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

ALLSTATE INSURANCE COMPANY, ALLSTATE LIFE INSURANCE COMPANY, ALLSTATE BANK (F/K/A ALLSTATE FEDERAL SAVINGS BANK), ALLSTATE LIFE INSURANCE COMPANY OF NEW YORK, ALLSTATE RETIREMENT PLAN, and AGENTS PENSION PLAN, Plaintiffs, -against- ACE SECURITIES CORP., DEUTSCHE ALT-A SECURITIES, INC., DB STRUCTURED PRODUCTS, INC., DEUTSCHE BANK AG NEW YORK BRANCH and DEUTSCHE BANK SECURITIES, INC. Defendants.	Index No. **COMPLAINT**

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Plaintiffs Allstate Insurance Company, Allstate Life Insurance Company, Allstate Bank (f/k/a Allstate Federal Savings Bank), Allstate Life Insurance Company of New York, Allstate Retirement Plan, and Agents Pension Plan (collectively, "Allstate"), by and through their attorneys, bring this action against ACE Securities Corp., Deutsche Alt-A Securities, Inc., DB Structured Products, Inc., Deutsche Bank Securities and Deutsche Bank AG New York Branch and allege as follows:

NATURE OF ACTION

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

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

(i) ***Underwriting guidelines.*** The Offering Materials each represented that a particular, reasonable underwriting process was followed to ensure that only loans that the borrower could repay would be included in the pool underlying the Certificates (the "Mortgage Loans"). In fact, defendants systematically ignored their own due diligence and that of their own hired third-party firms in acquiring non-compliant loans that violated the underwriting guidelines of the originators. For instance, recent reviews of the loan files underlying some of Allstate's Certificates by defendants' own insurers revealed a pervasive lack of proper documentation, facially absurd (yet unchecked) claims about the borrower's purported income, and the routine

disregard of purported underwriting guidelines. Based on data compiled from third-party due diligence firms, the federal Financial Crisis Inquiry Commission ("FCIC") noted (at 187) in its January 2001 report:

> The Commission concludes that firms securitizing mortgages failed to perform adequate due diligence on the mortgages they purchased and at time knowingly waived compliance with underwriting standards. ***Potential investors were not fully informed or were misled*** about the poor quality of the mortgages contained in some mortgage-related securities. ***These problems appear to be significant.***

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

(iii) ***Owner Occupancy Statistics.*** The Offering Materials made specific representations regarding the percentage of borrowers who would be occupying the property being mortgaged – a key risk characteristic given that borrowers are less likely to walk away from properties they live in, as compared to properties being used as a vacation home or as an investment. Analytical tools recently made available confirm that in truth, a greater percentage of the loans underlying Allstate's Certificates were in fact given to borrowers who lived elsewhere.

(iv) ***Loan-to-Value Ratios*.** The Offering Materials represented that the loans had specific loan-to-value and combined loan-to-value ratios. These are additional key risk metrics, because they represent the equity "cushion" that borrowers have, and the likelihood of repayment to lenders upon foreclosure. Analytical tools recently made available 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.

3. Allstate purchased approximately $185 million in the defendants' mortgage-backed securities in reliance on these and the other misrepresentations and omissions:

Asset	Purchase Price
ACE 2004-OP1, M2	9,751,224.06
ACE 2004-OP1, M2	7,967,500.00
ACE 2004-HE4, M1	16,508,995.37
ACE 2004-RM2, M2	5,830,162.50
ACE 2004-RM2, M2	5,830,162.50
ACE 2005-WF1, M1	5,000,000.00
ACE 2005-WF1, M2	3,000,000.00
ACE 2005-WF1, M3	4,530,000.00
DBALT 2005-AR1, 1A1	10,024,764.90
ACE 2006-HE4, A2C	10,000,000.00
ACE 2006-HE4, A2C	3,000,000.00
ACE 2006-HE4, A2C	2,000,000.00
ACE 2006-HE4, A2C	5,000,000.00
ACE 2006-HE4, A2C	5,000,000.00
ACE 2006-HE4, A2D	20,000,000.00
ACE 2006-OP2, A2B	500,000.00
ACE 2006-OP2, A2B	250,000.00
ACE 2006-OP2, A2B	7,250,000.00
ACE 2006-OP2, A2C	9,000,000.00
ACE 2006-OP2, A2C	500,000.00
ACE 2006-OP2, A2C	250,000.00
ACE 2006-OP2, A2C	2,000,000.00
ACE 2006-OP2, A2C	6,990,000.00
ACE 2006-GP1, A	13,000,000.00
ACE 2006-GP1, A	2,000,000.00
ACE 2006-GP1, A	10,000,000.00
ACE 2006-SL4, A-1	10,000,000.00
ACE 2006-SL4, A-1	10,000,000.00

TOTAL	$185,182,809.33

Exhibits A and B further detail the Certificates. 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 systemic (but hidden) abandonment of the disclosed underwriting guidelines and the misrepresentation of Mortgage Loan characteristics has predictably led to soaring default rates in the mortgage loans underlying the Certificates. For instance, despite the fact that most of the of the Certificates started out with AAA ratings – the same rating given to treasury bills backed by the full faith and credit of the United States government – 50% are now considered to be highly speculative. These problems are so drastic and their onset was so rapid (in comparison to the long-term security of the investments Allstate thought it was purchasing) that the Certificates' poor performance to date is itself powerful evidence that the Mortgage Loans were not underwritten according to the procedures represented to Allstate, and that the Mortgage Loans in the collateral pools were not of the quality represented. With the underlying loans performing so poorly, the market value of Allstate's Certificates has plummeted, causing Allstate to incur significant losses.

6. As the FCIC concluded (at 224):

> As mortgage securities lost value, investors found significant deficiencies in securitizer's due diligence on the mortgage pools underlying the mortgage-backed securities as well as in their disclosure about the characteristics of those deals. As private mortgage insurance companies found similar deficiencies in the loans they insured, they have denied claims to an unprecedented extent . . .

The report also recounted (at 224) that investigations by the government-sponsored entities Fannie Mae and Freddie Mac similarly found loan disclosures consistently lacking. For instance, "Freddie reviewed $76.8 billion of loans . . . and found $21.7 billion to be ineligible, meaning they did not meet representations and warranties."

PARTIES

7. ***The Plaintiffs.*** Plaintiff Allstate Insurance Company is an insurance company formed under the laws of, and domiciled in, the State of Illinois, with its principal place of business in Northbrook, Illinois. It 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.

8. 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.

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

10. Plaintiff Agents Pension Plan is an ERISA plan sponsored by Allstate Insurance Company.

11. 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. 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.

12. Plaintiff Allstate Retirement Plan is an ERISA plan sponsored by Allstate Insurance Company.

13. ***Defendants.*** 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 acquisition, to mortgage pooling, to securities underwriting, to sale to Allstate. Allstate is not seeking relief against any bankrupt entity.

14. Defendant Deutsche Bank Securities Inc., is a Delaware corporation and an SEC registered broker-dealer with its principal place of business in New York, New York. Defendant Deutsche Bank Securities Inc.'s banking operations are limited to broker-dealer functions in the issuance and underwriting of residential and commercial mortgage backed securities.

15. Defendant Deutsche Alt-A Securities, Inc., is a Delaware corporation with its principal place of business in New York, New York. As Depositor of the DBALT 2005-AR1 (the "DBALT Offering"), it is considered as an 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).

16. Defendant ACE Securities Corp., is a special purpose Delaware corporation with its principal place of business in Charlotte, North Carolina. Ace Securities acted as Depositor for ACE 2004-RM2, ACE 2004-HE4, ACE 2004-OP1, ACE 2005-WF1, ACE 2006-HE4, ACE 2006-GP1, ACE 2006-SL4, and ACE 2006-OP2 (collectively the "Ace Offerings") and is considered as an 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). Ace Securities was formed by Deutsche Bank Securities to, among other things, facilitate the sale of residential mortgage loans through securitization programs.

17. Defendant DB Structured Products, Inc., is a Delaware corporation with its principal place of business in New York, New York. It acquired the residential loans from the originators, and sponsored the securitization of some of the mortgage loans at issue here.

18. Defendant Deutsche Bank AG New York Branch is the New York Branch of Deutsche Bank AG, a German corporation with its principal place of business in Frankfurt, Germany. It acquired the residential loans from the originators, and sponsored the securitization of the Certificates for ACE 2004-OP1.

19. ***Relevant Non-Parties.*** 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. The Trusts are managed by a trustee. The trustees for the offerings here were HSBC Bank USA, National Association, a national banking association (whose principal place of business is in New York), and Deutsche Bank National Trust Company, a New York-chartered limited purpose trust company, as indenture trustee for the ACE 2006-GP1 offering.

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

JURISDICTION AND VENUE

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

22. All of the defendants do business in or derive substantial revenue from activities carried out in New York. The defendants are licensed to do business in New York and have maintained principle offices in New York during the relevant time period. Nearly all activity pertaining to the securitization of the Mortgage Loans at issue occurred in New York, including the underwriting, negotiating, drafting and signing of operative agreements, the compilation of Offering Materials, and the marketing of the securities.

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

SUBSTANTIVE ALLEGATIONS

I. THE DEFENDANTS ABUSED THEIR CONTROL OF THE RAPIDLY-EXPANDING SECURITIZATION PROCESS

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

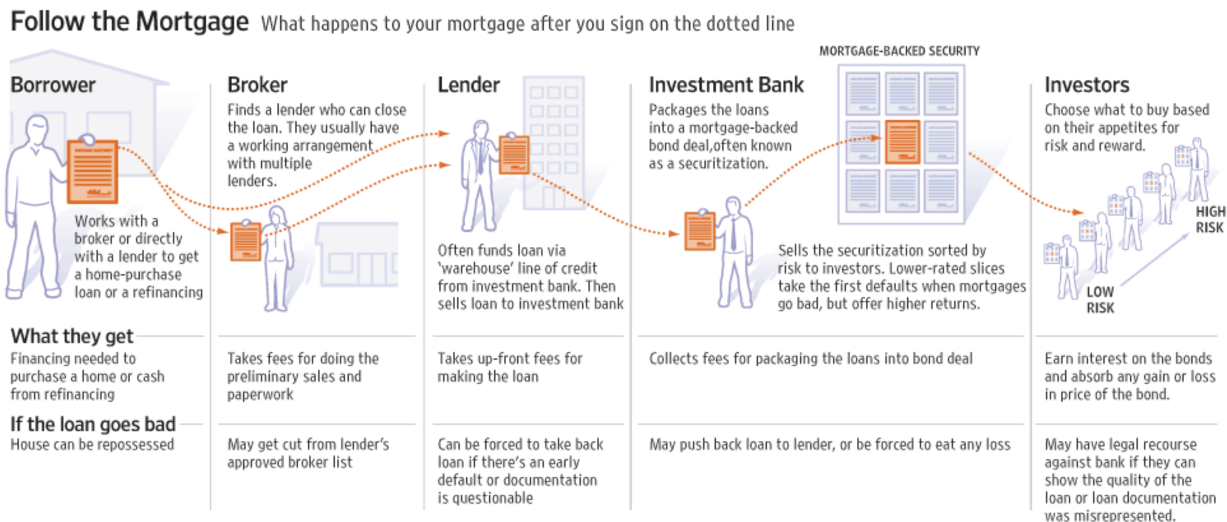
24. The FCIC "reviewed millions of pages of documents, interviewed more than 700 witnesses, and held 19 days of public hearings in New York, Washington, D.C., and communities across the country." In the resulting January 2011 report, the FCIC stated (at xvi):

> 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 packaged, repackaged, and sold to investors around the world.

25. 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 ultimately as many as 13 million households in the United States may lose their homes to foreclosure." Already, according to the report, "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."

26. 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*:



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

28. 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, banks began to look for ways to increase the fees they could generate. Banks, lenders, and securitizers 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.

29. A larger perceived potential borrower base and higher profits per borrower created a huge incentive to increase lending volume. The number of loans issued 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 FCIC, non-conforming loans went from around $670 billion in 2004 to over $2 trillion in 2006. The same report indicates that Deutsche Bank was the seventh-largest sponsor of non-agency mortgage-backed securities in 2007.

30. Such a huge increase in mortgage volume in a short period of time also created the problem of where the money to actually fund those loans would come from, 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."

31. In other words, simultaneous with a shift away from non-traditional loans was 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 would be stuck with any resulting losses. In an "originate and distribute" model, the incentives are 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 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."

32. Because the underlying loans were 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, they were in fact much riskier because the defendants misrepresented many aspects of the Mortgage Loans.

33. For instance, though the defendants may have disclosed that the 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 owner-occupied (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 done (understating the risk that the borrower could not actually afford the monthly payments), and omitted to inform Allstate 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).

34. 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 defendants defrauded investors like Allstate into accepting the risks created by the 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 at 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."

35. 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***.

36. 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

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."

37. 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.

38. 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.

39. 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 in November 2009 stated 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***." (Emphasis added.)

B. The Defendants Were a Market Leader Controlling Nearly Every Aspect of the Securitization Process

40. The defendants and their affiliates controlled, and thus had actual knowledge of or were reckless as to the truth about, every aspect of the securitization process, from loan acquisition through sale to Allstate.

41. The individual defendants' roles were:

a. DB Structured Products, Inc. acted as the sponsor and seller for the ACE 2004-RM2, ACE 2006-OP2, ACE 2006-SL4, ACE 2006-GP1, ACE 2006-HE4, ACE 2004-HE4, DBALT 2005-AR1 and ACE 2005-WF1 offerings. Deutsche Bank AG New York Branch acted as the sponsor and seller for the ACE 2004-OP1 offering. The sponsor/sellers obtained the Mortgage Loans that were pooled together in the securitizations and then sold, transferred, or otherwise conveyed title to those loans to the Depositor pursuant to Pooling and Servicing Agreements, which are governed by New York law.

b. Ace Securities Corp. was the depositor for the Ace Offerings while Deutsche Alt-A Securities, Inc. (together with Ace Securities Corp., the "Depositors") was the depositor for the DBALT Offering. The Depositors purchased the Mortgage Loans pursuant to the Pooling and Servicing Agreements, which are governed by New York law. The Depositors then sold, transferred, or otherwise conveyed the Mortgage Loans to the Trustees, which held the Mortgage Loans in the Trusts for the benefit of Allstate and other Certificateholders. The

Depositors then issued the Certificates, which represent interests in the Mortgage Loans held by the Trusts, to Allstate and other investors. The Depositors and the Sponsors 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. Deutsche Bank formed special purpose vehicles, including Defendant Ace Securities Corporation, to facilitate the sale of RMBS.

c. Deutsche Bank Securities Inc. was the underwriter for the offerings at issue here. In that role, it was responsible for underwriting and managing the securitizations' sale of Certificates to Allstate and other investors, including screening the Mortgage Loans for compliance with the defendants' underwriting guidelines.

C. Defendants' Offering Materials

42. Allstate acquired certificates in the following offerings issued by defendants:

Asset	Purchase Price
ACE 2004-OP1, M2	9,751,224.06
ACE 2004-OP1, M2	7,967,500.00
ACE 2004-HE4, M1	16,508,995.37
ACE 2004-RM2, M2	5,830,162.50
ACE 2004-RM2, M2	5,830,162.50
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ACE 2006-HE4, A2C	3,000,000.00
ACE 2006-HE4, A2C	2,000,000.00
ACE 2006-HE4, A2C	5,000,000.00
ACE 2006-HE4, A2C	5,000,000.00
ACE 2006-HE4, A2D	20,000,000.00
ACE 2006-OP2, A2B	500,000.00
ACE 2006-OP2, A2B	250,000.00
ACE 2006-OP2, A2B	7,250,000.00

ACE 2006-OP2, A2C	9,000,000.00
ACE 2006-OP2, A2C	500,000.00
ACE 2006-OP2, A2C	250,000.00
ACE 2006-OP2, A2C	2,000,000.00
ACE 2006-OP2, A2C	6,990,000.00
ACE 2006-GP1, A	13,000,000.00
ACE 2006-GP1, A	2,000,000.00
ACE 2006-GP1, A	10,000,000.00
ACE 2006-SL4, A-1	10,000,000.00
ACE 2006-SL4, A-1	10,000,000.00
TOTAL	$185,182,809.33

43. Deutsche Alt-A Securities, Inc., as depositor for the DBALT Offering, filed Form S-3 Registration Statements with the SEC indicating its intention to sell mortgage-backed securities. The Registration Statement for DBALT 2005-AR1 was prepared and signed by Defendant Deutsche Alt-A Securities, Inc. The relevant Registration Statements covering the DBALT Offering at issue here was filed on January 27, 2004.

44. Ace, as depositor for the Ace Offerings, filed Form S-3 Registration Statements with the SEC indicating its intention to sell mortgage-backed securities. The Registration Statements for the Ace Offerings were prepared and signed by Ace Securities. The relevant Registration Statements covering the Certificates at issue here were filed on October 28, 2003, September 24, 2004, June 24, 2005, or May 10, 2006. The Registration Statements were prepared and signed by ACE Securities.

45. The Certificates were issued pursuant to a prospectus. The relevant prospectuses provided that the Trusts would offer a series of certificates representing beneficial ownership interests in the related trust, and that the assets of each trust would generally consist of a pool or pools of fixed or adjustable interest rate mortgage loans secured by a lien on a one- to four-family residential property.

46. The respective prospectus supplements provided the specific terms of a particular certificate series offering. The prospectus supplements, also filed with the SEC, contained a more detailed description of the mortgage pools underlying the certificates, including (but not limited to) the type of loans, the number of loans, the mortgage rates and net mortgage rates, the aggregate scheduled principal balance of the loans, the purported original weighted-average combined LTV ratio, the borrowers' debt-to-income ratio, the property type, the owner-occupancy data, and the geographic concentration of the mortgaged properties.

47. The Offering Materials for each of the offerings at issue here had similar representations to those highlighted below. A larger sample of the representations on which Allstate relied are found in the exhibits to this Complaint.

II. THE DEFENDANTS' MATERIAL MISREPRESENTATIONS AND OMISSIONS

48. The defendants' representations regarding the Mortgage Loans underlying the Offerings were highly material to investors including Allstate. Because the revenue paid to investors is derived from the stream of payments received from the Mortgage Loan borrowers, the value of an investment is necessarily tied to the perceived risk of default in the Mortgage Loan pool. In other words, the market value of a Certificate decreases as the perceived risk of the underlying pool increases. Allstate therefore looked closely at the representations made by the defendants regarding the Mortgage Loans underlying each of the Offerings at issue here.

49. The defendants made a series of specific representations regarding the quality of the Mortgage Loans underlying each of the Offerings at issue. In fact, the defendants specifically represented that "[t]he Depositor believes that the information set forth in [each] prospectus supplement will be representative of the characteristics of the Mortgage Pool as it will be constituted at the time the certificates are issued." *See, e.g.*, ACE 2006-HE4 Prospectus Supplement at S-72. Indeed, the defendants represented that if "any material pool characteristic

differs by 5% or more from the description in this prospectus supplement, revised disclosure will be provided." *See, e.g.*, *id.*

50. The following list is representative of the specific representations contained in the Offering Materials for each of the Offerings at issue here; a larger sample of the representations on which Allstate relied is found in Exhibits C through K of this complaint.

A. <u>Underwriting Guidelines</u>

51. Deutsche Bank, as the underwriter and sponsor in these securitizations, acquired mortgage loans in bulk from unaffiliated third party originators with whom it had longstanding business relationships. As was the custom and practice in the industry, Deutsche Bank, and third party firms employed by Deutsche Bank, would perform due diligence on the loans prior to Deutsche Bank's purchase and securitization of the loans to ensure that the Mortgage Loans adhered to the underwriting standards of the originators, and to Deutsche Bank's own standards.

52. The underwriting process used to form the pools of Mortgage Loans underlying Allstate's Certificates was material to Allstate because, as discussed above, the quality of loans in the pool determines the risk of the Certificates backed by those loans. If a reasonable underwriting process was not actually followed, the chances that the loans had riskier features than what the defendants claimed (whether due to error, borrower misrepresentation, or otherwise) greatly increases. This makes the resulting loan pool much more risky. A systemic 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 represented that the Mortgage Loans had been vetted to ensure that they had been originated according to a reasonable, consistent underwriting program that ensures a borrower's ability to repay their loan. For example, the Offering Materials for

2006-SL4 represented: "The mortgage loans have been purchased or originated, underwritten and documented in accordance with the guidelines of Fannie Mae and Freddie Mac, the underwriting guidelines of specific private investors, and the non-conforming or Alt-A underwriting guidelines of the Originators." It also represented that the "Originators consider, among other things, a mortgagor's credit history, repayment ability and debt-service income ratio, as well as the value, type and use of the mortgaged property." And the Offering Materials for 2006-OP2 represented that "[the] Underwriting Guidelines require that mortgage loans be underwritten in a standardized procedure which complies with applicable federal and state laws and regulations." Further similar representations for each Certificate are set forth in the Exhibits.

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

54. The 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, the 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.

55. The defendants, however, did not disclose that: (1) many of the loan pools were subject to review by defendants and/or third-party due diligence firms; (2) defendants were informed from those processes that a substantial percentage of loans in the collateral pools were defective; (3) the defendants nonetheless had waived the defects as to a substantial percentage of these loans; and (4) the defendants had instead used the due diligence reports to negotiate a lower price for the loan pools.

56. 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 defendants' underwriting, sampling, and due diligence processes even more misleading.

C. Owner-Occupancy Statistics

57. Owner-occupancy statistics were material to Allstate and other investors 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.

58. 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 ACE 2006-HE4, it was claimed that among the 2,222 loans in the collateral pool, 93.3% were owner-occupied properties. And the Offering Materials for ACE 2006-OP2 represented that 4,143 of the 4,472 loans in the collateral pool (92.6%) were for the borrower's primary residence.

59. Similarly, in the Offering Materials for ACE 2005-WF1, it was claimed that among the 3,435 loans in the collateral pool, 97% were purportedly owner-occupied properties. And the Offering Materials for DBALT 2005-AR1 represented that "[i]nvestment properties are generally not permitted under the National City underwriting guidelines." DBALT 2005-AR1, Prospecuts Supplement at S-55. Further similar representations for each Certificate are set forth in the Exhibits.

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

60. 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.

61. The Offering Materials contained detailed statistics regarding these ratios for the Mortgage Loans in the collateral pool. For example, the Offering Materials for ACE 2006-SL4, ACE 2005-WF1, ACE 2006-HE4 and 2006-OP2 represented that no loan had a combined loan-to-value ratio greater than approximately 100%. The Offering Materials for ACE 2006-HE4 represented that only 25.2% of the loans had a CLTV ratio over 90%. And the Offering Materials for 2005-WF1 represented that only 12.2% of the loans had a CLTV ratio over 90%. Similar representations for each Certificate are set forth in the Exhibits.

E. Credit Ratings

62. Each of the Certificates received a rating purportedly indicating the rating agencies' view of the risk profile of the securities. The ratings were material to reasonable investors, including Allstate, because the ratings provide 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.

63. 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 2006-OP2 represented: "It is a condition to the issuance of the certificates that the Offered Certificates receive at least the following ratings from Standard & Poor's Ratings Service, a division of The McGraw-Hill Companies, Inc. . . . and Moody's Investors Service, Inc. . . . The ratings assigned to mortgage pass-through certificates

address the likelihood of the receipt by certificateholders of all distributions to which the certificateholders are entitled."

F. 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.

65. The Offering Materials for each of the offerings described the credit enhancements applicable to the certificates. For example, the prospectus supplement for ACE 2006-OP2 listed the specific credit enhancements "for the benefit of the holders of the Offered Certificates" as "excess interest, overcollateralization and subordination." These credit enhancements were intended "to enhance the likelihood of timely receipt by the holders of the Class A Certificates of the full amount of their scheduled monthly payments of interest and principal, as applicable, and to afford the holders of Class A Certificates protection against Realized Losses."

66. "Excess cash flow," "excess interest," and "overcollateralization" all generally refer to the purported effects 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 first out of the

funds available despite those losses. Any leftover funds then "waterfall" into the next class of investors, and so on.

G. Case-by-Case Underwriting Exceptions

67. Whether the defendants were making case-by-case (rather than wholesale) exceptions to the otherwise-applicable underwriting guidelines was material to Allstate and other investors. A disclosed guideline is factually irrelevant – and indeed misleading – from a risk-analysis perspective if large numbers of loans were excused from those standards.

68. The defendants represented that they made case-by-case exceptions to the disclosed underwriting standards, based on compensating factors that increased the quality of a loan application. For example, the Offering Materials for 2006-GP1 represented that "Under no documentation programs, income ratios for the prospective borrower are not calculated. Emphasis is placed on the value and adequacy of the mortgaged property as collateral and the credit history of the prospective borrower, rather than on verified income and assets of the borrower." And the Offering Materials for 2006-HE4 represented that exceptions to the underwriting guidelines may be made "on a cases-by-case basis where compensating factors exist." Further similar representations for each Certificate are set forth in the Exhibits.

III. ALL OF THE REPRESENTATIONS WERE UNTRUE AND MISLEADING

69. The defendants were uniquely situated to make the aforementioned representations. As sponsor and underwriter of the Offerings, the defendants purchased the Mortgage Loans from their originators and re-packaged them into the securities that they sold to Allstate and other investors. In connection with their purchase of the Mortgage Loans, the defendants engaged in due diligence, either directly or through third parties, to evaluate the quality of the Mortgage Loans being purchased. In light of this due diligence, Allstate reasonably relied on the defendants' representations regarding the quality of the loan pool,

including conformity with the originators' stated underwriting guidelines and exceptions, owner occupancy rates, loan-to-value and combined loan-to-value ratios, debt-to-income ratios, credit ratings, and credit enhancements.

70. But all of these representations were false. The Mortgage Loans were not originated according to the underwriting standards disclosed in the relevant Offering Materials and did not conform with the representations made in these documents. In fact, the defendants' own due diligence had revealed that many of the loans were defective. Yet instead of excluding these defective loans from the pools underlying the Offerings, or at least disclosing their true characteristics, the defendants subordinated loan quality to the goal of originating and securitizing as many loans as possible to generate fees in the secondary mortgage market. The defendants' misrepresentations and omissions rendered all of the above representations false or misleading at the time they were made.

71. 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 systemically ignored. In acquiring the loans, the defendants ignored borrowers' actual repayment ability and the value and adequacy of mortgaged property used as collateral in issuing loans. Systematic, bulk exceptions were used without consideration of any compensating factors. The defendants also misleadingly omitted that the defendants were systematically abusing "exceptions" in order to further circumvent their purported underwriting standards.

72. The defendants' representations regarding the underwriting and due diligence processes were made even more misleading by their fraudulent omission of information

regarding the number of rejected loans that the due diligence process did identify, and the high number of such loans that were "waived" in to the collateral pools anyway.

73. The representations regarding owner-occupancy and debt-to-income 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, and borrowers' claimed income was regularly inflated. The defendants also failed to disclose that the statistical representations were baseless.

74. The representations regarding loan-to-value and combined loan-to-value ratios were untrue. The defendants did not genuinely believe the appraisal values used in these statistics because they knew that the property values were being artificially and baselessly inflated in order to increase the amount of money that could be given to a borrower. The CLTV ratios also omitted the effect of additional liens on the underlying properties, rendering them even further from the truth. The defendants also misleadingly omitted that the disclosed statistics were baseless and that the appraisers were systematically pressured to inflate their appraisals.

75. The representations regarding the credit ratings were also untrue. The defendants fed baseless loan statistics to the credit rating agencies, essentially pre-determining the ratings that would be given. These ratings have fallen precipitously as the true quality of the loan pools has become apparent and the ratings agencies have ceased to be dependent on the defendants' misrepresentations.

A. Evidence of the Securities' High Default Rates and Plummeting Credit Ratings

76. A statistical review of the Offerings at issue reveals significant rates of default and delinquency that illustrate the pervasive faults in the underwriting and origination of the

Certificates. For instance, for ACE 2006-OP2, ***52% of the loans in the current pool are delinquent***. For ACE 2006-HE4, 48% of the loans in the current pool are delinquent. The current delinquency rates for all of the Offerings are as follows:

Offering	Current Number of Loans in Pool	Current Number of Delinquent Loans	Delinquent Loans as a Percentage of Current Loans
ACE 2005-WF1	729	249	34.16%
ACE 2006-SL4	1599	247	15.45%
ACE 2006-HE4	1467	703	47.92%
ACE 2006-OP2	1635	856	52.35%
ACE 2004-HE4	778	333	42.80%
ACE 2004-OP1	1,242	381	30.68%
ACE 2004-RM2	341	152	44.57%
ACE 2006-GP1	1,449	150	10.35%
DB 2005-AR1	469	167	35.61%

77. Relatedly, the ratings given to the Certificates have significantly deteriorated. Half of Allstate's investments initially received the highest possible ratings – S&P's AAA rating or their equivalent from the other rating agencies. According to S&P's website: "An obligation rated 'AAA' has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is extremely strong." Moody's similarly describes its highest rating, Aaa, as meaning that the investment is "judged to be of the highest quality, with minimal credit risk." This is the same rating typically given to bonds backed by the full faith and credit of the United States government, such as treasury bills. Historically, a AAA rated security had an expected loss rate of less than .05%.

78. Because of the high delinquency and default rates and other factors, most of Allstate's Certificates have been downgraded. ***Whereas half of the Certificates initially received the same rating given to treasury bills (i.e., AAA), more than half of the Certificates are now rated as non-investment grade by S&P or Moody's.*** According to S&P's website, far

from having the "extremely strong capacity" to meet commitments that AAA ratings do, instead these ratings now indicate that the Certificates are "more subject to adverse economic conditions" or "currently vulnerable and dependent on favorable business, financial and economic conditions to meet financial commitments."

79. Remarkably, ***each Certificate that initially received a AAA rating is now rated as non-investment grade by S&P or Moody's:***

Offering and Class	Original S&P Rating	Current S&P Rating	Original Moody's Rating	Current Moody's Rating
DBALT 2005-AR1, 1A1	AAA	B-	AAA	CAA2
ACE 2006-HE4, A2C	AAA	CCC	AAA	CA
ACE 2006-HE4, A2D	AAA	CCC	AAA	CA
ACE 2006-OP2, A2B	AAA	BBB	AAA	CAA1
ACE 2006-OP2, A2C	AAA	BBB	AAA	CA
ACE 2006-GP1, A	AAA	BBB	AAA	CA
ACE 2006-SL4, A-1	AAA	CC	AAA	C

80. The drastic rise in default rates on the Mortgage Loans underlying Allstate's Certificates, and the resulting drastic decline in credit ratings, reflects the 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 which contained loans that actually had the characteristics the Offering Materials claimed.

81. Statistical studies by other parties corroborate these findings. For instance, in a study of more than three million residential mortgages, the Federal Bureau of Investigation determined that between 30% and 70% of early payment defaults were linked to significant misrepresentations in the original loan applications. Loans containing egregious misrepresentations were five times more likely to default in the first six months than loans that did not contain such egregious misrepresentations. Similarly, the FCIC found a significant

increase in defaults, and concluded that the increased default rate reflected the fact that borrowers were taking out loans that they had no intention of repaying.

82. In short, the fact that a significant percentage of the loans underlying the offerings at issue have defaulted or become delinquent 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 credit rating and market value thus are due to the defendants' wrongdoing, and not because of the general change in economic conditions.

B. Evidence Demonstrating that Owner Occupancy Representations Were False and Misleading

83. As above, the defendants repeatedly represented that the loan pools underlying the Certificates had high percentages of loans issued to borrowers who 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.

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

85. Allstate need not rely purely on such industry-wide studies to support its allegation that the Mortgage Loans here were misrepresented. Allstate selected a random sample of loans from all but one of the offerings in which it invested to test the defendants' representations on a loan-level basis. Using techniques and methodologies that only recently became available, Allstate conducted loan-level analyses on more than 12,000 Mortgage Loans

underlying the 2005-WF1, 2006-OP2, 2006-HE4, 2006-SL4, 2004-HE4, 2004-OP1, 2004-RM2 and DBALT 05-AR1 offerings.

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

87. 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.

88. 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.

89. 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.

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

91. 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 the Exhibits. Failing multiple of the above tests is strong evidence the borrower did not in fact reside at the mortgaged properties. These statistics thus show that, despite the defendants' representations, a much higher percentage of borrowers did not occupy the mortgaged properties:

Asset	Owner-Occupied Properties (Prospectus)	Owner-Occupied Properties (Estimated Actual)	Prospectus Overstatement
ACE 2006-HE4	93.3%	83.0%	10.3%
ACE 2006-OP2	92.6%	82.1%	10.5%
ACE 2005-WF1	97.0%	87.5%	9.5%
ACE 2006-SL4	74.3%	65.1%	9.2%
ACE 2004-OP1	92.1%	80.0%	12.15%
ACE 2004-HE4	95.0%	83.0%	11.94%
ACE 2004-RM2	97.4%	84.5%	12.91%
DBALT 2005-AR1	87.6%	75.5%	12.08%

92. The facts alleged in this complaint show the defendants' problems were systemic, and such is confirmed by the consistency of the results set forth above. Allstate made a total of

twenty-nine investments in the nine offerings at issue here. Of those, eight offerings, totaling twenty-six of Allstate's investments, were tested by Allstate. In total, Allstate tested more than 12,000 loans. The lone transaction not tested by Allstate, 2006-GP1, involved the same parties, the same originators, and nearly identical disclosures; moreover, both the underlying loans and the certificates themselves were generated around the same time according to the same purported processes. As such, on information and belief, the Offering Materials for the one offering that Allstate was not yet able to test on a loan-level basis also misrepresented the owner-occupancy information at approximately the same material rate as seen in the large sample of Certificates discussed above.

C. **Statistical Evidence Demonstrating that the Stated Loan-to-Value and Combined Loan-to-Value Ratios Were False**

93. As above, the defendants 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.

94. Using techniques and methodologies that only recently became available, Allstate had a sample of the property underlying eight of the offerings at issue valued by an industry-standard automated valuation model ("AVM"). AVMs are routinely used in the industry 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.

95. The results of this analysis for each Certificate in the tested offerings is set forth in the Exhibits. Applying the AVM to the available data for the loans underlying these Certificates shows that the value used by the defendants in the represented CLTVs were materially and consistently inflated. This caused the disclosed 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.

96. Overall, 36.5% of the loans sampled with sufficient data had recalculated CLTV ratios more than 10% higher than what it supposedly had, and 12.4% of the loans sampled with sufficient data had recalculated CLTV ratios more than 25% higher than what it supposedly had. This overvaluation affected numerous statistics in the Offering Materials.

97. The Offering Materials likewise misrepresented the percentage of loans with CLTVs higher than 80%. CLTVs in excess of 80% 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 than represented had CLTV ratios higher than 80%, as shown in the chart below:

Asset	Percentage of Loans Represented to Have CLTVs Greater than 80%	Actual Percentage of Loans With CLTVs Greater than 80%	Prospectus Understatement of Percent of Loans Already Underwater
ACE 2006-HE4	43.49%	84.01%	40.52%
ACE 2006-OP2	50.20%	78.65%	28.45%
ACE 2005-WF1	38.37%	65.66%	27.29%
ACE 2006-SL4	96.26%	92.77%	-3.49%
ACE 2004-OP1	29.54%	57.95%	28.41%
ACE 2004-HE4	44.28%	77.57%	33.29%

ACE 2004-RM2	40.59%	80.08%	39.49%

98. Unlike the other tested Offerings, the Prospectus Supplement for ACE 2006-SL4 actually *over*stated the percentage of loans with a CLTV greater than 80%. This is because the Prospectus Supplement grossly *under*stated the percentage of loans with a CLTV above 100%. As reflected in the tables above, Allstate's statistical analysis reveals that whereas the Prospectus Supplement represented that no loans in the ACE 2006-SL4 pool had a CLTV above 100%, in truth more than 57% of the loans had a CLTV above 100%. The defendants concealed this extreme and troubling figure by overstating the percentage of loans with a lesser (though still significant) CLTV greater than 80% but below the true value in excess of 100%.

99. The Offering Materials represented the share of loans that had CLTVs in excess of 90%. CLTVs in excess of 90% provide the lender even less of a value cushion to protect against borrower default and loss upon foreclosure. However, the AVM indicates that a much higher percentage of the loans than represented had CLTV ratios higher than 90%, 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 Already Underwater**
ACE 2006-HE4	25.22%	71.10%	45.88%
ACE 2006-OP2	35.06%	63.37%	28.31%
ACE 2005-WF1	12.20%	48.43%	36.24%
ACE 2006-SL4	72.13%	81.62%	9.50%
ACE 2004-OP1	8.24%	38.90%	30.66%
ACE 2004-HE4	21.03%	62.65%	41.62%
ACE 2004-RM2	26.86%	65.46%	38.60%

100. The Offering Materials also made representations about the percent of loans that had CLTVs higher than 100%, meaning the size of the loan was greater than the value of the property. (This is known as being "underwater," in that the borrower owes more on the property

than it is worth.) 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%:

Asset	Percentage of Loans Represented to Have CLTVs Greater than 100%	Actual Percentage of Loans With CLTVs Greater than 100%	Prospectus Understatement of Percent of Loans Already Underwater
ACE 2006-HE4	0.00%	51.35%	51.35%
ACE 2006-OP2	0.00%	45.17%	45.17%
ACE 2005-WF1	0.00%	29.52%	29.52%
ACE 2006-SL4	0.00%	57.48%	57.48%
ACE 2004-OP1	0.00%	24.72%	24.72%
ACE 2004-HE4	0.00%	43.31%	43.31%
ACE 2004-RM2	0.00%	43.28%	43.28%

101. Allstate has also analyzed the weighted average CLTV of the Mortgage Loans in each pool and has found that the weighted average CLTV was also overstated, because of the overstatement of individual Mortgage Loans within the pools. The AVM again indicates that the representations were untrue:[1]

Asset	Represented Weighted Average CLTV	Actual Weighted Average CLTV	Prospectus Understatement
ACE 2006-HE4	81.92%	99.40%	17.48%
ACE 2006-OP2	82.19%	95.12%	12.93%
ACE 2005-WF1	79.02%	91.71%	12.69%
ACE 2006-SL4	95.60%	109.37%	13.77%
ACE 2004-OP1	77.06%	86.47%	9.41%
ACE 2004-HE4	80.14%	96.91%	16.77%
ACE 2004-RM2	80.85%	96.18%	15.33%

[1] The Offering Materials for the DBALT 2005-AR1 do not make representations as to CLTV. The mirepresentations as to LTV, however, are similar to the other offerings. Specifically, the represented weighted average LTV was 75.76% but the actual weighted average LTV was 83.35%. Similarly, only 15.58% of the loans were represented as having an LTV of 80% or greater. Research showed, however, that 61.16% had LTVs over 80%. Also, 8% of the loans were represented as having an LTV of 90% or greater. Research showed, however, that 30.40% had LTVs over 90%. Finally, although the Offering Materials stated that no loans had an LTV above 100%, 14.59% of the loans tested had LTVs over 100%.

102. The facts alleged in this complaint show the defendants' problems were systemic, and such is confirmed by the consistency of the results set forth above. Allstate made a total of twenty-nine investments in the nine offerings at issue here. Of those, eight offerings, totaling twenty-six of Allstate's investments, were tested by Allstate. In total, Allstate tested over 12,000 loans. The lone transaction not tested by Allstate, 2006-GP1, involved the same parties, the same originator, and nearly identical disclosures; moreover, both the underlying loans and the certificates themselves were generated around the same time according to the same purported processes. As such, on information and belief, the Offering Materials for ACE 2006-GP1 misrepresented the LTV and CLTV statistics at approximately the same material rate as seen in the large sample of Certificates discussed above.

103. The defendants did not genuinely believe the appraised values were reasonable estimations of the properties' values at the time they were given. The 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."

D. <u>Evidence From the Defendants' Own Insurer Demonstrates that the Problems in the Defendants' Loans Were Tied to Underwriting Abandonment</u>

104. Unlike Allstate, Assured Guaranty Corporation had access to some of the complete loan files for certain of the defendants' securitizations of RMBSs issued contemporaneously with the securities at issue here. Its analyses – made public in October 2010 – provides additional strong evidence that essential characteristics of the Mortgage Loans underlying the Certificates were misrepresented, and that the problems in the defendants' underwriting practices were systemic.

105. Assured is a New York-based monoline insurer that wrote insurance on certain ACE/Deutsche Bank mortgage-backed securities offerings. Assured conducted an investigation into certain loan files after it observed signs of significant deterioration in the loans underlying securities it insured.

106. Specifically, Assured analyzed more than 3,000 loan files underlying the ACE 2007-SL2 and ACE 2007-SL3 offerings. These offerings are substantially identical to the offerings at issue here.

107. The 2007-SL2 offering – like the 2006-SL4 offering into which Allstate purchased – contained a pool of conventional, one-to-four family, second lien fixed-rate mortgage loans on residential real property. It shared a sponsor (Deutsche Bank Structured Products), Depositor (ACE), Servicers (Ocwen Loan Servicing and GMAC Mortgage LLC), Master Servicer and Security Administrator (Wells Fargo, NA), and Trustee (HSBC Bank USA, NA) with many of the offerings at issue here. And it was offered at or about the same time as the offerings at issue here.

108. Similarly, the 2007-SL3 offering contained a mixed pool of conventional, one-to-four family, second lien fixed-rate mortgage loans on residential real property, as well as one-to-four family, first lien adjustable-rate home equity lines of credit. The offering shared a sponsor (Deutsche Bank Structured Products), Issuer (ACE Securities Corp. Home Equity Loan Trust), Indenture Trustee (Deutsche Bank National Trust Co.), and Security Administrator (La Salle Bank NA) with many of the offerings at issue here. And it was offered at or about the same time as the offerings at issue here.

109. Assured reviewed loan files associated with 1,306 of the 3,363 loans underlying 2007-SL2. This review uncovered significant deficiencies in 1,084 of the 1,306 tested loans –

more than 83%. These deficiencies included misrepresentations regarding the borrower's income, assets, employment, or intent to occupy the property as a primary residence; misrepresentations regarding the borrower's liabilities, including the existence of other mortgage loans; and misrepresentations regarding adherence to stated underwriting standards.

110. Assured also reviewed loan files associated with 1,774 of the 4,428 loans underlying the 2007-SL3 offering. This review uncovered deficiencies in 1,532 of the 1,774 tested loans – more than 86%. The deficiencies again included misrepresentations regarding the borrower's income, assets, employment, or intent to occupy the property as a primary residence; misrepresentations regarding the borrower's liabilities, including the existence of other mortgage loans; and misrepresentations regarding adherence to stated underwriting standards.

111. Assured's analysis is probative of problems underlying Allstate's Certificates. Its discovery of material deficiencies in the loan files, including deficiencies related to owner occupancy and the existence of additional mortgage loans, confirms and corroborates Allstate's own analysis of the owner occupancy and CLTV statistics associated with the Offerings at issue. Assured's review of offerings having collateral pools composed of the same type of collateral as some of Allstate's Certificates, packaged and issued by many of the same parties involved in the packaging and issuing of Allstate's Certificates, and issued at approximately the same time as Allstate's Certificates demonstrates that the defendants' misconduct was systemic and pervasive.

E. Evidence From the Defendants' Own and Third Party Due Diligence Demonstrates the Falsity of the Defendants' Representations

112. The defendants wore multiple hats in connection with the Offerings at issue here, acting in various capacities including sponsor and underwriter of the offered securities. In their overlapping capacities, the defendants were responsible for purchasing large blocks of lortgage

loans from third party originators, repackaging those loans into securities, and selling the newly-created securities to investors like Allstate.

113. In connection with their purchase of the Mortgage Loans from the loan originators, and consistent with industry practice, the defendants performed due diligence to determine the quality of the Loans they were purchasing. The defendants performed some of this due diligence themselves, and they also hired third-party due diligence firms, such as Clayton Holdings, Inc., to conduct reviews of the proposed loan pools.

114. Specifically, on information and belief, the defendants operated quality assurance and risk management departments tasked with ensuring that loans purchased from third-party originators met the defendants' own standards. To make this determination, the defendants employed a team of underwriters who reviewed a sample of the purchased loans to confirm that they both conformed with the representations made by the originators and complied with the defendants' own credit policies.

115. The Prospectus Supplements for the Offerings at issue make specific reference to this internal due diligence practice, stating that "[p]rior to the issuance of the certificates, Mortgage Loans may be removed from the Mortgage Pool as a result of incomplete documentation or otherwise if the Depositor deems the removal necessary or desirable . . . ." *See, e.g.*, ACE 2006-HE4 Prospectus Supplement at S-72.

116. On information and belief, the defendants' own due diligence revealed that a significant percentage of loans purchased from third-party originators failed to meet applicable underwriting standards.

117. Defendants at other times relied on outside firms to conduct the requisite due diligence. One of the largest such firms is Clayton Holdings. As the FCIC put it (at 166):

"Because of the volume of loans examined by Clayton during the housing boom, the firm had a unique inside view of the underwriting standards that originators were actually applying – and that securitizers were willing to accept."

118. Clayton reviewed loan files 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, they also analyzed whether, to the extent a loan was deficient, there were any "compensating factors."

119. 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, 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.

120. According to the FCIC, only 54% of the nearly one-million loans reviewed by Clayton Holdings "met guidelines," a number that indicated "there [was] a quality control issue in the factory" for mortgage-backed securities, according to Clayton's former president.

121. Defendants hired Clayton to perform due diligence on the proposed loan pools offered for sale by third-party originators, including, on information and belief, the Mortgage Loans underlying the offerings at issue here. As a result of the due diligence it performed for the

defendants in this case, Clayton determined that ***35% of the loans*** it reviewed "failed to meet guidelines" and did not have sufficient compensating factors. In other words, 35% of the loans that the originators offered for sale to the defendants for use in RMBS offerings such as the ones at issue here were found by Clayton not to meet the applicable underwriting standards. Nevertheless, Deutsche Bank provided waivers for ***54% of those rejected loans***, which meant that those non-compliant loans were included in mortgage-backed securities sold to Allstate and other investors.

122. The defendants generally did not make any disclosure to Allstate that problem loans that its due diligence had rejected were nonetheless included in the loan pools sold to RMBS investors. This was an important omission that 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.***

F. Evidence That the Ratings Were Meaningless

123. 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.

124. As such, the defendants essentially pre-determined the ratings by feeding garbage into the ratings system. This rendered misleading the defendants' promises that the various tranches within a particular offering would obtain a certain initial rating; these promises failed to disclose that the initial rating would be based entirely on false information provided by the defendants, and therefore would not reflect the true credit risk associated with each tranche and Offering.

125. As previously noted, the credit ratings of the Offerings at issue have plummeted as the true quality of the collateral pools and the true nature of the defendants' misconduct has been revealed, and as the ratings agencies have thereby obtained more accurate information regarding the tranches and Offerings at issue—and ceased to be dependent on information obtained directly from the defendants themselves.

G. Evidence Demonstrating That the Originators Used by the Defendants Abandoned their Own Underwriting Standards

126. As noted, the loans that the defendants included in the securities sold to Allstate were originated by third-party banks and then sold in bulk to defendants Deutsche Bank or Ace. The Offering Materials associated with each of Allstate's Certificates described each of the specific originators' underwriting guidelines. The purported goal of the guidelines was "to assess the ability and willingness of the mortgagor to repay the debt and to evaluate the adequacy of the property as collateral for the mortgage loan." (*See*, *e.g.*, ACE 2006-HE4 Prospectus dated April 18, 2006 at S-14.)

127. The underwriting process used to form the pools of mortgage loans underlying Allstate's Certificates was material to Allstate because, as discussed above, the quality of loans in the pool determines the risk of the certificates backed by those loans. If a reasonable underwriting process was not actually followed, the chances that the loans had riskier features

than claimed in the Offering Materials (whether due to error, borrower misrepresentation, or otherwise) greatly increases, making the entire loan pool much riskier. A systemic 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.

128. While the Offering Materials represented that the Mortgage Loans were underwritten in accordance with the underwriting standards of the originators, many of the originators involved in these transactions are known to have, among other things, ignored their own underwriting guidelines and used inflated appraisals to generate loans with higher principal balances. The questionable practices employed by many of these originators have lead to numerous allegations and investigations into their operations. In fact, faulty underwriting has lead to the demise of several of the originators utilized by the defendants in these offerings. The percentage of loans in each of the offerings originated by these unaffiliated originators is as follows:

Originator	**# of Loans in Trust**	**Originator(s)**	**% of Origination**
ACE 2005-WF1	3,435	Wells Fargo Bank	100%
ACE 2006-GP1	6,276 (HELOCs)	GreenPoint Mortgage Funding, Inc.	100%
ACE 2006-HE4	3,725	First NLC Financial Services, LLC	28.47%
		Chapel Funding Corporation	18.64%
		The remainder of the mortgage loans were originated by various originators, none of which have originated more than 10% of the mortgage loans	
ACE 2006-OP2	4,474	Option One Mortgage Corporation	100%
ACE 2006-SL4	5,661	American Home Mortgage Corp.	70.91%
		People's Choice Home Loan, Inc.	10.85%
		The remainder of the mortgage loans were originated by various originators, none of which have	

		originated more than 7.25% of the mortgage loans	
ACE 2004-OP1	10,095	Option One Mortgage Corporation	100%
ACE 2004-HE4	6,429	Fremont Investment & Loan	74.10%
		People's Choice Home Loan, Inc.	14.25%
ACE 2004-RMS	3,787	Residential Mortgage Assistance Enterprise, LLC	74.94%
		ResMae Mortgage Corporation	25.06%
DBALT 2005-AR1	1,376	National City Mortgage Co.	36.43% (Group 1)
		Pinnacle Financial Corporation	29.64% (Group 1) 3.71% (Group 2)
		Quicken Loans Inc.	5.64% (Group 1) 48.88% (Group 2)
		IndyMac Bank, FSB	7.67% (Group 1) 18.51% (Group 2)
		Greenpoint Mortgage Funding, Inc.	15.83% (Group 1)

(1) Well Fargo Bank

129. Wells Fargo was the sole originator for the ACE 2005-WF1 offering. As recently disclosed, beginning in 2005, faced with shrinking profits and loss of market share, Wells Fargo abandoned its strategy of less-risky underwriting and initiated a program of "discretionary underwriting" providing incentives to employees for more aggressive underwriting, resulting in the underwriting of significantly more risky mortgage loans in spite of their own underwriting guidelines. Part of Wells Fargo's scheme to increase market share and to make as many loans as possible involved, among other things, the corruption and control of the appraisal process. Wells Fargo needed appraisals that supported the loans it wished to make, irrespective of the actual values of the properties being appraised. To accomplish this objective, Wells Fargo engaged in a pattern and practice of pressuring appraisers to write an appraisal designed to have the loan underwritten even if the appraisal violated the Uniform Standard of Professional Appraisal Practice. If an appraiser did not succumb to the pressures of Wells Fargo, they were placed on its "Field Review List" or some other list of exclusion.

130. Throughout 2005 through 2007, Wells Fargo continued pushing ever-increasing subprime mortgage loan volume through its system by loosening its underwriting practices and introducing a growing percentage of higher risk mortgage products, including adjustable-rate, interest only loans and "stated income" loans, where even W-2 wage earners did not have to bother verifying their stated income levels.

131. Wells Fargo's mortgage underwriting department was a "production based shop" where underwriters were required to make certain amount of loans regardless of the repayment ability of the borrower. Underwriters were expected to "find a way" to deem the loans as acceptable even when they did not meet the underwriting standards. During 2006-2007, Wells Fargo began to completely ignore its loans underwriting standards and began lending to people who could not afford to repay their loans.

132. 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. During the period in which Wells Fargo was originating loans which were eventually pooled into the ACE 2005-WF1 offering, upon information and belief, Wells Fargo had abandoned sound underwriting practices.

133. Countless different entities have conducted investigations of Wells Fargo and numerous complaints have been filed against the bank as a result. In denying in part a motion to dismiss *in In re Wells Fargo Mortgage-Backed Securities Litigation,* No. 3:09-1376 (N.D. Cal.) (the "*Wells Fargo* Complaint"), the court found that plaintiffs had adequately pled that "variance from the stated [underwriting] standards was essentially [Wells Fargo's] norm" and that this conduct "infected the entire underwriting process."

134. On information and belief, Wells Fargo employees increasingly disregarded the credit risk of the Mortgage Loans and their own quality controls in favor of generating loan volume in order to increase their own commissions and bonuses. Even more alarming, Wells Fargo employees manipulated loan data in order to close loans and generate volume and had a standard practice of approving exceptions which deviated from prudent underwriting guidelines.

135. By the end of 2008, Wells Fargo's true underwriting practices became known to the public. During this time, Wells Fargo was forced to take significant write-downs due to its massive exposure to the subprime market. In October 2008, Wells Fargo received a $25 billion subsidy from the Federal Government as part of the Federal Emergency Economic Stabilization Act.

(2) IndyMac Bank

136. As a result of faulty lending, originating and underwriting practices, on July 11, 2008, IndyMac Bancorp, Inc. became the third-largest bank failure in U.S. history when the U.S. Department of the Treasury, Office of Thrift Supervision seized it and announced that the Federal Deposit Insurance Corporation would seek a buyer for IndyMac Bank. This led IndyMac Bank to file for bankruptcy protection on July 31, 2008.

137. A February 26, 2009 report issued by the Office of Inspector General ("OIG") of the U.S. Department of Treasury entitled "Safety and Soundness: Material Loss Review of IndyMac Bank, FSB" (the "OIG Report") confirmed that many of these faulty practices were part of long, systematic problems at IndyMac. The OIG Report portrays IndyMac Bank as a company that focused on aggressive growth without any regard to risk. To feed its aggressive growth model, IndyMac Bank ignored its stated underwriting guidelines. IndyMac Bank originated and acquired as many loans as possible (and as quickly as possible) in order to bundle, securitize and then sell them as Certificates to investors without regard to the quality of the

loans, the creditworthiness of the borrowers or the value of the underlying collateral. *See* OIG Report at 2-3.

138. For example, while the Offering Documents state that appraisals were conducted in "accordance with the Uniform Standards of Professional Appraisal Practice" and that the "appraiser generally inspects the property, analyzes data including the sales prices of comparable properties and issues an opinion of value," the OIG Report concluded, inter alia, that: "IndyMac officials accepted appraisals that were not in compliance with the Uniform Standard of Professional Appraisal Practice" and IndyMac "accepted appraisals where the property valuation was made without physical site inspection of the subject property or comparable properties." *See* OIG Report at 2, 12, 26.

139. A June 30, 2008 report issued by the Center for Responsible Lending ("CRL") also found that IndyMac Bank often ignored its stated underwriting and appraisal standards and encouraged its employees to approve loans regardless of the borrower's ability to repay them. *See* IndyMac: What Went Wrong? How an "Alt-A" Leader Fueled its Growth with Unsound and Abusive Mortgage Lending (the "CRL Report"). For example, CRL noted that IndyMac Bank "engaged in unsound and abusive lending practices" and "allowed outside mortgage brokers and in-house sales staffers to inflate applicants' [financial information] . . . [to] make them look like better credit risks." *See* CRL Report at 2, 8.

140. Both the CRL Report and OIG Report confirm that statements made by IndyMac that its underwriting guidelines "include[] an analysis of the borrower's credit history, ability to repay the mortgage loan and the adequacy of the mortgaged property as collateral" were untrue when made because IndyMac underwriters "routinely . . . [made] loans without regard to

borrowers' ability to repay [them]," CRL Report at 2, and with "little, if any, review of the borrower['s] qualifications, including income, assets, and employment," OIG Report at 11.

141. The OIG Report found that rather than following its disclosed underwriting processes, IndyMac Bank had "embarked on a path of aggressive growth" that was supported by its high risk business strategy of "originating . . . Alt-A loans on a large scale" and then "packag[ing] them together in securities" and selling "them on the secondary market" to investors. OIG Report at 2, 6, 7. "To facilitate this level of [loan] production, [OIG] found that IndyMac often did not perform adequate underwriting." *Id.* at 21. This "aggressive growth strategy" resulted in IndyMac Bank's assets "gr[owing] from nearly $5 billion [in mid-2000] to over $30 billion [in the first quarter of 2008]" and was also "[t]he primary cause[] of IndyMac's failure." *Id.* at 2, 6.

142. In its effort to "produce as many loans as possible and sell them in the secondary market," (*Id.* at 21), IndyMac Bank "relaxed" and effectively abandoned its underwriting standards to permit risky borrowers to qualify for Alt-A loans, sacrificing loan quality for quantity. "IndyMac often made loans without verification of the borrower's income or assets, and to borrowers with poor credit histories. Appraisals obtained by IndyMac on underlying collateral were often questionable as well." *Id.* at 2. Ultimately, IndyMac Bank was making loans to "borrowers who simply could not afford to make their payments." *Id.*

143. OIG documented several examples of loans that it felt demonstrated IndyMac Bank's "high-risk activities over many years." OIG Report at 4. In fact, the Appendix of the OIG Report contained a detailed discussion of several IndyMac Bank originated loans that it believed demonstrated IndyMac's "weakest underwriting practices." *Id.* at 71.

> On May 2, 2007, IndyMac Bank approved a so-called "stated income" loan in the amount of $926,000, which was secured by a piece of property located in Florida. The claimed

purpose of the loan was to pay off a previous loan made from a different lender and to fund the building of a house on the property. As a "stated income" loan, IndyMac Bank did not verify the borrower's claimed income of $50,000 per month nor did IndyMac Bank verify the borrower's assets. In addition, while the loan file did include a signed authorization from the borrower to allow IndyMac Bank to request his previously-filed tax returns, the OIG "found no evidence that IndyMac ever obtained the tax returns." In fact, according to a former First Vice President, Quality Control – Enterprise Risk Management, "IndyMac had borrowers sign such requests as a 'scare tactic,' assuming that they would be more forthcoming on their stated income." Indeed, the OIG "w[as] told that IndyMac seldom forwarded the signed requests on to the IRS." To make matters worse, while the loan file contained an appraisal for the property of $1.43 million, "the comparable properties were located closer to the ocean and bay, and their values were based on listing price instead of the actual selling price. The appraised value also did not take in[to] consideration a slowdown in the real estate market." The borrower ended up defaulting on the loan and owed IndyMac $1.01 million. At the time the OIG was conducting its review, the property was listed for sale for only $599,000 – or 50% less than the claimed appraised value. (OIG Report at 71-72.)

In November 2007, IndyMac Bank approved a $3.0 million stated income loan which was secured by the borrower's primary residence. The loan was allegedly going to be used to refinance the primary residence that the borrower had owned for eleven years. "Contrary to IndyMac policy, the borrower selected the appraiser who appraised the property at $4.9 million." However, notes in the loan file indicated that the borrower was unable to sell the house previously for $4.9 million and also failed to sell the house once he reduced the asking price to $4.5 million. "Despite this, the appraiser concluded that the value of $4.9 million appeared to be reasonable" and did not insist on physically inspecting the property. "The borrower made no payments on the loan before default. The total delinquent loan amount as of November 2008 was $3,015,625. According to the IndyMac official, the property sold in October 2008 for $2.0 million" – or 200% less than the appraised price. (OIG Report at 72.)

In February 2007, IndyMac approved a stated income loan for a total combined value of $1.475 million, which was also the original appraised value of the property. Because the loan was based on the borrower's stated income, IndyMac Bank performed no verification of his claimed income of $28,500 a month. Also, while IndyMac Bank's guidelines for 80/20 loans only allowed for a combined maximum loan amount of $1.0 million (i.e., $800,000 first loan and $200,000 second loan), "[t]his loan was an exception to [that] policy. . ." However, "[v]arious appraisals in the loan file [for the property] contained significant differences with no indication of how [the differences] were resolved by IndyMac." For example, an appraisal in January 2007 claimed the property was worth $1.48 million, but "[a] valuation analysis prepared by an IndyMac Bank employee on January 25, 2007, stated that the skill level of the appraiser was unacceptable – the appraiser had not provided accurate comparable properties . . . and did not accurately consider the location of the property." Rather than accept the original appraisal of $1.48 million, the IndyMac Bank employee estimated that the property was worth only $1.0 million "and recommended that another appraisal be obtained." Yet the loan file also indicated that another IndyMac Bank official "overruled the employee's

> recommendation and the appraisal was accepted [with a slight 10% discount]." The borrower defaulted on the loan prior to making a single payment. In November 2008, an IndyMac Bank official estimated "that the property was worth about $700,000" – or less than 50% of the originally-accepted appraised value. (OIG Report, at 72-73.)

144. The CRL Report similarly found a number of underwriting failures prevalent at IndyMac Bank during the relevant time. According to CRL, "the quality of [IndyMac Bank's] loans became a running joke among its employees . . ." CRL Report at 2. "These practices left many [borrowers] deep in debt and struggling to avoid foreclosure." *Id.* In fact, IndyMac Bank CEO Perry "admitted" that IndyMac Bank "had gotten a little bit lax[]" about underwriting and "didn't have the focus on fraud that we should have in this area." *Id.* at 17.

145. Former IndyMac Bank underwriters explained that low-doc loans were a "big problem" because the "loans allowed outside mortgage brokers and in-house sales staffers to inflate applicants' [financial information] . . . and make them look like better credit risks." CRL Report at 8. In fact, the "shoddily documented loans were known inside [IndyMac] as 'Disneyland loans' – in honor of a mortgage issued to a Disneyland cashier whose loan application claimed an income of $90,000 a year." *Id.* at 3.

146. On Friday, February 12, 2011, the SEC announced that it had filed charges against three former officers of IndyMac Bancorp, which collapsed in the summer of 2008. According to the SEC's complaints, which were filed in Los Angeles federal district court, former chief executive officer Michael Perry and former chief financial officer A. Scott Keys and his successor S. Blair Abernathy violated securities laws by misrepresenting the financial condition of IndyMac Bancorp and its subsidiary IndyMac Bank. Abernathy was also charged with making misleading statements in documents issued by IndyMac for a $2.5 billion sale of residential mortgage-backed securities.

147. According to the SEC, Abernathy received internal monthly reports showing that 12% to 18% of a random sample of IndyMac Bank's loans contained misrepresentations regarding important information about the loans' characteristics (such as a loan's status as an owner-occupied loan or its LTV ratio and/or the borrowers' creditworthiness, such as a borrower's identity, income, or debt load). Despite receiving monthly reports showing that a significant percentage of loans contained misrepresentations, Abernathy negligently failed to take reasonable or responsible steps to ensure that the RMBS offering documents (which had been prepared by inside and outside counsel) included accurate disclosures concerning the loans in the RMBS, or notified investors that the presented information was materially misleading in light of IndyMac Bank's monthly reports. Abernathy authorized and/or signed Commission filings relating to these offerings. These six offerings have experienced substantial loan delinquencies and ratings downgrades. Abernathy has settled with the SEC by agreeing to pay a $100,000 penalty and $25,000 in disgorgement. He has also been suspended from practicing before the SEC as an accountant.

(3) Fremont Investment & Loan

148. Fremont Investment & Loan originated over 74% of the loans in the ACE 2004-HE4 offering. As above, Clayton Holdings is a third-party due diligence firm hired by underwriters such as Deutsche Bank to determine whether loans in a given loan pool met certain guidelines. Clayton's "unique view" allowed them to internally track the number of loans underwriters were "waiving" into securitization pools.

149. The FCIC's investigation not only recently revealed the rate at which Deutsche Bank was "waiving in" rejected loans, but also revealed details regarding how bad certain originators were. According to an internal Clayton Holdings "Trending Report" made public by the government in conjunction with testimony given in September 2010, for the period studied

by that report (2006 through early 2007, i.e., around the same time the loans at issue here would have been generated), Clayton rejected around 10% of Freemont's loans as not being complaint and not being subject to any purported compensating features. In the second quarter of 2006, that number soared to over 20%.

(4) GreenPoint Mortgage Funding, Inc.

150. GreenPoint Mortgage Funding, Inc. was the sole originator of the 2006-GP1 offering and originated 15.83% of the mortgage loans in the DBALT 2005-AR1 offering.

151. 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.

152. As of August 2007, GreenPoint specialized in non-conforming and Alt-A mortgages which generated higher origination fees than standard loans. GreenPoint's employees and independent mortgage brokers also 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.

153. 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 granted 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.

154. 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.

155. 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.

156. GreenPoint's CEO, S.A. Ibrahim, maintained that these no-doc loans were the preferred instrument in their arsenal, incurring minimal losses even in times of economic slowdown; moreover, although GreenPoint's guidelines claimed that they did not calculate the borrowers loan-to-value ratio, Ibrahim has said that loan-to-value ratios of 70% or 80% are not uncommon.

157. 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.

- 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.
- 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.

158. 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 but were merely the minimum standards that investors were willing to accept for loans they would purchase and securitize.

159. 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.

160. GreenPoint's investor-driven underwriting guidelines were woefully inadequate. 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, justifying this trend on the ground 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.

161. 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 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.

162. GreenPoint did not verify the income of borrowers as represented but had a reputation in the industry for cutting corners on underwriting. GreenPoint was one of the first innovators of Alt-A mortgages. However, many of GreenPoint's Alt-A loans were actually subprime loans in disguise. GreenPoint's practice of disguising subprime loans as Alt-A loans was confirmed a former GreenPoint Account Executive. 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.

(5) Option One Mortgage Corporation

163. Option One Mortgage Corporation, the originator of ACE 2004-OP1 and ACE 2006-OP2, is another example of a company suspected of using inflated appraisals to grant mortgages. Actions have also been commenced against Option One by borrowers, alleging that the company failed to accurately state borrower's APR and to explain finance charges that accompanied loans.

164. 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.

165. According to the Comptroller of the Currency's "Ten Worst in the Ten Worst" list, Option One is ranked as the sixth worst mortgage originators by number of foreclosures as of March 22, 2010.

166. Upon information and belief, former Option One employees will testify 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. This witness 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 the witness' 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, this witness stated that he 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, a witness stated that "[o]f course they inflated values" and that 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 a witness 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. Another witness, an Assistant Vice President of Option One from 2005 to 2007, 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.

- Instances where a witness "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."

167. 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 (the "Massachusetts Option One Complaint"). 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."

168. The Attorney General alleged 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."

(6) First NLC Financial Services, Inc.

169. First NLC, originator of over 28% of the loans in the ACE 2006-HE4 offering, was one of the top subprime residential mortgage lenders in the United States, originating over $7.4 billion in mortgage loans in 2006. The company was sold in 2007 to an affiliate of the private equity firm Sun Capital Partners. In January of 2008, the company announced that it had ceased loan origination, and filed for bankruptcy later that month.

(7) National City Mortgage Company

170. National City, originator of over 36% of the loans in the DBALT 2005-AR1 offering, was once among the nation's top 10 subprime lenders. In 2008, National City disclosed that the U.S. Securities and Exchange Commission had launched an informal investigation into National City's loan underwriting standards.

171. Further, in 2008, National City agreed to pay the United States $4.6 million to settle allegations arising under the False Claims Act concerning 58 federally insured loans for mortgages submitted to the Department of Housing and Urban Development (HUD). The government alleged that National City improperly submitted 58 late endorsement loans for FHA insurance coverage that were not current, in violation of FHA regulations.

172. Facing mounting economic pressures, National City was forced to sell its mortgage operations to PNC Bank in October 2008.

(8) People's Choice Home Loan, Inc.

People's Choice has faced numerous allegations in connection with its underwriting practices including: (i) a lack of quality control which led mortgage brokers to manipulate documents and allowed borrowers to get away with lying on their loan applications; (ii) borrowers missing one or more of their first three payments, indicating poor underwriting done by People's Choice; and (iii) approving borrowers with insufficient income required by People's Choice own guidelines to afford the required mortgage loan payments, because mortgage brokers forged borrower's bank statements, signatures, and income.

173. Multiple borrower suits have also been filed. Some allege People's Choice failed to accurately state the borrower's APR and to explain finance charges that accompanied loans.[2]

[2] *Curtis v. Option One Mortgage Corp,* No. 1:09-CV-1982, 2010 WL 1729770 (E.D. Cal April 28, 2010); *Brown v. Option One Mortgage Corp.*, No. C 09-5705, 2010 WL 1267774 (N.D. Cal. April 1,

Others alleged the company used inflated appraisal values. People's Choice Home Loan, Inc. was one of the largest subprime lenders in the country prior to its Chapter 11 bankruptcy filing on March 20, 2007.

(9) Quicken Loans Inc.

174. Quicken Loans, one of the originators involved in the DBALT 2005-AR1 transaction, has been the subject of allegations questioning its underwriting standards. In June 2008, Wells Fargo filed suit against Quicken. In its complaint, Wells Fargo alleged that "Quicken made certain representations and warranties to Wells Fargo regarding the loans and lines of credit being sold, such as but not limited to the income and employment of the borrower and the fair market value of the real estate collateral." Wells Fargo claimed some loans had false representations and "were not eligible to be sold to Wells Fargo in the first place." The lawsuit stated that as of June 2008, the amount of bad loans Quicken refused to buy back totaled $4,047,000 and "to the extent additional repurchase demands are made by Wells Fargo and declined by Quicken, this sum will likely increase."

(10) ResMAE Mortgage Corp.

175. ResMAE was the primary originator of loans in the ACE 2004-RMS offering. ResMAE's underwriting practices have been publicly criticized. Among the claims alleged are that ResMae (1) systematically disregarded its stated underwriting standards and regularly made exceptions to its underwriting guidelines in the absence of sufficient compensating factors; and (2) largely disregarded appraisal standards.

2010); *Bentley v. American Home Mortg. Assets Trust*, No. 2:09-CV-588, 2010 WL 520279 (D. Utah Feb. 9, 2010).

IV. THE DEFENDANTS KNEW THEIR REPRESENTATIONS WERE FALSE

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

176. Allstate's statistical analysis of representative loans underlying representative offerings reveals Mortgage Loan characteristics so greatly at variance with the representations contained in the Prospectus Supplements that the only plausible explanation for the discrepancy is that the defendants knew – for they must have known – that their representations were false.

177. As previously noted, the Mortgage Loans have demonstrated shockingly poor performance. In fact, every statistic Allstate has been able to test (given that, as an investor, it does not have direct access to the loan files) reveals consistent and drastic misrepresentations as to key mortgage loan characteristics. As recited in greater detail above, Allstate analyzed data related to defaults and delinquency in eight representative Offerings, and found that in some cases as many as ***60% of Mortgage Loans from the original pool have either defaulted or are currently delinquent***. Even setting aside those loans that have already defaulted – up to 41.6% of the loans in the tested Offerings – Allstate determined that up to 52.4% of the remaining loans are currently delinquent.

178. These dramatic delinquency rates have had an equally dramatic effect on the ratings assigned to the Certificates at issue. Whereas half of the Certificates initially received the same rating given to treasury bills (i.e., AAA), ***more than half of the Certificates are now rated as non-investment grade by S&P or Moody's***, including ***every Certificate that initially received a AAA rating***.

179. Second, in addition to the default and delinquency rates, Allstate's statistical review revealed that the mortgage loans had combined loan-to-value ratios completely at variance with the ratios represented in the Prospectus Supplements. As previously noted,

Allstate's statistical review shows that the defendants ***routinely understated the number of underwater loans by 30%-50%.***

180. Third, Allstate's statistical review also revealed that, as detailed above, the defendants routinely ***overstated owner-occupancy rates for a given loan pool by approximately 10%***.

181. The fact that the misrepresentations regarding CLTVs and owner occupancy rates tends so heavily in one direction – toward an understatement of the CLTV ratio, an overstatement of owner occupancy rates, and a consequent over-statement of the quality of the loan pool – is itself persuasive evidence that the discrepancies revealed by Allstate's statistical analysis were not mere errors or differences of opinion, but conscious misrepresentations. This 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.

182. For instance, Richard Bitner, a former executive of a subprime lender for fifteen years, testified in April 2010 that "the appraisal process [was] highly susceptible to manipulation," and that the rise in property values was in part due to "the subprime industry's acceptance of overvalued appraisals." Similarly, Patricia Lindsay, a former wholesale lender, testified in April 2010 that in her experience appraisers were "often times pressured into coming in 'at value,'' i.e., at least the amount needed for the loan to be approved. The appraisers "fearing" their "future business and their livelihoods" would choose properties "that would help support the needed value rather than finding the best comparables to come up with the most accurate value."

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

184. 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."

185. The remarkable default and delinquency rates, understated CLTV ratios, and overstated owner occupancy statistics are not only evidence that the Mortgage Loans underlying the Offerings were defective. They are themselves strong evidence that the defendants knew the Mortgage Loans underlying the Offerings were grossly defective when they made contrary representations to Allstate. Simply put, the defendants – among them Deutsche Bank, the seventh-largest sponsor of non-agency mortgage backed securities in 2007 – could not have pooled these Mortgage Loans without knowing that, contrary to their representations, the loans were widely defective.

186. That the Mortgage Loans could have made it to the securitization market without the defendants' knowledge of their problems is made all the less improbable by the fact that the defendants, as purchasers of the loans, had extensive business relationships with the originators, had access to the originators mortgage origination personnel and internal information and conducted due diligence into the originators through their own personnel and third-party loan

review firms. Defendants also controlled the entire process, from acquisition of the loans from the originators to Allstate.

B. <u>Evidence that Defendant's Due Diligence Reports Highlighted Problematic Loans for the Defendants</u>

187. Not only *must* the defendants have know that the Mortgage Loans were widely defective; as a matter of fact they *did* know. As previously described, the defendants engaged in their own due diligence review of the Mortgage Loans to determine whether the loans both conformed with the representations made by the originators and complied with the defendants' own credit policies.

188. This review would necessarily have revealed the pervasive deficiencies in the Mortgage Loans at issue here. And if such a review was not performed, such a failure would render totally false the defendant's representation that "[t]he Depositor believes that the information set forth in [each] prospectus supplement will be representative of the characteristics of the Mortgage Pool as it will be constituted at the time the certificates are issued." *See, e.g.*, ACE 2006-HE4 Prospectus Supplement at S-72.

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

190. The defendants also hired-third party due diligence firms including Clayton Holdings, to review mortgage loans and determine whether the loans at issue "[met] the underwriting guidelines" and "compl[ied] with federal and state laws, notably predatory-lending

laws and truth-in-lending requirements," and whether "the reported property values [were] accurate."

191. Clayton determined that ***35% of the loans*** it reviewed for defendants "failed to meet guidelines" and did not have sufficient compensating factors. These findings were provided to the defendants in a ***daily*** report that summarized Clayton's review and included summaries of the deficient loan files.

192. Despite receiving this daily and specific evidence that a significant percentage of the loans it was buying were defective, the defendants provided waivers for ***50% of the loans Clayton had recommended for rejection***. Clayton's internal analyses showed that the defendants had the ***second-highest waiver rate of any major financial institution*** it analyzed.

193. According to the September 2010 testimony of Clayton's Vice President Vicky Beal, the third-party due diligence firms' "exception reports" were provided not just to the underwriter, but also to the sponsors. On information and belief, then, the defendants here through their numerous roles of underwriter these deals (Deutsche Bank Securities) and sponsors (DB Structured Products and Deutsche Bank AG New York Branch), were made fully aware ***on a daily basis*** that a significant percentage of loans were being rejected as non-compliant by their own third-party due diligence firm.

C. Evidence that the Defendants Leveraged Their Unique Knowledge to Increase Their Own Profits

194. Deutsche Bank 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, Deutsche Bank "waived in" 50% 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, Deutsche Bank leveraged its unique knowledge to its own advantage.

195. 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 that the Deutsche Bank Knew the Products it was Securitizing Were Vehicles for Mortgage Fraud

196. Armed with actual data confirming the poor quality of the loans underlying the RMBS it was arranging and promoting, Deutsche Bank encouraged its favored investors to adopt a strategy to short this very same type of securities. Deutsche Bank trader Greg Lippmann, whose strategies were recently exposed in the 2010 book "The Big Short," was one of the leading proponents of Deutsche Bank's short position on RMBS. He was assisted by Deutsche Bank research analyst Karen Weaver, the same analyst involved in the presentation of data for Deutsche Bank's long sales of RMBS. Deutsche Bank's shorting strategy – which it implemented on its own balance sheet and hawked to investors in order to profit from both sides of the RMBS transactions – was based on the true facts regarding the credit characteristics of the securitizations similar to those invested in by Allstate.

197. Beginning at least as early as 2005, Mr. Lippmann prepared for a presentation called "Shorting Home Equity Mezzanine Tranches," in which he described to select investors a strategy of shorting (i.e., betting against) residential mortgage loans. *See* Michael Lewis, *The*

Big Short: Inside the Doomsday Machine 65, 83 (2010). Although this presentation went through several iterations, it described a Deutsche Bank "strategy to cash in on a slowing housing market" by "shorting (or buying protection on)" certain securities. *See* "Shorting Home Equity Mezzanine Tranches" at 1, 3 (Aug. 2006). In this "[s]trictly private and confidential" presentation, Deutsche Bank explained that "[i]t is increasingly evident that the housing boom in the past 10 years has come to its end." *Id.* at 3. According to Deutsche Bank, these expected losses in the housing market represented investment opportunities.

198. In the "Shorting Home Equity Mezzanine Tranches" presentation, Deutsche Bank specifically pointed out the dangers of "[s]tated-income mortgage loans," whereby the "[i]ncome of the borrowers is not substantiated by the documentation, nor is it verified." *Id.* at 53. In particular, Deutsche Bank Securities noted that "[b]orrowers may inflate income to get loan approved." *Id.* Thus, Deutsche Bank was on full notice that borrower misrepresentations were a significant concern, and this was further validated by the due diligence performed by Clayton. Yet, despite its own knowledge and the evidence provided by third party firms, Deutsche Bank not only continued to include problematic loans in its securitizations but devised an investment strategy to profit from its own fraud.

V. ALLSTATE'S DETRIMENTAL RELIANCE AND DAMAGES

199. In making the investments, Allstate relied upon the defendants' representations and assurances regarding the quality of the mortgage collateral underlying the Certificates, including the quality of their underwriting processes 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.

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

201. 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.

202. The false and misleading statements of material facts and omissions of material facts in the Offering Materials directly caused Allstate damage, because the Certificates were in fact far riskier than the defendants had described them to be. The loans underlying the Certificates experienced default and delinquency at very high rates due to the defendants' abandonment of the disclosed underwriting guidelines.

203. 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 has been lower than Allstate expected under the "waterfall" provisions of the securitizations.

204. The disclosure of irregularities in the defendants' underwriting practices and increased risk regarding future cash flow has also led to a substantial decline in market value of the Certificates. Allstate purchased the Certificates not only for their income stream, but 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.

205. Allstate's losses on the Certificates have been much greater than they would have been if the loans were as the 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.

206. 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 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 not attributable to the recent decline in the American housing market, but rather due to the defendants' wrongdoing.

FIRST CAUSE OF ACTION
(Common-law Fraud)

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

208. The material representations set forth above were fraudulent, and the 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.

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

210. Allstate justifiably relied on the defendants' false representations and misleading omissions.

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

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

SECOND CAUSE OF ACTION
(Negligent Misrepresentation)

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

214. Including not only the Certificates at issue here but others not part of this action, Allstate made twenty-eight purchases in numerous offerings of mortgage-backed securities that the defendants securitized and sold.

215. Because the 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.

216. 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 defendants' unique and special knowledge regarding the Mortgage Loans when determining whether to make each investment of Certificates. Allstate was entirely reliant on the defendants to provide accurate information regarding the loans in engaging in that

analysis. Accordingly, the defendants were uniquely situated to evaluate the economics of each Securitization.

217. Going back seven years over twenty-eight separate purchases, Allstate relied on the 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 defendants and Allstate.

218. The 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.

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

220. 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 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 defendants but not known or readily known to Allstate, and the defendants knew that Allstate was acting in reliance on mistaken information.

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

222. The 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.

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

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

PRAYER FOR RELIEF

WHEREFORE Allstate prays for relief as follows:

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

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

b. Attorneys' fees and costs;

c. Prejudgment interest at the maximum legal rate; and

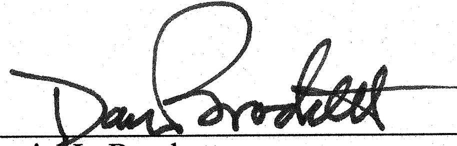
d. Such other and further relief as the Court may deem just and proper.

JURY TRIAL DEMANDED

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

DATED: New York, New York
February 17, 2011

QUINN EMANUEL URQUHART &
SULLIVAN, LLP

By: 

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