revealed that the mortgage loans likely had a substantially higher risk profile than investors (including Allstate) were led to believe. As noted above, perceived and actual risk is a component of current value. Thus, Allstate is not seeking recovery for (or, in the alternative, to rescind based on) future potential losses, but recovery based on its current damages.

196. The drastic and rapid loss in value of Allstate's Certificates was primarily and proximately caused by the issuance of loans to borrowers who could not afford them, in contravention of the prudent underwriting guidelines described in the Offering Materials. Delinquencies and defaults were much higher than they would have been if the Mortgage Loans had been properly underwritten.

FIRST CAUSE OF ACTION
(Common-law Fraud)

197. Allstate realleges each allegation above as if fully set forth herein.

198. This count is against all Defendants.

199. The material representations set forth above were fraudulent, and Defendants' representations fraudulently omitted material statements of fact. The representations at issue are identified and summarized in Section I above and further identified in Exhibits C-K.

200. Each of the Defendants knew their representations and omissions were false and/or misleading at the time they were made. Each made the misleading statements with an intent to defraud Allstate.

201. Allstate justifiably relied on Defendants' false representations and misleading omissions.

202. Had Allstate known the true facts regarding the Defendants' underwriting practices and quality of the loans making up the securitizations, it would not have purchased the Certificates as it ultimately did.

203. As a result of the foregoing, Allstate has suffered damages according to proof or, in the alternative, Allstate has the right to rescind the fraudulently induced Certificate purchases and to require Defendants to repurchase the Certificates at their original cost, plus interest.

SECOND CAUSE OF ACTION
(Fraudulent Inducement)

204. Allstate realleges each allegation above as if fully set forth herein.

205. This count is against Defendants.

206. Allstate was fraudulently induced to purchase the Certificates by Defendants' misrepresentations and omissions of material facts. The misrepresentations and omissions at issue are identified above, further identified in Exhibits C-K, and are summarized in Section I above.

207. Each of the Defendants knew their representations and omissions were false and/or misleading at the time they were made. Each made the misleading statements with an intent to induce Allstate to purchase the Certificates.

208. Allstate justifiably relied on the Defendants' false representations and misleading omissions in purchasing the Certificates.

209. Had Allstate known the true facts, it would not have purchased the Certificates as it ultimately did.

210. As a result of the foregoing, Allstate has suffered damages according to proof or, in the alternative, Allstate has the right to rescind the fraudulently induced Certificate purchases and to require Defendants to repurchase the Certificates at their original cost, plus interest.

THIRD CAUSE OF ACTION
(Negligent Misrepresentation)

211. Allstate realleges each allegation above as if fully set forth herein.

212. Including not only the Certificates at issue here but others not part of this action, Allstate made approximately thirty-six purchases in offerings of mortgage-backed securities that Defendants securitized and sold.

213. Because Defendants arranged the securitizations, and originated or acquired, underwrote, and serviced most of the underlying mortgage loans, they had unique and special knowledge about the loans in the offerings. In particular, they had unique and special knowledge and expertise regarding the quality of the underwriting of those loans, as well as the servicing practices employed as to such loans.

214. Because Allstate could not evaluate the loan files for the mortgage loans underlying its Certificates, and because Allstate could not examine the underwriting quality or servicing practices for the mortgage loans in the offerings on a loan-by-loan basis, it was heavily reliant on Defendants' unique, special, and superior knowledge regarding the mortgage loans when determining whether to make each investment in the Certificates. Allstate was entirely reliant on Defendants to provide accurate information regarding the loans in engaging in that analysis. Accordingly, Defendants were uniquely situated to evaluate the economics of each offering.

215. Going back six years covering thirty-six separate purchases, Allstate relied on Defendants' unique, special and superior knowledge regarding the quality of the underlying mortgage loans and their underwriting when determining whether to invest in the Certificates at issue in this action. Allstate's longstanding relationship with Defendants, coupled with Defendants' unique and special knowledge about the underlying loans, created a special relationship of trust, confidence, and dependence between Defendants and Allstate.

216. Defendants were in the business of providing information for use by others, including Allstate. Specifically, but without limitation, it was in the business of providing information by way of the Offering Materials so that investors could rely on them in deciding whether to invest in the securities being offered. This information was for the use of a small class of large, institutional investors.

217. Defendants were aware that Allstate relied on their unique, special, and superior knowledge, expertise, and experience and depended upon them for accurate and truthful information in making the decision to invest in each of the Certificates. Defendants were also aware that the representations regarding the underwriting standards, as well as the Mortgage Loans underlying each of the Certificates, would be used for the particular purpose of deciding whether to invest in those Certificates. Defendants also knew that the facts regarding their compliance with their underwriting standards were exclusively within their knowledge.

218. Based on their expertise, superior knowledge, and relationship with Allstate, Defendants owed a duty to Allstate to provide complete, accurate, and timely information regarding the mortgage loans and the offerings. Defendants breached their duty to provide such information to Allstate.

219. Defendants breached their duty to provide such information to Allstate by making misrepresentations that induced Allstate's investment in the offerings. The misrepresentations are set forth above and in Exhibits C-K. At the time Defendants made these misrepresentations, there were, at a minimum, negligent in their due diligence and/or understanding of the extent to which the Mortgage Loans underlying the Certificates complied with the underwriting guidelines and had the characteristics represented in the Offering Materials. Thus, Defendants were at the very least negligent in making statements that were false, misleading, and incorrect. Such information was known or reasonably should have been known by Defendants, and was not known or readily knowable by Allstate. In addition, Defendants knew that Allstate was acting in reliance on that information.

220. Allstate reasonably relied on the information Defendants did provide and was damaged as a result of these misrepresentations. Had Allstate known the true facts regarding Defendants' underwriting practices and the quality of the loans making up the offerings, it would not have purchased the Certificates as it ultimately did.

221. As a result of the foregoing, Allstate has suffered damages according to proof.

PRAYER FOR RELIEF

WHEREFORE Allstate prays for relief as follows:

An award of damages in favor of Allstate against the Defendants, jointly and severally, for all damages sustained as a result of Defendants' wrongdoing, in an amount to be proven at trial, but including at a minimum:

a. Allstate's monetary losses, including loss of market value and loss of principal and interest payments;

b. Attorneys' fees and costs;

c. Prejudgment interest at the maximum legal rate; and

d. Such other and further relief as the Court may deem just and proper.

In the alternative, Allstate demands rescission and recovery of the consideration paid for the Certificates, with interest thereon.

JURY TRIAL DEMANDED

Allstate hereby demands a trial by jury on all issues triable by jury.

DATED: New York, New York
February 28, 2011

QUINN EMANUEL URQUHART & SULLIVAN, LLP

By: Daniel Brockett

Daniel L. Brockett
David D. Burnett
51 Madison Avenue, 22nd Floor
New York, New York 10010-1601
Telephone: (212) 849-7000
Fax: (212) 849-7100
danbrockett@quinnemanuel.com
daveburnett@quinnemanuel.com

Of Counsel: (pro hac vice applications forthcoming where applicable)

D. M. Rawlings
Richard A. Schirtzer (NY Bar No. 1992841)
865 South Figueroa Street, 10th Floor
Los Angeles, California, 90017
Telephone: (213) 443-3000
Fax: (213) 443-3100
chiprawlings@quinnemanuel.com
richardschirtzer@quinnemanuel.com

David J. Ruderman
Alexander B. Binder
50 California Street, 22nd Floor
San Francisco, California 94111
Telephone: (415) 875-6600
Facsimile: (415) 875-6700
davidruderman@quinnemanuel.com
alexbinder@quinnemanuel.com

Attorneys for Plaintiffs Allstate Insurance Company, Allstate Life Insurance Company, Allstate Bank, and Kennett Capital, Inc.