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# Loan Losses Pit Insurers Vs. Lenders

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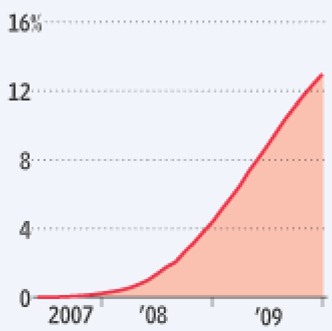
In the slugfest between the banks that created now-busted mortgages and mortgage bonds and the insurance companies that guaranteed them, insurers increasingly believe they can avoid losing billions.

Bond and mortgage insurers, among the hardest hit players in the housing crisis, have hired financial sleuths to comb through thousands of mortgage files. They say lenders and Wall Street firms stuck them with flawed loans marred by poor underwriting and faulty appraisals.

Moody's Investors Service estimates the insurers collectively could save over $10 billion if they succeed in rescinding or recovering claims. Savings would be welcome news for these firms, some of which are facing financial difficulties after making large payouts amid the financial crisis.

**Damaged Goods**

Cumulative loss rates for 2007-originated mortgage securities underpinned by subprime loans




Source: Moody's Investors Service

Any gain for the insurers would cost the lenders and investment banks. These firms say insurers knew or should have known the risks of the loans and bonds they insured.

The outcome of the showdown is far from certain and may depend on potentially contentious negotiations and litigation that could drag out for years.

Over the past 18 months, bond insurers have sued banks and mortgage lenders in more than a dozen lawsuits. On Tuesday, Ambac Assurance Corp., the bond-insurance unit of Ambac Financial Group Inc., sued a unit of Credit Suisse Group in New York state court.

Ambac alleges the securities firm made "false and misleading" representations about the attributes of home equity lines of credit backing bonds the insurer guaranteed in 2007.

A Credit Suisse spokesman said the firm believes the suit is "without merit, and we intend to defend ourselves vigorously."

During the housing boom, lenders, investment banks and insurers worked together to fuel home sales. Bond insurers agreed to pay investors if bonds backed by home loans defaulted. Mortgage insurers provided coverage in case borrowers defaulted on monthly mortgage bills.

Proving allegations of shoddy loan originations is tedious work. MBIA Inc. said in a third-quarter earnings report that it had hired "loan level forensic review consultants" to review some 26,805 mortgage loans.

That review, MBIA said, led the firm to determine that thousands of loans shouldn't have been put in loan pools backing bonds that MBIA agreed to guarantee.

MBIA has said it believes it can recover $1.2 billion from securities and loans it has reviewed. That allows the company to set aside fewer reserves to cover losses.

## *$4 Billion in Offsets*

Moody's, in a December report, said that bond insurers had as of the end of September amassed $4 billion in offsets to loss reserves. Effectively, that $4 billion represents the current value of the amount that these insurers ultimately expect to recover over time.

Several bond insurers continue to struggle. MBIA Insurance Corp. and other troubled rivals effectively have been unable to sell new bond guarantees for over a year after their ratings were sharply downgraded, and they are facing mounting losses from other mortgage-linked securities.

Meanwhile, mortgage insurance firms are refusing to cover up to as much as 25% of the loans they agreed to cover against loss, Moody's said. That compares with a historical rate of about 7%. Moody's said it estimates that four of the biggest mortgage insurers have avoided paying loss claims totaling $6 billion since January 2008 and that that amount could increase by as much as $4 billion.

The growing pile of litigation—still in an early stage—provides a window into the mortgage-loan industry.

In December, MBIA, based in New York, sued Credit Suisse in New York state court over a $900 million loan pool, a large portion of which MBIA agreed to cover. MBIA said it had relied on Credit Suisse to vet the quality of the loans. As losses increased, MBIA sought access to loan-origination files, the lawsuit claims. MBIA alleges in the complaint that Credit Suisse for months "stonewalled" MBIA's attempts to obtain the files.

When MBIA got the information, it said in the lawsuit, it reviewed 1,798 loans and founded some 85% breached contractual agreements about the quality of the loans. MBIA so far has had to pay out $296 million in claims on the securities. By October 2009, about half of the 15,615 loans in the pool had defaulted, MBIA said in its complaint.

A Credit Suisse spokesman said the lawsuit lacked merit and the bank would fight it.

## *Countrywide and MGIC*

In December, a unit of California lender Countrywide Financial Corp., now owned by Bank of America Corp., sued mortgage insurer Mortgage Guaranty Insurance Corp., or MGIC, in San Francisco county court.

Mortgage-insurance policies insured for lenders like Countrywide that, in the event of borrower default, firms such as MGIC would cover principal and interest payments.

"MGIC now, however, faces the reality of steep financial losses because of a significant economic downturn," the Countrywide complaint alleges. "MGIC has adopted unreasonable interpretations of its mortgage insurance policy language to justify its failure to pay claims."

Spokeswomen for Bank of America and MGIC declined comment.

Countrywide said in its lawsuit that a sizable number of the problem loans were so-called stated-income loans. Those loans enabled borrowers to obtain loans without having to provide income records. They are seen as a big contributor to the mass of defaults in the housing market.

Countrywide claims that MGIC knew that borrower income wouldn't be verified and that "these loans involved increased risk."

Countrywide says that even though MGIC knew the loans had stated income and that MGIC didn't ask for borrower information, MGIC has denied or rescinded loss coverage because MGIC claims the stated income was misrepresented.

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