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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, AGENTS PENSION PLAN, and ALLSTATE RETIREMENT PLAN, Plaintiffs, -against- MERRILL LYNCH & CO., MERRILL LYNCH, PIERCE, FENNER & SMITH INC., MERRILL LYNCH MORTGAGE INVESTORS, INC., and MERRILL LYNCH MORTGAGE LENDING, 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, Agents Pension Plan, and Allstate Retirement Plan (collectively, "Allstate"), by and through their attorneys, bring this action against Merrill Lynch & Co., Inc., Merrill Lynch, Pierce, Fenner & Smith Inc., Merrill Lynch Mortgage Investors, Inc., and Merrill Lynch Mortgage Lending, Inc. (collectively "Merrill" or the "Defendants"), and allege as follows:

NATURE OF ACTION

1. This action arises out of Merrill's fraudulent sale of residential mortgage-backed securities in the form of pass-through certificates (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, Merrill actually knew the pool was a toxic mix of loans given to borrowers that could not afford the properties, and thus were highly likely to default.

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

(i) ***Underwriting Guidelines.*** The Offering Materials represented that a particular, reasonable, underwriting process was followed to ensure that only loans that the borrower could repay would be included in the pools underlying the Certificates (the "Mortgage Loans"). In fact, the disclosed underwriting standards were systematically ignored in originating or otherwise acquiring non-compliant loans. Based on data compiled from third-party due diligence firms and other information, the federal Financial Crisis Inquiry Commission ("FCIC") noted (at 187) in its January 2011 report ("FCIC 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) ***<u>Percentage of Known Non-Conforming Loans.</u>*** Merrill fraudulently omitted the fact that both the underwriters' internal due diligence, as well as third-party due diligence firms, had identified numerous loans that did not conform to the stated underwriting guidelines. Nor did Merrill disclose that many of those same non-conforming loans had been "waived" into the collateral pools underlying the Certificates despite not having any purported "compensating" factors. Data recently made available from one of the largest due diligence firms – which worked for Merrill – 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 Merrill's knowledge of those underwriting violations.

(iii) ***<u>Owner Occupancy Statistics</u>.*** The Offering Materials made specific representations regarding the percentage of borrowers who would be occupying the properties being mortgaged – a key risk metric because borrowers are less likely to "walk away" from properties they live in, as compared to properties being used as vacation homes or investments. In truth, a far greater percentage of the loans underlying Allstate's Certificates, than represented by Merrill, were given to borrowers who did not live in the homes that secured the mortgages in question.

(iv) ***<u>Loan-to-Value Ratios</u>.*** The Offering Materials represented that the underlying loans had specific loan-to-value ("LTV") and combined loan-to-value ("CLTV") ratios. The LTV and CLTV represent the size of the borrower's obligations as compared to the value of the property being used as collateral. The CLTV is the LTV after all loans are considered, not just the first mortgage. These are also key risk metrics, because they represent

the equity "cushion" that borrowers have and the likelihood of repayment to lenders upon foreclosure. Analytical tools recently made available to investors confirm that 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.

(v) ***Purpose And Use Of Exceptions.*** The Offering Materials represented that loans which did not meet certain criteria were approved as "exceptions" only on the basis of countervailing features of the borrowers' risk profiles that "made up" for negative aspects of the risk profile. In truth, "exceptions" were used routinely as a way to increase loan volume by circumventing the applicable underwriting guidelines," without having any cognizable "countervailing features." Many non-compliant mortgage loans did not have any countervailing features.

(vi) ***Credit Ratings.*** The Offering Materials represented that the Certificates had specific investment-grade credit ratings. Merrill fed the same misrepresentations found in the Offering Materials to the ratings agencies in an attempt to manufacture predetermined ratings. This not only rendered false Merrill's representations about how the ratings process really functioned, but also assured that the ratings themselves in no way reflected the actual risk underlying the Certificates.

(vii) ***Credit Enhancement Features.*** The Offering Materials represented that the Certificates had certain "credit enhancements" that Merrill was using to improve the likelihood that holders of such certificates would receive regular principal and interest payments. "Credit enhancements" are features designed to reduce the risk of loss to investors in the senior tranches of certificates. These features can include overcollateralization (*i.e.*, the value of the collateral underlying the certificates is greater than the principal balance of the certificates); the

subordination in right of payment of junior certificates to senior certificates; the establishment of reserve accounts; a mortgage pool insurance policy; an interest-rate swap agreement; or a combination of such features. The level of credit enhancement utilized for each Offering was supposed to be correlated to the risk associated with the underlying loan pool. However, due to the pervasive underwriting deficiencies that rendered the Mortgage Loans far riskier and less valuable than disclosed, and because the credit enhancements themselves depended on the quality of those Mortgage Loans, the credit enhancements described in the Offering Materials were never adequate to protect certificate holders from loss. As a result, the purported "credit enhancements" were really no protection at all.

3. In reliance on these and the other misrepresentations and omissions, Allstate purchased over $167 million of Merrill's mortgage-backed securities:

Asset	Purchase Price
FFML 2007-FF2 A2B	$30,000,000
MLMI 2005-A2 A2	$19,028,041
MLMI 2006-OPT1, A2D	$5,096,000
MLMI 2006-RM1, A2D	$8,235,076
MLMI 2006-RM5, A2B	$21,914,000
MLMI 2006-WMC2, A2B	$22,182,889
OWNIT 2006-2, A2B	$10,000,000
SURF 2005-BC3, M2	$8,952,187
SURF 2006-BC2, A2B	$14,999,985
SURF 2006-BC3, A-2C	$27,000,000
TOTAL	**$167,408,178**

Exhibits A and B provide further detail on the Certificates. All of the exhibits attached to this Complaint are incorporated as if set forth fully herein. These offerings are collectively referred to herein as the "Offerings," and the certificates are collectively referred to as the "Certificates."

4. Allstate invested in the Certificates as part of a broader plan to invest in a diverse array of carefully-underwritten, mortgage-backed securities. Allstate typically purchased senior classes of mortgage-backed securities (*i.e.*, those rated AAA/Aaa or AA/Aa by the rating

agencies Standard & Poor's and Moody's Investors Service). Allstate purchased the Certificates to generate income and total return through safe investments. Allstate also purchased the securities with the expectation that the investments could be – and indeed some would be and were – purchased and sold on the secondary market.

5. The systemic (but hidden) abandonment of the disclosed underwriting guidelines led to soaring default rates in the mortgage loans underlying the Merrill 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 – 97% are now not even considered to be investment-grade. 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 poor performance to date of the Certificates is itself powerful evidence that the Mortgage Loans were not underwritten according to the procedures represented to Allstate. With the underlying loans performing so poorly, the value of Allstate's Certificates has plummeted, causing Allstate to incur significant losses. These losses were not caused by the downturn in the U.S. housing market, but by Merrill's faulty underwriting.

PARTIES

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

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

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

9. Plaintiff Allstate Life Insurance Company of New York is an insurance company formed under the laws of, and domiciled in, the State of New York, with its principal place of business in Hauppauge, New York. Allstate Life Insurance Company of New York is licensed to do business in New York and writes insurance policies to New York residents. It sells life, accident, and health insurance and annuity products. Allstate Life Insurance Company of New York is a wholly-owned subsidiary of Allstate Life Insurance Company.

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

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

12. ***<u>The Defendants.</u>*** All of the Defendants in this action are part of the same corporate family, and acted together to control the creation, marketing and sale of the Certificates at issue here, from loan origination, to mortgage pooling, to securities underwriting, to sale to Allstate. Allstate is not seeking relief against any bankrupt entity. It is, however, seeking relief from Defendants, including their successors-in-interest (if any), by reason of a sale or transfer of all or a portion of its assets.

13. ***Corporate Parent Defendant.*** Merrill Lynch & Co., Inc. ("Merrill Lynch") is the ultimate parent corporation of all the Merrill Defendants. It is a Delaware corporation with its principal executive office in New York, New York and is a holding company that, through its subsidiaries, purports to be a leading global trader and underwriter of securities and derivatives across a broad range of asset classes and serves as a strategic advisor to corporations, governments, institutions and individuals worldwide. On January 1, 2009, Merrill Lynch & Co., Inc. became a wholly owned subsidiary of Bank of America Corporation.

14. ***Sponsor Defendant.*** Defendant Merrill Lynch Mortgage Lending, Inc. is a Delaware corporation with its principal place of business in New York, New York. It is a wholly owned subsidiary of Merrill Lynch Mortgage Capital Inc. It is engaged in the business of, among other things, acquiring residential mortgage loans and selling those loans through securitization programs. It acted as the sponsor for each of the offerings at issue in this action.

15. ***Underwriter Defendant.*** Defendant Merrill Lynch, Pierce, Fenner & Smith Inc. is a Delaware corporation and registered broker-dealer with its principal place of business in New York, New York. Merrill Lynch, Pierce, Fenner & Smith Inc. acted as underwriter of the Certificates, and as the underwriter it participated in the drafting and dissemination of the Offering Materials pursuant to which the Certificates were sold to Allstate. Merrill Lynch, Pierce, Fenner & Smith Inc. acted as an underwriter for each of the offerings at issue in this action.

16. ***Depositor Defendant.*** Defendant Merrill Lynch Mortgage Investors, Inc. is a Delaware corporation and an indirect subsidiary of Merrill Lynch & Co., Inc. with its principal place of business in New York, New York. It was the Depositor for each of the offerings at issue here, the Registrant for certain Registration Statements filed with the SEC, and the issuer for

each of the offerings at issue in this action. The depositor is considered the issuer of the Certificates within the meaning of Section 2(a)(4) of the Securities Act of 1933, 15 U.S.C. § 77b(a)(4), and in accordance with Section 11(a), 15 U.S.C. § 77k(a).

17. ***Relevant Non-Parties.*** The Certificates for each securitization relevant to this action were issued by a trust (collectively, the "Trusts"). The Trusts are identified in Exhibit A along with other details regarding Allstate's purchases. The following Trusts were formed under New York law: FFML 2007-F2; MLMI 2006-OPT1; MLMI 2006-RM1; MLMI 2006-RM5; MLMI-2006-WMC2; OWNIT 2006-2; SURF 2006-BC2; and SURF 2006-BC3.

18. At all relevant times, Merrill committed the acts, caused or directed others to commit the acts, or permitted others to commit the acts alleged in this Complaint. Any allegation 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

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

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

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

BACKGROUND

A. The Mechanics of Mortgage Securitization

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

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

24. In many cases, Merrill would provide a "warehouse" loan to the loan originator, with the warehouse line providing the money that was loaned to the ultimate borrower. These warehouse lines gave Merrill the inside track on acquiring the loans that were generated using Merrill's funds. The process of implementing the warehouse loan also provided Merrill with detailed information about the loans being made using its money, including the right to access the loan files and other detailed information about the underwriting process for the loans in question.

25. Upon acquisition, the depositor transfers, or deposits, the acquired pool of loans to an "issuing trust." The depositor then securitizes the pool of loans in the issuing trust so that the rights to the cash flows from the pool can be sold to investors. The securitization transactions are structured such that the risk of loss is divided among different levels of investment, or "tranches." Tranches consist of multiple series of related securities offered as part

of the same offering, each with a different level of risk and reward. Any losses on the underlying loans – whether due to default, delinquency, or otherwise – are generally applied in reverse order of seniority. As such, the most senior tranches of pass-through securities receive the highest credit ratings. Junior tranches, being less insulated from risk, typically obtain lower credit ratings.

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

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

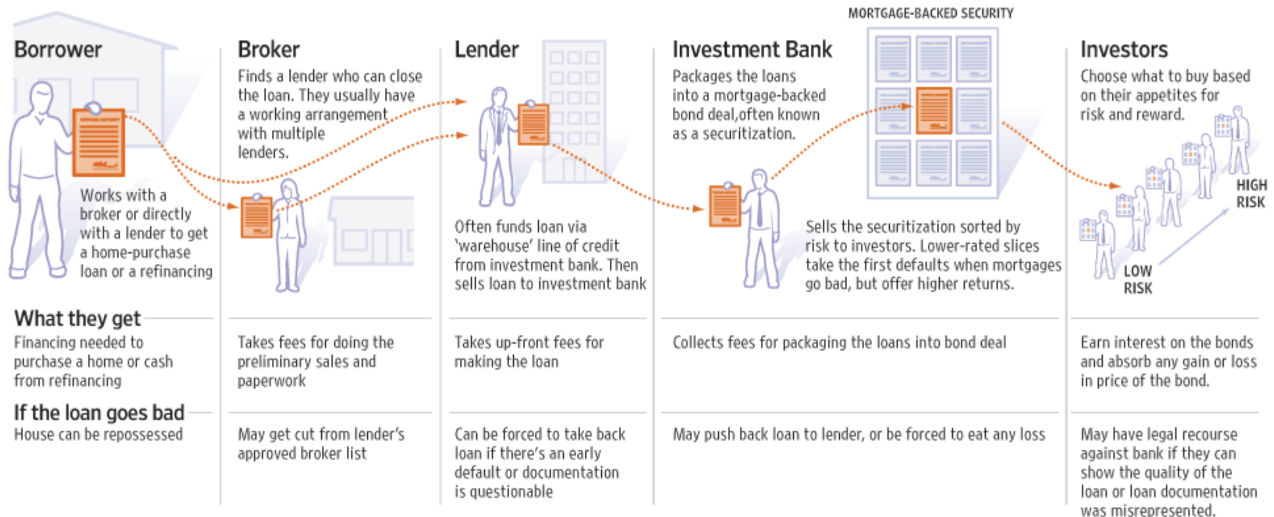
28. Because the cash flow from the loans in the collateral pool of a securitization is the source of payments to holders of the securities issued by the trust, the credit quality of the securities depends upon the credit quality of the loans in the collateral pool. The most important information about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

29. For residential mortgage loans, each loan file normally contains documents including the borrower's application for the loan; verification of the borrower's income, assets, and employment; references; credit reports on the borrower; an appraisal of the property that will secure the loan and provide the basis for measures of credit quality, such as loan-to-value ratios;

and a statement of the occupancy status of the property. The loan file also typically contains the record of the investigation by the loan originator of the documents and information provided by the borrower, as well as the detailed notes of the underwriter setting forth the rationale for the making of each loan. Investors like Allstate were not given access to the loan files and they must rely on the representations made by the sponsors and underwriters in the Offering Materials.

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

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



B. Securitization of Mortgage Loans: The Traditional Model

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

33. Mortgage loan securitization, however, shifted the traditional "originate to hold" model to an "originate to distribute" model, in which originators sell residential mortgages and transfer credit risk to investors through the issuance and sale of RMBS (residential MBS). Under the new model, originators no longer hold the mortgage loans to maturity. Instead, by selling the mortgages to trusts, which provide their securities to investors, the originators obtain the funds to make more loans. Securitization also enables originators to earn most of their income from transaction and loan-servicing fees, rather than from the spread between interest rates paid on deposits and interest rates received on mortgage loans, as in the traditional model. Thus, securitization gives originators an incentive to increase the number of mortgages they issue regardless of credit quality. However, contractual terms, adherence to solid underwriting standards, and good business practices obligate originators to underwrite loans in accordance with their stated policies and to obtain accurate appraisals of the mortgaged properties.

34. At the time, most mortgage securitizations were conducted through the major Government Sponsored Enterprises (the "Agencies"), *i.e.*, the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac"), and the Government National Mortgage Association ("Ginnie Mae"). The Agencies purchased

loans from originators and securitized the loans. These Agency securitizations had high credit quality because the Agencies required the underlying loans to be originated in accordance with strict underwriting guidelines. Most non-Agency mortgage securitizations during this period also had relatively high credit quality because they typically complied with the Agencies' underwriting standards.

C. Merrill's Rise in the Mortgage Securitization Industry

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

36. Over the past decade, investment banks like Merrill began to focus on creating products outside the traditional lending guidelines and on expanding the number of borrowers who could purportedly qualify for loans, while also charging those borrowers much higher fees than they would have paid on conforming loans. As a result, the number of loans that were riskier than those that could be securitized through Fannie Mae or Freddie Mac skyrocketed. According to an April 7, 2010 report by the FCIC, loans that did not conform with Fannie Mae and Freddy Mac underwriting guidelines grew from around $670 billion in 2004 to over $2 trillion in 2006.

37. The FCIC found that this increase in subprime origination grew hand-in-hand with an increase in securitization as "[t]he nonprime mortgage securitization process created a pipeline through which risky mortgages were conveyed and sold throughout the financial system.

The pipeline was essential to the origination of the burgeoning numbers of high-risk mortgages." (January 2011 FCIC Report at 70, 125.)

38. Throughout the 2000s, Wall Street banks started touting their position in certain "league tables" that ranked top issuers of asset-backed securities (including RMBS) by volume. In 2004, Merrill was far down in the rankings reflected on those league tables, while other institutions dominated the RMBS securitization business, including Royal Bank of Scotland, Morgan Stanley, Credit Suisse, Citigroup, Lehman Brothers, and Bear Stearns.

39. By 2004, Merrill, led by then-Chief Executive Officer E. Stanley O'Neal, was determined to take aggressive action to pursue the mortgage securitization business and to climb to the top of the league tables for asset-backed securities and in particular, RMBS. O'Neal revamped his trading desk by bringing in new people, including Michael Blum, to lead Merrill's global asset-based finance operations, and George Davies, a trader whose job it was to increase the volume of mortgage loans coming into Merrill's trading desks.

40. With its securitization operations revamped, Merrill began buying up immense volumes of subprime mortgage loans. With the competitive field more crowded with underwriters, Merrill began using its other operations to entice subprime lenders to sell their loans to Merrill. For example, Merrill began offering the subprime lenders "warehouse" financing, which the lenders needed to originate subprime mortgages, at very little or no cost so long as the lender continued to sell Merrill its subprime loans. In other words, Merrill sacrificed its warehouse lending business for a bigger share of the securitization business. At the same time, Merrill adopted "liberal" standards as to what it was prepared to acquire and routinely purchased loans that did not comply with the underwriting standards that it was telling its investors it was using as a safeguard for its mortgage pools.

41. Within a short time, Merrill had climbed the league tables and was buying and securitizing residential mortgages in enormous volumes and at break-neck pace. Around 2005, Merrill purchased a stake in subprime lender Ownit Mortgage Solutions, Inc., and, around 2006, Merrill announced that it was planning to buy another subprime lender First Franklin, which transaction Merrill finalized in February 2007. Over that period, Merrill aggressively pursued its strategy to capitalize on RMBS by controlling a constant stream of loans to securitize and to sell to investors.

42. During that time, Merrill continued to face a key problem in its quest to top the league tables in subprime securitization – fierce competition from an increasing number of market players. The intense competition led Merrill to loosen the underwriting guidelines and to have as many as loans as possible appear to pass muster under those guidelines. For example, Merrill began ignoring the results of its due diligence. Merrill often outsourced its review of the loans that it purchased to entities such as Clayton Holdings, Inc. ("Clayton"). Data recently released by the government's investigation shows that Clayton told Merrill that many of the loans it was looking to purchase were improperly underwritten – but Merrill proceeded to include those loans in securitization pools anyway. To create a market for its RMBS securities, Merrill hid from its investors what it was doing in order to increase its RMBS market share.

43. Within only a few short years, Merrill moved to the top of the league tables for RMBS securities, a direct function of its willingness to push through as many loans as possible, to securitize those loans, and to falsely market them to investors as safe investments collateralized by mortgage loans carefully underwritten to adhere to specific guidelines. Merrill made huge profits at the expense of its investors who were purchasing RMBS products that were

extremely risky because the truth of what the pools contained was concealed from Allstate and Merrill's other investors.

D. **Merrill Was An Integrated Vertical Operation Controlling Every Aspect Of The Securitization Process**

44. As described above, because Merrill wanted to ensure a steady supply of mortgage loans to securitize, it acquired its own loan originators and provided cheap warehouse financing to those originators and others to entice them to sell loans to Merrill. In this way, Merrill's securitization operations became integrated and vertical, controlling every aspect of the securitization process and giving Merrill actual knowledge about every aspect of Merrill's securitization process, from loan origination through sale to Allstate and other investors.

45. Merrill's affiliates – namely First Franklin and Ownit – originated or acquired all or substantially all of the mortgage loans collateralizing certain of Allstate's Certificates, including all of the loans in OWNIT 2006-2 and FFML 2006-FF2. The other Certificates purchased by Allstate were backed by loans originated by various third-party originators, including ResMAE, which received substantially discounted warehouse loans from Merrill to finance the loan originations. Although the originators provided Mortgage Loans to borrowers purportedly according to underwriting guidelines described in the Offering Materials, the truth was that the underwriting guidelines were systematically ignored and the resulting toxic mortgages were included in the RMBS pools that provided the security for the RMBS Certificates that Allstate purchased.

46. Merrill represented that it conducts a thorough review of originators and their underwriting guidelines and practices. For example, with respect to Ownit, Merrill represented that "[p]rior to acquiring any residential mortgage loans, [Merrill Lynch Mortgage Lending, Inc.] conducts a review of the related mortgage loan seller that is based upon the credit quality of the

selling institution" and that the "review process may include reviewing select financial information for credit and risk assessment and conducting an underwriting guideline review, senior level management discussion and/or background checks." (OWNIT 2006-2 Prospectus Supplement at S-33.) Merrill further represented that "[t]he underwriting guideline review entails a review of the mortgage loan origination processes and systems. In addition, such review may involve a consideration of corporate policy and procedures relating to state and federal predatory lending, origination practices by jurisdiction, historical loan level loss experience, quality control practices, significant litigation and/or material investors." (OWNIT 2006-2 Prospectus Supplement at S-33-34.)

47. In addition to being affiliated with or otherwise having close ties to the originators of the loans, Merrill and/or its affiliates acted as the sponsor, seller, and, at times, servicer for the Mortgage Loans.

48. Merrill Lynch Mortgage Lending, Inc. acted as the sponsor and seller for all of the Certificates. Merrill Lynch Mortgage Lending, Inc. first obtained the underlying Mortgage Loans from originators or sellers, including from its affiliates. Defendants then pooled the Mortgage Loans in the securitizations and sold, transferred, or otherwise conveyed title to those loans to the Depositor pursuant to Pooling and Servicing Agreements, which are governed by New York law. As set forth herein, Merrill Lynch Mortgage Lending, Inc. undertook to review the originators and their underwriting guidelines and processes.

49. Merrill Lynch Mortgage Investors, Inc. was the depositor for each of the offerings. In this capacity, it sold, transferred, or otherwise conveyed the Mortgage Loans obtained from Merrill Lynch Mortgage Lending, Inc. to the trustees of the Trusts, which held the Mortgage Loans pursuant to Pooling and Servicing Agreements, which are governed by New

York law. Merrill Lynch Mortgage Investors, Inc. then securitized the pool of loans and issued the Certificates.

50. Merrill Lynch, Pierce, Fenner & Smith Inc. was the underwriter for all of the Offerings at issue. In that role, it was responsible for underwriting and managing the sale of the Certificates to Allstate and other investors, including screening the Mortgage Loans for compliance with the stated underwriting guidelines, and assisting in the preparation of the Offering Materials.

51. The Pooling and Servicing Agreements also established Merrill or one of its affiliates as servicer of the Mortgage Loans underlying each of the Certificates. Home Loan Services, Inc. was the servicer for the FFML 2007-FF2 series of Certificates and Wilshire Credit Corporation was servicer for the remaining Certificates, except for OWNIT 2006-2. Both Home Loan Services and Wilshire Credit were owned by affiliates of Merrill. Under the Pooling and Servicing Agreements, the servicer was primarily responsible for debt collection, mitigation, high risk property management, bankruptcy, foreclosure, and real estate owned for the underlying Mortgage Loans on behalf of the Trusts.

52. In short, Merrill controlled and/or facilitated all aspects of originating, servicing, acquiring, and pooling the mortgage loans, and subsequently creating the securities and marketing and selling the Certificates at issue. Merrill and its affiliates thus had actual knowledge of, or were reckless as to the truth or falsity about, every aspect of the securitization process, from loan origination through sale to Allstate.

E. <u>Merrill's Offering Materials</u>

53. Merrill Lynch Mortgage Investors, Inc., as depositor, filed Form S-3 Registration Statements with the SEC indicating its intention to sell mortgage-backed securities. The relevant registration statements covering the Certificates at issue here were filed on January 27, 2004;

December 23, 2004; August 5, 2005; and December 21, 2005 (each, as amended from time to time a "Registration Statement" and collectively, the "Registration Statements").

54. The certificates for all the Offerings were issued pursuant to a prospectus, prospectus supplement, and term sheets. The relevant prospectuses, filed on June 18, 2004, August 26, 2005, January 18, 2006, March 31, 2006, September 8, 2006 and February 20, 2007, 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.

55. 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 loan-to-value ratio, the borrowers' debt-to-income ratios, the property type, the owner-occupancy data, and the geographic concentration of the mortgaged properties.

56. 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 Exhibits C-L.

ALLEGATIONS REGARDING PARTICULAR CERTIFICATES

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

A. Merrill's Misrepresentations Regarding Underwriting Standards And Practices

57. Proper underwriting of the 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 Merrill claimed greatly increased, making the entire loan pool much riskier. A systemic underwriting failure would decrease the reliability of *all* the information investors had about the loans, and thus would significantly increase the perceived and actual risk to investors, while materially decreasing the value of the Certificates.

58. The Offering Materials associated with each of Allstate's Certificates describe underwriting guidelines purportedly employed by the lenders or underwriters to evaluate the loans. The Offering Materials for SURF 2006-BC3 represented that "[a]ll of the Mortgage loans were originated generally in accordance with SURF's [i.e., the issuer's] Underwriting Guidelines," which "are primarily intended to evaluate the prospective borrower's ability and willingness to repay the loan, determine the value and marketability of the proposed mortgaged property, and ensure the loan complies with applicable regulations." (SURF 2006-BC3 Prospectus Supplement dated June 22, 2006, at S-33.)

59. The Offering Materials represent that the underlying Mortgage Loans had been originated according to a consistent underwriting program. In SURF 2006-BC3, for example, the issuer's guidelines were represented to "provide clear underwriting standards to help

originators understand the type of mortgage loans eligible for purchase . . . In most cases, the Mortgage Loans were either originated and underwritten in accordance with the SURF Underwriting Guidelines, or otherwise acquired from mortgage collateral seller based on standards consistent with SURF underwriting criteria, loan program guidelines, and credit grade classifications." (*Id.*)

60. Similarly, the Offering Materials for MLMI 2006-OPT1 represented that "[t]he Mortgage Loans will have been originated generally in accordance with Option One's Non-Prime Guidelines," and that the originator's "Underwriting Guidelines require that mortgage loans be underwritten in a standardized procedure which complies with applicable federal and state laws and regulations and require [the originator's] underwriters to be satisfied that the value of the property being financed, as indicated by an appraisal supports the loan balance." (MLMI 2006-OPT1 Prospectus Supplement dated September 22, 2006, at S-37.)

61. As set forth above, in addition to these representations, Merrill represented in the Offering Materials that it conducts a vetting process with respect to the originators and their underwriting practices.

62. The Offering Materials for each Offering contain substantially similar, if not identical, statements of material fact concerning the relevant underwriting standards and practices. These statements are excerpted in Exhibits C-L.

63. These representations were false. The Mortgage Loans underlying Allstate's Certificates did not comply with the underwriting standards represented in the Offering Materials and those standards were systemically ignored. In originating or acquiring the loans, the originators – including Merrill affiliates – ignored borrowers' actual repayment ability, and the value and adequacy of mortgaged property that was used as collateral, pursuant to Merrill's

demands that more and more mortgages be churned out and packaged to investors. Systematic, bulk exceptions to underwriting standards were granted without consideration of compensating factors. Merrill intentionally failed to inform its investors that lenders were systematically abusing the "exceptions" process, and Merrill itself was providing unjustified "waivers," in order to circumvent purported underwriting standards. Instead of focusing on assessing a borrower's credit standing and repayment ability, Merrill subordinated loan quality to its goal of originating and securitizing as many loans as possible in order to maximize its fees.

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

B. Merrill's Misrepresentations Regarding Due Diligence Results

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

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

loan pools, while retaining the toxic loans for inclusion in the loan pools; and (5) Merrill improperly failed to adjust its investigations (such as by increasing their sampling size or refusing to continue to work with problem originators) given the high number of non-conforming loans the due diligence process had in fact identified.

67. That Merrill was including loans that its due diligence procedures had flagged as being defective has been confirmed by the recent release of documents from Merrill's third-party due diligence firm, Clayton, and other facts set forth below.

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

C. Merrill's Misrepresentations Regarding Owner-Occupancy Statistics

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

70. The Offering Materials for each Offering contain detailed statistics regarding the Mortgage Loans in the collateral pools, including their reported owner-occupancy characteristics. For example, in the Offering Materials for MLMI 2006-WMC2, Merrill claimed that among the 6,561 loans, 95% were purportedly owner-occupied properties. (MLMI 2006-WMC2 Prospectus Supplement dated March 28, 2006, at Annex II-6.)

71. The Offering Materials for each Offering contain the same type of statistics concerning the proportion of loans secured by owner-occupied properties underlying each mortgage pool. These statistics are excerpted in Exhibits C-L.

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

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

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

74. The Offering Materials contained detailed statistics regarding these ratios for the Mortgage Loans in the collateral pool. For example, the Offering Materials for MLMI 2006-WMC2 represented that the weighted-average loan-to-value ratio at origination was 82.21%. (MLMI 2006-WMC2 Prospectus Supplement dated March 28, 2006, at Annex II-5.) Similarly, the Offering Materials for FFML 2007-FF2 represented that no loans had a CLTV greater than 100%. (FFML 2007-FF2 Prospectus Supplement dated February 27, 2007, at Annex II-4.)

75. The Offering Materials for each Offering contain the same type of factual representations concerning the LTV and CLTV ratios of the underlying mortgage pools. These representations are excerpted in Exhibits C-L.

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

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

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

78. The Offering Materials represented that the underwriting process was designed to ensure that borrowers could afford the loan, and often made specific representations as to the borrower's debt-to-income ratios. For example, in the Offering Materials for SURF 2005-BC3, Merrill represented that "[t]he SURF Underwriting Guidelines rely on income analysis as a key

determinant of the borrower's ability to repay the Mortgage Loan." (SURF 2005-BC3 Prospectus Supplement dated September 27, 2005, at Annex S-58.) In addition, in the Offering Materials for MLMI 2006-OPT1, Merrill represented that:

> Option One Underwriting Guidelines require a reasonable determination of an applicant's ability to repay the loan. Such determination is based on a review of the applicant's source of income, calculation of a debt service-to-income ratio based on the amount of income from sources indicated on the loan application or similar documentation, a review of the applicant's credit history and the type and intended use of the property being financed.

(MLMI 2006-OPT1 Prospectus Supplement dated September 22, 2006, at S-37.)

79. The Offering Materials for MLMI 2006-OPT1 also represented that the weighted debt-to-income ratio was 42.59%, and the majority of the loans were originated with a debt-to-income ratio of less than 55%.

80. The Offering Materials for each Offering contain the same type of factual representations concerning the underwriter's evaluation of the prospective borrower's ability to repay a mortgage loan, and debt-to-income ratios in the underlying loan pool. These representations are excerpted in Exhibits C-L.

81. These representations were false. The abandonment of sound underwriting practices facilitated the widespread falsification of these statistics within the Offering Materials. This abandonment is evidenced by all the facts set forth below, including Allstate's statistical analysis into the loans at issue here. In reality, the borrowers' claimed income was regularly inflated, such that the true debt-to-income ratios were materially higher than they were represented to be. Indeed, Merrill pressured its affiliated wholesale lenders and other nonbank mortgage originators to increase the number of stated income loans. Under a stated income loan, the borrower merely states the income on his or her application and does not provide any

documentation in support thereof. In other words, Merrill was directing originators to increase the amount of loans that were more likely to have misreported debt-to-income ratios.

F. <u>Merrill's Misrepresentations Regarding Credit Ratings</u>

82. Each tranche of the Allstate Certificates received a credit rating from one or more of the ratings agencies. The ratings were material to reasonable investors, including Allstate, because the ratings provided additional assurances that investors would receive the expected interest and principal payments. The Certificates would have been unmarketable to investors like Allstate and would not have been issued but for the provision of these ratings, as almost every prospectus stated that it was "a condition to the issuance of the Offered Certificates" that they receive certain, specified ratings from the rating agencies. (*See, e.g.,* OWNIT 2006-2 Prospectus dated January 18, 2006 at 125.)

83. The Offering Materials represent that the rating agencies conducted an analysis designed to assess the likelihood of delinquencies and defaults in the underlying mortgage pools and issued ratings accordingly. For example, the Offering Materials for MLMI 2006-WMC2 represented:

> The ratings on mortgage pass-through certificates address the likelihood of receipt by certificate holders of payments required under the operative agreements . . . [and] take into consideration the credit quality of the mortgage pool including any credit support providers, structural and legal aspects associated with the certificates, and the extent to which the payment stream of the mortgage pool is adequate to make payments required under the certificates.

(MLMI 2006-WMC2 Prospectus Supplement dated January 18, 2006, at S-13.)

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

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

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

87. As discussed below, the credit ratings have plummeted as the true quality of the collateral pools and Merrill's practices has been revealed.

G. Merrill's Misrepresentations Regarding Credit Enhancements

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

89. The Offering Materials for each of the Offerings describe the credit enhancements applicable to the certificates. For instance, the Offering Materials for MLMI 2006-RM5

represented that “The credit enhancement for the certificates will consist of: excess interest, overcollateralization, subordination, and net swap payments (if any) . . . .” (MLMI 2006-RM5 Prospectus Supplement dated October 25, 2006, at S-11.) And the Offering Materials for FFML 2007-FF2 represented: “The credit enhancement for the certificates will consist of excess interest, overcollateralization, subordination, net swap payments (if any) received from the swap counterparty and cap payments (if any) received from the cap contract counterparty described in this prospectus supplement.” (FFML 2007-FF2 Prospectus Supplement dated February 27, 2007, at S-3.) These credit enhancements were “intended to reduce the harm caused to holders of the certificates as a result of shortfalls in payments received and losses realized on the mortgage loans.” (MLMI 2006-OPT1 Prospectus Supplement dated September 22, 2006 at S-11.)

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

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

H. <u>Merrill’s Misrepresentations Regarding Underwriting Exceptions</u>

92. Whether Merrill and those from which Merrill was purchasing its loans were making case-by-case (rather than bulk) exceptions to the otherwise-applicable underwriting guidelines was material to Allstate. A disclosed guideline is irrelevant – and indeed misleading –

from a risk-analysis perspective if large numbers of loans were peremptorily excused from those guidelines.

93. Merrill represented that it and those that originated the loans made case-by-case exceptions to the disclosed underwriting standards based on compensating factors that increased the quality of the loan application. For example, the Offering Materials for MLMI 2006-OPT1 represented that "On a case-by-case basis, exceptions to the Option One Underwriting Guidelines are made where compensating factors exist." (MLMI 2006-OPT1 Prospectus Supplement dated September 22, 2006 at S-37.) Similarly, the Offering Materials for SURF 2005-BC3 represented that:

> ***Exceptions to the SURF Underwriting Guidelines are made where compensating factors exist*** or the Mortgage Loan is considered to be in substantial compliance with the SURF Underwriting Guidelines. Compensating factors may include, but are not limited to, a low loan-to-value ratio, a reduction in total monthly debt, a substantial level of verified reserves and/or residual income, a stable employment history, or a strong mortgage payment history. ***Exceptions are reviewed on a case-by-case basis*** by SURF credit management to determine eligibility and to ensure consistency.

(SURF 2005-BC3 Prospectus Supplement dated June 22, 2006 at S-33 (emphases added).)

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

95. These representations were false and misleading because loans had been granted outside of the stated guidelines, without regard to whether there were any purported "compensating factors" justifying a lending or underwriting exception. This is evidenced by, among other things, the high number of Merrill loans identified by the third-party due diligence

firm Clayton that both failed the given underwriting guidelines and that did not show any "compensating factors," and other facts set forth below.

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

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

96. The drastic rise in default rates on the Mortgage Loans underlying Allstate's Certificates is itself cogent evidence of faulty underwriting. Absent fraud, even in the face of a mortgage crisis, true AAA paper with adequate credit protection should not have experienced the drastic loss in value that was experienced by most of the Certificates.

97. 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 Merrill's Offering Materials claim. For instance, for MLMI 2006-RM5 ***74% of the loans from the original pool have either already been written off for a loss or are currently delinquent***. Similarly, for FFML 2007-FF2, ***60% have already been written off for a loss or are currently delinquent***, and for SURF 2006-BC3, ***55% have already been written off for a loss or are currently delinquent.***

98. Further, overall ***51% of the loans for the tested deals have already been written off at a loss or are currently delinquent.***

99. Because of the high delinquency and default rates, and deficient credit enhancement efforts, the majority of Allstate's Certificates have been downgraded from the highest possible ratings to "junk-bond" ratings.

100. Most of Allstate's Certificates initially received the highest possible ratings – S&P's AAA rating or its equivalent from the other rating agencies. According to S&P's website:

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

101. Because of the systematic abandonment of underwriting standards and the resulting inclusion of toxic, highly risky Mortgage Loans to back the Certificates, most of Allstate's Certificates have been downgraded from the highest possible ratings to junk-bond ratings. ***Despite all but one of the purchases being for Certificates that had the same rating given to treasury bills (i.e., AAA), currently almost 84% of the purchases are backed by Certificates currently rated by at least one of the major agencies as being non-investment grade***. Indeed, ***over half have fallen even further,*** falling into the "C" and "D" ranges of the agencies' scales. According to S&P's website, far from having the "extremely strong capacity" to meet commitments required by AAA-rated investments, instead these ratings for many now indicate that the Certificates are "***currently vulnerable*** and dependent on favorable business, financial and economic conditions to meet financial commitments." For example, Certificates in MLMI 2006-RM1 have been downgraded from an initial rating by S&P of "AAA" to a rating of "D" and Certificates in SURF 2006-BC3 have been downgraded from an initial rating by S&P of "AAA" to a rating of "CCC." Rarely did the downgrades take place before March 2008, and the most serious downgrades (i.e., to non-investment grade) did not take place until mid-2008 or later.

102. Defaults are usually caused by a large and unexpected disruption to a borrower's income. In a properly underwritten pool of loans, one would not expect to see a large spike of defaults occurring shortly after origination, because it is unlikely that many borrowers would all incur a sudden and unexpected change to their payment ability so soon after purchasing a home. However, when borrowers are put in loan products they cannot actually afford, they quickly and predictably fall behind on their payments.

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

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

105. These studies confirm that the dismal performance here is strong evidence that they were improperly underwritten, and that they did not have the credit risk characteristics that were claimed in Merrill's Offering Materials. The defaults and related drop in market value thus are due to Defendants' wrongdoing, and not because of the general change in economic conditions.

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

106. Actual owner-occupancy rates on the Mortgage Loans underlying the Offerings differ materially from those represented by Merrill. A much higher percentage of borrowers did not occupy the mortgaged properties than represented.

107. 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.

108. 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 Merrill's representations on a loan-level basis. Using techniques and methodologies that only recently became available, Allstate conducted loan-level analyses on over fourteen thousand loans underlying its Certificates, across nine of the ten Offerings at issue.

109. For each Offering, Allstate attempted to analyze approximately 800 defaulted loans and approximately 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.

110. 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.

111. 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.

112. 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.

113. 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.

114. 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 Merrill overstated the percentage of borrowers who occupied the mortgaged properties:

Asset	Percentage of Owner-Occupied Properties in Prospectus	Actual Percentage of Owner-Occupied Properties	Prospectus Overstatement
FFML 2007-FF2	94.88%	81.85%	13.03%
MLMI 2006-WMC2	94.82%	83.38%	11.44%
SURF 2005-BC3	98.01%	87.87%	10.14%
SURF 2006-BC2	97.83%	85.58%	12.25%
SURF 2006-BC3	96.85%	85.92%	10.93%
MLMI 2005-A2	95.72%	81.66%	14.07%
MLMI 2006-OPT1	93.40%	84.71%	8.68%
MLMI 2006-RM5	94.29%	83.50%	10.79%
OWNIT 2006-2	96.19%	87.01%	9.18%

115. The facts alleged in this Complaint show that Merrill's problems were systemic, and such is confirmed by the consistency of the results set forth above. Allstate tested thousands of Merrill's loans across multiple offerings. The one transaction at issue here that was not tested involved primarily 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 Offering that Allstate was not yet able to test on a loan-level basis also misrepresented the owner-occupancy information at approximately the same material rate as seen in the large sample of Certificates discussed above.

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

116. 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.

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

118. For instance, Merrill made representations in the Offering Materials about the percent of loans that had LTVs higher than 80%. However, for certain investments, a much higher percentage of the loans (than that represented by Merrill) had LTVs higher than 80%, including the following:

Asset	Percentage of Loans Represented to Have LTVs Greater than 80%	Actual Percentage of Loans With LTVs Greater than 80%	Prospectus Understatement of Percent of Loans With High LTVs
FFML 2007-FF2	35.87%	74.76%	38.89%
MLMI 2006-WMC2	48.91%	54.50%	5.59%
SURF 2005-BC3	50.36%	53.22%	2.86%
SURF 2006-BC2	50.61%	55.86%	5.24%
SURF 2006-BC3	49.69%	64.64%	14.95%
MLMI 2005-A2	0.25%	36.56%	36.31%
MLMI 2006-OPT1	40.20%	63.37%	23.17%
MLMI 2006-RM5	53.67%	58.58%	4.91%
OWNIT 2006-2	21.87%	63.70%	41.82%

119. The Offering Materials also made representations about how many of the Mortgage Loans had LTV ratios greater than 100%, meaning the size of the loan is greater than the value of the property. (This is known as being "underwater," where a borrower owes more on the property than it is worth.) Loans with over 100% LTV afford the lender no equity cushion and leave the lender with inadequate collateral from the outset of the loan. Merrill represented that ***no*** loans in the tested deals were underwater. To the contrary, ***as high as 26% of the mortgage loans in certain collateral pools were already underwater***:

Asset	Percentage of Loans Represented to Have LTVs Greater than 100%	Actual Percentage of Loans With LTVs Greater than 100%	Prospectus Understatement of Percent of Loans Already Underwater
FFML 2007-FF2	0.00%	26.30%	26.30%
MLMI 2006-WMC2	0.00%	14.86%	14.86%
SURF 2005-BC3	0.00%	12.67%	12.67%
SURF 2006-BC2	0.00%	16.42%	16.42%
SURF 2006-BC3	0.00%	21.16%	21.16%
MLMI 2005-A2	0.00%	6.55%	6.55%
MLMI 2006-OPT1	0.00%	22.20%	22.20%
MLMI 2006-RM5	0.00%	16.86%	16.86%
OWNIT 2006-2	0.00%	14.86%	14.86%

120. Merrill's also materially understated the weighted average LTV of the Mortgage Loans underlying the Certificates by up to nearly 15% in certain cases, as reflected in the Exhibits.

121. Other Offering Materials, particularly for those deals with large numbers of second-lien loans, also focused on the CLTV statistics of the underlying loans. This is because the quality of such a loan should take into account the pre-existing "senior" lien on the property, as that eats into the owner's equity and has to be paid first upon foreclosure. (Deals that purport to not contain many loans subject to a second lien often do not contain CLTV representations.) As with the LTV statistics, Merrill misrepresented the CLTV statistics, and in doing so significantly understated the riskiness of the Mortgage Loans underlying the Certificates.

122. Just as with LTVs, loans with CLTVs in excess of 100% provide the lender no cushion to protect against borrower default and against loss upon foreclosure. Just as with LTVs, Merrill represented for certain Offerings that ***no*** loans had CLTVs in excess of 100%. (The deals not included below do not make any similar representations regarding CLTV.) Just as with LTVs, in actuality, those deals had large portions of their respective collateral pools made up of loans with underwater CLTVs – including one with approximately ***sixty percent*** of its loans having such high CLTVs:

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**
FFML 2007-FF2	0.00%	53.89%	53.89%
MLMI 2006-OPT1	0.00%	41.62%	41.62%
MLMI 2006-RM5	0.00%	59.92%	59.92%
SURF 2006-BC2	0.00%	49.25%	49.25%
SURF 2006-BC3	0.00%	48.31%	48.31%

123. The facts alleged in this Complaint show that Merrill's problems were systemic, and such is confirmed by the consistency of the results set forth above. Allstate tested thousands of Merrill's loans across multiple deals. The one transaction at issue here that was not tested involved primarily 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 Offering that Allstate was not yet able to test on a loan-level basis also misrepresented these statistics at approximately the same material rate as seen in the large sample of Certificates discussed above.

D. Documentary and Testimonial Evidence that Merrill's Due Diligence Flagged Many Problem Loans That Were "Waived In" Anyway

124. Merrill wore multiple hats in connection with the Offerings at issue here, acting in various capacities including sponsor and underwriter of the offered securities. In its overlapping capacities, Merrill was responsible for purchasing large blocks of mortgage loans from third-party originators (many of whom were affiliated with or financially dependent on Merrill), repackaging those loans into securities, and selling the newly-created securities to investors like Allstate.

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

126. Specifically, on information and belief, Merrill operated quality assurance and risk management departments tasked with ensuring that loans purchased from third-party originators met the stated guidelines. Merrill conducted due diligence on the loans included in each offering to ensure compliance with Merrill-created or approved underwriting guidelines.

Merrill's analysis involved the individualized review of thousands of loans in each Mortgage Pool. To make this determination, Merrill 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.

127. On information and belief, Merrill's own due diligence revealed that a significant percentage of loans purchased from third-party originators failed to meet applicable underwriting standards, yet were provided unjustified exceptions. This is evidenced by Merrill's actions when it happened to outsource its due diligence obligations, and other facts set forth herein.

128. Sometimes, Merrill relied on outside firms to conduct the requisite due diligence. One of the largest such firms is Clayton. 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."

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

"were the reported property values accurate." (FCIC Report at 166.) It also "critically" analyzed whether, to the extent a loan was deficient, there were any "compensating factors." (*Id.*)

130. Each day, Clayton generated reports that summarized its findings, including summaries of the loan files that failed to meet the relevant underwriting standards. This included giving loans three grades – a Grade 3 loan "failed to meet guidelines and were not approved." Importantly, these Grade 3 loans did not contain any "compensating factors." Tellingly, only 54% of the nearly one-million loans reviewed by Clayton "met guidelines," a number that its former president admitted indicated "there [was] a quality control issue in the factory" for mortgage-backed securities.

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

132. Recently released internal Clayton documents show that, contrary to Merrill's representations, a startlingly high percentage of loans reviewed by Clayton for Merrill were defective, but were nonetheless included by Merrill in loan pools sold to Allstate and other investors.

133. According to an internal Clayton "Trending Report" made public in September 2010, Merrill was informed by Clayton that ***23% of the loans it had reviewed "failed to meet***

guidelines," which included a finding that the loans had been granted despite the lack of any purported "compensating factors" justifying an "exception."

134. With such a high failure rate, the proper response would be to reject the pool outright, and seriously investigate whether that originator could be considered a trusted source of loans in the future. Even assuming Merrill incredibly believed a 23% failure rate could be chalked up to 'sampling error' (due to the fact that Clayton did not review every loan in a pool), the proper response would be to increase the sample size to test that hypothesis.

135. Instead, Merrill not only continued to work with problematic originators, but, rather than expanding the sample size to truly investigate the problems, it simply ignored the red flags Clayton's results showed. ***According to Clayton's "trending report," Merrill "waived in" to its pools one third of those toxic loans that Clayton had identified as being outside the guidelines.*** Given the 23% failure rate to begin with, this waiver rate means that the data from that Merrill's own due diligence firm shows that approximately 8% of the loans that actually made it into Merrill's collateral pools had seriously failed the applicable guidelines and were not subject to any compensating factors.

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

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

> [M]any prospectuses indicated that the loans in the pool either met guidelines outright or had compensating factors, even though

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

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

E. Further Evidence the Originators Were Generating Loans Outside the Disclosed Underwriting Guidelines

(1) First Franklin

138. Merrill first announced it was going to acquire First Franklin in late 2006, and ultimately did acquire it from National City Bank in early 2007. Both prior to, and after, the acquisition, Merrill routinely included First Franklin originated (or acquired) loans in the Certificates, including all of the loans in FFML 2007-FF2. Upon information and belief, First Franklin routinely violated its stated standards for underwriting and appraisals. For example:

- First Franklin routinely approved loans on properties with overinflated values;
- First Franklin did not track appraisers that submitted appraisals with overinflated values or unsupported comparables; and
- First Franklin's managers regularly approved loans that had been rejected by underwriters for overinflated appraisals.

139. Based on Allstate's loan-level review of the misrepresented statistics, as well as the plummetting performance of the related collateral pools and the systemic nature of First Franklin's problems and other facts set forth herein, on information and belief the Mortgage

Loans underlying Allstate's Certificates here that were provided by First Franklin suffered from these same defects.

(2) Option One

140. Merrill acquired all of the loans for MLMI 2006-OPT1 from Option One. On information and belief, Option One routinely violated its stated standards for underwriting and appraisals. For example, Option One did the following:

- It was Option One's practice that if an underwriter denied a loan and an account executive complained, the loan was escalated to the branch manager and the loan would be pushed through. This included complaining to the Appraisals Department at headquarters in Irvine, California when a loan was being held up because of 'flawed' appraisals, and taking such loans up the chain until they received the green light;
- Option One knowingly approved stated income loans that contained falsified income information, and the majority of stated income loans contained falsified income information;
- Option One's main driver was income, not accuracy in the underwriting process;
- Option One account executives and managers did not seek to reduce risk because Option One shifted the mortgages to investors; and
- Option One was motivated to violate its underwriting and appraisal standards in order to increase the volume of loans it could sell to Wall Street Banks to be securitized.

141. The Attorney General for the Commonwealth of Massachusetts has investigated Option One, and its past and present parent companies, for their unfair and deceptive origination

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

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

(3) Ownit Mortgage Solutions

143. Merrill acquired all of the loans in OWNIT 2006-2 from Ownit Mortgage Solutions, in which it held a 20% ownership interest. Merrill placed a senior executive on Ownit's board of directors in its effort to rapidly expand its subprime mortgage securitization business. Having an ownership interest in Ownit gave Merrill the vertical integration of the entire business that allowed it greater control and knowledge over the routine disregard of purported underwriting guidelines.

144. According to Ownit's founder and chief executive, William Dallas, shortly after Merrill acquired an ownership interest in Ownit, Merrill instructed him to loosen underwriting

standards and originate more stated income loans. As a result, after Merrill's investment in Ownit, the number of stated income loans jumped from near zero to over 30%. Ownit also lowered the credit scores it required from borrowers. Merrill knew that Ownit was systematically ignoring its own underwriting guidelines to boost loan production because Merrill specifically requested Ownit engage in this practice. Merrill then placed those toxic loans into mortgage pools that acted as security for Certificates purchased by Allstate, without informing Allstate or the other investors of the toxic and risky nature of the loans in question.

145. On information and belief, Ownit routinely violated its stated standards for underwriting and appraisals. For example:

- Ownit knowingly approved loans with appraisals that were materially higher than the actual value of the property. This practice was intented to increase the volume of higher yield, riskier loans;
- As a general practice, Ownit violated its own underwriting guidelines by failing to scrutinize loan applications; and
- Ownit managers would regularly sign-off on loan applications even if an underwriter questioned, for example, the appraisal.

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

(4) ResMAE Mortgage Corporation

147. Merrill acquired all of the mortgage loans in MLMI2006-RM1 and MLMI 2006-RM5 from ResMAE. On information and belief, Merrill was ResMAE's largest loan purchaser by volume in 2006. Merrill's position as largest purchaser allowed it to influence and control much of the behavior of ResMAE in the loan origination process.

148. On information and belief, ResMAE routinely violated its stated standards for underwriting and appraisals. For example:

- ResMAE's sales department pushed through stated income loans that listed implausible incomes;
- ResMAE rejected underwriters' requests for income verification even in cases where the state income was not credible given the borrower's disclosed occupations;
- ResMAE made exceptions to its underwriting standards as a general practice, so that by some estimates, upwards of 50% of all underwritten loans were based on exceptions;
- Many loans were improperly classified as primary owner-occupied residences that were actually investment properties. ResMAE encouraged its employees not to perform in-depth investigations into whether the loan was actually for an investment property; and
- ResMAE knowingly wrote loans based on falisified data from appraisers, title companies and borrowers.

149. Based on Allstate's loan-level review of the misrepresented statistics, as well as the plummetting performance of the related collateral pools, and the systemic nature of

ResMAE's problems and other facts set forth herein, on information and belief the Mortgage Loans underlying Allstate's Certificates here that were provided by ResMae suffered from these same defects.

(5) WMC Mortgage Corp.

150. Merrill acquired all of the loans in MLMI 2006-WMC2 from WMC Mortgage Corp. WMC Mortgage was one of the largest subprime lenders in the country.

151. In June 2008, after a lengthy investigation, the Washington State Department of Financial Institutions, Division of Consumer Services filed charges against WMC and its principal owners. The investigation found that WMC had originated loans with unlicensesd or unregistered mortgage brokers, understated the amount of finance charges on loans, undestated annual percentage rates by almost .5%, and commited many other violations of Washington law.

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

III. MERRILL KNEW ITS REPRESENTATIONS WERE FALSE

A. The Statistical Evidence Is Itself Persuasive Evidence Merrill Knew Or Recklessly Disregarded The Falsity Of Their Representations – Particularly Given Merrill's Relationships With the Originators

153. As discussed above, all of Allstate's Certificates have significantly underperformed, and an analysis of the underlying loans shows seriously misrepresented owner-occupancy, LTV, and CLTV statistics. For instance, Allstate's loan-level analysis shows that Merrill frequently overstated the percentage of loans secured by owner-occupied properties in a given mortgage pool by more than 10%.

154. Allstate's loan-level analysis also revealed that Merrill consistently understated the percentage of loans with high LTV ratios, sometimes by more than 20%. This meant that many of the borrowers had no equity cushion to protect against borrower defaults, and had much higher risks of experiencing a loss upon foreclosure.

155. Further, overall ***51% of the loans for the tested deals have already been written off at a loss or are currently delinquent.***

156. The remarkable default and delinquency rates, understated LTV and CLTV ratios, and overstated owner occupancy statistics are not only evidence that the Mortgage Loans underlying the Offerings were defective. They are themselves strong evidence that Merrill knew the Mortgage Loans underlying the Offerings were grossly defective when they made contrary representations to Allstate. Simply put, Merrill could not have pooled these Mortgage Loans without knowing that, contrary to their representations, the loans were widely defective.

157. That the Mortgage Loans could have made it to the securitization market without Merrill's knowledge of their problems is made all the less improbable by the fact that, as above, many of the loans were originated by defendants' affiliates, or other companies that had extensive, economic ties to Merrill. For instance: (1) Because First Franklin was an affiliated entity, Merrill had a direct window into the lax practices that led to the creation of the toxic pool of loans. (2) Merrill provided cheap financing for Option One to originate loans and paid a premium for those loans that carried the carried the riskiest profile and the weakest underwriting. (3) Ownit was a critical tool in Merrill's attempt to vertically integrate its operations, and Merrill even had representation on Ownit's board. (4) Merrill provided cheap financing for ResMAE to originate loans and paid a premium for those loans that carried the riskiest profile and the weakest underwriting.

158. This vertical integration between originators and issuers heightened the already-perverse incentives created by the move to the "originate and distribute" business model. The originator, secure with a pipeline to the market, would have even more incentive to loosen its practices. Those responsible for the securitization, focused on volume, would push them to do so even more. And once the loans were issued, they would have significant incentives to ignore problem loans because rejecting a loan would saddle an affiliated company with a toxic loan.

159. As purchasers of the loans, Merrill had extensive business relationships with the originators (even the unaffiliated ones), 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.

160. Indeed, Merrill represented in the Offering Materials that it conducted due diligence on all of the originators with respect to the underwriting guidelines and processes used. Merrill, for example, represented that "[p]rior to acquiring any residential mortgage loans, [Merrill Lynch Mortgage Lending, Inc.] conducts a review of the related mortgage loan seller that is based upon the credit quality of the selling institution" and that the "review process may include reviewing select financial information for credit and risk assessment and conducting an underwriting guideline review, senior level management discussion and/or background checks." (OWNIT 2006-2 Prospectus Supplement at S-33.) Merrill further represented that "[t]he underwriting guideline review entails a review of the mortgage loan origination processes and systems. In addition, such review may involve a consideration of corporate policy and procedures relating to state and federal predatory lending, origination practices by jurisdiction, historical loan level loss experience, quality control practices, significant litigation and/or material investors." (OWNIT 2006-2 Prospectus Supplement at S-33-34. *See also* FFML 2007-

FF2 Prospectus Supplement at S-42-43; MLMI 2006-RM1 Prospectus Supplement, dated March 17, 2006 at S-36.)

161. Thus, regardless of the originator, Merrill was either aware, or willfully blind, to the fact that the Mortgage Loans underlying Allstate's certificates were not originated in accordance with the disclosed underwriting standards. In short, Merrill's relationships with the originators gave it yet another source of actual knowledge of the falsity of the representations it made to Allstate. Because of the ties between Merrill and the originators, Merrill had a direct window into the lax practices that led to the creation of the toxic pools of loans to begin with.

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

B. Evidence From Third-Party Due Diligence Firms Demonstrates That Merrill Knew Defective Loans Were Being Securitized

163. Not only *must* Merrill had known that the Mortgage Loans were widely defective; it *did* know. As previously described, Merrill engaged in its 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 Merrill's own credit policies. This review would necessarily have revealed the pervasive deficiencies in the Mortgage Loans at issue here.

164. In fact, upon information and belief, Merrill's own due diligence review revealed that a high percentage of the Mortgage Loans underlying Allstate's Certificates were deficient – both because the loans failed to conform to the originator's stated underwriting standards, and

because the loans failed to meet Merrill's own credit standards. Yet Merrill routinely included these deficient loans in loan pools underlying the Offerings.

165. That the Mortgage Loans were actually defective is evidenced by Allstate's loan-level analysis, and other facts set forth above. That those problems were caught by the due diligence process, yet knowingly given "waivers," is evidenced by, among other things, their reaction to loans being rejected by the due diligence process when it happened to involve a third-party due diligence firm who later released its statistical information to the government. Specifically, Merrill hired the third-party due diligence firm Clayton 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."

166. As discussed above, according to Clayton's internal documents provided to the government in September 2010, Merrill was informed that 23% of the loans it had reviewed "failed to meet guidelines." These findings were provided to Merrill in a ***daily*** report that summarized Clayton's review and included summaries of the deficient loan files. As above, with such a high failure rate, the proper response would be to reject the pool outright, or at a minimum to hold that pool to higher scrutiny (with, for instance, expanded sampling techniques).

167. Instead, despite receiving this daily and specific evidence that a significant percentage of the loans it was buying were defective, Merrill provided waivers for ***32%*** of those rejected loans.

168. 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, Merrill, through its

numerous roles of underwriter, depositor, sponsor, and affiliated originators, was made fully aware ***on a daily basis*** that a significant percentage of the Mortgage Loans here failed to meet the stated underwriting guidelines, but were being included in the pools underlying Allstate's Certificates anyway by way of Merrill's "waiver" process.

C. Evidence that Merrill Leveraged Its Unique Knowledge to Increase Their Own Profits

169. Merrill 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, or expanding their statistical tests to see if the rejects were anomalies, it "waived in" a third of the faulty loans. Even more damning, rather than mitigate the risks to investors such as Allstate by removing problematic loans or refusing to do business with problematic originators, Merrill not only sought to acquire and provide cheap warehouse lending facilities to encourage originators to sell their loans to Merrill, but leveraged its unique knowledge to its own advantage.

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

171. Further, according to the September 2010 testimony before the Federal Crisis Inquiry Commission by Clayton's former president, D. Keith Johnson, the investment banks would use the exception reports simply to force a lower price. In other words, rather than reject defective loans from collateral pools, or cease doing business with consistently failing originators, ***underwriters such as Merrill would instead use the Clayton Holdings data simply***

to insist on a lower price from the loan originators, leaving more room for their own profits when the problem loans were hidden in securitization pools.

D. **Evidence Of Merrill's Influence Over The Appraisal Process Demonstrates That Merrill Knew The Appraisals Were Falsely Inflated**

172. On information and belief, Merrill used its economic leverage over appraisers to make the appraised values fit the loan they wanted to approve, rather than to fit the true value of the property. Merrill thus knew that the LTV and CLTV statistics that Merrill was giving to its investors were false.

173. For instance, as discussed above, Merrill severely understated the percentage of loans in the mortgage pools that had high LTV ratios. In FFML 2007-FF2, the Offering Materials represented that 35.87% of the loans had an LTV ratio greater than 80%. In fact, however, ***74.76%*** of the loans had an LTV ratio greater than 80% – an understatement of ***38.89%***.

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

175. 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.

176. 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."

177. 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.'"

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

IV. ALLSTATE'S DETRIMENTAL RELIANCE AND DAMAGES

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

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

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

182. 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 Merrill described them to be. The loans underlying the Certificates experienced default and delinquency at extraordinarily high rates due to the abandonment of the disclosed underwriting guidelines. Allstate's losses on the Certificates have been much greater than they would have been if the loans were as Merrill described them to be.

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

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

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

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

186. Indeed, Allstate has already sold some of these Certificates on the secondary market. That they were sold at a significant loss evidences the Certificates did not have the value that the securities would have had if they were backed by Mortgage Loans.

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

188. The disclosure of fundamental irregularities in Merrill's underwriting practices and increased risk regarding future cash flow has also led to a substantial decline in market value of the Certificates. Allstate purchased the Certificates not only for their income stream, but held them on a "available for sale" basis, with the expectation that some of Allstate's RMBS portfolio

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

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

V. OTHER MATTERS

A. Merrill Lynch's Liability as Control Person

190. The primary violators in this action for purposes of the Securities Act of 1933 are Merrill Lynch Mortgage Investors, Inc. as Depositor and Merrill, Lynch, Pierce, Fenner & Smith Inc. as Underwriter.

191. Merrill Lynch Mortgage Investors, Inc. is a limited purpose, indirect wholly-owned subsidiary of Merrill Lynch and was the issuer of the Certificates. Merrill, Lynch, Pierce, Fenner & Smith Inc. is a wholly-owned subsidiary of Merrill Lynch and was the underwriter for the Certificates. Both committed primary violations of the Securities Act as alleged herein.

192. Merrill Lynch had the power to direct or cause the direction of the management and policies of the primary violators. Indicia of Merrill Lynch's control includes, for example, the following: (i) Merrill, Lynch, Pierce, Fenner & Smith Inc. also conducts business under the name Merrill Lynch & Co.; (ii) upon information and belief Merrill Lynch created Merrill Lynch Mortgage Investors, Inc. and defined its purpose; (iii) Merrill Lynch's SEC filings show Merrill Lynch's control through comprehensive involvement with the securitization operations including the issuance and underwriting of mortgage-back securities; (iv) Merrill Lynch directly participated in the issuance and sale of the Certificates, including prominently featuring "Merrill Lynch & Co." on the front page of each Prospectus and Prospectus Supplement; (v) revenue from the securitizations involving the primary violators inured to Merrill Lynch's benefit; and (vi) Merrill Lynch's managing partner and its director and senior counsel signed Merrill Lynch Mortgage Investors, Inc.'s registration statements.

193. Merrill Lynch also created the special-purpose entities ("SPEs"), wholly-owned subsidiaries, that purchased residential mortgage loans for Merrill Lynch's securitization business. Merrill Lynch established Merrill Lynch Mortgage Investors, Inc. in order to acquire the mortgage loans and to securitize and sell those loans to investors in the form of the Certificates. Thus, Merrill Lynch established Merrill Lynch Mortgage Investors, Inc. for the purpose of advancing the interests of Merrill Lynch's securitization business. According to the Offering Materials, Merrill Lynch Mortgage Investors, Inc.'s certificate of incorporation limited its activities to "those necessary or convenient to carry out its securitization activities."

194. Merrill Lynch also publicly represented that it controlled the securitization business. For example, in Merrill Lynch's Form 10-K for the years ended December 29, 2006 and December 28, 2007, Merrill Lynch represented that "[i]n the normal course of business,

Merrill Lynch securitizes . . . residential mortgage loans." (emphasis added). Merrill Lynch further described its significant involvement in securitization in its 2007 Form 10-K, stating that its "involvement with SPEs used to securitize financial assets includes: structuring and/or establishing SPEs; selling assets to SPEs; managing or servicing assets held by SPEs; underwriting, distributing, and making loans to SPEs; making markets in securities issued by SPEs; engaging in derivative transactions with SPEs; owning notes or certificates issued by SPEs; and/or providing liquidity facilities and other guarantees to, or for the benefit of, SPEs."

195. Exhibit 21 to Merrill Lynch's 2006 and 2007 Form 10-Ks provide that Merrill, Lynch, Pierce, Fenner & Smith Inc. "[a]lso conducts business under the name 'Merrill Lynch & Co.'" Merrill Lynch stated in both its 2006 and 2007 Form 10-Ks that it had "[r]etained interests in securitized assets," and the majority consisted of "mortgage-backed securities that Merrill Lynch expect[ed] to sell to investors in the normal course of its underwriting activity." (emphasis added). Thus, Merrill Lynch not only represented that it was involved in the structuring and issuance of mortgage-backed securities through SPEs, but also represented that it conducted underwriting of those securities in the normal course of its business.

196. Merrill Lynch executives and directors also played roles in Merrill Lynch's control over Merrill Lynch Mortgage Investors, Inc. For example, Paul Park, who was, at the relevant times, a managing partner of Merrill Lynch, was simultaneously the President and Chairman of the Board of Directors of Merrill Lynch Mortgage Investors, Inc. Similarly Michael M. McGovern, who was, at the relevant times, a Director and Senior Counsel of Merrill Lynch, was simultaneously a Director of Merrill Lynch Mortgage Investors, Inc. Merrill Lynch also established Merrill Lynch Mortgage Investors, Inc. in the same facilities that it occupied, with the same registered agent and registered office in Delaware.

197. Merrill Lynch's direct role in the issuance and underwriting of the Certificates at issue here is also evidenced by the use of its corporate name – "Merrill Lynch & Co." – in bold on the front page of each Prospectus and Prospectus Supplement of the Offerings in this case. Thus, Merrill Lynch, through Merrill Lynch Mortgage Investors, Inc. and Merrill, Lynch, Pierce, Fenner & Smith Inc., used these Prospectuses and Prospectus Supplements to market and sell the Certificates to investors.

198. The benefits of the securitization business, including the issuance and sale of the Certificates at issue here, inured directly to Merrill Lynch, which consolidated the revenues from the issuance and sale of residential mortgage-backed securities in its financial statements. According to the 2007 Form 10-K, in 2006 and 2007, Merrill Lynch reported "cash inflows" of $95.8 billion and $100.2 billion, respectively, from residential mortgage loan securitization transactions.

B. Tolling of the Securities Act of 1933 Claims

199. The statutory claims raised by Allstate herein are currently the subject of class action lawsuits. Allstate is a putative class member of a class action lawsuit for its purchases of certificates from the following trusts: FFML 2007-FF2; MLMI 2006-OPT1; MLMI 2006-RM5; SURF 2006-BC3; SURF 2006-BC2; OWNIT 2006-2; and MLMI 2006-WMC2

200. On May 20, 2009, a consolidated class action complaint was filed against various Merrill entities, former officers and directors thereof, and certain other parties on behalf of all investors who purchased or otherwise acquired certain mortgage-backed securities that were issued, underwritten or sold by these entities. *See Public Employees' Retirement System of Mississippi, et al. v. Merrill Lynch & Co., Inc., et al.*, Civil Action No. 08 CIV. 10841 (JSR) (S.D.N.Y. 2008) (the "Class Action"). This action was comprised of four consolidated actions

by different named plaintiffs, the earliest being filed on December 8, 2008. The Class Action complaint alleges claims under Sections 11, 12(a)(2), and 15 of the Securities Act of 1933.

201. Allstate was included in the defined class in the Class Action complaint with respect to its investments in: FFML 2007-FF2; MLMI 2006-OPT1; MLMI 2006-RM5; SURF 2006-BC3; SURF 2006-BC2; OWNIT 2006-2; and MLMI 2006-WMC2.

202. Defendants Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Inc., and Merrill Lynch Mortgage Investors, Inc. in this Complaint were also named as defendants in the Class Action, for the same statutory causes of action asserted herein.

203. Allstate reasonably and justifiably relied on the named plaintiffs in the Class Action to protect its rights and it reasonably and justifiably relied on the class action tolling doctrines of *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974) and *In re WorldCom Securities Litigation*, 496 F.3d 245, 256 (2d Cir. 2007) to toll the statute of limitations on its 1933 Act claims.

204. Under *American Pipe*, all putative class members are treated as if they filed their own individual actions until they either opt out or until a certification decision excludes them. *American Pipe*, 414 U.S. at 255. As the Second Circuit stated in *WorldCom*: "because Appellants were members of a class asserted in a class action complaint, their limitations period was tolled under the doctrine of *American Pipe* until such time as they ceased to be members of the asserted class, notwithstanding that they also filed individual actions prior to the class certification decision." *WorldCom*, 496 F.3d at 256.

205. Although the classes in the Class Actions have not been certified yet and Allstate's claims related to these trusts may be covered in the Class Actions, Allstate has chosen

to file this separate action and to assert its 1933 Act claims, which have been tolled by the pendency of the Class Actions, in order to preserve its rights thereto.

FIRST CAUSE OF ACTION
(Common-law Fraud)

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

207. This count is against all defendants except Merrill Lynch & Co., i.e., Merrill Lynch, Pierce, Fenner & Smith Inc., Merrill Lynch Mortgage Investors, Inc., and Merrill Lynch Mortgage Lending, Inc. (the "misrepresentation Defendants").

208. The material representations set forth above were fraudulent, and the misrepresentation Defendants' representations fraudulently omitted material facts. The materially untrue statements and omissions of material fact in the Offering Materials are summarized in Sections I-II above and are further set forth in Exhibits C-L.

209. Each of the misrepresentation 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 misrepresentation Defendants' false representations and misleading omissions.

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

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

SECOND CAUSE OF ACTION
(Fraudulent Inducement)

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

214. This count is against the misrepresentation Defendants, as defined above.

215. Allstate was fraudulently induced to purchase the Certificates by the misrepresentation Defendants' misrepresentations and omissions of material facts. The materially untrue statements and omissions of material fact in the Offering Materials are summarized in Sections I-II above and are further set forth in Exhibits C-L.

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

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

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

219. As a result of the foregoing, Allstate has the right to rescind the fraudulently induced Certificate purchases and to require Defendants to repurchase the Certificates at their original cost, plus interest.

THIRD CAUSE OF ACTION
(Negligent Misrepresentation)

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

221. This count is against the misrepresentation Defendants, as defined above.

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

223. Because the misrepresentation 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.

224. 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 misrepresentation Defendants' unique and special knowledge regarding the Mortgage Loans when determining whether to make each investment of Certificates. Allstate was entirely reliant on them to provide accurate information regarding the loans in engaging in that analysis. Accordingly, they were uniquely situated to evaluate the economics of each Securitization.

225. Going back six years covering twenty-five separate purchases, Allstate relied on the misrepresentation Defendants' unique and special knowledge regarding the quality of the underlying Mortgage Loans and the quality of underwriting when determining whether to invest in the Certificates at issue in this action. This longstanding relationship, coupled with its unique and special knowledge about the underlying loans, created a special relationship of trust, confidence, and dependence between the misrepresentation Defendants and Allstate.

226. The misrepresentation 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.

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

228. Based on their expertise, superior knowledge, and relationship with Allstate, the misrepresentation Defendants owed a duty to Allstate to provide complete, accurate, and timely information regarding the Mortgage Loans and the offerings.

229. The misrepresentation Defendants breached their duty to provide such information to Allstate by making misrepresentations that induced Allstate's investment in the offerings. The materially untrue statements and omissions of material fact in the Offering Materials are summarized in Sections I-II above and are further set forth in Exhibits C-L.

230. At the time it made these misrepresentations, the misrepresentation Defendants were, at a minimum, negligent in its due diligence and/or understanding of the extent to which the Mortgage Loans underlying the Certificates complied with the underwriting guidelines and had the characteristics represented in the Offering Materials. Thus, they were at the very least negligent in making statements that were false, misleading, and incorrect. Such information was known or reasonably should have been known by the misrepresentation Defendants, and was not known or readily knowable by Allstate. In addition, the misrepresentation Defendants knew that Allstate was acting in reliance on that information.

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

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

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

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

234. This claim is brought under Section 11 of the 1933 Act, 15 U.S.C. §77k ("Section 11"), against Merrill Lynch, Pierce, Fenner & Smith Inc. as underwriter; and Merrill Lynch Mortgage Investors, Inc. as depositor (together, the "Section 11 Defendants"), arising from Allstate's purchases of the Certificates.

235. This cause of action is based solely on claims of strict liability or negligence under the 1933 Act. This count is predicated upon the Section 11 Defendants' strict liability for making untrue and materially misleading statements in the Offering Materials for the following Offerings that Allstate invested in (identified by the name of the Offering and the class): FFML 2007-FF2, A2B; MLMI 2006-OPT1, A2D; MLMI 2006-RM5, A2B; SURF 2006-BC3, A-2C; SURF 2006-BC2, A2B; OWNIT 2006-2, A2B; and MLMI 2006-WMC2, A2B.

236. Each of Allstate's purchases of the Certificates was made pursuant to the false and misleading Offering Materials, including the registration statements.

237. The Offering Materials for the Offerings were materially untrue, misleading, contained untrue statements of material facts, and omitted to state material facts required to be

stated therein or necessary to make the statements therein not misleading. At the time it obtained the Certificates, Allstate did not know of the facts concerning the untrue and misleading statements and omissions alleged herein.

238. The materially untrue statements and omissions of material fact in the Offering Materials are summarized in Sections I-II above and are further set forth in Exhibits C-L.

239. The Section 11 Defendants caused to be issued and disseminated, directed other parties to disseminate at the time of the filing of the Offering Materials, and/or participated in the issuance and dissemination to Allstate of materially untrue statements of facts and omissions of material facts, which were contained in the Offering Materials.

240. The Section 11 Defendants are strictly liable to Allstate for the materially untrue statements and omissions in the Offering Materials under Section 11. Defendant Merrill Lynch Mortgage Investors, Inc., as depositor, is liable for issuing the Certificates, in particular, 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). Defendant Merrill Lynch, Pierce, Fenner & Smith Inc. is liable for its role as underwriter of the Offerings, in accordance with Section 11(a)(5) of the 1933 Act, 15 U.S.C. §77k(a)(5).

241. The Section 11 Defendants owed to Allstate a duty to make a reasonable and diligent investigation of the statements contained in the Offering Materials at the time they became effective to ensure that such statements were true and correct and that there was no omission of material facts required to be stated in order to make the statements contained therein not misleading. The Section 11 Defendants failed to exercise such due diligence by failing to conduct a reasonable investigation.

242. This action is brought within one year of the discovery of the materially untrue statements and omissions in the Offering Materials and brought within three years of the effective date of the Offering Materials, by virtue of the timely filing of the Class Actions and by the tolling of Allstate's claims afforded by such filings.

243. Allstate has sustained damages measured by the difference between the price Allstate paid for the certificates and (1) the value of the Certificates at the time this suit is brought, or (2) the price at which Allstate sold the Certificates in the market prior to the time suit is brought. Allstate's Certificates lost substantial market value subsequent to and due to the materially untrue statements of facts and omissions of material facts in the Offering Materials alleged herein.

244. By reason of the conduct herein alleged, the Section 11 Defendants violated Section 11 of the 1933 Act and are jointly and severally liable for their wrongdoing. By virtue of the foregoing, Allstate is entitled to damages from each of the Section 11 Defendants.

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

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

246. This is a claim brought under Section 12(a)(2) of the 1933 Act, 15 U.S.C. §77l(a)(2) ("Section 12(a)(2)"), against Merrill Lynch, Pierce, Fenner & Smith Inc. as underwriter and Merrill Lynch Mortgage Investors, Inc. as depositor (together the "Section 12(a)(2) Defendants"), arising from Allstate's purchases of the Certificates.

247. This cause of action is based solely on claims of strict liability or negligence under the 1933 Act. This count is predicated upon the Section 12(a)(2) Defendants' negligence

for making untrue and materially misleading statements in the Offering Materials for the following Offerings that Allstate invested in (identified by the name of the Offering and the class): FFML 2007-FF2, A2B; MLMI 2006-OPT1, A2D; MLMI 2006-RM5, A2B; SURF 2006-BC3, A-2C; SURF 2006-BC2, A2B; OWNIT 2006-2, A2B; and MLMI 2006-WMC2, A2B.

248. The Section 12(a)(2) Defendants offered and sold the Certificates to Allstate by means of the defective Offering Materials, including the Prospectuses and Prospectus Supplements, which contained materially untrue statements of facts and omitted to state material facts necessary to make the statements, in light of the circumstances under which they were made, not misleading. Allstate purchased the Certificates directly from the Section 12(a)(2) Defendants, who both transferred title to Allstate and who solicited Allstate for financial gain.

249. The materially untrue statements and omissions of material fact in the Offering Materials are summarized in Sections I-II above and are further set forth in Exhibits C-L.

250. The Section 12(a)(2) Defendants offered the Certificates for sale, sold them, and distributed them by the use of means or instruments of transportation and communication in interstate commerce.

251. The Section 12(a)(2) Defendants owed to Allstate the duty to make a reasonable and diligent investigation of the statements contained in the Offering Materials, to ensure that such statements were true, and to ensure that there was no omission to state a material fact required to be stated in order to make the statements contained therein not misleading. The Section 12(a)(2) Defendants failed to exercise such reasonable care.

252. The Section 12(a)(2) Defendants knew, or in the exercise of reasonable care should have known, that the Offering Materials contained materially untrue statements of facts and omissions of material facts, as set forth above, at the time of the Offerings. Conversely,

Allstate did not know, nor in the exercise of reasonable diligence could it have known, of the untruths and omissions contained in the Offering Materials at the time it purchased the Certificates.

253. This action is brought within one year of the time when Allstate discovered or reasonably could have discovered the facts upon which this action is based, and within three years of the time that the Certificates upon which this cause of action is brought were sold to the public, by virtue of the timely filing of the Class Actions and by the tolling of Allstate's claims afforded by such filings.

254. Allstate sustained material damages in connection with its investments in the Offerings and accordingly has the right to rescind and recover the consideration paid for the Certificates, with interest thereon, in exchange for tendering the Certificates. Allstate hereby tenders its Certificates and demands rescission.

SIXTH CAUSE OF ACTION
(Violation of Section 15 of the 1933 Act)

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

256. This is a claim brought under Section 15 of the 1933 Act, 15 U.S.C. §77o ("Section 15"), against Merrill Lynch & Co. for controlling-person liability with regard to the Section 11 and Section 12(a)(2) causes of actions set forth above. Merrill Lynch & Co was named as defendant in the Class Action for violation of Section 15 of the Securities Act.

257. Merrill Lynch & Co. is a controlling person within the meaning of Section 15 by virtue of its actual power over, control of, ownership of, and/or directorship of the Section 11 Defendants and the Section 12(a)(2) Defendants, defined above, at the time of the wrongs alleged herein and as set forth herein.

258. The Section 11 and 12(a)(2) Defendants acted negligently and without reasonable care regarding the accuracy of the information contained in and incorporated by reference in the Offering Materials. The Section 11 and 12(a)(2) Defendants lacked reasonable grounds to believe that such information was accurate and complete in all material respects.

259. For the reasons set forth in Section V(A) above, Merrill Lynch & Co. had power and influence over the Section 11 and 12(a)(2) Defendants and exercised the same to cause those Defendants to engage in the acts described herein. By virtue of its control, ownership, offices, directorship and specific acts, Merrill Lynch & Col. had the power to influence and control, and did influence and control, directly or indirectly, the decision-making of the Section 11 and 12(a)(2) Defendants named herein.

260. Merrill Lynch & Co.'s control, ownership, and position made them privy to and provided them with actual knowledge of the material facts concealed from Allstate.

261. Neither of the Section 11 and Section 12(a)(2) Defendants named herein conducted a reasonable investigation or possessed reasonable grounds for the belief that the statements contained in the Offering Materials were true, were without omissions of any material fact, or were not misleading.

262. Allstate did not know, nor in the exercise of reasonable diligence could it have known, of the untruths and omissions contained in the Offering Materials at the time it purchased the Certificates.

263. By virtue of the conduct alleged herein, Merrill Lynch is liable for the aforesaid wrongful conduct, jointly and severally with – and to the same extent as – the entities it controlled for the violations of Sections 11 and 12(a)(2) by the controlled entities.

PRAYER FOR RELIEF

WHEREFORE Allstate prays for relief as follows:

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

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

b. Attorneys' fees and costs;

c. Prejudgment interest at the maximum legal rate; and

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

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

JURY TRIAL DEMANDED

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

DATED: New York, New York
March 1, 2011

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