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

ALLSTATE INSURANCE COMPANY, ALLSTATE LIFE INSURANCE COMPANY, ALLSTATE LIFE INSURANCE COMPANY OF NEW YORK , AGENTS PENSION PLAN, and ALLSTATE RETIREMENT PLAN,

Plaintiffs,

-against-

CITIMORTGAGE, INC., CITICORP TRUST BANK, FSB, CITIGROUP GLOBAL MARKETS REALTY CORP., CITIGROUP MORTGAGE LOAN TRUST, INC., CITIGROUP GLOBAL MARKETS, INC., CITICORP MORTGAGE SECURITIES, INC., and CITICORP RESIDENTIAL MORTGAGE SECURITIES, INC.,

Defendants.

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Plaintiffs Allstate Insurance Company, Allstate Life Insurance Company, Allstate Life Insurance Company of New York, Agents Pension Plan, and Allstate Retirement Plan (collectively, "Allstate"), by and through their attorneys, bring this action against CitiMortgage, Inc., Citicorp Trust Bank, fsb, Citigroup Global Markets Realty Corp., Citigroup Mortgage Loan Trust, Inc., Citigroup Global Markets, Inc., Citicorp Mortgage Securities, Inc., Citicorp Residential Mortgage Securities, Inc., and Citigroup Mortgage Loan Trust Inc. (collectively, "Defendants" or the "Citigroup Defendants"), and allege as follows:

NATURE OF ACTION

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

2. Each of the Citigroup 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 (the "Offering Materials"). For example:

(i) ***Underwriting guidelines*.** The Offering Materials represented that a particular, reasonable underwriting process was followed to ensure that only loans that the borrowers could repay would be included in the pools underlying the Certificates (the "Mortgage Loans"). In fact, the disclosed underwriting standards had been systematically ignored in originating or otherwise acquiring the loans underlying the Certificates. A former Chief Underwriter for Citigroup, Inc. ("Citigroup") recently testified to a federal commission about the

abandonment of underwriting standards at Citigroup. As the Citigroup Defendants pushed to sell more residential mortgage backed securities to investors, *higher ups "revers[ed] large numbers of underwriting decisions on mortgage loans from 'turn down' to 'approved,'"* and approved purchases of hundreds of millions of dollars of pools of mortgages that did not meet internal underwriting standards. April 7, 2010 Testimony of Richard Bowen, III to the Financial Crisis Inquiry Commission at 2 ("Bowen Testimony"). As Mr. Bowen put it: *"A decision was made that 'We're going to have to hold our nose and start buying the stated product if we want to stay in business.'"* Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report* at 111 & n.59 (Jan. 2011) ("FCIC Report"). All the while, "[t]here was no disclosure being made to investors with regard to the quality of the files [Citigroup was] purchasing." FCIC Report at 169.

(ii) ***Owner Occupancy Statistics.*** The Offering Materials made specific representations regarding the percentage of borrowers who would be occupying the properties 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 vacation homes or as investments. Analytical tools recently made available confirm that, in truth, a far greater percentage of the loans underlying Allstate's Certificates were in fact provided to borrowers who lived elsewhere.

(iii) ***Loan-to-Value Ratios.*** The Offering Materials represented that the loans had specific loan-to-value and combined loan-to-value ratios. These are 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 confirm that the 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.

(iv) ***Percentage of Known Non-Conforming Loans.*** The Citigroup Defendants fraudulently omitted the fact that their own due diligence and that of third-party audit firms they hired had identified numerous, specific loans that did not conform to the underwriting guidelines. 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. That high numbers of rejected loans were knowingly being included is not only a fraudulent omission in its own right, but also made even more misleading the Citigroup Defendants' disclosures about their underwriting process. The Citigroup Defendants intended for Allstate and other investors to understand that their audit and due diligence procedures were being used to keep out problem loans – not just to go through the motions of appearing to search for such loans only to have them routinely approved for inclusion anyway.

3. Allstate purchased over $200 million of the Citigroup Defendants' mortgage-backed securities in reliance on these and the other misrepresentations and omissions:

Asset	Purchase Price	Further Details
CMALT 2006-A7 1A13	$996,842.03	Exh. A, B & H
CMLTI 2004-OPT1, M1	$2,573,897.04	Exh. A, B & C
CMLTI 2005-3, 2A4	$1,624,918.75	Exh. A, B & D
CMLTI 2005-3, 2A4	$5,445,945.54	Exh. A, B & D
CMLTI 2005-3, 2A4	$6,066,817.99	Exh. A, B & D
CMLTI 2005-WF2, MV1	$2,829,943.40	Exh. A, B & E
CMLTI 2006-4 2A1B	$2,350,452.99	Exh. A, B & F
CMLTI 2007-WFHE2 A2	$2,612,947.74	Exh. A, B & I
CMLTI 2007-WFHE2 A2	$3,749,925.00	Exh. A, B & I
CMLTI 2007-WFHE2 A2	$2,449,926.50	Exh. A, B & I
CMLTI 2007-WFHE2 A2	$2,038,898.05	Exh. A, B & I
CMLTI 2007-WFHE2 M2	$5,196,948.03	Exh. A, B & I
CRMSI 2006-3, A6	$10,356,792.86	Exh. A, B, & G
CRMSI 2006-3, M1	$4,561,817.52	Exh. A, B, & G

Asset	Purchase Price	Further Details
CRMSI 2006-3, M1	$2,829,943.40	Exh. A, B, & G
CRMSI 2006-3, M2	$2,613,947.72	Exh. A, B, & G
CRMSI 2006-3, M2	$2,350,452.99	Exh. A, B, & G
CRMSI 2006-3, M3	$10,356,792.86	Exh. A, B, & G
CRMSI 2006-3, M3	$3,749,925.00	Exh. A, B, & G
CRMSI 2006-3, M4	$903,138.97	Exh. A, B, & G
CRMSI 2006-3, M5	$3,739,000.00	Exh. A, B, & G
CRMSI 2006-3, M6	$15,000,000.00	Exh. A, B, & G
CRMSI 2006-3, M7	$1,375,000.00	Exh. A, B, & G
CRMSI 2007-1 A6	$1,000,000.00	Exh. A, B, & J
CRMSI 2007-1 A6	$4,000,000.00	Exh. A, B, & J
CRMSI 2007-1 A6	$10,375,000.00	Exh. A, B, & J
CRMSI 2007-1 M1	$6,879,845.35	Exh. A, B, & J
CRMSI 2007-1 M1	$12,495,945.71	Exh. A, B, & J
CRMSI 2007-1 M2	$12,074,079.65	Exh. A, B, & J
CRMSI 2007-1 M2	$12,499,500.00	Exh. A, B, & J
CRMSI 2007-2 A6	$3,317,904.46	Exh. A, B, & K
CRMSI 2007-2 A6	$7,499,850.00	Exh. A, B, & K
CRMSI 2007-2 M1	$12,499,500.00	Exh. A, B, & K
CRMSI 2007-2 M1	$20,815,791.84	Exh. A, B, & K
CRMSI 2007-2 M1	$7,499,850.00	Exh. A, B, & K
CRMSI 2007-2 M1	$10,356,792.86	Exh. A, B, & K
CRMSI 2007-2 M2	$10,356,792.86	Exh. A, B, & K
CRMSI 2007-2 M2	$9,999,600.00	Exh. A, B, & K
CRMSI 2007-2 M3	$14,999,700.00	Exh. A, B, & K
CRMSI 2007-2 M3	$3,319,896.40	Exh. A, B, & K
CRMSI 2007-2 M4	$10,050,000.00	Exh. A, B, & K
CRMSI 2007-2 M4	$39,411,351.69	Exh. A, B, & K
CRMSI 2007-2 M5	$11,942,833.84	Exh. A, B, & K
CRMSI 2007-2 M5	$5,390,199.01	Exh. A, B, & K

Exhibits A and B further detail the Certificates Allstate purchased. All of the exhibits attached to this Complaint are incorporated as if set forth fully herein.

4. Allstate invested in the Certificates as part of a broader plan to invest in a diverse array of 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. But Allstate also purchased these securities with the expectation that the investments could be – and indeed some would be – sold on the secondary market.

5. The Citigroup Defendants' systematic (but hidden) abandonment of the disclosed underwriting guidelines has predictably led to soaring default rates in the Mortgage Loans underlying the Certificates. For instance, *21% of the original loans in one offering have already been written off for a loss.* The offerings show signs that the these numbers will continue to increase – *44% of the remaining loans are themselves currently delinquent*. And credit ratings on many of the Certificates have plummeted from investment grade to junk status. These problems are so drastic and their onset was so rapid (in comparison to the supposed long-term security of the investments Allstate was purchasing) that the Certificates' own poor performance to date is itself powerful evidence that the Mortgage Loans were not underwritten according to the procedures represented to Allstate. With the underlying loans performing so poorly, the market value of Allstate's Certificates has plummeted, causing Allstate to incur significant losses.

PARTIES

Plaintiffs

6. 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 is the nation's largest publicly-held personal-lines insurer, selling 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 Life Insurance Company of New York is an insurance company formed under the laws of, and domiciled in, the State of New York, with its principal place of business in Hauppauge, New York. Allstate Life Insurance Company is licensed to do business in New York and writes insurance policies to New York residents. It sells life, accident and health insurance and annuity products. Allstate Life Insurance Company of New York is a wholly-owned subsidiary of Allstate Life Insurance Company.

9. Plaintiff Agents Pension Plan is an ERISA plan sponsored by Allstate Insurance Company that is managed in the State of Illinois.

10. Plaintiff Allstate Retirement Plan is an ERISA plan sponsored by Allstate Insurance Company that is administered in the State of Illinois.

Defendants

11. All of the defendants in this action are part of the same corporate family and acted together to control the entire creation of the Certificates at issue here, from loan origination, to mortgage pooling, to securities underwriting, to sale to Allstate. All of the Citigroup Defendants are direct or indirect subsidiaries of Citigroup, Inc. Citicorp Residential Mortgage Securities, Inc. is a wholly owned subsidiary of Citicorp Trust Bank, fsb, which is a direct, wholly owned subsidiary of Citigroup, Inc. Citigroup Mortgage Loan Trust, Inc., Citigroup Global Markets Realty Corp., and Citigroup Global Markets, Inc. are all direct, wholly-owned subsidiaries of

Citigroup Financial Products, Inc., which is in turn a wholly owned subsidiary of Citigroup, Inc. Citigroup, N.A. is a direct wholly-owned subsidiaries of Citicorp Holdings Inc., which is also a wholly owned subsidiary, of Citigroup Inc. Citicorp Mortgage Securities, Inc. is a wholly-owned subsidiary of CitiMortgage, Inc., which in turn is a subsidiary of Citigroup Inc.

Sponsor Citigroup Defendants

12. Defendant CitiMortgage, Inc., is a New York corporation with its principal place of business in O'Fallon, Missouri. It was engaged in the business of, among other things, originating and acquiring residential mortgage loans and selling those loans through securitization programs. It originated many of the residential loans at issue here, serviced most of the residential loans at issue here, and sponsored securitization of some of Mortgage Loans at issue here.

13. Defendant Citicorp Trust Bank, fsb, is a federally chartered savings bank with its principal place of business in Delaware. It originated many of the residential loans at issue here and sponsored the securitization of many of the Mortgage Loans at issue here.

14. Defendant Citigroup Global Markets Realty Corp. is a New York corporation with its principal place of business in New York. It sponsored the securitization of some of the Mortgage Loans at issue here.

Affiliated Underwriter Citigroup Defendants

15. Defendant Citigroup Global Markets, Inc. (formerly known as Salomon Smith Barney or Smith Barney) is a New York corporation with its principal place of business in New York. It served as the underwriter for the offerings by Citigroup Mortgage Loan Trust Inc. and the offerings by Citigroup Global Markets Realty Corp. It served as the primary underwriter for the offerings by Citicorp Trust Bank, fsb and Citicorp Residential Mortgage Securities, Inc. It

also acted as broker for several of the certificates at issue here, aiding the other Citigroup Defendants and other Citi entities in their sale of the securities.

<u>Depositor Citigroup Defendants</u>

16. 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), Section 11(a) of the 1933 Act, 15 U.S.C. § 77k(a).

17. Defendant Citicorp Mortgage Securities, Inc. is a Delaware corporation with its principal place of business in Missouri. It was the Depositor for certain of the offerings in which Allstate invested, the Registrant for certain Registration Statements filed with the SEC, and an issuer of certain mortgage-backed Certificates purchased by Allstate.

18. Defendant Citicorp Residential Mortgage Securities, Inc. is a Delaware corporation with its principal place of business in Missouri. It was the Depositor for certain of the offerings in which Allstate invested, the Registrant for certain Registration Statements filed with the SEC, and an issuer of certain mortgage-backed Certificates purchased by Allstate.

19. Defendant Citigroup Mortgage Loan Trust Inc. is a Delaware corporation with its principal place of business in New York. It is an affiliate of Citigroup Global Markets, Inc. It was the Depositor for certain of the offerings in which Allstate invested, the Registrant for certain Registration Statements filed with the SEC, and an issuer of certain mortgage-backed Certificates purchased by Allstate.

<u>Relevant Non-Parties</u>

20. All the loans underlying the Certificates were originated or acquired by defendants CitiMortgage Inc. and Citicorp Trust Bank, fsb, or non-parties Wells Fargo Bank, N.A., PHH Mortgage Corporation, National City Mortgage Inc., Equity Now Inc., GreenPoint Mortgage Funding, Inc., Quicken Loans Inc., SunTrust Mortgage, Inc., American Home

Mortgage Corp., Washington Mutual Bank, Ameriquest Mortgage Company, MortgageIT, Inc., Option One Mortgage Corporation, and Countrywide Home Loans, Inc.

21. The Certificates for each securitization relevant to this action were issued by a trust. The issuing trusts (collectively, the "Trusts") are identified in Exhibit A along with other details regarding Allstate's purchases. Each Trust is managed by a trustee. The trustee for all of the offerings here was U.S. Bank National Association, Corporate Trust Services.

22. At all relevant times, the Citigroup 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 Citigroup 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

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

24. All of the Citigroup Defendants do business in or derive substantial revenue from activities carried out in New York. The Defendants engaged in significant business activity in the State of New York as it pertains to the securitization of the mortgage loans at issue, including preparing the offering materials, and negotiating, securitizing, and marketing the Offerings, and selling the Certificates to New York residents.

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

SUBSTANTIVE ALLEGATIONS

I. DEFENDANTS' ABUSE OF THEIR CONTROL OF THE RAPIDLY EXPANDING SECURITIZATION PROCESS

A. Evidence of a Rise in Securitization Volume Leading to a Decline in Underwriting Standards

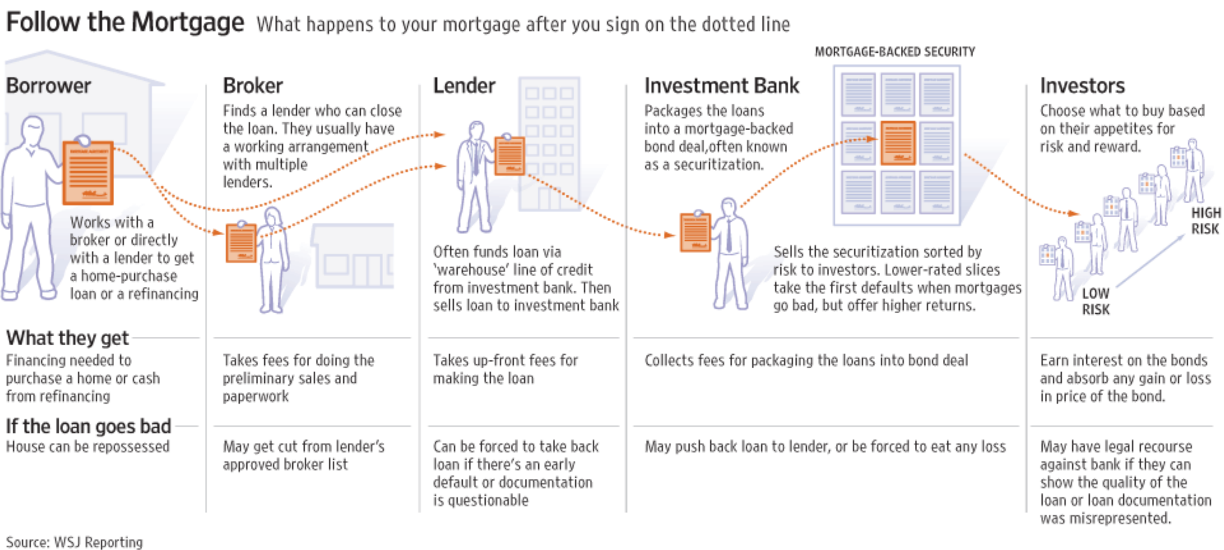
26. The federal Financial Crisis Inquiry Commission ("FCIC") "reviewed millions of pages of documents, interviewed more than 700 witnesses, and held 19 days of public hearings in New York, Washington, D.C., and communities across the country." The FCIC issued its report in January 2011:

> In this report, we detail the events of the crises . . . [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 packages, repackaged, and sold to investors around the world.

27. The report noted (at 22-23) that in July 2008 the Federal Reserve adopted "new rules," "including a requirement that borrowers have the ability to repay loans made to them. By that time, however, the damage had been done. The total value of mortgage-backed securities issued between 2001 and 2006 reached $13.4 trillion . . . . [I]t has been estimated that ultimate as many as 13 million households in the United States may lose their homes to foreclosure." Already, according to the report (at 22), "four million families have lost their homes to foreclosure and another four and a half million have slipped into the foreclosure process or are seriously behind on their mortgage payments."

28. In a securitization, mortgages are aggregated, then securities are sold that are backed by the resulting mortgage pools. The cash flows from the pooled loans, in the form of payments of interest and principal, are used to make payments on the securities. The purchase of

each Certificate here was thus the purchase of a right to participate in the cash flows generated by the pool of Mortgage Loans. As summarized by the *Wall Street Journal*:



29. Traditional securitizations were primarily arranged in conjunction with the government-sponsored entities Fannie Mae and Freddie Mac. Those entities limited the types of loans that could be securitized, and their perceived government backing simultaneously lowered the risk.

30. In the early 2000s, as interest rates at historic lows were pushing down the profits of traditional lending and even securitization through Fannie Mae or Freddie Mac, Wall Street began to look for ways to increase the fees they could generate. Banks began increasingly focusing on creating products outside the traditional lending guidelines, expanding the number of borrowers who could purportedly qualify for loans while also enabling themselves to charge those borrowers much higher fees than they would have realized on conforming loan terms.

31. A larger perceived potential borrower base and higher profits per borrower created a huge incentive to increase lending volume. The number of loans that were on terms 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 Federal Crisis Inquiry Commission, non-conforming loans went from around $670 billion in 2004 to over $2 trillion in 2006.

32. Such a huge increase in mortgage volume in a short period of time also created the problem of where to locate the money to fund those loans, and who would bear the risk. As the FCIC put it (at 7): "under the radar, the lending and financial services industry had mutated." It found (at 70) that "[s]ecuritization and subprime origination grew hand in hand," as (at 125) "[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."

33. In other words, simultaneously with a shift away from non-traditional loans came a focus on an "originate and distribute" business model. In a traditional "originate and hold" business model, the lender is economically vested in establishing the creditworthiness of the borrower and the true value of the underlying property, as it is stuck with any resulting losses. In an "originate and distribute" model, the incentives were vastly different. The risk of non-payment was transferred to the investors, and thus the only incentive for the originators, underwriters, and others in the securitization chain was to pump out as many loans as possible, the more exotic (and thus the higher-fees) the better – as long as they could be sold. The Citigroup Defendants were willing to abandon sound underwriting practices because they were routinely placing the risk onto investors like Allstate by misrepresenting the resulting loans to ensure their marketability. As the FCIC concluded (at 125): "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."

34. Because the underlying loans were extended on non-traditional terms, the banks could offer investors higher rate of returns 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 investments were in fact much riskier because the Citigroup Defendants misrepresented many aspects of the Mortgage Loans. For instance, though the Citigroup Defendants may have disclosed that a loan pool included adjustable-rate mortgages (which may be riskier than fixed-rate as the borrower may be unable to afford his or her monthly payment should interest rates rise), they overstated how many loans were for owner-occupied properties (owner-occupied properties have lower risks), understated the loan pools' average loan-to-value ratios (suggesting the owners had more of an equity "cushion" than they did), misrepresented the amount of verification of the borrower's assets and income that had been performed (understating the risk that the borrower could not afford the monthly payments), and omitted to inform Allstate and other investors about the high number of rejected loans that were "waived" in by the underwriters (making representations regarding the quality of the underwriting process even more misleading).

35. 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. In short, by misrepresenting the true risk profile of the loan pools, the Citigroup Defendants defrauded investors like Allstate into accepting the risks created by the Citigroup Defendants' shoddy lending and underwriting practices. A managing director of a financial services analyst quoted in the FCIC's report (at 6) described the financial products created during this time as being a lot like "cheap sangria," "[a] lot of cheap ingredients

repackaged to sell at a premium . . . it might taste good for a while, but then you get headaches later and you have no idea what's really inside."

36. The FCIC report summarized (at 28, emphasis added):

> [W]e follow the profound changes in the mortgage industry, from the sleepy days when local lenders took full responsibility for making and servicing 30-year loans to a new era in which the idea was to sell the loans off as soon as possible, so that they could be packaged and sold to investors around the world. New mortgage products proliferated, and so did new borrowers. *Inevitably, this became a market in which the participants – mortgage brokers, lenders, and Wall Street firms – had a greater stake in the quantity of mortgages signed up and sold than in their quality*.

37. The perverse incentives created by the move to "originate and distribute" did not just operate on an entity level, but flowed down to the individual decisionmakers within the Citigroup Defendants. The FCIC's January 2011 report noted (at 6) that "[b]ondsalesman earned multi-million dollar bonuses packaging and selling new kinds of loans, offered by new kinds of lenders, into new kinds of investment products that were deemed safe but possessed complex and hidden risks." It also found (at 64) that "[c]ompensation structures were skewed all along the mortgage securitization chain."

38. In a section discussing "employee compensation," the chair of the FDIC provided a statement to an investigative panel in January 2010 that:

> The standard compensation practice of mortgage brokers and bankers was based on the volume of loans originated rather than the performance and quality of the loans made. From the underwriter's perspective, it was not important that consumers be able to pay their mortgages when interest rates reset . . . . The long-tail risk posed by these products did not affect mortgage brokers and bankers' incentives because these mortgages were sold and securitized. The lack of a downside in these compensation schemes ultimately hurt both those who could not pay their risky mortgages and the economy.

39. To make matters worse, the FCIC found (at 14) that the explosion also created a surging demand for people to carry out the paperwork – a void that was filled, according to a study cited by the FCIC, with thousands of newly-minted "mortgage brokers" with criminal

records, including thousands with convictions for fraud, racketeering, and extortion. The FCIC also found (at 162) that "despite the underreporting" of fraud, there was a 20-fold increase in "suspicious activity reports" related to mortgage fraud between 1996 and 2006, numbers that kept climbing during the time the Mortgage Loans at issue here were originated.

40. In short, as summarized by the President's Working Group in March 2008, there was a "significant erosion of market discipline by those involved in the securitization process . . . related in part to failures to provide . . . adequate risk disclosures." It also found that the "turmoil in the financial markets was triggered by a dramatic weakening of underwriting standards for U.S. subprime mortgages . . . ." Similarly, the Comptroller of Currency's written statement for a Special Seminar on International Banking and Finance held in November 2009 found that a lethal combination of poor practices "produced, on a nationwide scale, the worst underwritten mortgages in our history." And the FCIC's January 2011 report concluded (at 101) that "there was untrammeled growth in risky mortgages. *Unsustainable, toxic loans polluted the financial system and fueled the housing bubble*."

B. Citigroup Defendants' Vertically Integrated Operation Profits from Non-Agency Securitizations

41. The Citigroup Defendants cashed in on demand for and growth in securitizations of mortgage loans. Citigroup doubled its mortgage origination business between 2002 and 2006 – increasing its originations from $73 billion in 2002 to over $140 billion in 2006. By 2006, Citigroup was the fourth largest overall mortgage originator, with $132.92 billion of originations in the first nine months of 2006. Mortgage Banking Magazine, *CitiMortgage on the Move*, December 2006.

42. While traditional mortgages remained a significant part of Citigroup's business, the growth was also driven by non-traditional loans. Bradley J. Brunts, CitiMortgage's

managing director in 2006, explained that their subprime business had changed from a niche business into a volume business because it had higher profit margins. Mortgage Banking Magazine, *CitiMortgage on the Move*, December 2006. Citigroup's subprime mortgage origination in 2006 increased by 85% over 2005 levels to approximately $38 billion. Mortgage Banking Magazine, *Inside the Market Correction*, May 2007.

43. Citigroup was also one of the leading structurers and underwriters of RMBS securitizations and had intimate knowledge of the markets for those securities. Citigroup's mortgage origination business served as a direct channel to its securitization business.

44. The Citigroup-affiliated entities were all direct or indirect subsidiaries of their parent, Citigroup, Inc. This vertical integration meant the Citigroup 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 and other investors.

45. Mortgage Loans were originated by CitiMortgage, Inc., and third-party originators. The Seller, Sponsor, and Servicer Citigroup Defendants obtained the Mortgage Loans from the originators. For Certificates issued by Citicorp Residential Mortgage Securities, Inc. ("CRMSI"), Citicorp Trust Bank, fsb, acted as the sponsor and seller, while CitiMortgage, Inc. was the servicer. For the Certificates issued by Citigroup Mortgage Loan Trust, Inc. ("CMLTI"), the seller and sponsor was Citigroup Global Markets Realty Corp. and the servicer varied. For the Certificates issued under the title CitiMortgage Alternative Loan Trust ("CMALT"), the seller, sponsor, and servicer was CitiMortgage, Inc.

46. The pools formed by the Seller, Sponsor, and Servicer Citigroup Defendants – which included large amounts of loans originated by CitiMortgage, Inc. itself – were then

transferred to the Depositor Citigroup Defendants. CRMSI, CMLTI, and Citicorp Mortgage Securities, Inc. ("CMSI") were the Depositors for the offerings. The Depositor Citigroup Defendants, in turn, transferred the loan pools to the Trustees, which held the Mortgage Loans in the Trusts for the benefit of Allstate and other Certificate holders.

47. The Trust then issued the Certificates, which represent interests in the Mortgage Loans held by the Trusts, to the Depositor Citigroup Defendants. The Depositor Citigroup Defendants then transferred the Certificates to the underwriters, who in turn transferred them to Allstate and other investors.

48. The Depositor Citigroup Defendants and the sellers and underwriters marketed and sold the Certificates to investors such as Allstate. The Certificates were sold in classes according to their expected credit ratings, and were expected to provide interest on the income stream generated by the Mortgage Loans in the collateral pools. The Depositor Citigroup Defendants were established as limited-purpose finance subsidiaries of the other Citigroup Defendants.

49. Citigroup Global Markets, Inc. was the underwriter or co-underwriter for all of the offerings at issue here. In that role, it held or shared responsibility for the marketing and managing of the securitizations' sale of Certificates to Allstate and other investors, including screening the Mortgage Loans for compliance with the Citigroup Defendants' underwriting guidelines.

II. DEFENDANTS' MATERIAL MISREPRESENTATIONS AND OMISSIONS

50. The Offering Materials made repeated representations regarding the risk profile of the Mortgage Loans. Because the value of the Certificates was dependent upon borrowers making payments on the underlying loans, if enough loans in the pool defaulted, investors would not be paid the interest returns promised and might even lose their principal. The market value

for the Certificates also would decrease as the perceived risk of the underlying pool increased. Information bearing on the riskiness of the underlying Mortgage Loans thus was material to investors, including Allstate.

51. The Offering Materials for each of the securitizations at issue here had similar representations to those highlighted below. A larger sample of the representations on which Allstate relied are found in Exhibits C through K.

A. <u>Underwriting Guidelines</u>

52. The underwriting processes used to form the pools of Mortgage Loans underlying Allstate's Certificates were 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 reasonable underwriting processes are not actually followed, the chance that the loans would have riskier features than what the Citigroup Defendants claimed (whether due to error, borrower misrepresentation, or otherwise) greatly increases. This makes the resulting loan pool much more risky. A systematic underwriting failure decreases the reliability of *all* of the information investors have about the loans, and thus greatly increases their perceived and actual risk, and greatly decreases their market value.

53. The Offering Materials all represented that the Mortgage Loans had been vetted to ensure that they had been originated according to a reasonable, consistent underwriting program, and did not present undue credit risk. For example, the Offering Materials for the CMALT 2006-7 Certificates represented: "In purchasing third-party loans, CitiMortgage will review a sample of the loans to determine whether they generally conform to CitiMortgage's underwriting standards. CitiMortgage will fully or partly credit score or re-underwrite the third-party loans to determine whether the original underwriting process adequately assessed the borrower's ability

to repay and the adequacy of the property as collateral, based on CitiMortgage's underwriting standards."

54. The Offering Materials also represented that the Mortgage Loans had been subjected to the rigorous underwriting procedures of the originators, which were all designed to ensure that the borrower could actually repay the loan. For example, the Offering Materials for CMLTI 2004-OPT1 represented that: "The mortgage loans will have been originated generally in accordance with the originator's underwriting guidelines, which are referred to in this prospectus supplement as the Option One Guidelines." They also represented: "The Option One Guidelines are primarily intended to assess (i) the value of the mortgaged property and to evaluate the adequacy of such property as collateral for the mortgage loan and (ii) the creditworthiness of the related mortgagor." The Offering Materials went on to provide detailed descriptions of those standards and procedures.

55. The Offering Materials further represented that exceptions to those underwriting standards would only result from careful consideration of compensating factors that increased the quality of a loan application. For example, the Offering Materials for CRMSI 2007-2 represented that departures would be based on "positive credit considerations ('compensating factors')" such as low LTV ratios, high FICO scores, or substantial liquid assets.

56. Further similar representations for each Certificate are set forth in Exhibits C through K.

B. <u>Due Diligence Results</u>

57. 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 defendants would apply certain disclosed standards to underwrite loans, but securitize them anyway even if they failed those standards.

58. The Citigroup Defendants, however, did not disclose that: (1) their audit and internal due diligence found substantial loans that did not meet underwriting standards; (2) third-party due diligence firms who were hired by the Citibank Defendants, such as Clayton Holdings, had informed their clients that a substantial percentage of loans in the collateral pools were defective; (3) the Citigroup Defendants nonetheless waived these non-conforming loans into securitized mortgage-backed securities that were sold to Allstate and other investors; and (4) the Citigroup Defendants had instead used the third-party due diligence reports to negotiate a lower price for the loan pools. Nor did they disclose that Citigroup's own internal processes were similarly identifying large numbers of loans with missing documentation, or that loan rejections were being included over the objection of Citigroup's own professional underwriting staff.

59. The failure to disclose the high number of loans that had been rejected yet "waived" in anyway was a fraudulent omission, and rendered the disclosures regarding the Citigroup Defendants' underwriting, sampling, and due diligence processes even more misleading.

C. Owner-Occupancy Statistics

60. 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. Common sense and experience suggests that homeowners who reside in mortgaged properties are less likely to default than owners who purchase homes as investments or vacation homes.

61. The Offering Materials contained detailed statistics regarding the Mortgage Loans in the collateral pool, including the reported owner-occupancy characteristics of the Mortgage

Loans. For example, in the Offering Materials for CRMSI 2007-2, it was represented that among the 5,218 loans, 99% of the properties were owner-occupied properties. Further similar representations for each Certificate are set forth in Exhibits C through K.

D. Loan-to-Value and Combined Loan-to-Value Ratios

62. 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. 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.

63. The Offering Materials contained detailed statistics regarding these ratios for the Mortgage Loans in the collateral pool. For example, in the Offering Materials for CRMSI 2007-2, it was represented that the weighted-average loan-to-value ratio at origination was 79.04%. And the Offering Materials for CMLTI 2007-WFHE2 represented that the weighted-average combined loan-to-value was 84%. Further similar representations for each Certificate are set forth in Exhibits C through K.

E. Credit Enhancements

64. 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 interest and principal to which they are entitled. 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 certificateholders. Credit enhancements for a given Trust also impact the overall credit rating a Trust receives. The level of credit enhancement for the Certificates was material to Allstate and other investors.

65. The Offering Materials represented that the Certificates had certain credit enhancements used to improve the likelihood that holders of such Certificates would receive regular principal and interest payments thereon. For instance, the Offering Documents for CMLTI 2007-WFHE2 represented that "Credit enhancement for the offered certificates will be provided in the form of excess interest, subordination, overcollateralization and a primary mortgage insurance policy." And the Offering Materials for CRMSI 2007-01 represented: "Credit enhancement will be provided for the Certificates through overcollateralization, excess interest, subordination and loss allocation features."

66. The Offering Materials made further representations about the purported benefit of these enhancements. For example, the Offering Materials for CMLTI 2006-4 represented that "Subordination is intended to enhance the likelihood of regular distributions on the more senior certificates in respect of interest and principal and to afford such certificates protection against realized losses on the mortgage loans in the mortgage pool as described below." And the Offering Materials for CRMSI 2006-3 represented that "Overcollateralization will provide credit enhancement to all classes of Certificates to the extent that the aggregate principal balance of loans in the Pool is greater than the aggregate principal balance of the Certificates. Overcollateralization will be maintained by application of excess interest as additional principal payments on the senior classes of Certificates. Losses allocable to the Certificates will be allocated to the classes of Certificates in reverse order of seniority."

67. “Excess cash flow,” “excess interest,” and “overcollateralization” all generally refer to the purported affects of including in the collateral pool more mortgage loans than would be strictly necessary to pay off all investors, assuming that every mortgage never missed a payment. “Subordination” refers to the fact that, should loans become delinquent or default, not all investors are treated equally. Rather, generally, certain investors are paid out of what funds are available despite those losses first. Any leftover funds from what was actually received then “waterfall” into the next class of investors, and so on.

68. Further similar representations for each Certificate are set forth in Exhibits C through K.

F. Credit Ratings

69. Each of the Certificates received a rating purportedly indicating the rating agencies’ view of the risk profile of the securities. The initial and current ratings given to the Certificates are set forth in paragraph 114 below.

70. The ratings were material to Allstate because the ratings provided additional assurances that the investors would receive the expected interest and principal payments. But for the provision of these ratings, the Certificates would have been unmarketable to Allstate, and likely would not have been issued.

71. 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. For example, the Offering Materials for CRMSI 2007-2 represented: “The offered Certificates will not be sold unless S&P and Moody’s have rated the offered Certificates as shown above.” The Offering Materials for CRMSI 2007-2 further represented: “The ratings assigned to mortgage pass-through certificates address the likelihood of the receipt by certificate holders of

all distributions to which they are entitled." Further similar representations for each Certificate are set forth in Exhibits C through K.

III. EVIDENCE OF THE OFFERING MATERIALS' MISSTATEMENTS AND OMISSIONS OF MATERIAL INFORMATION

72. The Mortgage Loans were not originated according to the underwriting standards disclosed in the relevant Offering Materials. Instead of focusing on assessing an applicant's credit standing and repayment ability, the Citigroup Defendants subordinated loan quality to the goal of originating and securitizing as many loans as possible to generate fees in the secondary mortgage market. That the disclosed underwriting standards were regularly ignored rendered all of the above representations false or misleading at the time they were made.

73. The representations regarding the underwriting processes, underwriting quality, loan selection, and use of exceptions were untrue. The loans did not comply with the underwriting standards the Offering Materials described, as those standards were regularly ignored. In originating or acquiring the loans, the Citigroup Defendants disregarded borrowers' actual repayment ability and the value and adequacy of mortgaged property used as collateral in issuing loans. Although the Offering Materials stated that loan-by-loan exceptions might be made based upon careful consideration of compensating factors bearing on credit quality, in reality loans were "waived" into pools without consideration of any compensating factors, a fact that the Defendants fraudulently omitted.

74. The representations regarding owner-occupancy were untrue. The abandonment of sound underwriting practices facilitated the widespread falsification of these statistics within the Mortgage Loans. In reality, a far greater percentage of properties were not owner-occupied.

75. The representations regarding loan-to-value and combined loan-to-value ratios were untrue. The appraisal values used in these statistics artificially and baselessly inflated

property values in order to increase the amount of money that could be given to a borrower. The Citigroup Defendants also misleadingly omitted that the disclosed statistics were baseless and that the appraisers were systematically pressured to inflate their appraisals.

76. The representations regarding due diligence were also false and misleading. Although the Citigroup Defendants obtained information as part of their due diligence which established that numerous loans did not meet their underwriting requirements, Citigroup Defendants did not disclose these glaring problems or alert investors that Citigroup Defendants were disregarding the red flags and including problem loans in the pools underlying the securities.

77. 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. Highly risky, misrepresented loans piled on top of other highly risky, misrepresented loans was not a true "enhancement" as represented. Even representations regarding the presence of such enhancements as insurance or similar agreements with third parties were misleading, in that the Citigroup Defendants' fraudulently omitted to disclose that, on information and belief, they procured those contracts making similar misrepresentations as the Citigroup Defendants made to Allstate, calling into doubt whether their terms would ultimately be honored.

78. The representations regarding the credit ratings were also untrue. The Citigroup Defendants fed baseless loan statistics to the credit rating agencies, essentially pre-determining the ratings that would be given. The use of baseless statistics also made representations about the ratings process being designed to assess credit risk false, as the entire ratings process was

rigged from the start through the use of incorrect data. The Citigroup Defendants thus did not genuinely believe that the Certificates' ratings reflected their actual risk.

A. Evidence from Citigroup's Whistleblowing Chief Underwriter

(1) Chief Underwriter Richard Bowen

79. As part of its investigation into the causes of the financial crisis, the FCIC both interviewed and took public testimony from Richard Bowen, a CPA with over thirty-five years of experience in banking, finance, and information technology.

80. During the very time the Mortgage Loans at issue here were being originated, purchased, securitized, and sold to Allstate, Bowen was a Chief Underwriter in Citigroup's Consumer Lending Group. Since 2005, the Consumer Lending Group housed the bank's consumer-lending activities, including prime and subprime mortgages and home equity loans.

81. As a chief underwriter during this key period, Bowen was responsible for ensuring that the mortgages Citigroup was acquiring met the credit standards required by the bank's credit policies. He was also responsible for working closely with the bank's Chief Risk Officer, and overseeing over 220 professional underwriters and $90 billion in annual residential mortgage productions.

82. In general there were two paths for purchased mortgage loans to take within Citigroup. For certain "prime" loans, Citigroup purchased loans based on the originator's representations that the loans were underwritten in accordance with Citigroup's guidelines. For "subprime" mortgages, Citigroup policy was to re-underwrite the loans itself before purchase to ensure the pool confirmed with Citigroup's own policies. The Certificates purchased by Allstate were backed by both prime and subprime loans purchased by Citigroup.

83. As set forth below, Bowen testified that regardless of which channel the purchased loans flowed through on their way to securitization pools such as those underlying

Allstate's Certificates, a staggeringly high number of loans were found to be defective, yet approved anyway.

(2) Evidence That Huge Numbers of Prime Loans Were Approved in Violation of Citigroup's Credit Policies

84. Citigroup's Quality Assurance department, which operated under Bowen, was supposed to ensure that the prime loans purchased from other originators did in fact meet Citigroup's own policies. The Quality Assurance underwriters were to review a "small sample" of the loans to ensure they conformed with the representations made by the originator that the loans complied with Citigroup's policies.

85. The Quality Assurance department reported to Bowen, including through his role in the bank's Third Party Origination committee. Citigroup had a policy that 95% of the loans sampled were supposed to meet an "agree" standard, indicating the Citigroup re-underwriter "agreed" with the original mortgage company's representation that the loan met Citigroup's own credit policies.

86. According to Bowen, however, Citigroup was cooking the books to meet this standard. Whereas the 95% quality threshold was being nominally met, this was occurring only because Citigroup was including as "agree" loans that were instead really "agree contingent." This designation (originally hidden even from the Third Party Origination committee) meant that documents and information were missing from the file, but the underwriter would agree if those documents existed somewhere and bore out certain additional conditions.

87. Bowen gave a hypothetical example of a mortgage file showing a 45% debt-to-income ratio. On its face, that ratio would be within guidelines. However, if the file did not contain the required documentation showing proof of the borrower's true income, it would be nonetheless classified for reporting to the Third Party Origination committee as "agree," even

though it really was better characterized as "agree—contingent [on confirming the borrower's represented income was accurate]."

88. Bowen's testimony indicates he conducted an investigation upon learning of this "agree—contingent" category of loans. It took a "significant effort" to disentangle the two conflated categories. He found 5% of the loans were facially defective, meaning there was no margin for any further errors to be found. Yet, *40%* of the loans reported to the committee as "agree" were in fact "agree—contingent," meaning they were *missing key documents. According to Bowen's testimony, these "agree-contingent" loans should have been considered a "defective file."*

89. A follow-up study found even worse problems. Bowen found that that 33% of the loans re-tested should have been "disagree," and another 37% merely "agree-contingent" due to their missing documentation. *Combined, this meant that Bowen discovered a staggering 70% defect rate in the sample Bowen re-reviewed in 2006.*

90. Far from these "contingent" loans being later cured with the documents their approval was "contingent" upon, Bowen also found in that over 40% of the loans in a study of those eventually actually sold to a third party were still missing documents that were required by the bank's policies.

91. These defects cannot be considered trivial technicalities. Bowen testified that, over the objections of others who thought "agree—contingent" loans were much ado about nothing, he found that the *delinquency rate was more than double that of loans that truly deserved the "agree" rating.*

92. *Overall, Bowen testified that the defect rate for the "designated flow" channel reached 60% in 2006, growing to 80% in 2007.* Bowen further interviewed his professional

underwriting staff, who reported to him that they believed that "over half" of the files being reported as "agree" were really missing key documents and information.

(3) Evidence That Huge Numbers of Subprime Loans Were Approved in Violation of Citigroup's Credit Policies

93. Bowen testified that for "subprime" mortgages the bank purchased, it would re-underwrite the loans it was purchasing, resulting in a "approve" or "turn down" decision. In contrast to the "prime" channel, a much larger sample was supposed to be reviewed, with the goal of reviewing 100% of the files for smaller pools, and as close to that as possible but at all times a statistically-significant sample of larger ones. As with the "prime" "designated flow" channel, Bowen testified that he personally witnessed systemic departures from the stated underwriting guidelines for the subprime loans.

94. Bowen testified that during the run-up in the market leading up to the crash, he witnessed "many changes to the way the credit risk was being evaluated" for the subprime pools. This included the Chief Risk Officer reversing the judgment of the professional underwriters, changing their decisions from "turn down" to "approval." This was done either directly, or with directions to the professional underwriters. According to Bowen, this "artificially increased the approval rate on the sample," which was then used as justification to approve the collateral pool. In the one instance Bowen specifically recalled, *36% of the loans for a certain pool that had been rejected by Citigroup's underwriters were flipped to "approve" by the Chief Risk Officer.*

95. He testified that large pools of loans ("many of $300 million") were being purchased based on "exceptions" despite their failure to meet the bank's minimum policies. For example, one pool of loans was approved for purchase while he was on vacation despite having a 30% failure rate. Citibank's policy at the time was to require a sampling to feature a 90% approval rate with a 95% degree of statistical confidence.

96. Another method Bowen discovered that Citigroup was using to circumvent its underwriting standards was that the Risk department was instructing underwriters to indicate loans were "approved" if they merely met the *originator's* guidelines, rather than Citigroup's. Bowen asked his underwriters to keep a log of when loans met the originator's guidelines but failed Citigroup's. He found that *20% of loans approved under this method would not have been approved if Citigroup's standards were applied instead*.

97. This practice was made more problematic by the fact that, according to Bowen, Citigroup overrode yet another policy it had in place – disallowing originators from re-submitting rejected loans. It made its decision to allow approval under either Citigroup or the originator's standards *retroactive* and reversed its policy of disallowing the resubmission of loans. This all but invited the submission of loans that Citigroup already knew fell outside its policies.

98. In sum, Bowen's testimony confirms that Citigroup did not follow underwriting guidelines and was "not compliant" with numerous bank policies, including minimum sample sizes, thresholds for testing by individual sellers or product types, enforcing policies on new sellers, and requirements for documenting the approval for "exceptions" to these and other policies. He testified that he thought Citigroup was "out of compliance" with "many standards" "since at least 2005."

99. As Bowen put it, "A decision was made that 'We're going to have to hold our nose and start buying the stated product if we want to stay in business.'" FCIC Report at 111. All the while, "[t]here was no disclosure being made to investors with regard to the quality of the files [Citigroup was] purchasing." FCIC Report at 169.

B. <u>Evidence from Analysis Conducted by Citigroup's Third-Party Due Diligence Firm</u>

100. Bowen also testified that, despite soaring volume, Citigroup issued a "hiring freeze" to help increase its bottom line. This required the bank to outsource its underwriting due diligence to third parties, such as the firm Clayton Holdings. Whether the due diligence was performed in-house or by an outside firm, the data arising from the FCIC's investigation confirms that the result was the same: large number of loans that were rejected by the underwriters were provided "waivers" by Citigroup for inclusion in collateral pools anyway.

101. According to the FCIC (at 166), "[b]ecause of the volume of loans examined by Clayton during the housing firm, the firm had a unique inside view of the underwriting standards that originators were actually applying – and that securitizes were willing to accept."

102. For each loan pool it was hired to review, Clayton Holdings 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. Critically, this also analyzed whether, to the extent a loan was deficient, there were any "compensating factors."

103. Each day, Clayton Holdings generated reports that summarized its findings, including summaries of the loan files that suffered from exceptions to the relevant underwriting standards. This included giving loans three grades – a Grade 3 loan "failed to meet guidelines and were not approved," while a Grade 1 loan "met guidelines." Importantly, these Grade 3

loans did not contain any "compensating factors." Clayton Holdings allowed the seller to attempt to cure any problems that were identified before a final grade was given.

104. According to the FCIC (at 166), 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.

105. Clayton Holdings was one of the third-party firms brought in because of Citigroup's hiring freeze, and thus performed work on behalf of Citigroup during this time. This is not only confirmed by Bowen's testimony, but by an internal Clayton Holdings "Trending Report" made public by the government in conjunction with testimony given in September 2010.

106. Clayton Holdings' internal "trending report" confirms that to be the case. In that report, Clayton Holdings analyzed some of the loans it had reviewed on behalf of Citigroup. It found that *42% of those loans "failed to meet guidelines."* Despite the fact that loans that received such a grade were *not* subject to any purported "compensating factors," Clayton Holdings found that Citigroup had *waived in 32% of those rejected loans.*

107. Similarly, Clayton Holdings internal "trending report" analyzed loans that were underwritten by Credit Suisse, who was the underwriter on the CMALT 2006-A7 Offering. Clayton Holdings found that *32% of those loans "failed to meet guidelines."* Despite the fact that loans received such a grade were *not* subject to any purported "compensating factors," Clayton Holdings found that Credit Suisse *waived in 33% of those rejected loans.*

108. As set forth above, there is ample evidence that the Mortgage Loans at issue here were not, in fact, properly underwritten. On information and belief, Citigroup was similarly informed of the high number of problematic Mortgage Loans at issue here, and similarly

wrongfully waived in high numbers of those loans into the loan pools underlying the mortgage-backed securities purchased by Allstate.

109. In sum, Citigroup's own due diligence firms identified high numbers of problematic loans, but those loans were "waived" into the collateral pools at issue here at a materially high rate. The hidden "waiver" of rejected loans that were not subject to any compensating factors was a fraudulent omission, and rendered the disclosures regarding the underwriting and due diligence processes even more misleading. As the FCIC report concluded (at 167, 170):

> [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 Even 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.*

C. Evidence of Continued Citigroup Underwriting Problems

110. Recent revelations show, remarkably, that Citigroup has still not fixed the problems plaguing its mortgage loan underwriting. Bloomberg recently reported that, according to a study by Freddie Mac, "[f]ifteen percent of the performing loans Citigroup sold to [Freddie Mac] in the second half of 2009 and the first half of 2010 had such flaws as missing appraisals or insurance documents or income miscalculations." *Citigroup 46% Gain Masks Flawed Loans Sold to Freddie*, Bloomberg, Jan. 18, 2011.

111. These findings evidence "that Citigroup is having significant problems with internal systems and controls" in its mortgage pipeline, according to expert consultant Christopher Whalen of Institutional Risk Analytics.

112. The CEO of defendant CitiMortgage Inc. – which served as originator and sponsor on one of the offerings at issue in this case, servicer of loans underlying several of the offerings, and corporate parent of the depositor for a multiple offerings – refused to comment on Freddie Mac's finding of a 15% flaw rate, but did say that "the bank's own quality control reviews show an improvement in underwriting." This CEO did not indicate how much higher than a 15% flaw rate Citigroup's underwriting had experienced before this "improvement." Other evidence cited herein establishes that the flaw rate was much higher than 15%.

D. Statistical Evidence Confirming That Citigroup Defendants Abandoned Underwriting Guidelines

113. Even though the Certificates were supposed to be long-term, stable investments, their performance since issuance is proof positive that the were not underwritten as advertised in the Offering Materials. For CMLTI 2007-WFHE2, *21% of the original loans have already been written off for a loss*. The offerings show signs that the these numbers will continue to increase. Of the loans left in CMLTI 2007-WFHE2, *44% are currently delinquent*. And for CMLTI 2006-4, *16% of the loans in the current pool are delinquent*. Overall, the delinquency data shows that an unusually high percentage of the Mortgage Loans underlying the offerings have experienced delinquency and default.

114. Similarly, the ratings given to the Certificates have significantly deteriorated. Many of Allstate's investments initially received high ratings indicating that the Certificates were high quality or upper-medium grade investments that were subject to low or minimal credit risk. For example, the CMLTI 2007 WFHE2 M2, CRMSI 2006-3, M2, and CRMSI 2007-1 M1

Certificates—all of which were originally rated Aa2 by Moody's—are now rated at C. According to Moody's website, these ratings now indicate that the Certificates are "the lowest rated class and are typically in default, with little prospect for recovery of principal or interest." The initial and current ratings of some of Allstate's Certificates are set forth below:

Asset	Current Moody's Rating	Original Moody's Rating
CMALT 2006-A7 1A13	Ca*-(sf)	Aa1
CMLTI 2006-4 2A1B	Ca*-(sf)	Aa1
CMLTI 2007-WFHE2 M2	C (sf)	Aa2
CRMSI 2006-3, M2	C (sf)	Aa2
CRMSI 2006-3, M4	C (sf)	A1
CRMSI 2006-3, M6	C (sf)	A2
CRMSI 2007-1 M1	C (sf)	Aa1
CRMSI 2007-1 M2	C (sf)	Aa2
CRMSI 2007-2 A6	Caa2 (sf)	Aaa
CRMSI 2007-2 M1	C (sf)	Aa1
CRMSI 2007-2 M2	C (sf)	Aa2
CRMSI 2007-2 M3	C (sf)	Aa3
CRMSI 2007-2 M4	C (sf)	A1
CRMSI 2007-2 M5	C (sf)	A2

115. The drastic rise in default rates on the Mortgage Loans underlying Allstate's Certificates reflects the Citigroup Defendants' 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 that contained loans that actually had the characteristics the Offering Materials claimed.

116. It is usually a large and unexpected disruption to a borrower's income that causes an actual payment default. In a properly underwritten pool of loans, one would thus 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 in their payment ability so soon after purchasing a home. Indeed, as discussed further below, economic studies have

confirmed that high default rates early in a loan's life are highly correlated with misrepresentations in the loan files. This makes sense – as borrowers are put in loan products they cannot actually afford, they quickly and predictably fall behind on their payments.

117. In short, the dismal performance of the Mortgage Loans is itself strong evidence that they were improperly underwritten, and that they did not have the credit risk characteristics the Offering Materials claimed. The defaults and related drop in market value thus are due to the Citigroup Defendants' wrongdoing, and not because of the general change in economic conditions.

E. Evidence of Misrepresentations Regarding Owner-Occupied Mortgaged Properties

118. As noted above, the Citigroup Defendants repeatedly represented that the loan pools underlying the Certificates had high percentages of loans issued to borrowers that were living in the mortgaged properties. The Certificates here were in fact backed by Mortgage Loans that had a far higher percentage of non-owner occupied properties.

119. 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 occupied or were quickly vacated by the borrower.

120. In addition to industry-wide evidence of owner-occupancy fraud, Allstate has amassed evidence of such fraud in connection with the Certificates. Allstate selected a sample of loans from each offering in which it invested to test the Citigroup Defendants' representations on a loan-level basis. Using techniques and methodologies that only recently became available to

investors, Allstate conducted loan-level analyses on over 9,000 Mortgage Loans underlying its Certificates.

121. For each offering, Allstate attempted to analyze 800 defaulted loans and 800 randomly-sampled loans from within the collateral pool. Where the loan pool contained fewer than 1,600 loans, Allstate tested every loan associated with that transaction.

122. These sample sizes are 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 is cost-prohibitive. 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 increases as well. Experts in RMBS cases have found that a sample size of 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.

123. 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.

124. 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.

125. 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.

126. 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 is good evidence that the borrower did not live in the subject property.

127. 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 to 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 a much higher percentage of borrowers did not occupy the mortgaged properties than was represented:

Asset	**Percentage of Owner-Occupied Properties Represented in Prospectus**	**Estimated Actual Percentage of Owner-Occupied Properties in the Pool**	**Prospectus Overstatement**
CMLTI 2006-04	69.6%	57.7%	11.9%
CMLTI 2007-WFHE2	94.2%	81.8%	12.3%
CMALT 2006-A7	88.4%	75.2%	13.2%
CRMSI 2007-02	98.7%	93.7%	5.0%
CRMSI 2006-03	98.6%	96.0%	2.6%
CRMSI 2007-01	99.2%	96.1%	3.1%

128. The fact that these statistics were overstated was unknown to investors like Allstate, who relied upon the inflated statistics in the Offering Materials to evaluate the Certificates as an investment. The overstatements are also further proof that the Citigroup Defendants abandoned underwriting guidelines touted in the Offering Materials in favor of chasing profits on subprime securitizations.

129. 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. The remaining Certificates involved the same parties, the same affiliated originators, nearly identical disclosures, and both the underlying loans and the Certificates themselves were being generated around the same time and purportedly according to the same processes. As such, on information and belief, the Offering Materials for all of the Certificates misrepresented the owner occupancy statistics at approximately the same, material rate as seen in the large sample of Certificates discussed above.

F. Evidence of False Loan-to-Value and Combined Loan-to-Value Ratios

130. The Citigroup Defendants also made representations about the Mortgage Loans' LTV and CLTV ratios. These ratios compare the amount of the loan to the value of the mortgaged property, theoretically calculated using an appraisal process. An erroneous appraisal would thus directly result in erroneous LTV and CLTV ratios. The Citigroup Defendants' representations as to LTV and CLTV ratios were false.

131. Using techniques and methodologies that only recently became available, Allstate had the underlying property valued by an industry-standard automated valuation model ("AVM"). AVMs are routinely used in the industry 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.

132. The results of this analysis for each Certificate is set forth in the Exhibits. Applying the AVM to the available data for the loans underlying the Certificates shows that the value used by the Citigroup Defendants in the represented LTVs were materially and consistently inflated. This caused the disclosed LTV and CLTV 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.

133. In CMLTI 2006-4, for example, 30 percent of the loans sampled had recalculated LTV ratios of more than 10% higher than what was claimed (for loans with available LTV data), and *14% had recalculated LTV ratios of more than 25% higher than what was claimed.* And in CMALT 2006-A7, 50 percent of the loans sampled had recalculated LTV ratios of more than 10% higher than what was claimed in the Offering Materials (for loans with available LTV data), and *23% had recalculated LTV ratios of more than 25% higher than what was claimed.* These severe overstatements affected numerous statistics in the Offering Materials.

134. For instance, the Offering Materials made representations about the percent of loans that had LTVs higher than 90%. LTVs in excess of 90% provide the lender little value cushion to protect against borrower default and loss upon foreclosure. However, the AVM

indicates that a much higher percentage of the loans had LTVs higher than 90%. The LTV ratios were consistently misstated, as shown in the chart below:

Asset	Percentage of Loans Represented to Have LTVs Greater than 90%	Actual Percentage of Loans with LTVs Greater than 90%	Prospectus Understatement of Percent of Loans with High LTVs
CMLTI 2006-4	5.21%	20.70%	15.50%
CMALT 2006-A7	0.14%	26.42%	26.28%
CRMSI 2007-02	29.63%	53.22%	23.60%
CRMSI 2006-03	30.85%	48.82%	17.97%
CRMSI 2007-01	32.95%	48.31%	15.35%

135. The Offering Materials also made representations about how many of the Mortgage Loans had LTV ratios greater than 100 percent, meaning the size of the loan is greater than the value of the property. (This is known as being "underwater," where a borrower owes more on the property than it is worth.) Loans with over 100% LTV afford the lender no equity cushion and leave the lender with inadequate collateral from the outset of the loan. Allstate's analysis has found that, despite the Citigroup Defendants contrary representations, a substantial number of the Mortgage Loans had LTVs greater than 100%, 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 Underwater
CMLTI 2006-4	0.00%	9.25%	9.25%
CMALT 2006-A7	0.00%	12.36%	12.36%
CRMSI 2007-02	0.00%	36.61%	36.61%
CRMSI 2006-03	0.00%	32.28%	32.28%
CRMSI 2007-01	0.00%	31.36%	31.36%

136. Allstate has also analyzed the average LTV of the Mortgage Loans in each pool and has found that the average LTV was also overstated, because of the overstatement of individual Mortgage Loans within the pools.

Asset	Represented Weighted Average LTV	Actual Weighted Average LTV	Prospectus Understatement
CMLTI 2006-4	70.30%	73.91%	9.05%
CMALT 2006-A7	70.65%	82.03%	11.38%
CRMSI 2007-02	79.04%	93.30%	14.26%
CRMSI 2006-03	78.08%	90.53%	12.45%
CRMSI 2007-01	79.39%	87.61%	8.22%

137. Other Offering Materials, particularly for those related to pools with large numbers of second-lien loans, focused more on the CLTV statistics of the underlying loans, so as to take into account the total value of the liens on the property. Again, as with the LTV statistics, the Citigroup Defendants misrepresented the CLTV statistics, seriously understating the riskiness of the Mortgage Loans underlying the Certificates. Using both the AVM to recalculate the value of the property and researching the existence of additional, hidden liens revealed numerous misrepresentations.

138. In some cases the Offering Materials also made representations about the percentage of loans that had CLTVs higher than 100%. Just as with LTVs, CLTVs in excess of 100% provide the lender no cushion to protect against borrower default and loss upon foreclosure. Using both the AVM to recalculate the value of the property and researching the existence of additional, hidden liens revealed that a much higher percentage of the loans had CLTVs higher than 100%. In the case of CMLTI 2007-WFHE2, for example, the Offering Materials stated that *none* of the Mortgage Loans had a CLTV ratio in excess of 100.00%. Allstate's analysis has shown that in fact, 25.49% of the Mortgage Loans had a CLTV ratio in excess of 100%. The Offering Materials also stated that the weighted average CLTV ratio was 84.37%, whereas Allstate's investigation has found that the weighted average CLTV ratio is actually 100.34%.

139. For instance, the Offering Materials made representations about the percent of loans that had CLTVs higher than 90%. Just as with LTV statistics, CLTVs in excess of 90% provide the lender little value cushion to protect against borrower default and loss upon foreclosure. However, the AVM indicates that a much higher percentage of the loans had CLTVs higher than 90%. The CLTV ratios were consistently misstated, as shown in the chart below:

Asset	Percentage of Loans Represented to Have CLTVs Greater than 90%	Actual Percentage of Loans with CLTVs Greater than 90%	Prospectus Understatement of Percent of Loans with High CLTVs
CMLTI 2006-4	15.07%	35.10%	20.03%
CMLTI 2007-WFHE2	55.61%	71.51%	15.90%
CRMSI 2007-02	29.67%	53.66%	23.99%
CRMSI 2006-03	30.96%	72.44%	41.48%
CRMSI 2007-01	33.02%	66.95%	33.93%

140. The Offering Materials also made representations about how many of the Mortgage Loans had CLTV ratios greater than 100 percent, meaning the size of the loan is greater than the value of the property. Just as with LTVs, loans with over 100% CLTV afford the lender no equity cushion and leave the lender with inadequate collateral from the outset of the loan. Allstate's analysis has found that, despite the Citigroup Defendants contrary representations, a substantial number of the Mortgage Loans had CLTVs greater than 100%, as follows:

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 Underwater
CMLTI 2006-4	0.00%	19.24%	19.24%
CMLTI 2007-WFHE2	0.00%	49.00%	49.00%
CRMSI 2007-02	0.00%	37.49%	37.49%
CRMSI 2006-03	0.00%	59.84%	59.84%
CRMSI 2007-01	0.00%	58.47%	58.47%

141. Allstate has also analyzed the average CLTV of the Mortgage Loans in each pool and has found that the average CLTV was also overstated, because of the overstatement of individual Mortgage Loans within the pools.

Asset	Weighted Average CLTV, as Represented by Prospectus	Actual Weighted Average CLTV	Prospectus Understatement
CMLTI 2006-4	73.17%	84.66%	11.49%
CMLTI 2007-WFHE2	84.37%	100.34%	15.97%
CRMSI 2007-02	79.05%	94.11%	15.06%
CRMSI 2006-03	78.19%	133.04%	54.85%
CRMSI 2007-01	79.42%	133.06%	53.64%

142. The Citigroup Defendants did not genuinely believe that the appraised values were reasonable estimations of the properties' values at the time they were given. The Citigroup Defendants knew that the appraisals were being inflated to allow borrowers to be approved for loans that they could not afford. As such, they knew the LTV and CLTV statistics were baseless. Further, the CLTV statistics above were inflated in part because of the presence of hidden liens, which do not turn on any purported difference in the appraisal "opinion."

143. The fact that these statistics were overstated was unknown to investors like Allstate, who relied upon the inflated statistics in the Offering Materials to evaluate the

Certificates as an investment. The overstatements are also further proof that the Citigroup Defendants abandoned underwriting guidelines touted in the Offering Materials, in favor of chasing profits on subprime securitizations.

144. 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. The untested Certificates involved the same parties, the same affiliated originators, nearly identical disclosures, and both the underlying loans and the certificates themselves were being generated around the same time and according to the same processes. As such, on information and belief, the Offering Materials for the Certificates that Allstate was not able to test on a loan-level basis also misrepresented the LTV and CLTV statistics at approximately the same, material rate as seen in the large sample of Certificates discussed above.

G. Evidence of Citigroup Defendants' Loan Originators' Misrepresentations Regarding Their Underwriting

145. As discussed above, the Offering Materials made various specific representations about careful underwriting guidelines and practices supposedly employed by the third-party loan originators used by the Citigroup Defendants. Recent revelations have shown that such originators had actually abandoned any such practices. Some examples of that abandonment are detailed below, on information and belief.

146. The originators used by the Citigroup Defendants contributed the following percentage of loans to each Trust:

Citigroup Trust	Originator(s)	% of Origination
CMLTI 2004-OPT1	Option One Mortgage Corporation	100.00%
CMLTI 2005-3	Countrywide Home Loans, Inc.	Group I - 78.57%; Group II - 23.42%; Group III - 1.05%
	Quicken Loans Inc.	Group II - 3.53%;

		Group III - 13.60%.
	MortgageIT, Inc.	Group III - 7.68%
	National City Mortgage Co.	Group II - 1.40%; Group III - 77.67%
	Wells Fargo Bank, N.A.	Group I - 21.43%; Group II - 71.65%
CMLTI 2005-WF2	Wells Fargo Bank, N.A.	100.00%
CMLTI 2006-4	PHH Mortgage Corporation	48.50%
	National City Mortgage Inc.	31.46%
	Equity Now Inc.	8.91%
	SunTrust Mortgage, Inc.	5.48%
	American Home Mortgage Corp.	3.65%
	Washington Mutual Bank	1.93%
	Ameriquest Mortgage Company	0.07%
CRMSI 2006-3	Citicorp Trust Bank, fsb	100.00%
CMALT 2006-A7	CitiMortgage, Inc. (and unspecified affiliates)	Combined Pool – 51.34% (Pool I - 51.54%; Pool II - 47.16%)
	GreenPoint Mortgage Funding, Inc.	Combined Pool - 11.32% (Pool I - 10.48%; Pool II - 29.15%)
	Quicken Loans Inc.	Combined Pool - 10.46% (Pool I - 10.19%; Pool II - 16.00%)
	Unspecified	Combined Pool – 26.88% (Pool I – 27.79%; Pool II – 7.69%)
CMLTI 2007-WFHE2	Wells Fargo Bank, N.A. (including unspecified number of loans acquired and re-underwritten from correspondent lenders)	100.00%
CRMSI 2007-1	Citicorp Trust Bank, fsb	100.00%
CRMSI 2007-2	Citicorp Trust Bank, fsb	100.00%

(1) Wells Fargo Bank, N.A.

147. Wells Fargo Bank, N.A. originated all of the mortgage loans for the CMLTI 2005-WF2 and CMLTI 2007-WFHE2 offerings. Wells Fargo Bank, N.A. also originated approximately 21.43% of the Group I Mortgage Loans, approximately 93.45% of the Group II-1

Mortgage Loans, approximately 78.07% of the Group II-2 Mortgage Loans, approximately 98.55% of the Group II-3 Mortgage Loans and approximately 43.57% of the Group II-4 Mortgage Loans in the CMLTI 2005-3 offering.

148. Government investigations and statements provided by insiders confirm that Wells Fargo was churning out problematic loans.

149. In 2010, Wells Fargo was identified by the Office of the Comptroller of the Currency (the "OCC") as the thirteenth worst subprime lender in the country based on the delinquency rates of the mortgages it originated in the ten metropolitan areas with the highest rates of delinquency. Upon information and belief, during the period in which Wells Fargo was originating loans which were eventually pooled into the CMLTI 2007-WFHE2 and CMLTI 2005-WF2 offering, Wells Fargo had abandoned sound underwriting practices.

150. Wells Fargo acknowledged its poor underwriting practices in its 2007 Annual Report. In a section entitled "Credit Quality: What We Did Wrong" Wells Fargo noted:

> We made some mistakes . . . . Too many of our home equity loans had "loan-to-value" ratios that were too high . . . . Sometimes we did not require full documentation for these home equity loans we purchased from brokers because these were prime borrowers who had high credit scores with lower expected risk of default . . . . We should not have offered such lenient loan terms . . . , and we made the mistake of taking on too much risk. We should have known better.

151. Countless different entities have conducted investigations of Wells Fargo and numerous complaints have been filed against the bank as a result.

152. Wells Fargo did not ensure for its "stated income" loans that the borrower's income as stated must be reasonable for the borrower's occupation as determined in the discretion of the loan underwriter. Rather, Wells Fargo expected that their borrowers would overstate their income on "stated income" loan applications and that these borrowers would not have the ability to make their monthly mortgage loan payments. Many of the loans in the pools

backing the CMLTI 2007-WFHE2 and CMLTI 2005-WF2 offering contained such "stated income" loans. For example, 14.62% of the loans in the CMLTI 2007-WFHE2 were "stated income" loans.

153. Wells Fargo and RELS Valuation, an appraisal entity jointly owned by an affiliate of Wells Fargo Bank, were sued over the illegal practice of pressuring and intimidating appraisers into using techniques that produce appraisals to meet Wells Fargo's objectives even when the use of such techniques is improper and violates industry standards.

154. Wells Fargo employees increasingly disregarded the credit risk of the Mortgage Loans and their own quality controls in favor of generating loan volume to increase their own commissions and bonuses. Even more alarming, Wells Fargo employees manipulated loan data to close loans and generate volume and had a standard practice of approving exceptions which deviated from prudent underwriting guidelines. Wells Fargo placed "intense pressure" on its loan officers to close loans, including by coaching borrowers to provide qualifying income information, accepting blatantly implausible or falsified income information, and lowering its standards near the end of the calendar year.

155. Wells Fargo went as far as firing one senior underwriter for choosing not to compromise his underwriting standards when he was pressured to do so. Wells Fargo's mortgage underwriting was a "production based shop," meaning that underwriters had to make the numbers, regardless of risk, and were expected to "find a way" to deem the loans as acceptable, when in fact they did not meet the required standards. As a result of its poor underwriting, Wells Fargo sold sub-par loans to Citigroup Mortgage that should never have been made in the first instance.

156. At Wells Fargo Home Mortgage, representatives constantly pushed the appraisers to inflate the value of the real estate underlying the mortgage loans and retail officers "always managed to get the value they wanted."

157. Defendants had the opportunity to – and did – review Wells Fargo's loan files as part of their due diligence and their obligations in the securitization process. This review revealed or should have revealed that Wells Fargo's actual underwriting practices were vastly inconsistent with the representations in the Offering Materials regarding the high standards of Wells Fargo and the Citigroup Defendants. That Wells Fargo had serious origination underwriting breakdowns is also confirmed by the testimony of Mr. Bowen, who gave detailed statistics about the reject rates for loans bought by Citigroup from third party originators like Wells Fargo.

(2) CitiMortgage Inc.

158. CitiMortgage Inc. was Citigroup's residential mortgage production arm. It originated 51.34% of the mortgage loans, by aggregate principal balance for the CMALT 2006-A7 offering.

159. As was recently disclosed, in 2005, CitiMortgage began aggressively expanding its subprime and Alt-A loan production. Loans originated by CitiMortgage were woefully deficient in terms of their underwriting and eventual performance, and suffered from severe infirmities that eventually led to significant defaults and losses that infiltrated Citigroup's RMBS and CDO securitizations.

160. Citigroup consolidated its mortgage operations beginning in 2005 in order to expand into the subprime market. Beginning in 2005 and throughout 2006, Citigroup furiously expanded its subprime mortgage originations. By 2006, Citigroup was the fourth largest overall mortgage originator, with $132.92 billion of originations in the first nine months of 2006.

161. Citigroup increasingly relied on the correspondent lender channel to build and sustain its market share growth and position as the fourth largest mortgage originator. Citigroup also increasingly relied upon its correspondent channel to generate loan production for itself and the securitization pools it was supplying. The value of Citigroup's portfolio of correspondent channel loans ballooned from approximately $69 billion in 2005, to $88 billion in 2006, and to $94 billion in 2007. These loans were permeated with fraud evidenced by early payment defaults that steadily rose beginning in the first quarter of 2006.

162. As spelled out in a March 3, 2008 confidential presentation entitled "The Subprime Crisis: An Overview," Citigroup admitted that "the late-2006, early-2007 subprime originations are generally regarded as the poorest credits." Citigroup further stated that "70+% of 2005-2006 subprime origination loans were '2-28' or '3-27' ARMs with low 'teaser' rates."

163. Citigroup was aware of the massive problems with its mortgage portfolio during 2006, evidenced by an exponential increase in loans that quickly defaulted, among other problems. However, these losses and defaults were concealed.

164. Defendants had the opportunity to – and did – review CitiMortgage's loan files as part of their due diligence and their obligations in the securitization process. This review revealed or should have revealed that CitiMortgage's actual underwriting practices were vastly inconsistent with the representations in the Offering Materials regarding the high standards of CitiMortgage and the Citigroup Defendants.

(3) Countrywide Home Loans, Inc.

165. Countrywide Home Loans, Inc. originated approximately 78.57% of the Group I Mortgage Loans, approximately 1.40% of the Group II Mortgage Loans, approximately 21.77% of the Group II-2 Mortgage Loans, approximately 0.00% of the Group II-3 Mortgage Loans,

approximately 41.47% of the Group II-4 Mortgage Loans, and approximately 1.05% of the Group III Mortgage Loans for CMLTI 2005-3.

166. In June 2009, the SEC initiated a civil action against Countrywide executives Angelo Mozilo, David Sambol, and Eric Sieracki. On September 16, 2010, the District Court denied the defendants' motions for summary judgment. The District Court found that the SEC raised genuine issues of fact as to, among other things, whether the defendants had misrepresented the quality of its underwriting processes:

> The SEC has presented evidence that these statements regarding the quality of Countrywide's underwriting guidelines and loan production were misleading in light of Defendants' failure to disclose, *inter alia*, that: (1) As a consequence of Countrywide's "matching strategy," Countrywide's underwriting "guidelines" would end up as a composite of the most aggressive guidelines in the market . . . and (2) Countrywide routinely ignored its official underwriting guidelines, and in practice, Countrywide's only criterion for approving a loan was whether the loan could be sold into the secondary market.
>
> For example, Countrywide's Chief Risk Officer, John McMurray, explained in his deposition that Countrywide mixed and matched guidelines from various lenders in the industry, which resulted in Countrywide's guidelines being a composite of the most aggressive guidelines in the industry . . . .
>
> SEC has also presented evidence that Countrywide routinely ignored its official underwriting to such an extent that Countrywide would underwrite *any* loan it could sell into the secondary mortgage market. According to the evidence presented by the SEC, Countrywide typically made four attempts to approve a loan . . . . According to the testimony of the Managing Director of Countrywide Home Loans' Secondary Marketing Division, once the loan was referred to Countrywide's Secondary Markets Structured Lending Desk, the sole criterion used for approving the loan was whether or not the loan could be sold in the secondary market. As a result of this process, a significant portion (typically in excess of 20%) of Countrywide's loans were issued as exceptions to its official underwriting guidelines . . . .
>
> In light of this evidence, a reasonable jury could conclude that Countrywide all but abandoned managing credit risk through its underwriting guidelines . . . .

S.E.C. v. Mozilo, No. CV 09-3994, 2010 WL 3656068, at *10 (C.D. Cal. Sept. 16, 2010). The Court also found that the SEC presented evidence from which a jury could find Countrywide's

statistics regarding "prime" mortgages to be misleading, based on Countrywide's internal definition of that term. *Id.* at *14-15. Mozilo, Sambol, and Sieracki, subsequently settled with SEC on the eve of trial, agreeing to pay substantial fines.

167. The testimony and documents only recently made available to Allstate by way of the SEC's investigation confirm that Countrywide was systematically abusing "exceptions" and low-documentation processes in order to circumvent its own underwriting standards, in order to grow its volume by implementing a "matching" strategy that let it lead a race to the bottom. 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."

168. For instance, the SEC has revealed that in November 2007, Countrywide prepared a "lessons learned" analysis. This included key observations from interviews of Countrywide's employees and culminated in an internal presentation. In this analysis, Countrywide repeatedly admits that it was singularly focused on market share and its "matching" strategy:

- "We were driven by market share, and wouldn't say 'no' (to guideline expansion)."
- "Competitiveness and aggressiveness are great, and part of our DNA. However, it can lead to arrogance and lack of friends. There are times when our strengths can turn into our weaknesses."
- "The strategies that could have avoided the situation were not very appealing at the time. Do not produce risky loans in the first place: This strategy would have hurt our production franchise and reduced earnings."
- "Market share, size and dominance were driving themes . . . . Created huge upside in good times, but challenges in today's environment. Net/net it was probably worth it."

169. Countrywide also repeatedly admits that the "matching" strategy led to product development far outpacing its risk-assessment procedures and misaligned the incentives of its employees:

- "With riskier products, you need to be exquisite in off-loading the risk. This puts significant pressure on risk management. Our systems never caught up with the risks, or with the pace of change."
- "Risk indicators and internal control systems may not have gotten enough attention in the institutional risk and Board committees."
- "Not enough people had an incentive to manage risk."
- "Decentralized and local decision making were another characteristic of our model . . . . The downside was fewer risk controls and less focus on risk, as the local decision makers were not directly measured on risk."
- "Our wide guidelines were not supported by the proper infrastructure (credit, risk management)."
- "[W]e did not put meaningful boundaries around the [broad product] strategy, even when our instincts might have suggested that we do so, and we allowed the model to outrun its critical support infrastructure in investment and credit risk management . . . . Our risk management systems were not able to provide enough counterbalance . . . ."
- "The focus of production was volume and margin, not credit risk. There was also massive emphasis on share."
- "Structure and capabilities of Secondary not in-sync with production."

170. The SEC has also revealed that, in a March 28, 2006 e-mail to Sambol and others, Mozilo admitted the problems with loans were caused by "errors of both judgment and protocol." And in an April 13, 2006 e-mail, Mozilo wrote to Sieracki and others that he was concerned that certain subprime loans had been originated "with serious disregard for process [and] compliance with guidelines," resulting in the delivery of loans "with deficient documentation":

> I want Sambol to take all steps necessary to assure that our origination operation "follows guidelines" for every product that we originate. I have personally

> observed a serious lack of compliance within our origination system as it relates to documentation and generally a deterioration in the quality of loans originated versus the pricing of those loan[s]. In my conversations with Sambol he calls the 100% sub prime seconds as the "milk" of the business. Frankly I consider that product line to be the poison of ours. Obviously as CEO I cannot continue the sanctioning of the origination of this product until such time I can get concrete assurances that we are not facing a continuous catastrophe. Therefore I want a plan of action not only from Sambol but equally from McMurray as to how we can manage this risk going forward.

171. In a June 2006 email chain that included Countrywide's Chief Risk Officer John McMurray and Sambol, Countrywide circulated the results of an audit it had conducted. 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." McMurray admitted that it's "obviously the case" that "perhaps many" of these overstatements were the result of misrepresentations. Another Countrywide Risk Officer, Clifford Rossi, agreed, testifying that "the vast majority" of the overstated income amounts was "likely" due to misrepresentations.

172. According to documents released by the SEC, Countrywide's Frank Aguilera, a Managing Director responsible for risk management, reported the "particularly alarming" results of an internal review on June 12, 2006. He reported to others in Countrywide that 23% of the subprime loans at the time were generated as exceptions, even taking into account "all guidelines, published and not published, approved and not yet approved." Again, this study occurred during the same period in which loans were being generated and included in Allstate's Certificates.

173. In April 2005, a Countrywide Managing Director admitted that the "exception" policy was not an attempt to deal with "compensating factors" but rather was an attempt to "approve all loans submitted . . . which are later determined to be outside [guidelines]," and an attempt to "keep pace with fast changing markets."

174. Countrywide's Chief Risk Officer would later testify that he would reject new products, only to see people in sales approve loans under "exceptions" in order to achieve the new result.

175. In a February 2007 internal email, a Regional Vice President noted that borrowers who did not qualify for a loan would be "flip[ped]" into stated-income products. Loan officers would then coach borrowers what income they would have to claim in order to qualify. Other former employees have similarly confirmed that Countrywide coached borrowers how to falsify their low- or no-documentation loan applications in order to circumvent the normal underwriting process. One Countrywide employee estimated that approximately 90% of all reduced-documentation loans sold out of the employee's Chicago office had inflated incomes.

176. Defendants had the opportunity to – and did – review Countrywide's loan files as part of their due diligence and their obligations in the securitization process. This review revealed or should have revealed that Countrywide's actual underwriting practices were vastly inconsistent with the representations in the Offering Materials regarding the high standards of Countrywide and the Citigroup Defendants. That Countrywide had serious origination underwriting breakdowns is also confirmed by the testimony of Mr. Bowen, who gave detailed statistics about the reject rates for loans bought by Citigroup from third party originators like Countrywide.

(4) Washington Mutual Bank

177. Washington Mutual Bank originated 01.93% of the mortgage loans, by aggregate principal balance, for the CMLTI 2006-4 offering.

178. WaMu pervasively violated its stated underwriting and appraisal standards, even in its purportedly prime mortgage business. In order to generate a greater volume of risky loan products, WaMu financially rewarded loan origination personnel for closing higher-risk loans

and instituted minimum loan sales quotas. Accordingly, WaMu's employees targeted more and more borrowers who were less able to afford the loan payments they would have to make, and many of whom had no realistic ability to make payments on the loans they were sold.

179. On April 13, 2010, the Senate Permanent Subcommittee on Investigations ("PSI") held a hearing that focused on the role high-risk loans played in the financial crisis, using WaMu as a case history. It showed how WaMu originated and sold hundreds of billions of dollars in high-risk loans to Wall Street Banks in return for big fees, polluting the financial system with toxic mortgages.

180. The PSI reached the following findings of fact following the April 13, 2010 hearing:

- High Risk Lending Strategy. Washington Mutual ("WaMu") executives embarked upon a high risk lending strategy and increased sales of high risk home loans to Wall Street, because they projected that high risk home loans, which generally charged higher rates of interest, would be more profitable for the bank than low risk home loans.

- Shoddy Lending Practices. WaMu and its affiliate, Long Beach Mortgage Company ("Long Beach"), used shoddy lending practices riddled with credit, compliance, and operational deficiencies to make tens of thousands of high risk home loans that too often contained excessive risk, fraudulent information, or errors.

- Steering Borrowers to High Risk Loans. WaMu and Long Beach too often steered borrowers into home loans they could not afford, allowing and encouraging them to make low initial payments that would be followed by much higher payments, and presumed that rising home prices would enable those borrowers to refinance their loans or sell their homes before the payments shot up.

- Polluting the Financial System. WaMu and Long Beach securitized over $77 billion in subprime home loans and billions more in other high risk home loans, used Wall Street firms to sell the securities to investors worldwide, and polluted the financial system with mortgage backed securities which later incurred high rates of delinquency and loss.

- Securitizing Delinquency-Prone and Fraudulent Loans. At times, WaMu selected and securitized loans that it had identified as likely to go delinquent, without disclosing its analysis to investors who bought the securities, and also securitized

loans tainted by fraudulent information, without notifying purchasers of the fraud that was discovered.

- Destructive Compensation. WaMu's compensation system rewarded loan officers and loan processors for originating large volumes of high risk loans, paid extra to loan officers who overcharged borrowers or added stiff prepayment penalties, and gave executives millions of dollars even when its high risk lending strategy placed the bank in financial jeopardy.

181. Upon information and belief, former employees of WaMu will testify as follows:

- With regard to WaMu's loans, "[t]he more you slammed out, the more you made."

- Sometimes mortgage originators were surprised by the loans they could get approved. However, as a loan officer, if the employee could personally earn $2,000 - $3,000 by closing a loan, then the employee's only concern was getting the loan approved. According to such an employee: "Once you get paid, you don't care what happens."

- WaMu employees were "greedy" and the borrowers suffered as a result. Consequently, such employees concluded, "[w]e could never figure it out why people came to us [for loans]."

- The primary factor driving WaMu's mortgage lending practices was to produce as much volume as possible, and WaMu's priority regarding loans was "always quantity rather than quality,"

- There was a companywide culture that required WaMu employees to do "whatever it took to get loans closed." WaMu managers would constantly press WaMu underwriters and salespeople to "push, push, push" to close loans.

- "WaMu's top priority was to get as many loans closed as quickly as they could close and not worry – they just wanted the volume, and it didn't seem to matter how they got it . . . . Everybody just wanted their chunk of the money." Not only did loan coordinators receive bonuses for loans they closed, but also such employees understood that if loan officers did not meet their quotas, WaMu fired them.

- At WaMu "[i]t's not about what's best for the client; it's about what's best for the Company."

- WaMu managers also received increases in their bonuses if their group closed a certain percentage of Option ARM loans.

182. In a November 2, 2008 New York Times article entitled "Was There a Loan It Didn't Like?," former WaMu Senior Mortgage Underwriter Keysha Cooper, who started at WaMu in 2003 and left in 2007, explained that "[a]t WaMu it wasn't about the quality of the loans; it was about the numbers . . . . They didn't care if we were giving loans to people that didn't qualify. Instead, it was how many loans did you guys close and fund?" According to the article, "[i]n February 2007, . . . the pressure became intense. WaMu executives told employees they were not making enough loans and had to get their numbers up . . . ." Ms. Cooper concluded, "I swear 60 percent of the loans I approved I was made to. . . . If I could get everyone's name, I would write them apology letters."

183. An internal WaMu presentation on Option ARM loans shows that WaMu focused on unsophisticated borrowers for its high-risk Option ARM loans. The internal WaMu presentation states that appropriate "Option ARM Candidates" were people such as "savvy investors" and "high income earners." In stark contrast, the next page of the same presentation further explained that WaMu's target borrowers were of "all ages," "any social status," and "all economic levels." In other words, WaMu pushed its Option ARM loans on borrowers regardless of their sophistication, income level, or financial stability.

184. WaMu financially incentivized its underwriters, who supposedly served as WaMu's "gatekeepers" of loan credit quality, to approve an enormous volume of loans without regard to loan quality. For example, loan underwriters received commissions based upon volume of loans underwritten and closed, with no consideration given to the quality of the loans. Also, underwriters were required to underwrite a minimum of nine loans a day, and any loans underwritten in excess of that number provided for bonus payments that could exceed $100,000 per year. Moreover, WaMu refused to provide loan delinquency data to its underwriters.

185. Highly experienced mortgage underwriters were shocked by how lenient WaMu was in its lending. WaMu's supposedly "A paper" (*i.e.*, prime loans) consisted of loans made to borrowers with credit scores in the 500s, high LTV ratios, and Option ARM loans. Frequently underwriters did not think that the borrower could ever actually repay the loan that WaMu had sold. Underwriting guidelines at WaMu "changed every minute. . . . You would literally be getting an email every second that the guidelines changed or would have a pissed off account executive at your desk asking why the loan can't go through."

186. WaMu's loans could be automatically underwritten through a computer program, modeled after Fannie Mae's "Desktop Underwriter" ("DU") program. Loans that could be underwritten using the DU system could be approved by a loan processor without any involvement from an underwriter. However, if a loan was rejected by the computer, the loan consultant would repeatedly re-enter the loan's information, changing the information a little each time, "tweak[ing] the system."

187. Notwithstanding the fact that, according to regulatory agencies including the Federal Deposit Insurance Corporation and the Office of Thrift Supervision, "prime" loans should have been available only to borrowers with FICO scores of 660 or above, WaMu regularly made loans to borrowers with FICO scores well below this standard. A WaMu training document for subprime loan production employees, entitled "Specialty Lending UW [Underwriter] HLCA [Home Loans Credit Authority] Training," revised September 26, 2007, makes clear that, regardless of a borrowers' credit history or actual potential to repay a loan, if the borrower WaMu targeted for one of its "prime" loans had a FICO score over 619, that borrower was considered a "prime" borrower.

188. Defendants had the opportunity to – and did – review WaMu's loan files as part of their due diligence and their obligations in the securitization process. This review revealed or should have revealed that WaMu's actual underwriting practices were vastly inconsistent with the representations in the Offering Materials regarding the high standards of WaMu and the Citigroup Defendants. That WaMu had serious origination underwriting breakdowns is also confirmed by the testimony of Mr. Bowen, who gave detailed statistics about the reject rates for loans bought by Citigroup from third party originators like WaMu.

(5) GreenPoint Mortgage Funding, Inc.

189. GreenPoint Mortgage Funding, Inc. originated 11.32% of the mortgage loans, by aggregate principal balance for the CMALT 2006-A7 offering.

190. GreenPoint systematically disregarded its underwriting standards, granted exceptions in the absence of compensating factors, required less documentation, and granted no- or limited documentation loans to individuals without good credit histories. Appraisals on properties originated by GreenPoint were inflated as appraisers knew 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.

191. As of August 2007, GreenPoint specialized in non-conforming and Alt-A mortgages which generated higher origination fees than standard loans. Further, as reported in Business Week Magazine in November 2008, GreenPoint's employees and independent mortgage brokers targeted more and more borrowers who were less able to afford the loan payments they were required to make, and many had no realistic ability to pay off the loans.

192. GreenPoint's employees used this system to increase their own commissions at the expense of their underwriting guidelines. Exceptions to guidelines were granted in many circumstances – not just where compensating factors existed. The exceptions were granted when

the borrower could not qualify. Many of the loans were extended by the over 18,000 brokers that were approved to transact with GreenPoint – a large enough number that GreenPoint could not exercise any degree of realistic control. Typically, new brokers were actively monitored for only the first five to seven loans submitted, usually during only the first 90 days of being approved. In addition, GreenPoint did not verify the income of borrowers as represented. Many of GreenPoint's Alt-A loans were actually subprime loans.

193. The practice of quantity over quality continued until August 2007 when Capital One Financial Corp. ("Capital One"), which had purchased GreenPoint less than a year earlier, took an $850 million charge, and shut down the mortgage wholesaler's operations.

194. GreenPoint routinely extended "stated income" or "no doc" loans to borrowers with weak credit, and knew that such "low doc" or "no doc" loans, particularly when coupled with nontraditional products, such as ARMs, were highly likely to contain misinformation from the borrower, such as overstated incomes, that would result in increased defaults in the loan application.

195. GreenPoint is now a defendant in numerous lawsuits alleging misrepresentations regarding the quality of the loans GreenPoint underwrote and originated. For example, in *U.S. Bank Nat'l Ass'n, et al., v. GreenPoint Mortgage Funding, Inc.*, No. 09-600352 (N.Y. Sup. Ct.), a consultant's investigation concluded that 93% of the loans that GreenPoint sold contained errors, omissions, misrepresentations, and negligence related to origination and underwriting. The investigation found that GreenPoint loans suffered from serious defects including:

- Pervasive misrepresentations and/or negligence with respect to the statement of the income, assets or employment of the borrower.
- Violations of GreenPoint's own underwriting guidelines and prudent mortgage-lending practices, including loans made to borrowers (i) who made unreasonable claims as to their income, (ii) with multiple, unverified social security numbers,

(iii) with credit scores below the required minimum, (iv) with debt-to-income and/or loan-to-value ratios above the allowed maximum or (v) with relationships to GreenPoint or other non-arm's-length relationships.

- Misrepresentations of the borrower's intent to occupy the property as the borrower's residence and subsequent failure to so occupy the property.
- Inflated appraisal values.

196. GreenPoint's underwriting guidelines were not applied to evaluate the prospective borrower's credit standing, repayment ability or the value and adequacy of the mortgaged property as collateral. Rather, GreenPoint used guidelines supplied by Wall Street investors that were not based upon sound underwriting standards.

197. GreenPoint forced underwriters to approve mortgage loan applications containing fraudulent information by approving applications after underwriters had either denied such applications or made approval contingent upon obtaining additional borrower documentation.

198. Recent revelations have shown that beginning in 2005, GreenPoint's underwriting standards became increasingly lenient, especially towards higher risk borrowers. GreenPoint's loose underwriting guidelines became progressively looser during the 2005 through 2006 timeframe as a result of its desire to remain competitive in the lending market explaining that as other lenders relaxed their underwriting standards and began extending loans to "people who probably couldn't repay their loans," GreenPoint had to do the same in order to remain competitive. As GreenPoint began to significantly relax the requirements that borrowers would have to satisfy to qualify for a given loan program underwriting guidelines were ignored, including relaxing requirements involving documentation of repayment ability, minimum LTV ratios and minimum credit scores. GreenPoint's modification, in early 2007, of some of its underwriting standards, on some of its riskiest loan products, was not enough to stem the massive number of failed loans that led to GreenPoint's demise in August 2007.

199. These deficiencies in income documentation made accurate and reliable appraisals essential because so much emphasis was placed on the value of the mortgaged property. However, appraisers were in fact pressured to appraise to certain levels. Appraisers knew 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.

200. GreenPoint did not verify the income of borrowers that was represented but had a reputation in the industry for cutting corners on underwriting. GreenPoint's practice of disguising subprime loans as Alt-A loans was confirmed a former GreenPoint Account Executive identified in ¶181. This former Account Executive stated that GreenPoint offered loans it represented to be Alt-A even though their qualifying requirements were those of "junk" loans.

201. Defendants had the opportunity to – and did – review GreenPoint's loan files as part of their due diligence and their obligations in the securitization process. This review revealed or should have revealed that GreenPoint's actual underwriting practices were vastly inconsistent with the representations in the Offering Materials regarding the high standards of GreenPoint and the Citigroup Defendants. That GreenPoint had serious origination underwriting breakdowns is also confirmed by the testimony of Mr. Bowen, who gave detailed statistics about the reject rates for loans bought by Citigroup from third party originators like GreenPoint.

(6) American Home Mortgage Corp.

202. American Home Mortgage Corp. originated 3.65% of the mortgage loans by aggregate principal balance, for the CMLTI 2006-4 offering.

203. American Home Mortgage was the tenth largest retail mortgage lender in the United States during the height of the mortgage lending boom, prior to its August 2007 filing for bankruptcy protection.

204. In originating a high volume of loans, American Home did not weigh all the risk factors inherent in a loan file, nor did it encourage underwriters to use professional judgment based on their experience. Instead, the professional judgments of the underwriters were often overridden by automated underwriting software – an automated program that approved loans that made no financial sense and thus were not likely to be paid back.

205. In addition, American Home's management frequently overruled the underwriters' professional judgment and approved risky loans. As a matter of course American Home was making loans even where "compensating factors" did not exist.

206. The Ohio Attorney General filed suit against American Home in 2009 claiming numerous violations of the Ohio Consumer Sales Practices Act, including allegations of unfair and deceptive loan modification terms.

207. The SEC filed civil charges of accounting fraud against Michael Strauss, founder and former chairman and chief executive, alleging he misled American Home's auditor about the adequacy of its reserves against losses on mortgages. Mr. Strauss settled in 2009 for $2.5 million.

208. An internal American Home "Credit Update" presentation from October 2005, which was made public in June 2008, made clear that American Home's underwriting guidelines were to be either relaxed substantially or essentially rendered meaningless, in order to allow American Home to make loans to high-risk borrowers. Specifically, the Credit Update sets forth a new "interpretation" of guidelines that included:

- Not requiring verification of income sources on stated income loans.
- Reducing the time that need have passed since the borrower was in bankruptcy or credit counseling.
- Reducing the required documentation for self-employed borrowers.

- Broadening the acceptable use of second and third loans to cover the full property value.

209. An internal American Home e-mail sent on November 2, 2006, made public in June 2008, from Steve Somerman, an American Home Senior Vice President of Product and Sales Support in California and co-creator of the American Home's "Choice Point Loans" program, to loan officers nationwide, stated that American Home would make a loan to virtually any borrower, regardless of the borrower's ability to verify income, assets or even employment. The e-mail specifically encouraged loan officers to make a variety of loans that were inherently risky and extremely susceptible to delinquencies and default, including (1) stated income loans, where both the income and assets of the borrower were taken as stated on the credit application without verification; (2) "NINA" or No Income, No Asset loans, which allowed for loans to be made without any disclosure of the borrower's income or assets; and (3) "No Doc" loans, which allowed loans to be made to borrowers who did not disclose their income, assets or employment history.

210. Statements by former employees, made public in June 2008, revealed the following:

- "[T]he underwriters didn't do their jobs. They were lax, very lax."
- Exceptions were always being made to the underwriting guidelines, such that it was commonplace to overrule the objections of the underwriters in order to complete the loan.
- Borrowers who claimed to be self-employed were not required to prove that they had been in business for a specified period of time, as the stated underwriting guidelines required.
- Underwriters' objections to loans were frequently vetoed.
- Appraisal fraud was a common problem at American Home because loan officers pressured appraisers to come up with the "right number." Due to inflated appraisals, the loan-to-value ratios represented above were inaccurate because these ratios assumed accurate appraisals were performed.

211. American Home is involved in several criminal probes and investigations, and federal prosecutors have convicted one American Home sales executive, Kourash Partow, of mortgage fraud. After conviction, Partow, who worked for Countrywide before joining American Home, sought a lighter sentence on the grounds that his former employers (Countrywide and American Home) both had knowledge of the loan document inaccuracies and in fact encouraged manipulation by intentionally misrepresenting the performance of loans and the adequacy of how the loans were underwritten. Partow admitted that he would falsify clients' income or assets in order to get loans approved, and that American Home did not require documentary verification of such figures.

212. Prosecutors from the Eastern District of New York have investigated American Home for criminal activity, including alleged misrepresentations in securities filings about the company's financial position and quality of its mortgage loans, failing to disclose a rising number of loan defaults, and engaging in questionable accounting to hide losses.

213. Defendants had the opportunity to – and did – review American Home's loan files as part of their due diligence and their obligations in the securitization process. This review revealed or should have revealed that American Home's actual underwriting practices were vastly inconsistent with the representations in the Offering Materials regarding the high standards of American Home and the Citigroup Defendants. That American Home had serious origination underwriting breakdowns is also confirmed by the testimony of Mr. Bowen, who gave detailed statistics about the reject rates for loans bought by Citigroup from third party originators like American Home.

(7) MortgageIT, Inc.

214. MortgageIT, Inc. originated approximately 4.90% of the Group II-4 Mortgage Loans and approximately 7.68% of the Group III Mortgage Loans for CMLTI 2005-3.

215. MortgageIT, a subsidiary of Deutsche Bank (since late 2006), was extremely aggressive in granting loans with few controls over underwriting practices. MortgageIT's quality control practices have been described as "not perfect," "extremely aggressive," and driven by the mentality to "get the loans made and sold as quickly as possible." Thus, "there was no time to scrutinize loans and furthermore, there was less control over them than would be desirable."

216. As was recently disclosed, MortgageIT's underwriting standards became progressively looser from 2004 into 2006. MortgageIT's loans were "bad loans" that were extended to people whose credit scores "were not great." MortgageIT's Alt-A loans as "garbage." In addition, even loans that failed to meet these already lax lending standards were still approved. This is because branch managers would pressure underwriters to approve previously rejected loans, asking them to "have a second look" at the loan file. MortgageIT management would frequently override an underwriter's rejection of a loan.

217. MortgageIT did not exercise sufficient controls over brokers to prevent them from pressuring appraisers to appraise to certain values, causing larger numbers of inflated (and hence worthless) appraisals.

218. MortgageIT was a larger lender to subprime borrowers, and had exercised few controls over brokers to confirm that the origination policies were followed, making it possible for subprime borrowers to get mortgage loans. Indeed, as recently disclosures make clear, in 2006, MortgageIT was extending full doc and no-doc loans to borrowers with credit scores as low as 600.

219. Due to MortgageIT's lack of controls over its branch officers, there was no common sense underwriting. It was, in fact, the opposite, since brokers were compensated for

getting loans approved – not disapproved – and there were little or no consequences to the broker if the loan subsequently went bad.

220. Defendants had the opportunity to – and did – review MortgageIT's loan files as part of their due diligence and their obligations in the securitization process. This review revealed or should have revealed that MortgageIT's actual underwriting practices were vastly inconsistent with the representations in the Offering Materials regarding the high standards of MortgageIT and the Citigroup Defendants. That MortgageIT had serious origination underwriting breakdowns is also confirmed by the testimony of Mr. Bowen, who gave detailed statistics about the reject rates for loans bought by Citigroup from third party originators like MortgageIT.

(8) National City Mortgage Inc.

221. National City Mortgage Inc. originated 31.46% of the mortgage loans, by aggregate principal balance for the CMLTI 2006-4 offering. It originated approximately 4.90% of the Group II-4 Mortgage Loans and approximately 77.67% of the Group III Mortgage Loans for the offering CMLTI 2005-3.

222. In 1999, National City had purchased First Franklin Financial Corporation ("First Franklin"), a now-infamous subprime lender that consistently ignored underwriting guidelines, and used inflated appraisals to value the real estate underlying many of its loans. By 2003, over half of National City's profits were from the mortgage business, and it ranked number 6 in the nation, with over $130 billion in mortgages.

223. On June 30, 2008, National City was notified that the Chicago Regional Office of the SEC was conducting an informal investigation of National City and requested that it provide the SEC with certain documents concerning its loan underwriting experience, dividends, bank regulatory matters and the sale of First Franklin.

224. National City routinely lent money to people without regard to whether they could ultimately pay off the loan. National City's home-equity division specialized in risky second mortgages known as piggyback loans.

225. As of August 8, 2008, National City had an estimated $19 billion in risky loans on its books that it was unable to sell to the secondary market, including $6 billion in subprime loans from First Franklin.

226. Defendants had the opportunity to – and did – review National City's loan files as part of their due diligence and their obligations in the securitization process. This review revealed or should have revealed that National City's actual underwriting practices were vastly inconsistent with the representations in the Offering Materials regarding the high standards of National City and the Citigroup Defendants. That National City had serious origination underwriting breakdowns is also confirmed by the testimony of Mr. Bowen, who gave detailed statistics about the reject rates for loans bought by Citigroup from third party originators like National City.

(9) Option One Mortgage Corporation

227. Option One Mortgage Corporation originated all of the mortgage loans for the CMLTI 2004-OPT1 offering.

228. 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.

229. According to the Comptroller of the Currency's "Worst Ten in the Worst Ten" list, a compilation of the worst mortgage originators in the ten metropolitan areas with the highest foreclosure rates, Option One is ranked as the sixth-worst mortgage originator by number of foreclosures as of March 22, 2010.

230. Former Option One employees have reported that:

- If an underwriter denied a loan and an account executive complained, the loan was escalated to the branch manager, who then got in touch with the underwriter. With account executives, "the biggest screamer and shaker of trees gets the most fruit." For a "top-producing" account executive, whatever red flags there were would be "overlooked," and invariably the loan would be pushed through. It is estimated that at least 50% of the total loan volume in Option One's Atlanta branch was approved in this manner, and also stated that a loan applicant could tell "a straight up lie" about his income, but the untrue information would be overlooked and the loan would be approved, despite initial rejection of the application.

- Option One approved stated income loans "knowing good and well that those people did not make that much money in the position they were in."

- "The overwhelming majority of stated income loans were crafted," meaning that the borrowers were not making "anywhere near" what they claimed. However, employees felt pressured to push loans through because every loan generated income and "[i]f you applied any level of rational thought, you were frowned upon."

- With respect to artificially inflated appraisals, an employee admitted that "[o]f course they inflated values." If an underwriter questioned the appraised value, the account executive and branch manager would override the underwriter's objection, as with any other red flag in a loan file.

- Option One's appraisals "were all bad," and borderline fraudulent, not merely incompetent. However, underwriters were unable to prevent loans based on the flawed appraisals.

- When employees 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 someone high enough in the Underwriting and Sales Department said to go forward with the loan.

- 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. An Assistant Vice President of Option One from 2005 to 2007, who worked in the Correspondent Lending department, which purchased loans from small mortgage companies, stated that Option One purchased loans that raised concerns under the stated guidelines and that when he raised such concerns he was essentially told, "Shut up, Wall Street will buy it; don't worry about it."

- "If [a borrower] had a FICO and a pulse, they could get a loan" from Option One.

- There were instances where employees "caught blatant fraud, and the [account executive] would still fight for it. [The account executives and managers] would

> fight me because they didn't care. They knew they were going to sell it on the secondary market, and they didn't care because it wasn't their money. They were going to get paid regardless. . . . At Option One they didn't have a portfolio; they sold everything, so they didn't care. . . . [Option One] didn't have to worry about it, because once they're done with these crappy loans, they'd sell them off. They were the investors' problem."

231. On June 3, 2008, the Attorney General for the Commonwealth of Massachusetts filed an action against Option One, and its past and present parent companies, for their unfair and deceptive origination and servicing of mortgage loans. According to the Attorney General, since 2004 Option One had "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, 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."

232. The Attorney General maintained 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." Option One's "origination policies . . . employed from 2004 through 2007 have resulted in an explosion of foreclosures."

233. Defendants had the opportunity to – and did – review Option One's loan files as part of their due diligence and their obligations in the securitization process. This review revealed or should have revealed that Option One's actual underwriting practices were vastly inconsistent with the representations in the Offering Materials regarding the high standards of Option One and the Citigroup Defendants. That Option One had serious origination

underwriting breakdowns is also confirmed by the testimony of Mr. Bowen, who gave detailed statistics about the reject rates for loans bought by Citigroup from third party originators like Option One.

(10) PHH Mortgage Corporation

234. PHH Mortgage Corporation originated 48.50% of the mortgage loans, by aggregate principal balance for the CMLTI 2006-4 offering.

235. Its customers have sued PHH for engaging in predatory financing and attempting to defraud borrowers by making loans for which the borrowers were not qualified.

236. PHH itself admitted in its Form 10-Q filed August 8, 2008 that it had issued "loans with origination flaws."

237. Defendants had the opportunity to – and did – review PHH's loan files as part of their due diligence and their obligations in the securitization process. This review revealed or should have revealed that PHH's actual underwriting practices were vastly inconsistent with the representations in the Offering Materials regarding the high standards of PHH and the Citigroup Defendants. That PHH had serious origination underwriting breakdowns is also confirmed by the testimony of Mr. Bowen, who gave detailed statistics about the reject rates for loans bought by Citigroup from third party originators like PHH.

(11) Quicken Loans Inc.

238. Quicken Loans Inc. originated 10.46% of the mortgage loans, by aggregate principal balance for the CMALT 2006-A7 offering. Quicken Loans Inc. also originated approximately 5.14% of the Group II-1 Mortgage Loans, approximately 0.16% of the Group II-2 Mortgage Loans, approximately 1.45% of the Group II-3 Mortgage Loans, approximately 10.06% of the Group II-4 Mortgage Loans and approximately 13.60% of the Group III Mortgage Loans for the CMLTI 2005-3 offering.

239. In June 2008, Wells Fargo sued Quicken Loans for making false representations about loans Quicken had sold to Wells Fargo. These loans involved substantial fraud and did not meet underwriting guidelines. *Wells Fargo Sues Quicken, Claims Fraudulent Loans*, Crain's Detroit Business, Sept. 14, 2008.

240. Defendants had the opportunity to – and did – review Quicken Loans' loan files as part of their due diligence and their obligations in the securitization process. This review revealed or should have revealed that Quicken Loans' actual underwriting practices were vastly inconsistent with the representations in the Offering Materials regarding the high standards of Quicken Loans and the Citigroup Defendants. That Quicken had serious origination underwriting breakdowns is also confirmed by the testimony of Mr. Bowen, who gave detailed statistics about the reject rates for loans bought by Citigroup from third party originators like Quicken.

(12) SunTrust Mortgage, Inc.

241. SunTrust Mortgage, Inc. originated 5.48% of the mortgage loans, by aggregate principal balance for the CMLTI 2006-4 offering.

242. SunTrust has been named in numerous borrower lawsuits alleging that it committed fraud and violated federal lending laws by overstating borrowers' incomes in order to qualify them for loans, changing loans terms just before closing, and failing to disclose loan costs.

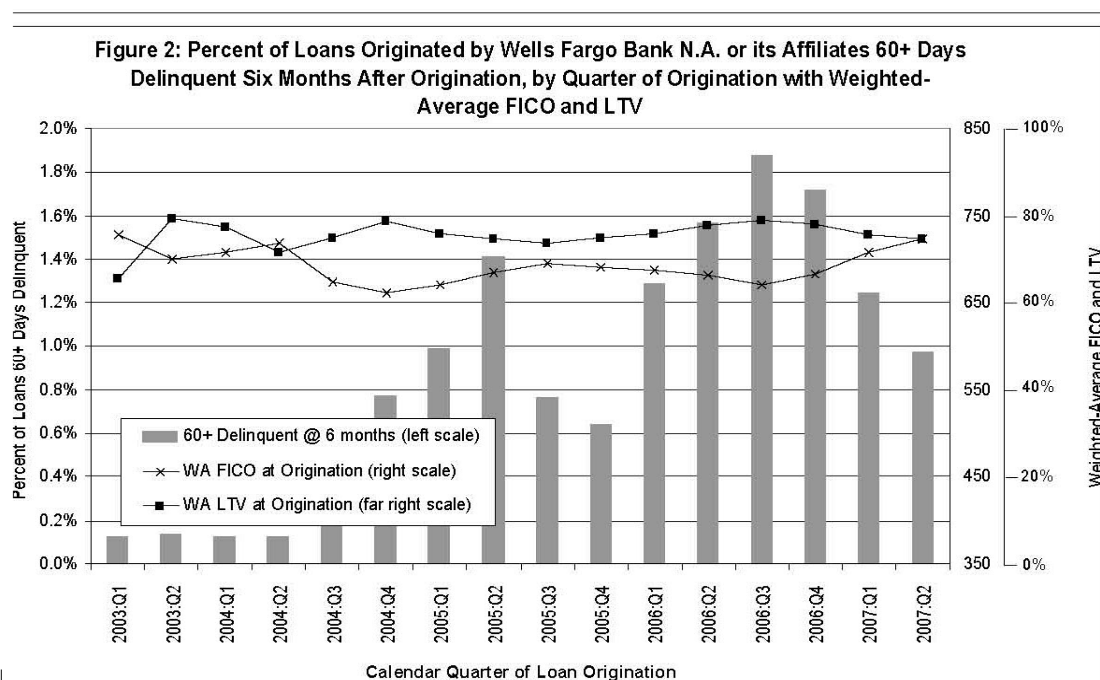
243. Defendants had the opportunity to – and did – review Sun Trust's loan files as part of their due diligence and their obligations in the securitization process. This review revealed or should have revealed that Sun Trust's actual underwriting practices were vastly inconsistent with the representations in the Offering Materials regarding the high standards of Sun Trust and the Citigroup Defendants. That Sun Trust had serious origination underwriting

breakdowns is also confirmed by the testimony of Mr. Bowen, who gave detailed statistics about the reject rates for loans bought by Citigroup from third party originators like Sun Trust.

H. Evidence That Early Defaults Within the Citigroup Transactions Are Indicia of Mortgage Fraud

244. The F.B.I. studied three million residential mortgages that 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* as likely to default in the first six months than loans that did not. The FCIC's "examination found [at xxii], according to one measure, that the percentage of borrowers who defaulted on their mortgages within just a matter of months after taking a loan *nearly doubled from the summer of 2006 to late 2007*. This data indicates they likely took out mortgages that they *never had the capacity or intention to repay*." (Emphasis added.)

245. Researchers at the University of Michigan have conducted studies that found that the number of loans originated by Wells Fargo (the largest third party originator for loans in those pools backing certificates sold to Allstate) suffered from a particular performance problem – sixty or more days delinquent as of six months of origination – that skyrocketed around the time many of the Mortgage Loans at issue here were being originated and securitized. The same studies showed that this drastic change did not occur because of a change in the claimed FICO or LTV scores:



246. The fact that studies conducted by others show a spike in early payment problems, despite the fact that key characteristics of the loan pools were supposedly not changing, is powerful evidence that the Citigroup Defendants were systematically abandoning their underwriting standards in creating and characterizing those loans, while representing that the risk characteristics had not changed. As set forth above, Allstate's investigation has confirmed this to be the case with respect to Allstate's Certificates as well.

I. <u>Evidence That Citigroup Defendants' Efforts to Obtain Tainted Ratings</u>

247. The supposedly independent ratings given by the major credit rating agencies were based on the loan profiles fed to the agencies by the Defendants. As previously explained, that data was false.

248. As such, the Defendants essentially pre-determined the ratings by feeding garbage into the ratings system. This made the promise of the tranches' obtaining a certain initial rating misleading. The initial promised ratings were meaningless as they were not tied to the actual collateral pools with which the defendants purported to associate them.

249. As discussed above, the credit ratings have plummeted as the true quality of the collateral pools and the Defendants' practices has been revealed, and thus as the agencies had information regarding the quality of the offerings that were not dependent on the defendants' misrepresentations.

IV. EVIDENCE OF CITIGROUP DEFENDANTS' KNOWLEDGE THAT THEIR REPRESENTATIONS WERE FALSE AND MISLEADING

A. Evidence from the Whistleblowing Testimony of Citigroup's Chief Underwriter

250. As noted above, Citigroup's Chief Underwriter Bowen testified that he observed loans being approved and included in securitization pools despite the fact they were missing key documents or for other reasons should have been rejected as falling outside the bank's credit risk policies.

251. His testimony about his own personal knowledge, as a high-ranking Citigroup executive, itself demonstrates that the Citigroup Defendants had actual knowledge of the underwriting problems at issue here. For instance, as explained above, his testimony reveals that he had personal knowledge that 60% of the "delegated flow" loans he had studied in 2006 were defective, and personally sought to disentangle the loans misreported as "agree" that in fact were based on missing information.

252. His testimony also confirms that other high-ranking executives were aware of, and in fact directed, the fraudulent practices. For instance, he testified that the Chief Risk Officer personally overturned 36% of the "turn down" ratings given by Citigroup's professional underwriters in order to "artificially increase[] the approval rate on the sample." Further, his professional underwriters, at Bowen's instruction, tracked the number of times a loan was approved using the seller's guidelines that would have failed under Citigroup's guidelines – and those underwriters found that 20% deviation.

253. Thus, his testimony shows actual knowledge by the Chief Underwriter, the Chief Risk Officer, the professional underwriters who worked with Bowen on his investigations, and the Quality Assurance and Third Party Origination Committee that Bowen worked with as part of his investigations. But his testimony shows the alarms had an even further reach.

254. Bowen's testimony on numerous occasion confirms that knowledge of the bank's underwriting problems was consistently raised throughout Citigroup, confirmed by the bank's follow-up investigations, but then, apparently, ignored:

- "I started issuing warnings in June of 2006 and attempted to get management to address these critical risk issues. *These warnings continued through 2007 and went to all levels of the Consumer Lending Group*."
- "*Beginning in 2006 I issued many warnings* to management concerning these practices, and specifically objected to the purchase of many identified pools."
- "I warned extensively of the scope of the problems identified, beginning in June 2006."
- "These warnings were reinforced *with weekly reports, emails, and discussions with many levels of management and [Third Party Origination] committee.* There was also a special sub-group of TPO committee formed to discuss more fully the issues identified. *These discussions were documented in their minutes.* And there were concerns that we were possibly not in compliance with self-reporting requirements to the investors."
- "My manager, the [Real Estate Lending] Chief Underwriter, also was alarmed by the issues I identified. The REL Chief Underwriter *widely distributed his concerns and warnings through emails, weekly reports and individual meetings and conversations with management.*"
- "*Our warnings went to all levels of REL's management*, including the [Consumer Lending Group] Chief Risk Officer, who was the [Real Estate lending] Chief Underwriter's manager."
- "I continued to warn management, through 2007, of these issues and risks to the shareholders posed by the increasing defective rate of mortgages purchased and sold through the correspondent delegated channel."

255. Bowen's testimony is supported by internal documentation that was also made public by his recent testimony. In a 2007 internal email attached to his testimony, he wrote to

the bank's Chairman of the Executive Committee, Senior Risk Officer, Chief Financial Officer, and Chief Auditor. The details provided corroborate his later testimony, and provide even more examples of how the bank consistently investigated problems, yet apparently allowed the results go unheeded:

> Since mid-2006, I have continually identified these breakdowns in processes and internal controls. *The REL Chief Underwriter (my 2006 manager) and I have widely communicated these breakdowns*, with possible ramifications, in weekly reports, emails, and discussions (which included the [Consumer Lending Group] Chief Risk Officer). *There have been two special investigations by CLG Business Risk and Control (the first initiated by me), with the findings confirming these breakdowns.*
>
> . . .
>
> Our internal Quality Assurance function, which underwrites a small sample of these files post-purchase, has reflected since 2006 (when this function started reporting to me) that 40-60% of these files are either outside policy criteria or have documentation missing from the files. *QA for recent months indicate 80% of the files fall into this category.*
>
> . . .
>
> *A CLG [Business Risk and Control] investigation, requested by me, confirmed the breakdowns* associated with the QA process and the fact that the QA findings were significantly out of compliance with QA risk policy. The Chief Risk Underwriter responsible for this function was terminated . . . .
>
> . . .
>
> We continue to be significantly out of compliance with the new QA Risk Policy.
> . . .
>
> During 2006-7 there were pools of mortgage loans aggregating $10 billion which were purchased from large mortgage companies with significant numbers of files identified as "exceptions" (higher risk and substantially outside of our credit policy criteria). These exceptions were approved by the Wall Street Channel Chief Risk Officer, many times over underwriting objections . . . .
>
> . . .

> The purchase decisions on many of these pools were approved even though the execution rates and other criteria established by the CLG Bulk Acquisition Policy were not met.
>
> Because of the initial high losses associated with many of these pools, *CLG BRC investigated and reviewed correspondence* which documented underwriting objections to purchasing identified pools.
>
> . . .

256. According to Bowen's testimony, the Real Estate Lending Chief Underwriter who assisted Bowen in raising these alarms was re-assigned in late 2006. Bowen continued to raise the alarm through 2007.

257. In response to Mr. Bowen's efforts to put a stop to violations of underwriting standards, Citigroup reduced his bonus, downgraded his performance review, and dropped the number of underwriters Mr. Bowen was supervising from over 220 to 2. This response further evidences that the Citigroup Defendants were intent on misleading outsiders about the nature and extent of Citigroup's abandonment of its underwriting standards.

B. Evidence from the Analysis Conducted by Citigroup's Third-Party Due Diligence Firm

258. As noted above, according to both Bowen's testimony and the information provided to the government by Clayton Holdings itself, Clayton Holdings was routinely used to carry out the bank's due diligence obligations as part of Citigroup's cost-cutting efforts to reduce its own employee expenses.

259. Also as above, Clayton Holdings reports show that it was informing Citigroup that *42% of the loans it was hired to review "failed to meet guidelines."* Despite the fact that loans that received such a grade were *not* subject to any purported "underwriting failures," Clayton Holdings found that Citigroup *waived in 32% of those rejected loans.* Based on the information released in conjunction with the government's investigation as well as the other facts

set forth above, on information and belief Citigroup here was informed by its third-party due diligence firms that high percentages of the Mortgage Loans underlying Allstate's Certificates "failed to meet guidelines," yet the underwriters waived in high numbers of such rejected loans.

260. Such third-party due-diligence reports, given on a daily basis, not only evidence the fact the Mortgage Loans were misrepresented, but also evidence the Citigroup Defendants' knowledge. These reports gave the bank actual knowledge *on a daily basis* that nearly half of the loans it was having reviewed were improperly underwritten.

C. <u>Evidence that the Defendants Leveraged Their Unique Knowledge to Increase Their Own Profits</u>

261. 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 or refusing to do business with problematic originators, Citigroup "waived in" high numbers of 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, Citigroup leveraged its unique knowledge to its own advantage.

262. Specifically, 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 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 Warehousing Relationship with Third-Party Originators

263. For commercial banks such as Citigroup, warehouse lending was a multi-billion dollar business. According to a report Citigroup produced for the FCIC, "Citigroup Warehouse Lines of Credit with Mortgage Originators, in Global Securitized Markets, 2000–2010 (revised)," from 2000 to 2010, Citigroup made available at any one time as much as $7 billion in warehouse lines of credit to mortgage originators, including $950 million to New Century and more than $3.5 billion to Ameriquest, both of which were third party originators on Mortgage Loans at issue in this case.

264. These arrangements created perverse incentives for Citigroup to overlook problems in underwriting by these third party originators, as Citigroup earned huge fees through fees associated with these warehouse lending arrangements that Citigroup would not earn if the originators did not have underwriters and sponsors such as Citigroup fueling demand for the loans being warehoused by the originators.

265. As seen by evidence showing that Citigroup accepted billions of dollars of loans that did not pass its own or third-party Clayton's underwriting standards, the Citigroup Defendants allowed these incentives to override adherence to their own underwriting standards, and in the process misled innocent investors like Allstate.

266. In an interview by the FCIC on March 17, 2010, Citigroup CEO Chuck Prince told the FCIC he would not have approved such arrangements, had he known about them. "I found out at the end of my tenure, I did not know it before, that we had some warehouse lines out to some originators. And I think getting that close to the origination function – being that involved in the origination of some of these products – is something that I wasn't comfortable with and that I did not view as consistent with the prescription I had laid down for the company not to be involved in originating these products."

E. **Evidence of Citigroup Defendants' Knowledge That Appraisals Were Falsely Inflated**

267. The Citigroup Defendants used their economic leverage over both in-house and third-party 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.

268. That the misstatements go heavily in one direction – seriously inflated values leading to materially understated LTV and CLTV statistics – is itself persuasive evidence that the overstatements revealed by Allstate's recent analysis were not mere errors or differences of opinion, but conscious misrepresentations. Such 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.

269. For instance, Richard Bitner, a former executive of a subprime lender for 15 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."

270. 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.'"

271. The FCIC's January 2011 report recounts the similar testimony of Dennis J. Black, an appraiser with 24 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."

V. ALLSTATE'S DETRIMENTAL RELIANCE AND DAMAGES

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

273. In purchasing the Certificates, Allstate justifiably relied on the Citigroup Defendants' false representations and omissions of material fact detailed above, including the misstatements and omissions in the Offering Materials.

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

275. 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 Citigroup Defendants had described them to be. The loans underlying the

Certificates experienced default and delinquency at very high rates due to the Citigroup Defendants' abandonment of the disclosed underwriting guidelines.

276. Allstate has incurred substantial losses in market value and lost principal and interest payments, due to the poor quality of the collateral underlying the Certificates. The income and principal payments Allstate received have been lower than Allstate expected under the "waterfall" provisions of the securitizations.

277. The disclosure of irregularities in the Citigroup 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 also with an expectation of possible reselling the Certificates on the secondary market. Allstate thus viewed market value as a critical aspect of the Certificates it purchased. Allstate incurred substantial losses on the Certificates due to a drastic decline in market value attributable to the misrepresentations which, when disclosed, revealed that the Mortgage Loans likely had a substantially higher risk profile than investors (including Allstate) were led to believe.

278. Allstate's losses on the Certificates have been much greater than they would have been if the loans were as the Citigroup Defendants described them to be. For example, the fact that the loans were not applied to 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.

279. 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. These rates of delinquency and default were much higher than expected for securitizations supported by collateral fitting the Citigroup Defendants' representations, and much higher than they would have been if the Mortgage Loans had been properly underwritten. The drastic increases in delinquency and default on the Mortgage Loans were attributable to the Citigroup Defendants' wrongdoing.

VI. TOLLING OF ALLSTATE'S 1933 ACT CLAIMS BY PREVIOUSLY-FILED CLASS ACTION COMPLAINTS

280. On March 19, 2008, a class action suit was filed in New York Supreme Court, Nassau County under Index No. 08/005187 against various Citigroup entities including Citigroup Mortgage Loan Trust Inc. and Citigroup Global Markets Inc., former officers, and underwriters on behalf of all investors who purchased or otherwise acquired certain mortgage-backed securities that were issued, underwritten or sold by Citigroup Mortgage Loan Trust Inc. On April 7, 2008, the action was removed to the United States District Court for the Eastern District of New York. *See City of Ann Arbor Employees' Retirement System v. Citigroup Mortgage Loan Trust Inc., et al.*, 08-civ-01418 (E.D.N.Y.) (LDW). The Ann Arbor complaint alleges claims under Sections 11, 12(a)(2), and 15 of the Securities Act of 1933.

281. The class at issue in Ann Arbor included purchasers of certificates issued by some 18 trusts, including CMLTI 2007-WFHE2. Allstate purchased certificates issued by CMLTI 2007-WFHE2, and was included in the defined class in the Ann Arbor complaint of March 19, 2008.

282. An Amended Complaint was filed on April 6, 2009, maintaining the causes of action alleged under Sections 11, 12(a)(2), and 15 of the 1933 Act, and a Second Amended Complaint was filed on May 24, 2010, alleging alleged similar claims and the same causes of

action against Citigroup Mortgage Loan Trust Inc. and Citigroup Global Markets Inc. related to, *inter alia*, the 2007-WFHE2 offering. The Second Amended Complaint included Allstate within the definition of the class, and maintained the causes of action alleged under Sections 11, 12(a)(2), and 15 of the 1933 Act.

283. Certain of Allstate's investments were made in the same Offerings as the named plaintiffs in Ann Arbor, specifically CMLTI 2007-WFHE2.

284. Under *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974), all putative class members are treated as if they filed their own individual actions until they either opt out or until a certification decision excludes them. *Id*. at 255. As the Second Circuit stated in *In re WorldCom Securities Litigation*, 496 F.3d 245 (2d Cir. 2007): "[B]ecause Appellants were members of a class asserted in a class action complaint, their limitations period was tolled under the doctrine of American Pipe until such time as they ceased to be members of the asserted class, notwithstanding that they also filed individual actions prior to the class certification decision." *Id.* at 256.

285. Allstate was a member of the putative class "asserted" in Ann Arbor and its 1933 Act claims are therefore timely pursuant to *American Pipe* and *In re WorldCom*.

286. Citigroup Defendants Citigroup Mortgage Loan Trust Inc. and Citigroup Global Markets Inc. were also defendants in the Ann Arbor class actions, for the same 1933 Act cause of action asserted herein.

CAUSES OF ACTION

FIRST CAUSE OF ACTION
(Common-Law Fraud)

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

288. The material representations set forth above were fraudulent, and the Citigroup Defendants' representations fraudulently omitted material statements of fact. The representations at issue are identified above and in the Exhibits, and are summarized in Section II above.

289. Each of the Citigroup 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.

290. Allstate justifiably relied on the Citigroup Defendants' false representations and misleading omissions.

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

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

SECOND CAUSE OF ACTION
(Negligent Misrepresentation)

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

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

295. Because the Citigroup Defendants arranged the securitizations, and originated or acquired, underwrote, and serviced all 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.

296. 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 securitizations on a loan-by-loan basis, it was heavily reliant on the Citigroup Defendants' unique and special knowledge regarding the Mortgage Loans when determining whether to make each investment of Certificates. Allstate was entirely reliant on the Citigroup Defendants to provide accurate information regarding the loans in engaging in that analysis. Accordingly, the Citigroup Defendants were uniquely situated to evaluate the economics of each Securitization.

297. Going back seven years over thirty-one separate purchases, Allstate relied on the Citigroup Defendants' unique and special 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. This longstanding relationship, coupled with their unique and special knowledge about the underlying loans, created a special relationship of trust, confidence, and dependence between the Citigroup Defendants and Allstate.

298. The Citigroup Defendants were aware that Allstate relied on their unique and special expertise and experience and depended upon them for accurate and truthful information. They also knew that the facts regarding their compliance with their underwriting standards were exclusively within their knowledge.

299. Based on their expertise, superior knowledge, and relationship with Allstate, the Citigroup Defendants owed a duty to Allstate to provide complete, accurate, and timely information regarding the Mortgage Loans and the offerings. The Citigroup Defendants breached their duty to provide such information to Allstate.

300. They likewise made misrepresentations in order to induce Allstate's investment in the offerings. The misrepresentations are set forth above and in the Exhibits. At the time they made these misrepresentations, the Citigroup Defendants knew, or at a minimum were negligent in not knowing, that these statements were false, misleading, and incorrect. Such information was known to the Citigroup Defendants but not known or readily known to Allstate, and the Citigroup Defendants knew that Allstate was acting in reliance on mistaken information.

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

302. The Citigroup Defendants were in the business of providing information for use by others, including Allstate. Specifically, but without limitation, they were 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.

303. The Citigroup Defendants' material misrepresentations and omissions set forth above were made without any reasonable ground for believing that the representations were true.

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

THIRD CAUSE OF ACTION
(Violation of Section 11 of the 1933 Act)

305. Allstate realleges each allegation above as if fully set forth herein, except Allstate expressly excludes from this cause of action any allegation that could be construed as alleging fraud or intentional or reckless conduct. This cause of action specifically excludes the allegations of scienter set forth above.

306. This claim is brought under Section 11 of the 1933 Act, 15 U.S.C. § 77k, against Citigroup Global Markets Inc. (the Underwriter) and Citigroup Mortgage Loan Trust Inc. (the Depositor) (collectively the "1933 Act Citigroup Defendants") based on Allstate's purchases of the Certificates for the CMLTI 2007-WFHE2 securitization.

307. This cause of action is based solely on claims of strict liability or negligence under the 1933 Act. This count is predicated upon the 1933 Act Citigroup Defendants' strict liability for making untrue and materially misleading statements in the Offering Materials for the Investment CMLTI 2007-WFHE2, identified in Exhibit I.

308. Each of Allstate's purchases of the CMLTI 2007-WFHE2 Certificates was made pursuant to the false and misleading Offering Materials, including the Registration Statement.

309. The Offering Materials for the Offering were materially untrue, misleading, contained untrue statements of material fact, and omitted to state material facts required to be stated therein or necessary to make the statements therein not misleading. At the time it obtained the Certificates, Allstate did not know of the facts concerning the untrue and misleading statements and omissions alleged herein.

310. The materially untrue statements and omissions of material fact in the Offering Materials are set forth in Sections II and III above and in Exhibits C-K.

311. The 1933 Act Citigroup Defendants caused to be issued and disseminated, directed other parties to disseminate, and/or participated in the issuance and dissemination of, to Allstate, the materially untrue statements of fact and omissions of material fact contained in the Offering Materials.

312. The 1933 Act Citigroup Defendants are strictly liable to Allstate for the materially untrue statements and omissions in the Offering Materials. The Depositor (Citigroup Mortgage

Loan Trust Inc.) is liable as issuer of the Certificates within the meaning of Section 2(a)(4) of the 1933 Act, 15 U.S.C. § 77b(a)(4), and in accordance with Section 11(a) of the 1933 Act, 15 U.S.C. § 77k(a).

313. Defendant Citigroup Global Markets Inc. is liable for its role as the lead underwriter of the CMLTI 2007-WFHE2 securitization, in accordance with Section 11(a)(5) of the 1933 Act, 15 U.S.C. § 77k(a)(5).

314. The 1933 Act Citigroup Defendants owed to Allstate a duty to make a reasonable and diligent investigation of the statements contained in the Offering Materials to ensure that such statements were true and correct and that there was no omission of material facts required to be stated in order to make the statements contained therein not misleading. The 1933 Act Citigroup Defendants, in the exercise of reasonable care, should have known of the misstatements and omissions contained in the Offering Materials as set forth above.

315. This action is brought within one year of the discovery of the materially untrue statements and omissions in the Offering Materials and within three years of the effective date of the Offering Materials, by virtue of the timely filing of the *Ann Arbor* complaint and the tolling of Allstate's claims resulting from those filings.

316. Allstate has sustained damages measured by the difference between the price Allstate paid for the certificates and (1) the value of the Certificates at the time this suit is brought, or (2) the price at which Allstate sold the Certificates in the market prior to the time suit was brought, plus any applicable interest. Allstate's Certificates lost substantial market value as a result of the materially untrue statements of fact and omissions of material fact in the Offering Materials alleged herein.

317. By reason of the conduct herein alleged, the 1933 Act Citigroup Defendants violated Section 11 of the 1933 Act and are jointly and severally liable for their wrongdoing. Allstate is entitled to recover its full damages from each of the 1933 Act Citigroup Defendants.

FOURTH CAUSE OF ACTION
(Violation of Section 12(a)(2) of the 1933 Act)

318. Allstate realleges each allegation above as if fully set forth herein, except Allstate expressly excludes from this cause of action any allegation that could be construed as alleging fraud or intentional or reckless conduct. This cause of action specifically excludes the allegations of scienter set forth above.

319. This claim is brought under Section 12(a)(2) of the 1933 Act, 15 U.S.C. § 77k, against the 1933 Act Citigroup Defendants based on Allstate's purchases of the Certificates for the CMLTI 2007-WFHE2 securitization.

320. This cause of action is based solely on claims of strict liability or negligence under the 1933 Act. This count is predicated upon the 1933 Act Citigroup Defendants' strict liability for making untrue and materially misleading statements in the Offering Materials for the Investment CMLTI 2007-WFHE2, identified in Exhibit I.

321. By means of the defective Offering Materials, the 1933 Act Citigroup Defendants promoted and sold the CMLTI 2007-WFHE2 Certificates to Allstate. Each of Allstate's purchases of the CMLTI 2007-WFHE2 Certificates was made pursuant to the false and misleading Offering Materials, including the Registration Statement and/or Prospectus Supplement.

322. The Offering Materials for the Offering were materially untrue, misleading, contained untrue statements of material fact, and omitted to state material facts required to be stated therein or necessary to make the statements therein not misleading. At the time it obtained

the Certificates, Allstate did not know of the facts concerning the untrue and misleading statements and omissions alleged herein.

323. The materially untrue statements and omissions of material fact in the Offering Materials are set forth in Sections II and III above and in Exhibits C-K.

324. The 1933 Act Citigroup Defendants caused to be issued and disseminated, directed other parties to disseminate,, and/or participated in the issuance and dissemination of, to Allstate, the materially untrue statements of facts and omissions of material fact contained in the Offering Materials.

325. The 1933 Act Citigroup Defendants owed Allstate the duty to make a reasonable and diligent investigation of the statements contained in the Offering Materials to ensure that such statements were true and correct and that there was no omission to state a material fact required to be stated in order to make the statements contained therein not misleading. The 1933 Act Citigroup Defendants, in the exercise of reasonable care, should have known of the misstatements and omissions contained in the Offering Materials as set forth above.

326. This action is brought within one year of the discovery of the materially untrue statements and omissions in the Offering Materials and within three years of the effective date of the Offering Materials, by virtue of the timely filing of the *Ann Arbor* complaint and the tolling of Allstate's claims resulting from those filings.

327. By reason of the conduct alleged herein, the 1933 Act Citigroup Defendants violated § 12(a)(2) of the 1933 Act, 15 U.S.C. § 77l(a)(2) and are jointly and severally liable for their wrongdoing. As a direct and proximate result of such violations, Allstate purchased the Certificates pursuant to the Offering Materials. Accordingly, Allstate, which holds the Certificates issued pursuant to the Offering Materials, has the right to rescind and to recover the

consideration paid for its shares, plus applicable interest, and hereby tenders those CMLTI 2007-WFHE2 Certificates it still holds to the 1933 Act Citigroup Defendants. Allstate also seeks damages to the extent permitted by law to the extent that it has sold CMLTI 2007-WFHE2 Certificates purchased pursuant to the defective Offering Materials.

PRAYER FOR RELIEF

WHEREFORE Allstate prays for relief as follows:

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

a. Rescission and recovery of the consideration paid for the Certificates, with interest thereon, pursuant to Allstate's Section 12(a)(2) claim;

b. Allstate's monetary losses, including loss of market value and loss of principal and interest payments, on all other claims besides Allstate's Section 12(a)(2) claim;

c. Attorneys' fees and costs;

d. Prejudgment interest at the maximum legal rate; and

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

JURY DEMAND

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

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