FILED: NEW YORK COUNTY CLERK 01/30/2013 INDEX NO. 603751/2009
NYSCEF DOC. NO. 391 RECEIVED NYSCEF: 01/30/2013

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

MBIA INSURANCE CORPORATION, Plaintiff, - against - CREDIT SUISSE SECURITIES (USA) LLC, DLJ MORTGAGE CAPITAL, INC., and SELECT PORTFOLIO SERVICING, INC., Defendants.	Index No. 603751/09 (Kornreich, J.) **FIRST AMENDED** **VERIFIED COMPLAINT**

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Plaintiff MBIA Insurance Corporation ("MBIA"), through its attorneys, Patterson Belknap Webb & Tyler LLP, for its first amended complaint against defendants Credit Suisse Securities (USA) LLC ("CS Securities") and affiliates DLJ Mortgage Capital, Inc. ("DLJ") and Select Portfolio Servicing, Inc. ("SPS") (collectively "Credit Suisse"),[1] hereby alleges as follows:

NATURE OF ACTION

1. This case concerns an insurance policy (the "Policy") issued by MBIA for a Credit Suisse residential mortgaged-backed securitization that closed on April 30, 2007 (the "Transaction"). As the "sponsor" of the securitization, Credit Suisse aggregated a pool of loans that it originated and acquired from other loan originators (the "Loans"). Credit Suisse, as "seller," then sold the loans to a securitization trust (the "Trust"), which in turn issued securities to be paid down with the proceeds from the repayment of the Loans. In its role as the "servicer," Credit Suisse committed to track and pursue recoveries on the Loans. As the lead "underwriter" for the deal, Credit Suisse marketed and sold the securities to investors. And, as culmination to its myriad roles in the Transaction, to improve the marketability of the securities, Credit Suisse induced MBIA to enter into an insurance agreement (the "Insurance Agreement"), pursuant to which MBIA issued the Policy. Under the Policy, MBIA guarantees payment of any shortfall, in the event that the Loans do not generate sufficient cash to make payments due on the securities issued by the Trust.

2. As discovery in this case thus far demonstrates, in this final role, Credit Suisse wantonly violated the norms of legitimate business practice to induce

[1] At every point in the securitization process and specifically with respect to the transaction at issue, CS Securities exercised exclusive and complete domination and control over DLJ and SPS. The affiliates are therefore referred together herein as "Credit Suisse," unless clarification is required.

MBIA to enter into the Insurance Agreement and issue the Policy. It knowingly made material misrepresentations to MBIA, and provided false warranties, to induce MBIA to issue the Policy. These false representations and warranties concerned, primarily, the attributes of the Loans and the manner in which Credit Suisse's loan conduit operations originated, acquired, and reviewed them. Credit Suisse ***knew***, but did not disclose to MBIA, that the collateral pool was replete with defective Loans, including hundreds of Loans that Credit Suisse ***already had attempted to return*** to the originators ***prior*** to the transaction with MBIA. Credit Suisse knew, but did not disclose to MBIA, that originators from which it was acquiring Loans were, for example, – in the words of Credit Suisse executives – ***"shady as fck,"*** [sic] would "try to get away with anything they c[ould]," and were selling to Credit Suisse "complete garbage. ***Utter complete garbage."*** And Credit Suisse knew but did not disclose that its loan operations were a farce, internally mocked by its own executives. Indeed, in April 2007, just weeks before the Policy issued, a Credit Suisse managing director joked to the senior executive responsible for Credit Suisse's mortgage loan conduit business, ***"what does our loan conduit and the Titanic have in common?"*** Five minutes later, the senior executive responded, ***"both sleep with the fish."*** Other Credit Suisse executives discussed their knowledge that Credit Suisse's practices encouraged loan sellers "to continue delivering us crap," which loans were then acquired and securitized by Credit Suisse ***"no matter how shitty production is and no matter how bad performance is."***

3. In addition to acting as the sponsor, underwriter and servicer for the Transaction, Credit Suisse was the originator of 34.4% of the securitized Loans and provided financing to originators accounting for at least one-third of the securitized

Loans. Credit Suisse consequently had intimate knowledge of the Loans and the protocols pursuant to which they were originated, acquired, reviewed and selected for securitization. The depth of Credit Suisse's actual knowledge and view of the Loans, and the flaws in its loan conduit operations, is only now coming to light from discovery in this matter. That information includes admissions from Credit Suisse's own files and the sworn testimony of former Credit Suisse underwriters, "client advocates" and "due diligence" providers (the "Confidential Witnesses" or "CW1" to "CW10"). The truth differs markedly from the specific representations made by Credit Suisse to MBIA to secure the Policy.

4. In this action, Credit Suisse hides behind general disclosures that it made in the Transaction's securities filings, concerning prospective ***market risks*** and ***potential*** risks associated with the Loans. These partial and misleading disclosures, however, were insufficient to overcome the specific and material misrepresentations that Credit Suisse made to MBIA of facts then-known by Credit Suisse to be false, pertaining to the Loans and Credit Suisse's own operations. Consistent with the true attributes of the Loans and its internal derision of its own loan conduit operations, the Loans failed miserably. Of the nearly $1 billion in second-lien Loans that Credit Suisse provided as collateral for the securities, more than 66% of the original loan balance have been charged off as of the date of this Amended Complaint, ***requiring claims payments by MBIA of more than $386 million under the Policy.***

5. Credit Suisse first solicited MBIA to participate in the Transaction in February 2007. Credit Suisse advised MBIA that the Transaction was scheduled to close in a matter of weeks, and Credit Suisse made specific oral and written

representations – and agreed to provide contractual warranties – to MBIA concerning its Loans and protocols with the ***specific intent*** to induce MBIA's participation in the Transaction. As the Credit Suisse managing director who was the primary Credit Suisse point of contact with MBIA described in a March 2007 email to ten senior Credit Suisse executives, Credit Suisse made these representations ***"to get [MBIA] comfortable with our process so that we can get them to commit to their proposed bid."*** The representations and warranties concerned each step of the Credit Suisse loan securitization conduit – and were entirely false and misleading.

6. Starting at the front end of its mortgage loan conduit, Credit Suisse misrepresented and gave false warranties concerning the underwriting standards pursuant to which the Loans were originated. The majority of the Loans were originated under "reduced document" loan programs, which Credit Suisse represented had been issued only to borrowers who met specified eligibility criteria warranting a lower disclosure requirement. Because of the reduced documentation requirements and the attendant higher risk profile for such loans, Credit Suisse understood its specific representations concerning the underwriting process were material to MBIA's decision-making process. Credit Suisse thus represented and warranted in the Pooling and Servicing Agreement that the originator underwriting standards for all of the Loans were in "accordance with customary and prudent underwriting guidelines" for the pertinent type of loan, and that in fact every loan was originated to such standards. Moreover, Credit Suisse represented that over 60% of the loans in the pool adhered to Credit Suisse's own guidelines, which it conveyed to MBIA. The guidelines that Credit Suisse represented applied to those Loans required the underwriters to (i) ensure every loan met the parameters specified in product

"matrices," (*i.e.*, summaries of the underwriting guidelines), (ii) confirm that ***each*** borrower met the "eligibility" requirements for the approved loan program, and (iii) "verify" certain representations made by borrowers in ***every*** loan program – including the reduced documentation programs (*e.g.*, employment history and residential payment history). The Credit Suisse guidelines also required the underwriters to assess for each loan "the borrower's willingness to repay the debt, the borrower's ability to repay the debt, and whether the property has sufficient security for the mortgage." Credit Suisse's general disclosures concerning reduced document loan programs, found in the Transaction's Prospectus and Prospectus Supplement, did not and do not in any way disclaim or diminish Credit Suisse's specific representations and warranties that the Loans comply with the underwriting and origination requirements of the reduced document loan program guidelines. As Credit Suisse's guidelines stated, "[w]hile many of the products are not conventional in nature, the loans must be sound and prudent for the associated risk."

7. As MBIA now knows, the overwhelming majority of Loans did not comply with the underwriting guidelines and origination standards as represented and warranted. After the close of the Transaction, as the defaults mounted, MBIA retained a consultant, through litigation counsel, to conduct a post-closing re-underwriting review of the Loans. In a review of 1,798 Loans drawn from the Transaction, MBIA discovered that nearly ***85% of the Loans did not meet the specific representations and warranties made by Credit Suisse with respect to the Loan attributes.*** Moreover, as discussed in more detail herein, discovery to date confirms that this high breach rate was not mere happenstance, but the result of deliberate disregard by Credit Suisse of the protocols it

represented it had implemented to ensure the loans it originated and acquired adhered to underwriting guidelines.

8. Credit Suisse represented and warranted, for example, that its underwriting function was insulated from its sales and trading functions to ensure that loan approval decisions were based on adherence to underwriting guidelines, and not driven by the revenue goals of the sales and trade desks. Credit Suisse also represented and warranted that it conducted an independent due diligence re-underwriting review on ***all*** Loans securitized in the Transaction, including the 34% of the pool Credit Suisse originated. Moreover, Credit Suisse represented and warranted that it engaged in post-closing or acquisition "quality assurance" or "quality control" protocols, whereby Credit Suisse "re-verif[ied] assets, income, credit worthiness, property value and compliance" on the Loans to avoid the securitization of defective loans and rectify patterns of deficiencies or the inadvertent securitization of bad loans. And Credit Suisse represented and warranted that if Credit Suisse became aware that any defective Loans had been securitized, Credit Suisse would promptly disclose the defective Loans to the Transaction participants and "be responsible for repurchasing [those] mortgage loans from the Trust." All these representations were intended to and did persuade MBIA that the protocols were implemented for the benefit of the securitizations and – based upon the evidence adduced to date – all were false and misleading.

9. The Confidential Witnesses have testified, for example, that contrary to Credit Suisse's representations that it maintained separate sales and credit/underwriting operations, Credit Suisse sales account executives routinely interfered with the underwriting, due diligence and credit and compliance operations, directing the

approval or acquisition of loans that did not meet underwriting guidelines or were procured through borrower or broker fraud. When reviewers identified loans that did not meet underwriting guidelines, Credit Suisse systematically overrode those findings, under the façade of "business decisions", and deemed the loans compliant, or directed its contractors to do so, in order to perpetuate the flow of Loans, even knowing that they did not meet guidelines. In other words, the underwriting and due diligence performed by Credit Suisse was not intended to identify defects in the loans and thus prevent them from being securitized, but rather to create a façade of diligence that would conceal defects and churn the resulting defective loans through Credit Suisse's securitization machine.

10. Credit Suisse internal emails, obtained through disclosure, reflect the corrupt nature of its internal due diligence and "exceptions" review processes. The emails corroborate Confidential Witness testimony, demonstrating that contracted due diligence reviewers notified Credit Suisse of underwriting and origination defects in Loans they were reviewing – including evidence of borrower and/or origination fraud in the form of unreasonable overstated incomes – but that Credit Suisse executives, including trading desk executives, directed the acquisition of the loans in spite of the known defects.

11. Credit Suisse's documents further reveal that its executives knew that Credit Suisse's due diligence operations were deficient, but did not address the failings. Moreover, contrary to its representation to MBIA, Credit Suisse did not in fact conduct due diligence on all the Loans, and indeed conducted no independent due diligence review of the Loans acquired through its wholesale channel. Significantly, Credit Suisse's records show that it conducted substantially less than 100% due diligence

on Loans originated by New Century Mortgage Corporation ("New Century"), an originator that had filed for bankruptcy protection. As Credit Suisse acknowledged in the Transaction Prospectus, the New Century Loans therefore were more susceptible to deviations from underwriting guidelines. Thus, it was particularly important that Credit Suisse conduct the 100% due diligence review of New Century Loans, and particularly egregious that it did not.

12. Moreover, discovery has shown that Credit Suisse's actual practices directly contravened its represented commitment to conduct quality assurance reviews aimed at identifying defective Loans, to provide prompt notice of defective Loans to the Trust and to MBIA, and to repurchase from the Trust any defective Loans. First, Credit Suisse adopted an ***undisclosed*** policy to repurchase defective loans from securitizations ***only*** to the extent Credit Suisse was "simultaneously selling them back to the originator." This concealed policy not to repurchase breaching loans unless it could simultaneously sell the loans back to the originator was not a valid condition or limitation on its compliance with its repurchase obligation, and the concealed intent to not repurchase all defective loans was fraudulent, in light of Credit Suisse's affirmative representation of intent to assure repurchases.

13. Second, the Credit Suisse trading desk instructed Credit Suisse's quality control reviewers to "avoid the previous [quality control] approach by which a lot of loans were qc'd regardless of opportunity for put-back ... creating a record of possible rep/warrant breaches in deals." Instead of performing quality control, as represented, to identify individual loan defects and patterns of deficiencies, Credit Suisse manipulated its quality control review of loans to try to avoid identifying facts and defects that would

trigger its repurchase obligations from securitizations.

14. Third, Credit Suisse routinely (i) made repurchase demands against originators for defective loans Credit Suisse identified, many of which it had already, or subsequently, sold into securitizations, (ii) settled those repurchase demands and (iii) incredibly, rather than contribute the proceeds of such repurchases to the securitization trusts where the loans resided, pocketed the recoveries without providing any notice to the trusts. These practices allowed Credit Suisse to circumvent its own repurchase obligations and obtain millions in incremental revenue to fund the bonuses of its trading desk, leaving the securitizations – and here, MBIA – to bear the losses.

15. Credit Suisse followed these concealed and misrepresented underwriting, due diligence, quality control, and repurchase practices at the time it originated, acquired, and securitized the Loans in the Transaction. As its documents confirm, ***at the time Credit Suisse made its representations to MBIA about the Loans and its business operations,*** Credit Suisse knew, but did not disclose to MBIA, that it had obtained quality control results showing that hundreds of the securitized Loans breached the representations and warranties that Credit Suisse made to MBIA, and had concluded that the Loans were non-compliant with applicable underwriting guidelines and origination standards. Credit Suisse also had already issued repurchase demands to the loan originators on more than ***five hundred*** Loans that it thereafter securitized in the Transaction. In the words of a senior Credit Suisse executive, by early 2007 Credit Suisse "already knew" that it had "systemic problems in ... compliance and credit." At the same time, Credit Suisse was inducing MBIA to participate in the Transaction with its specific representations concerning, among other things, its "[d]isciplined origination and

purchase strategy. "

16. With respect to Loans that Credit Suisse acquired from New Century, moreover, at the time of the Transaction Credit Suisse ***already had issued*** more than 200 repurchase demands with respect to Loans originated by New Century, which Loans Credit Suisse ***then*** securitized into the Transaction. Contemporaneous with its repurchase demands on New Century, as of March 2, 2007 – one month before including those Loans in the Transaction – Credit Suisse had extended to New Century a $1.3 billion warehouse credit line to finance the origination of loans. Credit Suisse thus fraudulently concealed from MBIA ***known facts*** that the New Century loans it securitized in the Transaction did not comply with its representations and warranties, while issuing a partial and misleading general disclaimer about prospective risks in the Prospectus Supplement. Moreover, by means of its extension of warehouse financing to New Century and other warehouse lenders who provided Loans to the Transaction, Credit Suisse perpetuated its double-dipping revenue model, funding loans by the very originators against which it was making repurchase demands, and generating for itself a discount on those defective loans that it sold into securitizations at full price, without disclosing their defects.

17. Credit Suisse concealed its true practices before the close of the Transaction, and has continued to cloak its practices through discovery in this case. At the outset of this matter, and for months after the Complaint was filed, Credit Suisse took the position that it had made no repurchase demands on originators with respect to any of the Loans. Only after MBIA discovered the demands through productions made by third-party originators did Credit Suisse acknowledge their existence.

18. Having induced MBIA to enter into the Insurance Agreement and issue the Policy with false and misleading representations and warranties, Credit Suisse then compounded the harm by refusing to comply with and frustrating the contractual covenants and remedy it gave to MBIA in the Insurance Agreement. Specifically, Credit Suisse committed to provide prompt notice to MBIA of any Loans known by Credit Suisse to violate its warranties concerning the Loans (the "Loan Warranties") and that, upon the discovery of any such defective Loans by any party, Credit Suisse would cure or repurchase the breaching Loans from the Trust. These covenants and the repurchase remedy reflect and effectuate the parties' bargain that Credit Suisse assumed the risk that any Loan did not conform to its represented and warranted attributes. Pursuant to this bargain and the express terms of the Insurance Agreement, MBIA demanded that Credit Suisse repurchase the thousands of breaching Loans identified by MBIA's litigation consultants.

19. In willful disregard and frustration of its contractual covenants, Credit Suisse refused to repurchase ***any*** of the breaching Loans identified by MBIA prior to the filing of this action. Credit Suisse demonstrated its bad faith in response to MBIA's pre-litigation inquiries about Credit Suisse's repurchase of defective loans. Prior to bringing this lawsuit, MBIA requested that Credit Suisse provide copies of the files relating to the origination of the Loans – a right MBIA obtained at closing, pursuant to the Insurance Agreement – so that MBIA's consultants could re-underwrite the Loans for breaches of the warranties provided at closing. Consistent with Credit Suisse's baseless policy of "hold[ing] off on buying [breaching loans] out of the deals until [the originators] agree to repurchase" them, the Credit Suisse managing director responsible

for its trading desk told MBIA that Credit Suisse would not provide all of the loan files, and that MBIA should just "sue Credit Suisse now." Credit Suisse knew that if the files were reviewed, Credit Suisse would be obligated to repurchase a large number of the Loans, which it had no intention of doing voluntarily. To derail MBIA's request, the same Credit Suisse managing director denied that Credit Suisse had possession of certain of the Loan files, a position that was proven false by Credit Suisse's production of such files during discovery in this matter. Thereafter, and only after disclosure in this action revealed that Credit Suisse had made its own repurchase demands on sellers from which Credit Suisse acquired the Loans based on the same kinds of breaches and on some of the same Loans identified by MBIA, did Credit Suisse agree to repurchase a mere forty-nine of the thousands of defective Loans identified by MBIA.

20. In sum, the Loans that Credit Suisse sold into the Transaction, and the policies and practices Credit Suisse employed in connection with the Transaction, were not remotely similar to the loans or business practices represented by Credit Suisse prior to the Transaction, and which it then contractually warranted. Had Credit Suisse truthfully represented the actual attributes of the Loans, as well as disclosed its actual business operations – which were designed to conceal defects and securitize Loans, notwithstanding Credit Suisse's actual knowledge of systemic credit and compliance failures – MBIA would not have entered into the Insurance Agreement or issued its Policy. Under New York common law and Insurance Law, Credit Suisse's material misrepresentations, material breaches of contract, and material breaches of warranties each entitled MBIA to monetary and/or equitable relief sufficient to place it back into the position it would be in had it not entered into the Insurance Agreement and issued the

irrevocable Policy. That relief includes the claims payments that MBIA has made, or will be liable to make in the future, under the fraudulently induced Policy, or pursuant to the contractual obligations breached by Credit Suisse, as well as its fees, costs, and other expenses incurred in connection with the Transaction.

THE PARTIES

21. MBIA is a New York corporation with its principal place of business at 113 King Street, Armonk, New York 10504.

22. DLJ is organized under the laws of the State of Delaware and maintains its principal place of business in New York, New York. DLJ is, or was at all relevant times herein, a wholly-owned subsidiary of Credit Suisse Group.

23. CS Securities is organized under the laws of the State of Delaware and maintains its principal place of business in New York, New York. CS Securities is, or was at all relevant times herein, a wholly-owned subsidiary of Credit Suisse Group.

24. SPS is organized under the laws of the State of Utah, and maintains its principal place of business in Salt Lake City, Utah. SPS is, or was at all relevant times herein, a wholly-owned subsidiary of Credit Suisse Group.

JURISDICTION AND VENUE

25. This Court has personal jurisdiction over DLJ, CS Securities and SPS pursuant to CPLR §§ 301 and 311. Further, in the Insurance Agreement, DLJ and SPS irrevocably submitted to the jurisdiction of any court in the State of New York located in the City and County of New York.

26. Venue is proper in New York County pursuant to CPLR §§ 503(a) and 503(c) because each of DLJ and CS Securities has its principal office within New

York County and therefore is deemed to reside therein. Further, in the Insurance Agreement, DLJ and SPS agreed to waive any defense of improper venue.

FACTUAL ALLEGATIONS

I. CREDIT SUISSE'S SECURITIZATION PROGRAM

27. Credit Suisse Group is a Swiss multinational financial services company headquartered in Zurich, which operates in the United States through its wholly-owned subsidiary CS Securities – a large broker-dealer registered with the United States Securities and Exchange Commission ("SEC") and licensed with the Financial Industry Regulatory Authority ("FINRA"). Through its trade desk in New York, CS Securities directed Credit Suisse's residential mortgage loan securitization operations in the United States.

28. Credit Suisse provided a concise summary of its RMBS securitization process in the Prospectus Supplement, dated April 27, 2007 ("Prospectus Supplement"), issued in connection with the Transaction:

> In the normal course of its securitization program, the sponsor [Credit Suisse] acquires mortgage loans from third party originators and through its affiliates. The sponsor or its affiliates structure securitization transactions in which the mortgage loans are sold to the depositor and the depositor issues the securities supported by the cash flows generated by the mortgage loans and secured by the mortgage loans. The sponsor will make certain representations and warranties to the depositor and the indenture trustee regarding the mortgage loans and if such representations and warranties are breached, the sponsor may have an obligation to repurchase or substitute such mortgage loans from the depositor (or directly from the indenture trustee). To mitigate these risks, however, to the extent the mortgage loans being securitized have been originated by third parties, the sponsor will generally obtain appropriate representations and warranties from these third parties upon the acquisition of such mortgage loans.

29. Starting as early as 2000, Credit Suisse built a fully-integrated

securitization program that afforded Credit Suisse control over the financing, acquisition, servicing and securitization of residential mortgages loans.

A. Credit Suisse Built Its RMBS Mortgage-Loan Conduit

30. In 2000, Credit Suisse acquired the investment bank, Donald, Lufkin & Jenrette (DLJ) for $11.5 billion, including DLJ's subsidiary, DLJ Mortgage Capital, Inc. This acquisition, according to Credit Suisse, "created a single firm that continues to lead the residential mortgage-backed securities market," and helped create an "MBS division that remains unparalleled on Wall Street." DLJ became Credit Suisse's primary vehicle, wholly-controlled by Credit Suisse, for the origination, aggregation, and securitization of residential mortgage loans. From 2003 to 2006, Credit Suisse securitized a total of $121 billion worth of loans through DLJ Mortgage Capital.

31. To enable the growth of its RMBS business, Credit Suisse developed its RMBS Conduit operations, and built a technology-enabled platform that permitted it to develop three different "channels" for the origination and aggregation of loans for securitization: First, Credit Suisse acquired loans from bulk sellers, which offered for sale on the open market portfolios of previously originated loans, bid on and purchased by Credit Suisse. Second, Credit Suisse acquired loans from correspondent sellers, through "loan-by-loan" or "minibulk" purchases of previously originated loans, originated by small and mid-sized lenders to Credit Suisse's specifications. And finally, Credit Suisse acquired loans through wholesale – mortgage broker origination operations. For wholesale loans, mortgage brokers submitted loan applications for review and/or underwriting through Credit Suisse's Consolidated Web Site ("CWS"), which allowed correspondent lenders to log in, check pricing, and lock loans, representing a binding commitment of both parties. Credit Suisse then oversaw the underwriting and funding of

these loans through its “Fulfillment Centers.”

B. Credit Suisse Financed Originators

32. In a “warehouse lending” arrangement, a bank extends a line of credit to a third-party loan originator to fund the issuance of mortgage loans. Funds can be provided by the lending bank either at the time the loan is closed and simultaneous with the completion of all loan documents (*i.e.* “wet funding”), or after the lending bank has had the opportunity to review the loan documents (*i.e.* “dry funding”). Credit Suisse engaged in both dry-funded and wet-funded warehouse lending.

33. Credit Suisse had allocated $14 billion to its warehouse lending relationships by early 2007, which encompassed warehouse lending relationships with a number of originators of loans in the Transaction, including New Century, Taylor Bean and Whitaker (“Taylor Bean”), and Alliance Bancorp, who originated, between them, approximately one-third of the securitized Loans.

34. As a condition of obtaining warehouse credit lines, these originators and others provided Credit Suisse with disclosures concerning their origination practices and procedures, including performance characteristics of loans they originated. Credit Suisse tracked the performance of its warehouse originators through a database called the Web-Promerit system, described by Credit Suisse as the “tracking system that carries out all Warehouse functionality.”

35. Credit Suisse used the Web-Promerit system to compile all information about each warehouse lender, allowing it to accumulate the “business volume and performance data of each Customer. . . (*e.g.*, length of time that loans remain outstanding against the line, line amount increases, loans repurchased or with document exceptions, delivery delays/issues, loan rejects).” According to Credit Suisse, this

information regarding trends and other business performance factors was "used to identify issues and to determine any additions or changes to monitoring or other required response actions." Where this monitoring identified "indications of abusive lending practices," or other concerns, Credit Suisse purportedly maintained an Observation List, which, if problems were confirmed, fed into a general originator watchlist. In addition, each warehouse lender was reviewed and certified on a quarterly basis, and monitoring issues were discussed during bi-weekly warehouse committee meetings.

36. Thus, in connection with these warehouse lending relationships, Credit Suisse developed a detailed understanding of its warehouse originators' business practices. Based on these monitoring programs, by early 2007, Credit Suisse knew that its warehouse originators, including New Century, Taylor Bean, and Alliance Bancorp (among others who originated loans securitized in the Transaction), had systematically abandoned their purported underwriting guidelines, originated loans in disregard of prudent and proper origination standards, and engaged in predatory lending practices.

37. Notwithstanding Credit Suisse's knowledge that its warehouse lending had facilitated the improper origination of loans, Credit Suisse continued extending warehouse credit to these originators, funding loans in reckless disregard of their improper origination practices. For example, as of March 2, 2007, Credit Suisse had extended to New Century a $1.3 billion credit facility. That same month Credit Suisse made a repurchase demand on New Century to repurchase more than 300 loans, with a principal balance of more than $20 million for early payment defaults (*i.e.*, the failure of the borrower to make required payments during the first few months of the origination of the loan). As Credit Suisse knew, early payment defaults or "EPDs" are red flags of

improper origination, and in particular a borrower's inability to repay a loan and/or fraud in connection with the loan origination. Credit Suisse nonetheless included in the Transaction at least 182 of the Loans submitted to New Century for repurchase.

38. Along with New Century, Credit Suisse similarly extended a $500 million warehouse credit line to Taylor Bean (which originated 1,325 loans in the Transaction), despite the fact that Credit Suisse knew Taylor Bean to be engaged in improper origination and underwriting practices, and despite the fact that Credit Suisse internally disparaged Taylor Bean's origination practices, referring to the bank as "our amateurs." Likewise, Credit Suisse extended a $500 million warehouse line of credit to Alliance Bancorp, which originated more than 600 loans in the Transaction, despite Credit Suisse's knowledge that Alliance Bancorp had demonstrated failings in loan and quality control performance. Credit Suisse's intentional or reckless extension of warehouse credit to originators known to engage in improper origination and underwriting of loans – and its reckless acquisition and securitization of those loans – inevitably led to Credit Suisse's origination, acquisition, and securitization of defective loans, including in the Transaction.

39. Credit Suisse took little or no action to correct the practices of its warehouse lenders, but rather exploited their improper and illegal origination practices and sought in 2007 (contemporaneous with the Transaction) ***to expand*** upon its reckless warehouse lending operations. A February 2007 flyer created by Credit Suisse for prospective warehouse lenders touted Credit Suisse as "one of the top 5 national warehouse lenders... [w]ith more than $20 billion in approved facilities;" and touted, among the "Credit Suisse advantages," "[i]ncentive based pricing to reduce [originator]

financing costs" and "[e]arly funding programs to provide you extra funding capacity for eligible collateral."

C. Credit Suisse Acquired Discredited Servicer Operations

40. As part of its integrated RMBS Conduit, Credit Suisse also developed the capacity to service residential mortgages once acquired (*i.e.*, collect monthly payments from borrowers and take action as necessary to obtain recoveries on defaulted loans). In 2005, Credit Suisse acquired Select Portfolio Servicing, Inc., which had recently changed its name from Fairbanks Capital Corporation ("Fairbanks"). Select Portfolio Servicing ("SPS") became Credit Suisse's wholly-owned subsidiary for servicing residential mortgage loans.

41. As Credit Suisse's wholly-controlled in-house servicer, SPS gave Credit Suisse complete control over, and access to information concerning, securitized loans assigned to SPS for servicing. In particular, Credit Suisse had access to servicing notes and delinquency data for each of the loans serviced by SPS. These servicing notes, which record the servicer's interactions with borrowers, contain information bearing on the borrowers' compliance with terms of the Mortgages, including whether the borrower occupied the mortgaged property as a primary residence. Delinquency data provides a key indicator of origination and underwriting defects. Accordingly, this information about the poor performance of securitized loans provided Credit Suisse with critical information about pervasive defects with loans that also plagued loans in the Transaction but went undisclosed to MBIA.

D. Credit Suisse Profited Significantly From RMBS Securitizations

42. Credit Suisse was well motivated to perpetuate its flow of mortgages through its loan conduit into securitizations. Credit Suisse's RMBS business

allowed Credit Suisse to claim substantial profits in the years preceding 2007, and its executives to earn remarkable compensation and bonuses. And in 2007, absent further securitization and sales, Credit Suisse stood exposed to enormous losses if it was left holding the defective loans it had originated or acquired.

43. In 2006, Credit Suisse claimed to be the fourth largest issuer of US mortgage-backed securities, "underwriting 98 transactions with a total volume of over $74 billion." This represented an increase of nearly 2000% over its five securitizations in 2000. And by 2007, the volume of Credit Suisse's RMBS business overshadowed its revenues and income. In its 2006 annual report, for example, Credit Suisse reported net revenues of approximately $37 billion and net income of $9 billion, with "RMBS Proceeds" of more than $59 billion and gains of $110 million

44. As described in more detail below, Credit Suisse produced these financial statements to MBIA as part of MBIA's due diligence for the Transaction, and warranted in the Insurance Agreement that the amounts disclosed therein were not false or misleading. But the financial disclosures were built upon fraudulent practices encompassing the entirety of Credit Suisse's RMBS business, including the knowing securitization of defective loans and fraudulent accounting practices. For example, in 2006 Credit Suisse claimed $36 billion in "RMBS Proceeds," and a corresponding gain of $67 million on its RMBS transactions. Credit Suisse failed, however, to properly account, under prevailing accounting standards, for contingent liabilities associated with its contractual repurchase obligations on defective loans it had securitized. Credit Suisse's intentional or reckless disregard of these contingent liabilities, of which Credit Suisse had knowledge, based upon the pervasive underwriting defects amongst the

securitized loans, resulted in Credit Suisse substantially overstating its profits and understating its liabilities. As a result, Credit Suisse's represented and warranted financial statements, supplied to MBIA and upon which MBIA relied in conducting its due diligence and agreeing to issue the Policy, were materially false and misleading.

II. CREDIT SUISSE FRAUDULENTLY INDUCED MBIA TO ISSUE THE POLICY

A. Credit Suisse Solicited the Policy, and MBIA Made Reasonable Due Diligence Inquiries of Credit Suisse Before Entering Into the Transaction

45. In February 2007, Credit Suisse approached MBIA about issuing the Policy. MBIA had not previously issued an insurance policy for an RMBS transaction sponsored by Credit Suisse. Accordingly, MBIA performed due diligence on Credit Suisse and its business practices as a pre-condition of MBIA's agreement to issue the Policy. In connection with this due diligence, MBIA asked Credit Suisse to make a presentation about specific practices within Credit Suisse's RMBS business operations, so that MBIA could become comfortable with the integrity of Credit Suisse's operations before agreeing to issue the Policy. This "diligence meeting" (as both Credit Suisse and MBIA referred to it) took place on or about March 21, 2007.

46. MBIA provided a written agenda for that diligence meeting, requiring representations from Credit Suisse on various subjects that were material to MBIA's decision of whether to insure the Transaction. In particular, MBIA specifically sought representations from Credit Suisse as to (i) Credit Suisse's "Origination and Aggregation" practices, including the sources of loans, their product types, and Credit Suisse's certification and review of originators; (ii) Credit Suisse's "Underwriting," including how the loans were underwritten, the loan "due diligence process," including

Credit Suisse's sampling procedures and the use of 3rd party underwriters, and the appraisal/valuation process; (iii) Credit Suisse's "compliance" practices, including "testing procedures" for quality control purposes and compliance with state and federal laws; and (iv) the "portfolio performance" of prior securitizations.

47. Disclosure has demonstrated that Credit Suisse was (i) fully aware of the significance of this diligence meeting, and (ii) understood that MBIA's inquiries constituted the appropriate investigation for a financial guarantor, consistent with industry standards for evaluating and issuing such policies. Credit Suisse intended for MBIA to rely upon Credit Suisse's representations at that diligence meeting and in follow-up to that diligence meeting in deciding whether to participate in the Transaction. The managing director at Credit Suisse who was the primary point of contact with MBIA and Credit Suisse negotiator for the Transaction sent an email to ten Credit Suisse executives asking them to attend the "shelf/conduit ***diligence meeting with MBIA,***" describing the meeting as of "high" importance, and acknowledging that the purpose of the meeting was ***"to get [MBIA] comfortable with our process so that we can get them to commit to their proposed bid."***

B. Credit Suisse Responded to MBIA's Due Diligence Inquiries With False and Misleading Representations About Its RMBS Business Practices

48. A Credit Suisse director, the Head of Credit Policy and Underwriting, took the lead in preparing Credit Suisse's presentation responding to MBIA's due diligence requests, for discussion at the diligence meeting. As the focus for that meeting, he prepared a pitchbook presentation entitled "Presentation About Credit Suisse's Mortgage Business," (the "Pitchbook").

49. The Pitchbook contains detailed representations, responsive to

MBIA's due diligence inquiries and agenda topics, concerning Credit Suisse's RMBS business practices. As specified below, the Pitchbook is replete with misrepresentations about Credit Suisse's RMBS business practices, in regard to each of the topics upon which MBIA required disclosures from Credit Suisse as MBIA's due diligence for the transaction. At the diligence meeting, Credit Suisse elaborated upon its Pitchbook to reiterate and emphasize the integrity of its business practices. In response to MBIA's due diligence requests, Credit Suisse also presented MBIA with other powerpoint "decks" containing false and misleading information, responsive to MBIA's diligence requests, knowing and intending that MBIA would rely on the disclosures to decide whether to participate in the Transaction.

50. In this action, Credit Suisse has repeatedly sought to shield itself from its fraudulent representations by reference to a legally ineffective and disingenuous disclaimer, tucked in 6-point font on the bottom of page. Rather than protecting Credit Suisse against liability, this legally ineffective disclaimer placed on materials that Credit Suisse knew and intended were for use by MBIA in conducting its "diligence" of Credit Suisse's operations, is evidence that Credit Suisse knew the Pitchbook contained false and misleading representations. In fact, as noted, Credit Suisse used these materials, in its words, "so that we can get [MBIA] to commit to their proposed bid."

1. Credit Suisse Misrepresented its Seller Approval and Monitoring Practices

51. MBIA specifically requested disclosures from Credit Suisse about its methods for selecting, evaluating, and monitoring the originator "sellers" from which it acquired loans. Credit Suisse's seller approval and monitoring processes were material to MBIA's consideration of whether to issue the Policy, because originators who comply

with legal, prudent, and proper origination practices and underwriting guidelines – even if they are reduced documentation loan programs – are more likely to originate high quality loans. Thus, a reasonable insurer is more likely to issue a financial guaranty for an RMBS transaction if there is adequate oversight and monitoring of the loan originators' practices by a reputable securitization sponsor.

52. In the Pitchbook and at the diligence meeting, Credit Suisse represented to MBIA that it had a comprehensive process by which it evaluated prospective sellers before Credit Suisse would purchase or originate their loans, and that Credit Suisse then monitored those sellers for indications that their originated loans did not meet Credit Suisse's standards, so as to avoid the acquisition and securitization of defective loans.

53. In particular, Credit Suisse represented that before agreeing to purchase loans from a seller, it undertook a review of the "size, experience, and integrity" of each applicant, as well as a review of each seller's "balance sheet" and "income statement," and then conducted a legal and regulatory review, checked references, and considered the "operational capabilities" of the seller. Credit Suisse also represented that it monitored its sellers using "customer scorecards," and "delinquency tracking" tools, utilizing a "watch list" and "seller reviews" to assure that if there were indications that a seller was not properly originating loans, acquisitions from the seller would be discontinued and their loans would not be securitized.

54. Consistent with those representations, according to Credit Suisse's disclosed policies, wholesale sellers (*i.e.*, brokers) were supposed to be approved based upon a documented application protocol and monitored for quality control purposes,

subject to placement on a "watch list" for any of a number of reasons, "including but not limited to, poor loan performance, excessive unsatisfied repurchase requests [or] negative QC [quality control] results." Once placed on a watch list "every loan" from the seller was supposed to be "subjected to heightened scrutiny in underwriting." And the relationship was supposed to be terminated if the concerns leading to the watch list designation were "validated" by Credit Suisse. Senior executives of Credit Suisse, including its "Head of Conduit, Head of Originations, Head of Underwriting, Head of Fulfillment, Head of Client Management Group, and Heads of Sales" were supposed to meet on a regular basis to "discuss matters of policy and client specific issues" related to the watch list, including the decision whether or not to terminate sellers "if the issues remain[ed] unaddressed long term, or worsen[ed.]" All correspondent sellers were purportedly subject to similar certification and monitoring protocols.

55. Disclosure to date shows that Credit Suisse's representations about its seller certification and monitoring practices were false and misleading, because Credit Suisse's actual practices materially deviated from its represented procedures for certifying, monitoring, and evaluating sellers. In fact, Credit Suisse ignored indications that its loan sellers were systematically originating loans in an improper manner, which in turn increased the likelihood that defective loans would end up in the HEMT 2007-2 securitization. Credit Suisse's watch list was little more than a fig leaf for originators with known origination problems, and became a way station for sellers that Credit Suisse knew were originating loans that failed quality control and performed poorly, but from which Credit Suisse continued to acquire loans for securitization. Lenders known by Credit Suisse to be engaged in imprudent, illegal, or improper origination practices were

placed on the watch list and remained there for months as the quality of their loans continued to deteriorate, and as Credit Suisse continued to securitize their improperly originated loans. Even when Credit Suisse did terminate sellers, it in some instances continued to securitize loans (including Loans securitized in the Transaction) that were originated by those terminated sellers.

56. More specifically, in March 2007, at the same time that Credit Suisse was soliciting the Policy from MBIA with representations about the integrity of its seller certification and monitoring protocols, a Credit Suisse executive directly involved with negotiations between Credit Suisse and MBIA, Credit Suisse's Director of Second Loan Trading, internally identified problems with four sellers – Resource Bank, Meridias Bank, Wall Street Mortgage Bankers, and New York Mortgage Company – who together originated approximately 750 of the loans in the Transaction. He asked other Credit Suisse executives "What should we do about these sellers?" noting that Credit Suisse had a "large amount of delq loans from these [four] sellers in inventory and we still purchase loans from them." He then proposed that Credit Suisse "cut them off or halt funding." Credit Suisse's Managing Director for Non-Agency Trading expressed personal familiarity with two of the originators, acknowledging the "bad performance" of Meridias Bank, and noting that Resource Bank routinely sold loans to Credit Suisse that were "complete garbage. ***Utter complete garbage.***"

57. More broadly, however, the Managing Director for Non-Agency Trading acknowledged "the more general problem" that Credit Suisse's "seller watch list" and monitoring practices were "completely biased" in favor of the continued acquisition and securitization of bad loans, and that Credit Suisse did not have

appropriate criteria in place for terminating sellers from its watch list. Credit Suisse's Director of Second Loan Trading inquired a week later as to whether the executives had "done anything regarding these sellers yet." No action had been taken. Instead, the Managing Director for Non-Agency Trading recommended that the sellers should be referred to the watch list process, which he had just described as "biased" and a "problem."

58. Thus, with knowledge that these sellers were originating "utter, complete garbage," Credit Suisse nonetheless intentionally or recklessly continued to securitize defective loans originated by those sellers, even though the sellers' loans routinely failed quality control review and generated high numbers of defaults. Of the loans originated by the four sellers identified by Credit Suisse's Director of Second Loan Trading and securitized in the Transaction, MBIA's litigation consultants have reunderwritten 570 and found that 430 of them (75%) breach the Loan Warranties.

59. Credit Suisse's intentional or reckless securitization of defective loans was not limited to these four sellers. As of April 30, 2007, Credit Suisse had 269 active originators on its watch list, including more than 100 originators that sold to Credit Suisse more than 2,600 (15%) of the Loans securitized in the Transaction. Each of these sellers had already demonstrated to Credit Suisse serious deficiencies in its origination practices. According to Credit Suisse's internal policies, each of the loans sold by these watch list originators should have specifically undergone quality control re-underwriting review prior to securitization. That policy, however, was disregarded by Credit Suisse.

60. By April 2007, the month the Transaction closed, Credit Suisse knew that as a result of its improper practices, its RMBS Business was on the precipice of

failure. Credit Suisse's RMBS Conduit managing director and Credit Suisse's senior-most executive of its RMBS Conduit Business emailed each other about the dire state of the loans in Credit Suisse's RMBS Conduit. "[W]hat does our loan conduit and the Titanic have in common?" one executive asked. Five minutes later, the other responded, "both sleep with the fish."

61. Credit Suisse thus falsely and misleadingly represented to MBIA that Credit Suisse employed seller certification, evaluation, and monitoring techniques to assure the quality of the loans, and used its watch list and other tools to assure that the sellers from which Credit Suisse obtained the loans employed "appropriate standards for origination practices" and properly reflected Credit Suisse's purported "[d]isciplined origination and purchase strategy." Disclosure to date demonstrates that while representing that it used these tools to assure the quality of the loans it securitized, Credit Suisse did not disclose that its own executives viewed the watch list as "biased," that Credit Suisse intended to securitize loans, in the Transaction, generated by originators that Credit Suisse viewed as producing "utter garbage," and that the Loans overwhelmingly came from sellers that Credit Suisse had already identified, and placed on its watch list, for systematic underwriting and origination deficiencies. Furthermore, Credit Suisse had already demanded that certain of these originators, known to be engaged in deficient origination practices, repurchase hundreds of the Loans that Credit Suisse securitized in the Transaction.

62. These misrepresentations and omissions were material to MBIA's consideration of whether to issue the Policy. MBIA would not have issued its Policy, and no reasonable insurer would issue a policy, guaranteeing the performance of a portfolio

of loans knowing that the loans overwhelmingly were originated by processes that identified and yet ignored systematic origination deficiencies. Moreover, the fact that Credit Suisse (as admitted) implemented its seller evaluation processes in a "biased" manner, and overlooked the production of "garbage" loans, would have been a material consideration for MBIA and any reasonable insurer in deciding whether or not to rely upon the integrity of Credit Suisse's other business practices.

2. Credit Suisse Misrepresented its Own Underwriting Practices

63. Credit Suisse represented that DLJ originated or acquired approximately 35% of the securitized Loans through its "wholesale channel," *i.e.*, the loans were processed by mortgage brokers but underwritten and originated by Credit Suisse. As a condition to issuing the Policy, MBIA required Credit Suisse's assurances that it adhered to its underwriting standards when originating these loans, and that its underwriting practices were legal, proper, and prudent. Credit Suisse responded to that request with false and misleading representations concerning its underwriting practices and its Credit and Compliance Organization, which oversaw the underwriting and acquisition of wholesale loans.

64. In the Pitchbook, Credit Suisse represented to MBIA that it had a "Credit and Compliance Organization" that took responsibility for underwriting decisions on wholesale loans. Credit Suisse further represented that it abided by a "credit philosophy" focusing on "risk management," including a "disciplined origination and purchase strategy," and a "philosophy to purchase/originate loans that demonstrate a borrower's ability and willingness to repay debt." Credit Suisse further represented that its credit and compliance organization focused on fraud prevention. These representations were false and misleading.

65. Moreover, at the March 2007 "diligence meeting" between MBIA and Credit Suisse, Credit Suisse represented to MBIA that it underwrote and acquired loans in accordance with Credit Suisse guidelines or guidelines that met Credit Suisse's standards. Credit Suisse also represented that the loans acquired from the originator Taylor Bean through the bulk channel, and the "minibulk, loan-by-loan and wholesale loans were all underwritten to our guides." All told, Credit Suisse represented that over 60% of the Loans adhered to its own guidelines, which it conveyed to MBIA.

66. The Credit Suisse underwriting standards require the underwriters to (i) ensure every loan met the parameters specified in product "matrices", (ii) confirm that ***each*** borrower met the "eligibility" requirements for the approved loan program, which was particularly important for reduced document loan programs that purportedly were reserved for special classes of borrowers, and (iii) "verify" certain representations made by borrower in every loan program – even reduced documentation programs. In addition, guidelines required the underwriters to assess for each loan "the borrower's willingness to repay the debt, ***the borrower's ability to repay the debt, and whether the property has sufficient security for the mortgage.***" Moreover, for all stated income loan programs, the guidelines explicitly recited that the **"[i]ncome stated must be reasonable for the position."** As Credit Suisse's guidelines expressly stated, "[w]hile many of the products are not conventional in nature, the loans must be sound and prudent for the associated risk."

67. Credit Suisse also represented that with respect to underwriting decisions on the wholesale loans originated by Credit Suisse, "Credit Suisse senior underwriters make final loan decisions, not contracted due diligence firms" and that "Sale

and Trading groups do not have credit/underwriting authority." These representations were false and misleading.

68. In sum, the disclosure had to date shows that, contrary to its representations, Credit Suisse's Credit and Compliance Organization intentionally or recklessly facilitated the origination, acquisition, and securitization of loans containing known underwriting defects, originated through improper procedures, and in disregard of applicable underwriting guidelines and legal, prudent, and proper origination standards. Credit Suisse designed its credit and compliance operations to ***conceal*** defects in loans it acquired, rather than to prevent them from being securitized, and intentionally concealed or recklessly ignored evidence of fraud or origination defects in the Loans.

69. Credit Suisse contracted out the underwriting for its self-originated wholesale loans to third-party firms (the "Underwriting Contractors") that operated fulfillment centers where underwriting was performed. Confidential witnesses formerly employed by these firms have revealed that Credit Suisse's wholesale loans were underwritten and approved without any meaningful review or control by Credit Suisse senior underwriters. Whereas loans that were ***rejected*** by the Underwriter Contractors were routinely reviewed, and the rejections overridden, by senior Credit Suisse employees, loans that were ***approved*** by the Underwriting Contractors were not underwritten by Credit Suisse underwriters..

70. Credit Suisse employees only took an active role in closing its originated loans when third-party underwriters identified red flags that should have resulted in ***denial*** of the loan applications. In many of those cases, Credit Suisse employees – such as account executives, or sales managers, earning hundreds of

thousands of dollars per year on commission to close loans, not senior underwriters – interceded with loan brokers and borrowers to generate fraudulent supporting materials and to pressure the Underwriting Contractors to approve and close the loans, regardless of underwriter findings that the loans should not be approved. In other cases, Credit Suisse employees intentionally or recklessly disregarded evidence that the loan applications did not meet applicable origination and underwriting standards, and instructed the Underwriting Contractors that the defective applications "met Credit Suisse guidelines" and should be approved.

71. According to CW1, a former employee of a Credit Suisse Underwriting Contractor, Credit Suisse account executives regularly inserted themselves in the underwriting process in order to pressure Underwriting Contractors to approve defective loans for funding, and regularly advised Underwriting Contractors to accept obviously fraudulent documents, such as gift letters that appeared to be written by children and asset verification letters that were not genuine, as a basis for clearing loans. CW1 described this practice as "pervasive," with Credit Suisse account executives encouraging underwriters to "just sign off" on defective loans. Even more, this former employee testified in deposition that Credit Suisse permitted exceptions to the underwriting guidelines that were inappropriate in order to facilitate the closing of loans.

72. According to CW2, another former employee of an Underwriting Contractor, Credit Suisse account executives instructed him to approve loans for funding even when a borrower's stated income was patently unreasonable. He was instructed, "you need to find a way to make it reasonable." Other times, this witness received pressure from Credit Suisse account executives to manipulate data in the loan files that

violated the applicable underwriting guidelines in order to inappropriately clear loans for closing.

73. According to yet another former employee of one of Credit Suisse's Underwriting Contractors, CW3, Credit Suisse account executives aggressively demanded that loans be closed as quickly as possible and that conditions be cleared even when it was inappropriate to do so. This employee was often threatened by Credit Suisse account executives that Credit Suisse would pull its business if loans were not closed with the requisite speed – and that oftentimes, the requisite speed did not afford the Underwriting Contractors enough time to appropriately review and investigate the loan files.

74. Credit Suisse's misrepresentations and omissions concerning its underwriting practices and standards concealed facts that impacted the risk associated with the Loans, and thus were material to MBIA's decision to issue the Policy.

3. Credit Suisse Misrepresented Its Loan Due Diligence Practices

75. In addition to misrepresentations about its front-line underwriting practices, Credit Suisse also misrepresented its "due diligence" re-underwriting review practices. Credit Suisse touted the due diligence re-underwriting reviews as an independent check on the initial loan underwriting to assure that loans were properly originated. Credit Suisse misrepresented the level of due diligence review it conducted on the Loans, and the integrity of the review process.

76. With respect to the level of review, Credit Suisse represented that it only securitized Loans approved through the due diligence process. That was false. Indeed, as disclosure has demonstrated, Credit Suisse did not conduct ***any*** due diligence re-underwriting review on its self-originated, wholesale loans. Moreover, the piecemeal

production Credit Suisse has made to date with respect to its other loan acquisition channels indicates that Credit Suisse did not conduct due diligence on 100% of the Loans.

77. As to the integrity of the practices, Credit Suisse represented to MBIA that its loan due diligence practices included a credit review for all loans, and that (1) all loans were "re-underwritten to determine both adequacy and legitimacy of information used for qualification," (2) "[a]ll information on the loan application [was] reviewed for completeness and reconciled to the borrower's credit report," (3) the "borrower's use of credit. . . prior mortgage payment history, and. . . debt to income rations" were analyzed, and (4) exceptions to the applicable underwriting guidelines were made only when adequate compensating factors were present to support the deviation. Credit Suisse represented that it, in fact, employed these practices, notwithstanding any disclosures in the Prospectus Supplement concerning general market risks or the risks associated with properly underwritten loans pursuant to the applicable loan program. Credit Suisse's representations were false.

78. In fact, as particularized below, Credit Suisse routinely instructed its due diligence reviewers ***not*** to perform a complete reunderwriting of the loans, and ***not*** to determine whether the information supplied by borrowers was "adequate and legitimate." Instead, Credit Suisse routinely instructed due diligence reviewers, directly or through the management of contractors Credit Suisse retained to perform due diligence (the "Due Diligence Contractors"), to perform only a superficial check and to determine only whether the information in the loan application matched the information on the loan tape. Reviewers understood that Credit Suisse expressly prohibited, or ignored, questions

from due diligence reviewers about loans that bore obvious indicators of fraud or improper underwriting or origination. Moreover, Credit Suisse routinely overrode due diligence reviewers' findings that loans should ***not*** have been approved, acquiring and securitizing those loans in knowing disregard of loan defects identified during the due diligence process.

79. The falsity of Credit Suisse's disclosures is corroborated by the statements of a number of former employees of third-party Due Diligence Contractors hired by Credit Suisse. These confidential witnesses confirm that Credit Suisse directed Due Diligence Contractors to overlook defects in loans, to grade defective loans as non-defective, and that to the extent the Due Diligence Contractors still found defects in the loans, to identify compensating factors, which were often insufficient to overcome the defects, and to grade such loans as non-defective. Finally, to the extent loans graded as defective remained in the due diligence pool, Credit Suisse directed Due Diligence Contractors to change the grades assigned to these loans from defective to non-defective.

80. According to CW4, a former employee of a Credit Suisse Due Diligence Contractor who oversaw due diligence for that firm, most of the due diligence performed for Credit Suisse was done on a sample basis, and thus Credit Suisse did not purchase only loans approved. In fact, Credit Suisse executives manipulated due diligence samples so that the results would artificially appear clean, when Credit Suisse knew that the pools from which the samples were drawn were riddled with defective loans. On the basis of these manipulated due diligence samples, Credit Suisse then acquired the entire pool of loans, whether or not they had been reviewed. This employee also confirmed that Credit Suisse routinely ignored evidence of fraud that her staff

identified in loans that were diligenced, and that Credit Suisse sales and trading personnel routinely interfered in the diligence process. According to this witness, Credit Suisse account executives frequently called her due diligence underwriters and attempted to intimidate them into speeding up their review or approving bad loans.

81. CW5 worked at Lydian, one of the Due Diligence Contractors hired by Credit Suisse, from 2005 until the end of 2006 and reviewed many Credit Suisse loans. According to CW5, he was routinely instructed to ignore evidence of fraud in the loan files he reviewed for Credit Suisse and to refrain from reviewing stated incomes for reasonableness – his job was instead described as a "data entry review". For example, CW5 recalled reviewing a loan where a cashier at Burger King claimed to earn $7,500 per month. Based on his experience in the mortgage industry, CW5 knew this income was unreasonable, but such loans were graded as passing because of directives from Credit Suisse. Even more, CW5 testified that it was a pervasive practice at his due diligence firm, Lydian, to approve loans based on compensating factors that were inadequate to overcome defects in the reviewed loans. Failing grades CW5 gave to loans were inappropriately changed by Lydian higher-ups to passing.

82. CW6 also worked at Lydian from 2005 to 2006 and reviewed many Credit Suisse loans. According to CW6, even though she found evidence of fraud in the loan files she reviewed for Credit Suisse, she was instructed to overlook such red flags of default. For example, she recalled one file in particular where a paystub had the word "checking" spelled incorrectly. Despite this warning sign of fraud, CW6 was instructed to grade this and other similar loans as passing. She remembered being instructed by her supervisors not to ask questions, but rather reassured that the approval

of loans should proceed without reunderwriting. Management encouraged her to approve defective loans with such reassurances as "It's in the file. The loan has closed. The borrower was in the home."

83. CW6 was also instructed ***not*** to review stated incomes for reasonableness while performing due diligence for Credit Suisse. Indeed, she testified that she even received instructions passed along from Credit Suisse to assume that borrowers with unreasonable stated incomes had higher-paying jobs than those listed on their loan applications in order to justify grading such loans as passing. CW6 also testified that she was routinely instructed to use compensating factors to grade loans as passing even though these compensating factors were weak and insufficient to overcome the defects in the loans she was reviewing. Finally, CW6 testified that Lydian higher-ups, working in close communication with Credit Suisse, would inappropriately change the grades she had given to loans from defective to passing.

84. CW7 worked at Lydian from 2004 to 2005 and also reviewed many Credit Suisse loans. Lydian supervisors, with the apparent authority of Credit Suisse, instructed her to fraudulently change information found in the loan files she reviewed in order to mask defects and grade problematic loans as passing. She often received instructions from her superiors to pad stated incomes and stated assets – her supervisors told her, "it's stated, so just pad it." CW7's supervisors, with the apparent authority of Credit Suisse, improperly changed the grades of those loans she graded as defective to passing.

85. Many of the confidential witnesses, including CW8-CW10, who conducted due diligence of Credit Suisse loans, were not provided with applicable

underwriting guidelines when conducting their reviews. Sometimes, they were not provided with underwriting guidelines at all and were instructed by their superiors to review the loans according to "general guidelines." Other times, they were provided with underwriting guidelines that obviously did not apply to the loans that were being reviewed (either because the guidelines were more recent than the loans' origination date or because they were outdated).

86. Credit Suisse's practice of improperly overlooking known defects identified through the due diligence process is corroborated by its disclosures to date. Credit Suisse maintained a series of generic email mailboxes, including "underwriting.questions@credit-suisse.com" and "fulfillment.exceptions@credit-suisse.com," to which underwriting contractors routinely sent notice of loans, identified in the due diligence process, that did not meet underwriting guidelines and should not have been originated.

87. Credit Suisse executives, including those on its trading desk, routinely instructed its contract reviewers to overlook identified defects, and to acquire loans in spite of non-compliance with origination standards and underwriting guidelines. For instance, with respect to one of the Loans securitized in the Transaction, on Tuesday, December 12, 2006, a contract reviewer notified Credit Suisse that "[t]he borrower has been employed for 2 1/2 years as a restaurant manager with Mucho Y Rico with stated monthly income of $9000, $108,000 annually. Salary.com [a commonly-used source of geographic salary data] shows an average of $62,000 for a restaurant manager." The contractor inquired to the "Fulfillment Exceptions" desk as to whether Credit Suisse "will accept this loan with the overstated income," *i.e.*, notwithstanding evidence of borrower

fraud. The next day, a response came back to the contractor, from the Credit Suisse "Underwriting Questions" email box, that "u/w [underwriting] is ok with this one." Credit Suisse's blatant disregard for known facts that Loans were originated or acquired in violation of underwriting and origination standards, based upon, *e.g.*, unreasonable and overstated incomes renders false its representations with respect to specific Loans, but also about its business practices, generally.

88. In January 2011, the Financial Crisis Inquiry Commission ("FCIC") issued a report further confirming these practices. FCIC specifically investigated one of the Due Diligence Contractors that Credit Suisse employed, Clayton Holdings ("Clayton"). Clayton classified loans that they reviewed into three groups: Grade 1, 2, or 3. Grade 1 loans were those that met guidelines, while Grade 2 loans were those that failed to meet guidelines but were nevertheless approved because of compensating factors. Grade 3, loans, however, were those that failed to meet guidelines and did not have sufficient compensating factors, and therefore were not approved by Clayton. According to the FCIC Report, Clayton rejected 32% of the loans it reviewed for Credit Suisse. Nevertheless, Credit Suisse waived in and thereafter securitized 33% of these Grade 3 loans, despite the fact that its Due Diligence Contractor had specifically found that the loan had no redeeming features and could not meet guidelines.

89. Credit Suisse's disclosures and representations regarding its due diligence were materially false and misleading because Credit Suisse knew, but deliberately or recklessly concealed, that the due diligence procedures it employed were not suitable for the purpose that they were proffered to MBIA, *i.e.*, to evaluate the quality of the diligenced loans and their compliance with applicable underwriting guidelines.

90. Disclosure has shown that, internally, Credit Suisse was aware that these representations about its due diligence practices were false or materially misleading. As early as January 2006, executives in the Credit Suisse RMBS Group discussed the failure of their due diligence practices, and the fact that they had purchased loans that did not meet underwriting standards. A senior executive in Credit Suisse's Credit and Compliance division complained that Credit Suisse knew of existing defects when it purchased loans. In response, Credit Suisse's Director of Second Loan Trading stated the obvious, observing the "break down" of Credit Suisse's due diligence procedures. Three months later, the same executive noted that 100% of the second-lien loans reviewed by Credit Suisse's Chicago due diligence facility were passing through (*i.e.*, being approved for acquisition) without any comments whatsoever. This led him to question openly "who is monitoring them to ensure they are held to a reasonable standard?" and later to conclude that "the mini bulk and LBL ["loan-by-loan"] side [of the due diligence operation] is virtually unmonitored." Minibulk and LBL loans represented more than one third of the Loans in the Transaction.

91. Disclosure has shown that Credit Suisse continued to discuss its inadequate due diligence operations up through March 2007, contemporaneous with its solicitation of the Policy from MBIA. In March 2007, Credit Suisse's Director of Underwriting noted a batch of loans approved through Credit Suisse's due diligence process that demonstrated "obvious concerns – poor credit, questionable income, payment shock, 0 $ into the purchase, [first time homebuyers], etc." Credit Suisse's Head of Credit Policy and Underwriting and Director of Second Loan Trading both acknowledged these defects, noting that Credit Suisse did not have appropriate due

diligence protocols in place. The Director of Second Loan Trading stated that Credit Suisse should start to "seriously monitor the quality control at the [Fulfillment Centers]," and noted that Credit Suisse did not have a "general acceptable underwriting principle and required procedure for every underwrit[er] to follow..." These admissions were made at the same time that Credit Suisse presented a pitchbook to MBIA with false and misleading representations that Credit Suisse's "[c]entralized [approach to] underwriting provide[d] tighter controls and consistency," and that Credit Suisse properly performed due diligence on loans to assure that Credit Suisse would only "purchase/originate loans that demonstrate a borrower's ability and willingness to repay debt."

92. In sum, Credit Suisse's representations about the manner in which it performed underwriting and due diligence were false and misleading, because Credit Suisse's actual underwriting and due diligence practices materially departed from those practices it represented. These representations were material to MBIA's decision to issue the Policy because they provided baseline assurances as to the processes employed by Credit Suisse to mitigate the inherent risks associated with providing financial guaranty insurance. Credit Suisse knew the representations it provided to MBIA as an inducement to issue the Policy were false, but made them, in any event, to induce the issuance of the Policy.

4. Credit Suisse Misrepresented its Quality Control Practices

93. As part of its diligence on Credit Suisse's business practices, MBIA also solicited from Credit Suisse representations concerning Credit Suisse's quality control "[t]esting procedures," and "[i]nternal controls to ensure compliance" of its loans with state and federal laws. The requirement for on-going post-origination or acquisition "quality control" – separate and apart from underwriting or due diligence of

loans – was industry standard, required by Fannie Mae and other government-sponsored entities as a pre-condition of their willingness to acquire or invest in loans aggregated by entities such as Credit Suisse. MBIA accordingly sought representations from Credit Suisse to confirm that its quality control practices, intended to safeguard against the sale or securitization of defective loans, met appropriate standards.

94. These requested disclosures, and Credit Suisse's misrepresentations supplied in response to MBIA's inquiries, were material to MBIA's decision to issue the Policy, as a reasonable insurer would be more likely to issue a financial guaranty policy and under more favorable terms, when assured that the collateral concerning the financial guaranty was subject to appropriate quality control processes.

95. Credit Suisse responded to MBIA's request with specific representations about its "Post Close Quality Assurance" practices. As elaborated upon by Credit Suisse in the diligence meeting it conducted for MBIA, Credit Suisse represented that the objective of its quality control program was to "monitor all areas of the origination and acquisition process," and to "[i]ncrease the quality of loans originated/acquired by testing loans diligenced/not diligenced." Credit Suisse further represented that it sampled "3% of all loans originated / acquired by all business channels," and that "[a]ll loans selected for QC review receive[d] a full credit and compliance underwrite," including "re-verification of assets, income, credit worthiness, property value and compliance with state/federal regulatory laws." Finally, Credit Suisse represented that it conducted "[m]onthly meetings ... with each business channel to discuss findings and design preventative policies." Credit Suisse made these

representations to persuade MBIA that the quality control protocols benefitted MBIA by preventing the securitization of defective loans, and by identifying and removing defective loans from securitizations.

96. Disclosure has shown that Credit Suisse's diligence meeting representations about its quality control practices were false and misleading. In reality, at the time that Credit Suisse made its representations to MBIA about its quality assurance programs, the objective of Credit Suisse's quality control process was ***not*** to ensure the quality of the loans in its securitizations. Rather, by 2007, disclosure has shown that Credit Suisse's objective in conducting quality control was simply to identify defective loans so that Credit Suisse could negotiate incentives and price breaks for itself on the further production of loans, while manipulating the quality control processes so as to ***conceal*** defects in the loans and enable their securitization.

97. First, Credit Suisse's own files reveal that in the months leading up to the diligence meeting with MBIA, Credit Suisse had identified widespread issues with the loans subject to its quality control, which issues were not disclosed to MBIA. Credit Suisse's internal correspondence confirms that for wholesale loans (the source for about 20% of Transaction Loans), performance was "deteriorating across the board," and for certain originators whose loans were later selected for the Transaction, delinquencies were piling up, both evidencing origination fraud and improper origination practices. On the basis of that evidence, at the time of the Transaction, Credit Suisse "already knew" that it had "systemic problems in ... compliance and credit," (*i.e.*, in loan underwriting) among its loan pipeline, and knew that if it continued to perform quality control consistent with its documented policies (which required that loans be subject to quality

control within sixty days of origination or acquisition) and as represented to MBIA, it would be "obligated to repurchase a fair chunk of the loans from deals" (*i.e.*, securitizations).

98. Credit Suisse did not disclose to MBIA that Credit Suisse had drawn the Loans from a population with **known** "systemic problems" in "compliance and credit," as established on a representative sampling basis through Credit Suisse's quality assurance programs. This failure to disclose known, material facts about the Loans renders false and misleading Credit Suisse's representations about its quality control programs and its "focus on risk management."

99. Second, Credit Suisse also failed to disclose that, rather than address or remedy the known pattern of credit and compliance deficiencies, as was represented to be the purpose of the quality control process, Credit Suisse instead adopted a policy to reduce its quality control efforts and conceal the evidence of credit and compliance defects known to exist in the quality control population. Credit Suisse devoted its efforts to asserting claims by Credit Suisse against its loan originators (generally for early payment default), while concealing or ignoring defects that would highlight Credit Suisse's own contractual obligations to repurchase loans from securitizations (*e.g.*, for origination or underwriting defects).

100. In an April 9, 2007 email, contemporaneous with the Transaction negotiations between Credit Suisse and MBIA, Credit Suisse's Director of Transaction Management and Securitization discussed this new approach, directing subordinates to "avoid the previous [quality control] approach by which a lot of loans were qc'd regardless of opportunity for put-back ... creating a record of possible rep/warrant

breaches in deals." Instead of performing quality control as represented, to identify individual loan defects and patterns of deficiencies, Credit Suisse manipulated its quality control review of loans to try to ***avoid*** identifying facts and defects that would concretely trigger its repurchase obligations from securitizations.

101. Additional e-mails from Credit Suisse obtained through disclosure confirm the effect of this directive to manipulate the quality control results. On June 15, 2007, the same Director sent an e-mail regarding his quality control goals: "I want to maintain an appropriate amount of true QC but avoid spending too much money and ***generating too many negative reports related to loans for which we have no recourse***, and instead re-focus some of the QC effort on recoveries/loss mit." In a follow-up e-mail on June 18, he again noted that for QC that month, the "sample size [was] limited so that it generate[d] meaningful feedback but ***avoid[ed] generating inordinate correspondence re potential loan defects that we may not repurchase*** from securitizations."

102. On June 28, 2007, Credit Suisse's director in charge of Credit Policy and Underwriting instructed instructed another Credit Suisse executive not to QC for potential fraud in loans that had suddenly failed ("went down quickly"), in furtherance of Credit Suisse's new policy not to investigate evidence of fraud and underwriting defects. On August 1, 2007, Credit Suisse's Director of Transaction Management and Securitization confirmed "the new 'Loss Mit' QC process: QC'ing delq loans with a focus on putback opportunities, as compared to 'QC' sourced by seller, u/w, vendor, etc. from purchases in the prior month."

103. <u>Third</u>, contrary to its representations and its policies, which required Credit Suisse to review "[l]oans reporting 90+ days delinquent, that were

acquired/originated in the preceding nine months," Credit Suisse did not conduct quality controls for loans with "red flags" of defective loans. In particular, Credit Suisse deliberately avoided quality control reunderwriting and review of loans that experienced early payment default or "EPD," *i.e.*, the borrower failed to make required payments during the first two to three months of the mortgage.

104. It is generally accepted in the industry that an EPD is an indicator of improper origination, and the borrower's inability to repay the loans as due. Credit Suisse confirmed that view in internal communications, highlighting in e-mails that the prevalence of EPD loans indicated a need to improve training in underwriting, due diligence and quality control practices. Moreover, Credit Suisse's own evaluation of EPDs in early 2006 confirmed that EPDs are evidence of fraud or improper underwriting. In early 2006, Credit Suisse executives took note of an increasing number of early payment defaults in their loan inventory, and undertook to understand why the loans were defaulting. Based upon a review of a sample set of EPD loans, Credit Suisse confirmed that the cause for most of the defaults were underwriting failures. Credit Suisse's head of Credit Policy and Underwriting noted that "most of the stated income loans have income that is overstated," and that the "no ratio loans are in question in that based on the employment stated on the application, borrowers would need to earn extensive income amounts to qualify."

105. Credit Suisse identified many of the loans in its securitizations, including in the Transaction, that experienced an EPD. Notwithstanding its own view that early payment default was generally caused by underwriting and origination failures, Credit Suisse did not review loans with EPDs for other defects, and did not provide

notice to MBIA of any of the Loans that experienced an EPD either prior to or after the securitization. Credit Suisse's deliberate decision not to review the loans with EPDs, and to conceal the existence of the Loans with EPDs, constitute material omissions concerning its operations and Loans. The omissions were particularly egregious when coupled with Credit Suisse's repurchase practices, described below.

5. Credit Suisse Misrepresented Its Repurchase Practices

106. As part of the negotiation process, Credit Suisse represented, and agreed to warrant and covenant, that it would provide notice to MBIA of any defective Loans that it identified, and be "responsible for repurchasing mortgage loans from the Trust in the event of a breach of any representation or warranty relating to a mortgage loan that materially and adversely affects the interest of the certificate holders in that mortgage loan." Moreover, MBIA specifically inquired concerning Credit Suisse's "post-review negotiations" with originators, after due diligence and/or quality control was performed on the loans, to ensure any negotiated resolution of defective loans in securitizations would benefit the securitizations. Credit Suisse provided that assurance.

107. These representations were material to MBIA's decision to issue the Policy because they affirmed that Credit Suisse, rather than MBIA, would bear the risk of loss for defective loans that circumvented Credit Suisse's purported controls and were securitized in the Transaction. This allocation of risk made sense because, consistent with the description of Credit Suisse's business processes herein, Credit Suisse was the only party to the Transaction with control over, and knowledge concerning, the origination, due diligence, quality control, and servicing of the Loans. MBIA accordingly sought protection in the form of Credit Suisse's representations and warranties that it would repurchase defective loans.

108. Credit Suisse's representation that it would be responsible for repurchasing defective Loans was false and misleading In fact, unknown to MBIA at the time of the Transaction, Credit Suisse's repurchase practices were, in fact, designed and intended to benefit Credit Suisse, while simultaneously avoiding any obligations to the Trust or MBIA.

109. First, in deliberate disregard of its representations and commitments to MBIA and the securitization participants, Credit Suisse maintained a practice of refusing to repurchase loans from securitizations, ***even when breaches of representations and warranties were discovered***, unless Credit Suisse could simultaneously obtain a recovery from the party that originated the loan or sold it to Credit Suisse.

110. Credit Suisse's internal documents show that it regularly discussed this practice. In discussing loans with "credit [and] underwriting deficiencies" that Credit Suisse was planning to putback to an originator, a Credit Suisse Director of Transaction Management and and Securitization (Securities/Bulk Funding) stated that Credit Suisse should "hold off on buying them out of the deals until [the originators] agree to repurchase." A Credit Suisse Vice President agreed that the decision on whether to repurchase the defective loans from the respective trusts "would depend on whether CS will. . . ultimately bear the losses." Another Credit Suisse Director of Transaction Management and Securitization described the policy in no uncertain terms: "As a general rule, we don't repurchase any delq loans from deals unless we are simultaneously selling them back to originator, unless we make a considered decision and I sign the memo." Thus, while Credit Suisse represented to MBIA that its practice was to promptly identify

and repurchase defective loans from its securitizations, its actual practices were secretly conditioned upon Credit Suisse being able to itself recover on the loan from the originator This co-head of Transaction Management and Securitization succinctly explained the rationale for Credit Suisse's policy: "We want to keep a close eye on loans repurchased from securitizations because in the past, we were concerned that [the Putback Group] was repurchasing loans from securitizations based on [the Putback Group's] expectation that they could put the loan back to the seller for [early payment default], and when they didn't, we got stuck with the loan in the markdown account."

111. Credit Suisse's misrepresentations, including that it would provide notice of defective loans and be "responsible for repurchasing mortgage loans from the Trust in the event of a breach of any representation or warranty relating to a mortgage loan," were crucial misrepresentations that induced MBIA's participation in the Transaction. Had Credit Suisse truthfully disclosed that it would not repurchase loans from the securitization in accordance with its contractual obligations, unless Credit Suisse could simultaneously put the loan back to the party that sold the loan to Credit Suisse, MBIA would not have agreed to issue the Policy. The Repurchase Protocol was intended for the benefit of MBIA and investors in the Transaction. Fundamental to MBIA's agreement to issue the Policy was its belief, based upon Credit Suisse's fraudulent misrepresentations, that Credit Suisse stood fully behind the Loan Warranties, regardless of whether Credit Suisse had recourse against the loan sellers from which it acquired the Loans. Credit Suisse's rights with respect to the Loans should have been wholly irrelevant to its decision whether or not to repurchase loans that it had warranted, and Credit Suisse's fraudulent practices with respect to the Repurchase Protocol have ensured

that MBIA, and investors, have born losses that the parties specifically bargained would rest with Credit Suisse.

112. Second, Credit Suisse's representations concerning its repurchase practices were further false and misleading because, unknown to MBIA, Credit Suisse engaged in a scheme to (i) securitize loans it knew to be defective, either because it had already obtained adverse credit and compliance quality control results on the loans, or because the early payment defaults were *prima facie* evidence of underwriting failure or fraud; (ii) issue and recover on its own repurchase demands against originators for loans in securitization, by settling the repurchase claims; and (iii) refuse to repurchase the defective loans from the securitization. Through this "double-dipping" scheme, Credit Suisse profited both from the securitization of defective loans and from its own repurchase demands on the same loans.

113. Related, Credit Suisse concealed from MBIA that, upon identifying defective loans, it routinely negotiated price breaks with originators for the known defects (generally in the form of discounts on future loans to be delivered by the originator), agreeing to overlook the credit and underwriting defects in those loans. Credit Suisse's Director of Adjustable Rate Mortgage ("ARM") trading observed that the senior-most executive of the RMBS Conduit Business was the "king of quietly forgiving [defaults] and premium recapture and make wholes in exchange for incentive laden forwards." According to the Credit Suisse's RMBS Manual, a premium recapture is a rfund given to Credit Suisse or DLJ by sellers for mortgages that were current and securitized or which qualify for securitization. A "make-whole" is a reimbursement by a seller to Credit Suisse for a loss on a loan that Credit Suisse had previously recognized.

The Director of ARM Trading further observed that "[n]ot only does [this practice] encourage these guys to continue delivering us crap, but its all done on the DL," so that the loans could be securitized without anyone noticing the defects, and without disclosure to investors or to the transaction insurers of the known problems. Credit Suisse's Managing Director for Non-Agency Trading agreed with this assessment, noting that Credit Suisse continued in these practices, "no matter how shitty production [was] and no matter how bad performance [was]."

114. Credit Suisse's widespread practice of issuing repurchase demands based upon known defects in loans, but not itself repurchasing the loans from securitizations, led to its recovery of substantial fraudulent profits. Though Credit Suisse has resisted a complete production of data reflecting its repurchase recoveries, disclosure to date shows that it tracked, on a quarterly basis, its "putback and premium recapture." In December 2007, Credit Suisse recorded year-to-date recoveries of approximately $205 million on $363 million of repurchase demands issued for loans in securitizations (including $7 million in repurchase demand recoveries on 83 loans from the Transaction). Approximately $70 million of those recoveries were applied to "straight repurchases" of loans from securitizations, and $19 million were used in prepayment of loans. Approximately $116 million was applied to various Credit Suisse trading accounts, rather than to the securitizations where the defective loans remained. Credit Suisse's accounting for this revenue, and accordingly the financial statements it supplied to MBIA as a condition of MBIA's willingness to issue the Policy (discussed below), are fraudulent, because Credit Suisse did not recognize the contingent liabilities to the securitization trusts, based upon known evidence of defective loans, and Credit Suisse's

related repurchase obligations. Credit Suisse's fraudulent intent is further confirmed by its conduct in this litigation. For nearly 10 months, Credit Suisse denied that it had issued any repurchase demands, at all, on the Loans. Only after MBIA proved the existence of these repurchase demands, and subsequent Credit Suisse settlements with originators that Credit Suisse should have remitted to the Trust, but instead kept for itself, did Credit Suisse reluctantly admit that it had issued repurchase demands on the Loans.

115. Credit Suisse engaged in this scheme with respect to Loans in the Transaction. Between September 28, 2005, and April 27, 2007, *i.e.*, ***prior to the securitization's closing*** on April 30, 2007, Credit Suisse issued repurchase demands or "putbacks" for more than 500 EPD loans to the parties from which Credit Suisse had acquired them (either the originators or loan sellers). Credit Suisse then securitized these loans into the Transaction, concealing and disregarding the evidence that the loans were originated illegally (*i.e.*, through fraudulent means) or in violation of underwriting guidelines. (Indeed, as described above, MBIA has re-underwritten 181 of these loans and determined that 111 of them breach the warranted representations.) Credit Suisse's own findings and admissions that an EPD is strong evidence of underwriting and origination failures, *supra*, demonstrates that its practice of routinely securitizing EPD loans that are put back to originators – without disclosure to the securitization participants – was a material omission.

116. Of the hundreds of Loans that Credit Suisse putback prior to the securitization, between February 15, 2007 and March 6, 2007, before the close of the Transaction, Credit Suisse put back at least 255 of the New Century loans that Credit Suisse then securitized in the Transaction (*i.e.*, more than 10% of the New Century loans it securitized in the Transaction), along with hundreds more loans to New Century that

Credit Suisse did not securitize. Credit Suisse's concealment of these repurchase demands constituted a material omission, given its (i) affirmative representations that it engaged in quality control and due diligence operations to avoid the securitization of defective loans; and (ii) partial, misleading securitization disclosures that there was a "risk" New Century may have departed from customary practices. In fact, Credit Suisse knew that New Century loans Credit Suisse securitized in the Transaction had suffered EPDs and had been subject of Credit Suisse repurchase demands.

117. Moreover, following the close of the Transaction, Credit Suisse put back to sellers/originators at least 200 more Loans (the bulk of which were also EPD). These were Loans that Credit Suisse no longer owned, because they had been sold to the Trust. Only 36 of these loans were either substituted out or repurchased from the trust by Credit Suisse. Credit Suisse's failure (i) to provide notice of these EPD loans – which EPDs were *prima facie* evidence of improper underwriting or origination – and (ii) to repurchase the loans from the securitization, based upon the corresponding credit and compliance defects, constitutes a breach of Credit Suisse's representations and warranties. Specifically, section 2.03(e) of the Pooling & Servicing Agreement requires that "[u]pon discovery . . . of a breach of a representation or warranty made pursuant to Section 2.03(d) . . . the party discovering such breach shall give prompt notice thereof to the other parties and the Certificate Insurer."

118. Finally, Credit Suisse settled repurchase demands made on originators/sellers pertaining to Loans in the Transaction, and pocketed those amounts, without providing notice to the Trust or repurchasing the Loans from the Trust. To date, based on the limited disclosures made, MBIA has identified twenty-six settlements by

Credit Suisse of its repurchase demands against originators/sellers for Loans in the Transaction, including a simultaneous sale and repurchase transaction (*i.e.*¸ the loans were "sold" by Credit Suisse to the seller/originator and then "repurchased" at a lower price) for loans that Credit Suisse did not own, because they had been sold to the Trust. None of the settled Loans were repurchased from the securitization. Nor did Credit Suisse disclose to MBIA, the Trust, or investors that it had asserted repurchase claims pertaining to Loans it did not own.

119. Third, as another tactic to avoid asserting credit and compliance breaches, Credit Suisse employed a tiered repurchase demand process. Credit Suisse obtained warranties from loan sellers concerning both the underwriting and origination of the loans ("credit and compliance" warranties), as well as against early payment default. However, Credit Suisse intentionally avoided issuing repurchase demands expressly based upon known credit and compliance warranties, citing only payment default, so as to avoid creating a record that would concretely trigger Credit Suisse's repurchase obligations from the securitizations. That is, Credit Suisse proceeded first with an EPD claim, and followed with a credit/compliance breach ***only if*** the EPD claim was unsuccessful. As discussed in Credit Suisse's Repurchase Policy Addendum, when Credit Suisse obtained evidence of credit or compliance breaches amongst its inventory or securitized loans (*e.g.*, Appraisal Issues, Fraud – Manipulated/Falsified docs, Borrower Misrepresentations, Missing Documentation Issues, Compliance Issues, Credit Issues, or Occupancy Issues), Credit Suisse issued "advice letters" to the corresponding sellers/originators of the loans as a means of "advis[ing] the Seller that CSFB maintains the right in the future to require the Seller to repurchase the loan." Credit Suisse did not,

however, provide a similar notice to the securitization trusts, as it was required to by the terms of the PSA.

120. Credit Suisse used these advice letters, and its legal right to demand repurchase based upon credit and compliance issues, in the event an EPD claim was unavailable or did not prevail. In those instances, when Credit Suisse no longer had EPD protection, Credit Suisse policy was to assert repurchase rights based upon the credit and compliance breaches. To date, MBIA has identified advice letters issued for 29 loans in the Transaction. These advice letters to sellers/originators constitute admissions by Credit Suisse that it knew of credit and compliance defects for securitized loans, but failed to provide notice to the securitization trust and its insurers, and to repurchase the loans as required.

121. Credit Suisse's failure to disclose that it had a policy designed to provide notice to originators/sellers of credit and compliance defects for loans in securitizations, without providing notice to the securitization participants, was another material omission that ran directly contrary to its representations concerning its repurchase protocols.

6. Credit Suisse Misrepresented the Performance of the HEMT Shelf

122. Because MBIA had not previously issued a policy for a Credit Suisse-sponsored RMBS transaction, evaluating the past performance of Credit Suisse's securitizations was an important element in determining whether to insure the transaction, a standard industry practice of which Credit Suisse was well-aware. MBIA made repeated requests for data concerning the past performance of the HEMT shelf. Initially, in February 2007 MBIA asked for performance data on Credit Suisse's previous

transactions. Credit Suisse provided incomplete loss and delinquency performance data, for its two most recent HEMT deals, hoping that its partial disclosure of data "would be good enough for [MBIA]." At the diligence meeting with Credit Suisse, MBIA pressed for additional disclosures regarding Credit Suisse's portfolio performance and the history of the HEMT shelf. In response to a further request by MBIA's Director of Structured Finance, Credit Suisse sent historical performance data for several past HEMT deals, including the conditional prepayment rates, the 60+ day delinquency rates, and the cumulative loss rates for the HEMT deals going back to late 2002. In addition, Credit Suisse provided MBIA with a presentation focused solely on the HEMT series of second-lien securitizations. Credit Suisse provided these results for the specific purpose of assuring MBIA of the reliability of Credit Suisse's business practices in developing similarly-performing securitizations.

123. Credit Suisse closed six or seven HEMT securitizations each year between 2002 and 2006. The data that Credit Suisse provided to MBIA suggested that over those five years, cumulative loss rates gradually decreased, from upwards of 5% in 2002 to zero in the early periods of 2006. This data, however, was materially misleading for the purpose it was provided (*i.e.*, to assure MBIA about the consistency of collateral) because Credit Suisse knew, but failed to disclose, that as of the time it provided the data to MBIA, Credit Suisse had systematically departed from its purported underwriting and origination practices.

124. The materiality of past-performance data as a means of evaluating proposed securitizations is well-established by regulatory authorities. During the relevant time period, Credit Suisse had a pattern and practice of misrepresenting its performance

data.

125. MBIA's detrimental reliance upon Credit Suisse's performance data also is documented. As documented in the "Credit Memorandum" that MBIA prepared to secure approval for the Transaction, MBIA relied upon Credit Suisse's representations that the "shelf aggregates collateral with similar attributes in an effort to produce consistent loan performance over time," Credit Suisse's representations showing that "[t]his HEMT transaction exhibits similar attributes to prior HEMT transactions dating back to 2002," and that the HEMT shelf "has experienced a relatively consistent loss curve." Had MBIA known the false and misleading nature of Credit Suisse's disclosures, it would not have issued the Policy.

C. Credit Suisse Misrepresented the Quality and Attributes of the Loans

126. In addition to its false and misleading representations concerning its RMBS business practices, which were threshold considerations for MBIA in performing its due diligence on the Transaction before agreeing to issue the Policy, Credit Suisse supplied MBIA with false and misleading information about the Loans to be securitized in the Transaction.

1. Credit Suisse Supplied MBIA With False and Misleading Loan Tapes

127. Before the close of the transaction, Credit Suisse provided to MBIA several iterations of "loan tapes." A loan tape is a compilation of data for each of the loans, with a series of metrics and data points about the loan, the borrower, and his or her credit-worthiness, such as the borrower's debt-to-income ("DTI") ratio, monthly income, disposable income, self-employed status, occupancy status for the property, and other attributes of the property serving as collateral for the loan, such as property value

and combined loan-to-value ratio ("CLTV").

128. Credit Suisse represented to MBIA that the characteristics of the loans found in the loan tapes were substantially similar to those which would be involved in the transaction, and as such the loan tape was representative of the final pool of loans that would be reflected on the Mortgage Loan Schedule – the final list of loans included in the transaction as filed with the Securities and Exchange Commission.

129. Credit Suisse provided MBIA with these loan tapes with the expectation and understanding that MBIA would use the data provided to evaluate the risk associated with issuing the Policy, and thus that the truth of the data provided in the loan tapes was crucial to MBIA's determination of whether or not to issue the Policy, and under what terms.

130. MBIA relied upon the loan tapes for this purpose. In reliance upon Credit Suisse's representations concerning the attributes of the loans, MBIA modeled the risk associated with issuing the Policy and insuring the payments to be made by the trust.

131. As the originator and aggregator of the loans, and based upon the findings through its due diligence and quality control, processes, Credit Suisse knew that the loans to be securitized in the Transaction were not of the quality represented on the loan tape.

132. The actual characteristics of the Loans, misrepresented and concealed from MBIA, rendered the risk of insuring the Trust payments materially greater than was disclosed. Had Credit Suisse truthfully and completely disclosed the actual attributes and characteristics of the loans, MBIA would not have agreed to participate in the Transaction or issue the Policy, and thus would have avoided the

damages it has incurred.

2. Credit Suisse Supplied MBIA With False and Misleading Due Diligence Results

133. As part of its due diligence on the Transaction, MBIA solicited from Credit Suisse representations concerning the due diligence Credit Suisse had performed on the Loans, including a specific request for "due diligence information" and "loan level originator information," which MBIA told Credit Suisse it would use to "set [its (MBIA's)] diligence requirement."

134. In response to MBIA's diligence requests, Credit Suisse handpicked some of its due-diligence related data from several of its bulk acquisitions, "amassed it into one file" (as described by internal Credit Suisse emails) and presented it to MBIA on the eve of MBIA's internal credit review meeting, aware that MBIA would not "have a lot of time" to review the voluminous results.

135. The partial selection of due diligence data presented by Credit Suisse (the "Loan-Level Due Diligence Results") purportedly represented Credit Suisse's completion of the loan-level due diligence process, as represented by Credit Suisse in the diligence meeting and Pitchbook. With these results, Credit Suisse represented that the reports were "summaries," and that "not all of the loans that are eligible according to these pull-through reports are in our pool." In other words, Credit Suisse did not, by its provision of the Loan-Level Due Diligence Results, contend that it was providing MBIA with comprehensive due diligence data for all of the Loans, but rather sufficient data, amassed into voluminous reports, intended to reassure MBIA that Credit Suisse had performed due diligence on the Loans in the manner represented.

136. The Loan-Level Due Diligence Reports were false and misleading,

and did not actually reflect the completion of loan due diligence ***in the manner that Credit Suisse represented the diligence to have been performed***. As noted above, Credit Suisse concealed from MBIA that it routinely instructed its due diligence reviewers not to question the validity or reasonableness of the information that they found in the loan files, and to avoid finding defects in the loans they reviewed. Moreover, Credit Suisse directed due diligence supervisors to routinely change the due diligence findings of line reviewers who had identified flaws in the loans, and to conceal or "waive" the findings of defects.

137. The Loan-Level Due Diligence Reports presented by Credit Suisse to MBIA reflect the fraudulent due diligence practices employed by Credit Suisse. MBIA's findings in its Pre-Complaint Reunderwriting Review, with respect to the Loans for which Credit Suisse provided the Loan-Level Due Diligence Reports, confirm the false and misleading nature of those disclosures. The Loan-Level Due Diligence Reports concealed fundamental flaws in the underwriting of the diligenced loans, such as the failure to conduct income-reasonableness tests, failure to verify or improper verification of income or employment, and the origination of loans pursuant to programs for which the borrower was not qualified. Had Credit Suisse actually performed due diligence in the manner represented, the overwhelming number of loans that were listed as "approved" on the Loan-Level Due Diligence Reports would have been rejected.

3. Credit Suisse Obtained False and Misleading Ratings

138. The independent assessment of the Transaction as provided by recognized ratings agencies played a key role in convincing MBIA to insure the Transaction. One of the conditions imposed by MBIA and included in the Policy was that "the risk secured by the Policy constitutes at least "A" by S&P and "A2" by

Moody's." These ratings were important to MBIA because of MBIA's lack of experience with Credit Suisse, and based upon the ratings agencies' extensive independent experience in modeling the risks associated with similar transactions.

139. Credit Suisse was fully aware of the importance of the ratings agencies' assessments to investors and MBIA. Credit Suisse's Director of Second Loan Trading specifically asked MBIA if Credit Suisse could "get an indication of where [MBIA's] attachment is on this pool," referring to the required ratings agency rating for the classes of securities MBIA would insure. MBIA responded that "MBIA would like to participate on your transaction at the minimum of 'A/A2' (S&P/Moody's) rating attachment" Credit Suisse thus knew that MBIA would rely upon the assessments of the ratings agencies – as obtained by Credit Suisse – in deciding whether to insure the Transaction.

140. Credit Suisse handled all communications with the ratings agencies, and was therefore in complete control of the data that the agencies used to make their assessments. And Credit Suisse thereafter disclosed to investors in the Prospectus Supplement that the ratings it had obtained were based upon ***"the credit quality of the related mortgage pool***, including any credit support providers, structural and legal aspects associated with those certificates, and the extent to which the payment stream on the mortgage pool is adequate to make payments required by those certificates."

141. These representations were false and misleading because Credit Suisse knew that the information it had provided to the ratings agencies concerning the credit quality of the pool was just as false and misleading as the information it had supplied to MBIA. Credit Suisse employed false and misleading representations

concerning the loans so that it could tout to MBIA and investors that the ratings agencies had concluded that the pools constitute a specified level of risk. Credit Suisse knew and intended that the ratings agencies would rely upon the false and misleading information that Credit Suisse supplied, and in turn intended for MBIA to rely upon the fraudulently induced ratings in MBIA's evaluation of the Transaction. As described above, Credit Suisse was well aware, through its due diligence of the loans, that the ratings were unwarranted.

D. Credit Suisse Issued False and Misleading Investor Disclosures

142. Credit Suisse represented and warranted that its investor disclosures, including the Prospectus and Prospective Supplement, did not contain any untrue statement of a material fact nor omit any material fact necessary to avoid making statements within those documents misleading.

143. As explained above, Credit Suisse made separate, additional, more detailed, and broader-ranging false and misleading representations to MBIA, in response to the due diligence requests MBIA demanded of Credit Suisse as a condition and in consideration of whether to issue the Policy. On those allegations, alone, MBIA's claim for fraudulent inducement may be established. However, in addition, Credit Suisse's investor disclosures, specifically provided to MBIA in advance of the Transaction contained materially false and misleading statements.

144. Credit Suisse's Prospectus and Prospectus Supplement for the Transaction misrepresented and did not adequately or accurately disclose, the true attributes of the loans (*e.g.*, the occupancy status or debt-to-income ratio of the borrowers), Credit Suisse's actual knowledge of fraud and underwriting failures permeating the loan pool, and the grossly deficient origination, underwriting, and due

diligence practices employed in reviewing the loans.

145. More specifically, the Prospectus Supplement represented (1) that the securitized loans were underwritten "in accordance with underwriting guidelines designated by the sponsor. . . or guidelines that do not vary materially" from such guidelines; (2) that the guidelines were "designated by the sponsor on the consistent basis for use by originators" in originating the loans; and (3) that Credit Suisse employed "certain quality assurance programs" to ensure that the correspondent from which Credit Suisse purchased the loans "properly applied the underwriting criteria."

146. These representations were false and misleading. At the time it made these disclosures, Credit Suisse had actual knowledge that a material number of Loans did not comply with applicable underwriting guidelines, that Credit Suisse employees routinely directed the funding of loans that did not meet underwriting guidelines, and that Credit Suisse had systematically departed from its stated quality assurance programs, which were not designed or applied to ensure that originators "properly applied the underwriting criteria." As described above, Credit Suisse concealed and ignored indications of underwriting and origination failures identified through its quality assurance programs, and manipulated those programs to ***avoid*** generating further evidence that the Loans were not properly underwritten.

147. More specifically, all of the applicable underwriting guidelines for the Loans, whether designed by Credit Suisse or by other originators, entailed various underwriting standards and procedures, including requirements that the underwriter (i) determine the ***eligibility*** of the borrower for the loan program (ii) ***verify*** certain data necessary to qualify the borrower for the loan, including for reduced documentation

loans, for which verification of income or assets, or at a minimum employment and housing payment history, is required and (iii) assess the ***reasonableness*** of the borrowers' disclosures.

148. The Credit Suisse eligibility requirements, for example, require for all loans that the borrower be a citizen of the United States and of age, restrict "non-arms length transactions," first-time homebuyers' utilization of second-lien loans, the number of properties financed, and preclude the issuance of loans to borrowers' whose debt-to-income ratios were in excess of 50%.

149. Similarly, under Credit Suisse guidelines, verification requirements include, for example, with respect to full documentation loans (which comprised 20% of the Loans), verification of income, employment or self-employment, assets, and ability to manage household debt. And for no income verification loans (43% of the Loans), verification of employment or self-employment, verification of assets, and verification of housing payment history were required.

150. And finally, the Credit Suisse guidelines require a reasonableness assessment, specifically because "the products are not conventional in nature, the loans must be sound and prudent for the associated risk," the "[i]ncome stated must be reasonable for the position," "[t]he transaction must be prudent for the borrower," and the underwriter "[must] consider the borrower's willingness to repay the debt, the borrower's ability to repay the debt, and whether the property has sufficient security for the mortgage."

151. Consistent with these common attributes to applicable underwriting guidelines, Credit Suisse represented in the Prospectus that it "expect[ed]

that the originator of each of the loans will have applied, consistent with applicable federal and state laws and regulations, underwriting procedures intended to evaluate the borrower's credit standing and repayment ability and/or the value and adequacy of the related property as collateral." In fact, as set forth above, Credit Suisse knew that the originators of the Loans – including those operating at Credit Suisse's direction to underwrite and originate loans on behalf of DLJ – did not conduct their underwriting in accordance with the applicable underwriting procedures.

152. Credit Suisse disclosed in the Prospectus various risks associated with reduced documentation programs, including the risks that "'alternative,' 'reduced,' 'stated income/stated asset' and 'no income/no asset' programs generally require either alternative or less documentation and verification than do full documentation programs," or that ***either*** assets or income are frequently not verified in connection with certain reduced documentation programs. But Credit Suisse concealed from MBIA its actual knowledge that the originators from whom Credit Suisse acquired the Loans had systematically departed from the eligibility, verification, and reasonableness assessments that ***did*** apply to the Loans, pursuant to the applicable underwriting guidelines and practices.

153. Finally, Credit Suisse misleadingly disclosed certain risks about New Century, which originated 14.87% of the Loans, including that New Century "***may*** also have experienced reduced management oversight or controls with respect to its underwriting standards." But Credit Suisse concealed its actual knowledge that New Century had not been following prudent and applicable underwriting guidelines, as evidenced by the hundreds of repurchase demands Credit Suisse issued in the weeks

leading up to the securitization, for New Century loans that Credit Suisse nonetheless securitized into the Transaction all while Credit Suisse was soliciting MBIA's participation with false representations and warranties about the Loans.

III. MBIA AGREED TO ISSUE THE POLICY BASED UPON THE REPRESENTED AND WARRANTED INFORMATION SUPPLIED BY CREDIT SUISSE

A. The Parties Agreed to An Allocation of Risks

154. As previously alleged, MBIA required – as a condition precedent of its agreement to issue the Policy – that Credit Suisse contractually warrant the truth, as of the closing date, of Credit Suisse's prior representations concerning (i) the attributes of the loans (the Loan Warranties) and (ii) the information provided to MBIA in connection with the Transaction (the Transaction Warranties).

155. MBIA obtained these warranties so that it could assure itself that Credit Suisse stood behind its representations about Credit Suisse's business practices and the attributes of the loans. MBIA reasonably believed that Credit Suisse would not provide these warranties if it knew that the information it had provided to MBIA was false, misleading, or incomplete. Unfortunately, MBIA has subsequently discovered that Credit Suisse provided those contractual warranties despite its fraudulent representations.

156. In addition, these contractual assurances were fundamental to the allocation of risk of loss in connection with the Transaction. As the seller of loans to the Transactions, Credit Suisse assumed the risks associated with the origination, selection, and description of the loans. That is, Credit Suisse expressly accepted the risk that its disclosures pertaining to its business practices and to the loans were true, accurate and complete (*i.e.*, not false or misleading), regardless of its own (or MBIA's) knowledge or diligence to the contrary. MBIA, in turn, accepted the payment risk on certain securities

backed by loans ***conforming to Credit Suisse's warranties, and securitized pursuant to practices truthfully represented to MBIA***.

157. This was a reasoned contractual risk allocation. Unlike MBIA, Credit Suisse either originated the loans or was in privity with the originators, and had purportedly established controls, protocols, and criteria governing the selection of loans to acquire from the originators and securitize. Credit Suisse dictated the protocols and the underwriting standards, to which its employees, affiliates, or other originators were obligated to adhere, for their loans to qualify for Credit Suisse origination, acquisition, or securitization. Credit Suisse thus had the ability to manage, and claimed in fact to have effectively managed, the risk associated with the origination, selection, and description of the loans. Credit Suisse routinely obtained representations and warranties from the originators of the loans it purchased and Credit Suisse had the ability to seek recourse for breaches of those provisions. Credit Suisse also had the ability to reject – and represented to MBIA that it did in fact reject – loans that it determined did not comply with prudent and applicable underwriting standards. And it was Credit Suisse that directed the loan-level due diligence on the Loans.

158. Conversely, as a financial guarantee insurer, MBIA was several steps removed from the process of vetting the borrowers to whom these loans were made. Moreover, the timing, the roles of the respective parties, and the economics of the Transactions made independent loan file due diligence by MBIA commercially impractical and duplicative of the work that Credit Suisse purportedly performed. Credit Suisse and MBIA agreed and expected that MBIA would rely upon the information supplied by Credit Suisse to MBIA about Credit Suisse's business practices, the results of

the due diligence of the loans, and the characteristics of the loans themselves, as the basis for MBIA's evaluating the risks of insuring the Transactions. The Transactions, as agreed to by the parties, simply could not work if MBIA could not rely upon the truthful representations of Credit Suisse. Accordingly, the contractual warranties assured that a reasoned risk allocation was enacted between the parties: MBIA only agreed to assume the payment risk of securities backed by the loans ***bearing the characteristics, and originated pursuant to the protocols, represented and warranted by Credit Suisse***.

B. MBIA Reasonably Relied Upon Credit Suisse's Misrepresentations When It Evaluated the Risk of Issuing the Policy

159. As documented in MBIA's Credit Memorandum, MBIA conducted reasonable diligence consistent with industry standards, and its internal criteria for the evaluation of such solicitations.

160. In evaluating the proposed Transaction MBIA employed its Risk Selection Criteria, consistent with industry standards for financial guarantors evaluating whether to issue such policies, and determined whether to issue the Policy in part based upon whether there had been satisfactory "third party review of collateral for underwriting compliance, legal compliance, and appraisal quality," the loans were issued to "high quality borrowers," as represented by Credit Suisse, and Credit Suisse's demonstration of "consistency of collateral attributes."

161. MBIA accordingly required specific disclosures from Credit Suisse, setting the agenda for the March 2007 diligence meeting, and in follow-up requests. Credit Suisse expressly intended for its responses to these requests "***to get [MBIA] comfortable with our process so that we can get them to commit to their proposed bid***." These false and misleading representations, including but not limited to

the representations concerning Credit Suisse's underwriting, due diligence, quality control, and repurchase practices, the performance of prior securitizations, and Credit Suisse's financial wherewithal, all had their intended effect: The Credit Memorandum reflects MBIA's reliance upon these representations, and more specifically that "[m]embers of [MBIA's] Risk and the Real Estate Group met with the HEMT team [Credit Suisse] to perform due diligence in March of 2007. The team was satisfied with the quality of the HEMT team management and their risk management systems pertaining to this program."

162. The Credit Memorandum further reflects that MBIA relied upon Credit Suisse's representations concerning its business operations. MBIA employed a fraud risk model, created by MBIA's Corporate Analytics Group and attached to the Credit Memorandum, which evaluated information provided by Credit Suisse about the company, including Credit Suisse's level of disclosure and transparency, internal audit function, financial condition and expansion of current lending products. The Credit Memorandum thus reflects MBIA's consideration and reliance upon the integrity of Credit Suisse's business practices, as represented.

163. In addition to the diligence it performed on Credit Suisse's business operations, MBIA conducted diligence in connection with the quality and attributes of the Loans for securitization, relying upon the data provided by Credit Suisse to be true. The Credit Memorandum makes clear that MBIA relied upon the representations that the Loans were "underwritten to guidelines which were either created or approved by Credit Suisse," that "over the course of a year, the credit requirements for this program have tightened, and that "Credit Suisse performs due diligence prior to loan

purchase, thus only buys the loans approved."

164. MBIA also took the loan tape data disclosed by Credit Suisse as true, and used certain data for inputs into its modeling of the risk associated with issuing the Policy. Specifically, the loan tape data was used and relied upon by MBIA to establish a perspective regarding collateral performance, and to estimate the cash flow for the transaction. MBIA analysts generated MBIA's own representative lines of collateral from the loan tape provided by Credit Suisse, which enabled it to create different stratifications that would replicate the composition of the collateral pool. Analysts stratified the loan tape by running the information in the tape through MBIA's Collateral Analytic System. And based on the information obtained from the stratifications, MBIA generated a base case loss number for the Transaction.

165. The stress case cash flow results generated by the model demonstrated, among other things, the percentage of losses that the Transaction could sustain, or, alternatively, the sufficiency of the credit enhancement to protect MBIA against being required to pay claims on its policy. MBIA's cash flow models were designed with the ability to generate multiple loss coverage amounts, reflecting alternative assumptions, and MBIA limited the credit risk of its insured portfolio by requiring that the securities it insured, including the Transaction, satisfied its "no-loss" underwriting policy. The loan tape data, the truth of which was represented and warranted by Credit Suisse, was false and misleading, and thus resulted in inaccurate modeling results. Credit Suisse knew and intended that MBIA would rely on Credit Suisse's representations that the loan tape data was true, and would use false loan tape data to evaluate the risk associated with issuing the Policy.

166. The falsity of Credit Suisse's misrepresentations about its own business practices and about the Loans could not have been discovered through the exercise of ordinary intelligence. As this Court and other courts have noted, "to suggest that discovery of the true nature of the securitizations could have been achieved through reasonable investigation severely oversimplifies a product that has humbled many financial titans who considered themselves experts in understanding securitizations." Docket No. 40, July 30, 2010 Order (entered Aug. 9, 2010) at 12, quoting *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.,* 27 Misc.3d 1061, 1077 (Sup. Ct. N.Y. County 2010). Indeed, it is only through painstaking disclosure – by obtaining the Loan files (of which Credit Suisse maintained exclusive custody and control), analyzing Credit Suisse's internal databases, emails, and documents, and through the statements of confidential and other third-party witnesses – that MBIA has been able to piece together the depth and breadth of Credit Suisse's misconduct.

IV. CREDIT SUISSE WARRANTED THE TRUTH OF THE INFORMATION PROVIDED TO MBIA AND THE ATTRIBUTES OF THE LOANS

167. The use of contractual warranties to allocate transactional risks among sophisticated parties in complex transactions is common. In addition to confirming the reliability of Credit Suisse's pre-contractual representations, these warranties assured that MBIA only assumed the risk of performance based upon loans properly originated and selected for securitization, pursuant to the represented and warranted processes. Credit Suisse, in turn, assumed the risk that the Loans did not actually comply with the warranties, and guaranteed to MBIA the integrity of Credit Suisse's business practices, which were purportedly intended to safeguard against the risks associated with the securitization. The use of these contractual warranties was an

efficient way of allowing the parties to confirm their roles, responsibilities, and risks in the Transaction – *i.e.*, Credit Suisse oversaw the origination, acquisition, due diligence, quality control, and securitization of the loans, maintained exclusive custody and access to the loan files, and had direct relationships with the originators; MBIA insured the risk of non-performance for loans bearing specific attributes, based upon the information provided by Credit Suisse. Given those roles and responsibilities, the allocation of risks made sense, and placed upon the respective parties the proper incentives for performance. The pricing and economics of the Policy confirm these principles.

168. As previously set forth, Credit Suisse made two types of contractual representations and warranties to implement the parties' negotiated risk-allocation. The Transaction Warranties concerned, generally, the attributes of the Transaction loan pool in the aggregate, and the truthfulness of the information provided to MBIA about Credit Suisse's mortgage-lending operations, practices and protocols, and related disclosures. The Loan Warranties concerned the characteristics of each individual loan that was securitized. Credit Suisse's certification as to the truth of the Transaction and Loan Warranties was an express condition precedent to MBIA's issuance of the Policies. *See*, *e.g.*, Insurance Agreement § 3.01(c).

A. The Transaction Level Warranties

169. The transaction-level warranties were made in Section 2.01 of the Insurance Agreement and include the following:

> (g) *Financial Statements*. The Financial Statements of the Seller and the Servicer, copies of which have been furnished to the Insurer, (i) are ... complete and correct in all material respects, (ii) present fairly the financial condition and results of operations of the Seller and the Servicer ... and (iii) have been prepared in accordance with generally accepted accounting principles...Except as disclosed in the Financial Statements, the Servicer and Seller are

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> not subject to any contingent liabilities or commitments that, individually or in the aggregate, could reasonably be expected to cause a Material Adverse Change in respect of the Servicer or the Seller.[2]
>
> (j) *Accuracy of Information*. Neither the Transaction Documents nor other material information relating to the Mortgage Loans, the operations of the Servicer, the Seller or the Depositor (including servicing or origination of loans) or the financial condition of the Servicer, the Seller or the Depositor or any other information (collectively, the "Documents"), as amended, supplemented or superseded, furnished to the Insurer by the Servicer, the Seller or the Depositor contains any statement of a material fact by the Servicer, the Seller or Depositor which was untrue or misleading in any material adverse respect when made. . . .
>
> (k) *Compliance with Securities Laws*. The offer and sale of the Securities comply in all material respects with all requirements of law.... Without limitation of the foregoing, the Offering Document does not contain any untrue statement of a material fact and does not omit to state a material fact necessary to make the statements made therein, in light of the circumstances under which they were made, not misleading; provided, however, that no representation is made with respect to the Insurer Information. Neither the offer nor the sale of the Securities has been or will be in violation of the Securities Act or any other federal or state securities laws.

170. As the foregoing provisions illustrate, the Transaction Warranties broadly attest that all the information provided by Credit Suisse concerning its financial condition, the Loans, the Credit Suisse mortgage lending operations (*e.g.*, its loan-acquisition practices, underwriting guidelines and due diligence), or any representations used to market the Certificates (*e.g.*, the Prospectus or Prospectus Supplement), were true, accurate and complete. Any material misstatement or omission with respect to such disclosures therefore is a breach of these provisions, ***irrespective*** of whether or not Credit Suisse knew or intended such misstatement or omission. Thus, for example, the

[2] [2] A "Material Adverse Change" is defined as a "material adverse change in (a) the business, financial condition, results of operations or properties of such Person or (b) the ability of such Person to perform its obligations under any of the Transaction Documents." Insurance Agreement § 1.01.

Transaction Warranties are breached by Credit Suisse's false and misleading written representations found in the Pitchbook, emails, loan data, representations provided at the diligence meeting, and in the investor disclosures.

171. The Financial Statements Warranty also is breached by Credit Suisse publication and provision of false and misleading financial statements that did not accurately reflect its contingent liability arising from its securitization of defective loans. As discussed above, Credit Suisse knew that it securitized defective loans, and indeed asserted and recovered on claims against originators/sellers for defective loans in securitizations. But Credit Suisse failed to reserve for its obligation to the securitizations to cure or repurchase those defective loans. The large volume of repurchase claims asserted against Credit Suisse affirms the materiality of the liability that Credit Suisse should have but elected not to recognize.

B. Loan-Level Warranties

172. The Loan Warranties were made in the Pooling and Servicing Agreement ("PSA") and explicitly incorporated by reference into the Insurance Agreement. Specifically, the Insurance Agreement, Section §2.01(l), provides as follows:

> *Transaction Documents*. Each of the representations and warranties of the Servicer, the Seller [Credit Suisse] and the Depositor contained in the Transaction Documents to which they are, respectively, a party is true and correct in all material respects, and the Servicer, the Seller and the Depositor hereby make each such representation and warranty to, and for the benefit of, the Insurer [MBIA] as if the same were set forth in full herein. . . .

The Insurance Agreement defines "Transaction Documents" to include the PSA.

173. In the PSA, Credit Suisse made numerous representations and warranties about the attributes of each Loan in the Transaction, and thereby assumed the

risk that those warranties proved false, ***irrespective*** of DLJ's knowledge of their falsity. These representations and warranties are found in Schedule IV to the PSA, and are made, by the PSA's express terms (Section 2.03(d)), for MBIA's benefit:

> The Seller [Credit Suisse] hereby makes the representations and warranties set forth in Schedule IV as applicable hereto, and by this reference incorporated herein, to the Trustee and the Certificate Insurer [MBIA], as of the Closing Date, or if so specified therein, as of the Cut-off Date or such other date as may be specified.

174. Credit Suisse's representations and warranties in Schedule IV of the PSA include, among others, the following with respect to each loan included in the Transaction:

> (ii) Any and all requirements of any federal, state or local law ... applicable to the Mortgage Loan have been complied with in all material respects at the time it was originated and as of the Closing Date.
>
> (iv) The Mortgage Loan complies with all the terms, conditions and requirements of the originator's underwriting standards in effect at the time of origination of such Mortgage Loan, which in all material respects are in accordance with customary and prudent underwriting guidelines used by originators of closed-end second lien mortgage loans.
>
> (v) The information set forth in the Mortgage Loan Schedule, attached to the Agreement as Schedule I, is complete, true and correct in all material respects as of the Cut-off Date.
>
> (xliv) The origination, underwriting, servicing and collection practices with respect to each Mortgage Loan have been in all respects legal, proper, prudent and customary in the mortgage lending and servicing business, as conducted by prudent lending institutions which service mortgage loans of the same type in the jurisdiction in which the Mortgaged Property is located.
>
> (xlv) There is no material monetary default existing under any Mortgage or the related Mortgage Note and there is no material event that, with the passage of time or with notice and the expiration of any grace or cure period, would constitute a default,

> breach, violation or event of acceleration under the Mortgage or the related Mortgage Note....

175. Thus, the Loan Warranties are breached by, among other violations, loans made to borrowers (i) with unreasonable stated incomes or that otherwise have no reasonable ability to repay the loan, which would contravene any prudent underwriting guideline, and/or (ii) who falsely stated their income, which would render the information on the Mortgage Loan Schedule untrue, and would constitute a breach of the terms of the borrower's Mortgage. As discussed below, the securitized loan pool is replete with such breaches and many others.

C. Credit Suisse Agreed to Provide Notice to MBIA of Known Breaching Loans, and to Cure or Repurchase Them From the Trust

176. Credit Suisse agreed to the "Repurchase Protocol" set forth in Section 2.03 of the PSA, pursuant to which "[u]pon discovery ... of a breach of a representation or warranty made pursuant to Section 2.03(d)," *i.e.*, the Loan Warranties, Credit Suisse was obligated to "give prompt notice thereof to the other parties and [MBIA]," and further agreed to cure, substitute, or repurchase such breaching Loans from the Trust.

177. The Repurchase Protocol thus required Credit Suisse to notify MBIA when it discovered conditions within the Loans that constituted breaches of the Loan Warranties, *e.g.*, Loans that did not meet applicable underwriting guidelines, Loans that were illegally originated or obtained through fraud, and Loans that were issued based upon false representations by borrowers that constituted defaults under the Mortgage Loan and Note. The requirement of prompt notice and repurchase of such Loans was intended for the protection of MBIA, given the risk allocation of the Transaction: To the extent Credit Suisse securitized non-conforming Loans, MBIA did not agree to insure the

Trust payments.

D. Credit Suisse's Servicing Obligations

178. Credit Suisse represented in the Pooling & Servicing Agreement that SPS would "service and administer the Mortgage Loans in accordance with. . . Accepted Servicing Practices," which were defined within the agreement as "those mortgage servicing practices of prudent mortgage lending institutions which service mortgage loans of the same type as such Mortgage Loan in the jurisdiction where the related Mortgaged Property is located." Credit Suisse's internal discussions, obtained as a result of discovery in this case, reveal that SPS failed to live up to these prudent servicing standards, and was utterly unprepared and unqualified to service the Loans.

179. In January 2007, Credit Suisse's Director of Second Loan Trading and Managing Director of Credit Trading noticed that the 2006 HEMT deals were not performing as well as expected, leading them to speculate that SPS may be the cause; the Director of Second Loan Trading made clear that "servicing at SPS needs to improve." After visiting SPS and learning that SPS's performance was significantly inferior to other servicers, he noted on February 15, 2007 that "[t]he 2nd lien servicing portfolio at SPS has grown from 542 loans in April 2006 to 43,474 loans today! Many collectors are inexperience[d]." Nevertheless, little more than two months later, and having taken no steps to rectify SPS's overmatched condition, Credit Suisse represented and warranted to MBIA that SPS could adequately service an additional 15,000 second lien loans for HEMT 2007-2. Credit Suisse did not disclose to MBIA its own criticism and distrust of SPS's servicing practices. To the contrary, it fraudulently touted SPS's servicing capabilities.

180. On June 22, 2007, less than two months after the Transaction

closed, Credit Suisse's Director of Second Loan Trading was shocked to find that a greater percentage of loans in HEMT 2007-2 were already delinquent than he had seen before in other deals. He immediately suspected servicing issues and e-mailed SPS to determine if there was "anything [they] could do to improve the performance." By July 13, 2007, the situation had not improved, leading Credit Suisse's head of Servicing Oversight to state the matter simply to an SPS employee: "If I look at bottom line performance. . . it shows SPS's performance substandard." In September 2007, Credit Suisse conducted a "Servicing Scorecard" review, which was "designed to collaboratively examine, with servicer input, key activities that drive portfolio results." Again, the outcome was poor, leading the SPS employee to state that if after an internal SPS review "the results are found to be as unfavorable as [Credit Suisse] has indicated, you will need to discuss plans to improve the metric."

181. By August 2008, MBIA had also taken note of the mounting default rate, and requested an on-site visit to determine SPS's servicing capabilities. Internally, SPS acknowledged that "MBIA is very concerned about the HEMT 2007-2 deal and SPS's servicing performance." In December 2008, counsel for MBIA, in expectation of litigation against SPS, enlisted a third-party consultant to review SPS's conduct as servicer; and specifically whether SPS had complied with the requirements of Section 3.01 of the PSA, that it act in accordance with prudent and accepted servicing practices.

182. MBIA's review of SPS's servicing capabilities was severely and improperly limited by SPS, but it nevertheless revealed that SPS had failed to adequately service the loans in the Transaction. As explained below, MBIA has a contractual right

of access to information regarding SPS's servicing work. Significantly, as the level of losses on the pool mounted, SPS ***reduced*** the staff dedicated to the servicing of those loans. SPS's loss mitigation efforts were grossly inadequate, as it did virtually nothing to contact delinquent borrowers and try to bring them current or make alternative arrangements for repayment of their debts.

183. Moreover, notwithstanding the industry's focus on loan modifications as a loss mitigation strategy, SPS modified the loans for only a small handful of borrowers. SPS did not, as was industry standard, send anyone to the mortgaged property to try to contact the borrower and/or to inspect the property that served as collateral for the loan. And, on those relatively rare occasions when SPS representatives managed to contact a delinquent borrower, the representatives lacked the basic skills and training necessary to obtain any meaningful assurances of future payments on the loan.

184. Furthermore, SPS determined that certain borrowers had "no equity" in their respective properties – a designation that effectively forestalled additional collection efforts – without any evidence to support the conclusion. SPS did not have a specialized group for servicing second-lien loans, and it was grossly understaffed for the collection and loss mitigation efforts that needed to be brought to bear on this troubled loan pool. In short, SPS failed to adhere to prudent and accepted servicing practices as required by the PSA. Ultimately, because of SPS's incompetence and further breaches of servicing obligations described below, MBIA terminated SPS in March 2009.

185. SPS's incompetence in servicing represented only one means by which it harmed MBIA and the Trust. To conceal Credit Suisse's malfeasance in

underwriting and reviewing the Loans, and to frustrate MBIA's ability to avail itself of the Repurchase Protocol, SPS intentionally prevented MBIA from accessing the Loan origination files that were essential to MBIA's evaluation of whether the loans in the Transaction complied with Credit Suisse's representations and warranties.

186. Following the inordinate number of defaults on the loans in the Transaction – which defaults ultimately triggered MBIA's payment obligations under the Policy – MBIA sought access to the Loan origination files, which were in the custody of SPS, consistent with SPS's role as servicer for the Transaction. By letter dated August 22, 2008, MBIA wrote SPS requesting a servicing review and a review of origination files for all loans that were then 60 or more days delinquent. MBIA's rights to conduct such reviews (the "Access Rights") were expressly and specifically provided for by contract, precisely so that MBIA could avail itself of the Repurchase Protocol and evaluate SPS's servicing of the Loan pool. In this regard, Section 3.07 of the PSA provides as follows:

> The Servicer shall afford the Depositor, the Certificate Insurer [MBIA] and the Trustee reasonable access to all records and documentation regarding the Mortgage Loans and all accounts, insurance information and other matters relating to this Agreement, such access being afforded without charge, but only upon reasonable request and during normal business hours at the office designated by the Servicer.

187. In response to MBIA's request, by a series of communications beginning with its letter dated September 18, 2008, SPS stonewalled and ultimately improperly denied MBIA access to the Loan origination files that MBIA sought and was contractually entitled to. SPS first responded to MBIA's request by indicating that it did not have the origination files MBIA sought. When that lie was debunked, SPS objected to providing access to MBIA on various equally illegitimate grounds for the next several

months, including feigned financial and operational burden and confidentiality concerns. While SPS stonewalled, the losses to MBIA mounted as its claim payments reached the hundreds of millions of dollars.

188. In addition, Credit Suisse underfunded SPS so that it did not have adequate resources to carry out its servicing responsibilities. Under a side agreement executed between SPS and Credit Suisse, SPS split its servicing fees with Credit Suisse affiliate DLJ. Thus, while the Transaction servicing fees provided significant compensation to Credit Suisse entities, the portion of that fee that SPS actually received did not provide it with the resources to do its job.

189. With SPS failing to comply with its contractual servicing obligations and refused MBIA the loan file documentation it required to assess the extent of DLJ's breaches, MBIA was left with no choice but to terminate SPS as servicer, in accordance with its contractual right to do so under the PSA. Only after such termination in March 2009 did MBIA finally obtain access to many of the origination files it first sought to obtain from SPS. As explained below, MBIA quickly discovered why SPS had been so intent on concealing the loans files: they confirmed Credit Suisse's pervasive lies about the quality of the Loans.

190. Making matters worse, MBIA also discovered after terminating SPS that SPS's malfeasance did not end with its inadequate servicing or obfuscation of its affiliates' wrongdoing by denying MBIA access to loan files. In connection with the servicing transfer, MBIA learned that SPS had wrongfully released and thus denied MBIA access to more than 2,000 charged-off Loans released from the Trust to the holders of the Class X-2 Certificates, which were all held by Credit Suisse entities.

191. Under the PSA, SPS was permitted to release charged-off loans to the holders of the Class X-2 Certificates subject to satisfying certain conditions. These "charged-off" loans were mortgages that were more than 180 days in default. The purpose of the provision in the PSA that allowed these loans to be released was to permit the removal of only those Loans from the Trust with respect to which SPS had made a good faith effort, for a reasonable period of time, to collect all that could be collected from the borrower. The Class X-2 Certificate holders could then seek to obtain recoveries from these mortgages by pursing the delinquent borrowers.

192. Before any Loan could be released in this manner, certain procedures had to be followed by SPS pursuant to the terms of the PSA, and MBIA had to be provided notice of the satisfaction of those procedures. Specifically, SPS could only release those charged-off Loans that SPS had affirmatively determined to service using industry appropriate "special servicing" techniques for a prescribed period of time after charge-off. The PSA required that SPS's determination be evidenced by a special notice to MBIA. And the special servicing under the PSA should have consisted of loss mitigation and/or recovery efforts by SPS to maximize proceeds to the Trust. But SPS did not engage in any legitimate "special servicing" activity with respect to these Loans post-charge-off and before releasing them from the Trust, nor did it ever notify MBIA of its intention to do so as required by the PSA. Accordingly, SPS improperly released more than 2,000 charged off Loans from the Trust, to another Credit Suisse affiliate, all of which loans rightfully continue to constitute property of the Trust.

193. This harmed MBIA in two ways. First, because SPS claimed that those Loans were no longer the property of the Trust, SPS did not transfer the loan files

associated with those loans to the successor servicer. As such, SPS continued to deprive MBIA of access to loan files relating to more than 2,000 defaulted loans. Without these files, it was impossible for MBIA to evaluate whether the loans were in compliance with Credit Suisse's representations.

194. Second, any recoveries that might have been obtained with respect to those Loans, including recoveries in the form of sales on a secondary market, rightfully belong to the Trust, and should therefore have been used to mitigate MBIA's claim payments or to offset future payments MBIA is required to make under its Policy. By breaching its contractual obligations with respect to the charged-off loans, SPS improperly diverted assets from the Trust to other Credit Suisse affiliates. On many occasions, once the Loans were released to the Class X Holder, SPS again began servicing the Loans for Credit Suisse and made additional collections, or Credit Suisse sold the Loans to third parties at a discount.

195. The foreseeability of the recoveries on the Loans at the time SPS instructed the Trust to release them is reflected in Credit Suisse's accounting records, which treated the released Loans as valuable assets.

V. MBIA DISCOVERS PERVASIVE BREACHES OF LOAN WARRANTIES

196. Upon finally obtaining access to some of the loan files for the Loans, pursuant to its contractual right of post-closing access, MBIA retained a third-party consultant to review the files created during the origination of the Loans for compliance with underwriting guidelines. From a sample of 1,386 defaulted loans in the Transaction, MBIA identified breaches of the Loan Warranties in a remarkable 1,213 loans—87%—with an aggregate principal balance of approximately $78.1 million. MBIA also reviewed a sample of 477 randomly-selected loans from the Transaction. Of

those, MBIA identified breaches of Loan Warranties with respect to 377 loans—79%—with an aggregate principal balance of approximately $20.6 million. The analysis demonstrates that breaches of the Loan Warranties are pervasive, and exist in a comparable percentage of loans in the total securitized loan pool.

197. The breaching loans contained one or, in most cases, more than one defect that constituted a breach of one or more of the Loan Warranties. These defects include:

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

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

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

198. The number and nature of the defects identified by MBIA's review indicated clearly that the Loans were systematically originated with virtually no regard for the borrowers' ability or willingness to repay their obligations – the fundamental precept of mortgage lending. Borrowers were permitted or encouraged to take out loans they obviously could not afford to repay.

199. These breaches materially and adversely affected MBIA's interests in the identified Loans. Loans that were not appropriately originated and underwritten, or with key attributes otherwise misrepresented, are markedly more risky and therefore less

valuable than loans not suffering from such shortcomings, and materially increased the risk profile for the Policy.

200. The pervasive breaches in the securitized pool are borne out by the performance of the loans since closing. As of February 29, 2012, 9,398 loans with an aggregate original principal balance of approximately $597 million (or approximately 66% of the original pool balance) have defaulted and been charged-off, resulting in the payment by MBIA of more than $386 million in claims.

VI. CREDIT SUISSE FRUSTRATED THE REPURCHASE PROTOCOL BY REFUSING TO REPURCHASE ANY OF THE DEFECTIVE LOANS

201. Based upon its ongoing reunderwriting of Loans, and in accordance with Section 2.03(e) of the PSA, MBIA has issued 41 notices to Credit Suisse of breaching loans. The Trustee demanded that DLJ comply with its obligations under the Repurchase Protocol and cure or repurchase the affected loans within 90 days.

202. DLJ provided substantive responses with respect to the first three repurchase demands issued by MBIA, refusing to repurchase any of the Loans identified by MBIA. Thereafter, Credit Suisse stopped providing substantive responses to MBIA's repurchase demands, and refused to cure or repurchase any of the first 5,489 loans identified by MBIA as breaching the Loan Warranties.

203. MBIA has discovered, through Credit Suisse's limited disclosure of its quality control data and its own repurchase demands to originators, that on many occasions, Credit Suisse identified the same kinds of factual defects as underwriting and origination deficiencies for Loans, and other loans, written to the same guidelines as those identified by MBIA. Indeed, in some instances, Credit Suisse issued repurchase demands to originators on the same basis, and under substantially identical contractual

rights, as MBIA has asserted against Credit Suisse.

204. Credit Suisse had actual notice of hundreds of such breaches amongst the Loans, as reflected in its underwriting, due diligence, and quality control data, and as reflected in "advice letters" and repurchase demands that it sent to the originators or sellers from which Credit Suisse obtained the Loans. And based upon the manner in which it had notice of those breaches, *i.e.*, through its sample-based quality control process (sampling and reviewing 3% of its loan population), by extrapolation of the data Credit Suisse was on notice that there were thousands more breaching Loans in the securitization pool. Notwithstanding notice of Loan Warranty breaches amongst the Loans, both before and after securitizing the Loans, Credit Suisse did not provide to MBIA notice of any breaches of Loan Warranties, and did not repurchase the breaching Loans from the Trust.

205. Credit Suisse has produced fragments of data generated from its quality control process that reveal Credit Suisse identified defects, and issued repurchase demands, for more than 500 Loans included in the Transaction, based upon its process of sampling 3% of its loans for quality control review and reviewing defaulted Loans. These defects included breaches of the Loan Warranties such as improper verification of assets or employment, non-compliance with applicable laws, violation of underwriting guidelines, income misrepresentations, and the origination of "high cost" loans, as well as early payment defaults that were recognized by the industry as evidence of improper origination. More than 125 of these loans were expressly flagged in Credit Suisse's quality control results as "Risk Class 3," meaning "Does Not Meet Guidelines," and included findings of defects such as undisclosed debts, errors in income calculation,

insufficient credit history, excessive borrower debt ratios, and high cost loans. Even in the month that the Transaction closed, April 2007, Credit Suisse employees reviewed quality control data that showed these serious unresolved defects.

206. Further evidence that Credit Suisse knew it had securitized defective Loans, but failed to provide notice of those defective Loans to MBIA or repurchase them from the Trust, comes in the form of Credit Suisse's "advice letters." As discussed above, instead of demanding that the originator or seller repurchase the loan, Credit Suisse issued advice letters, notifying the seller or originator that Credit Suisse had identified conditions that would require repurchase, and then negotiated with the originator or seller for a price reduction, forward-incentive, or other settlement. Credit Suisse would thereby obtain the benefit from the settlement (in the form of a cash payment or future price reductions), while failing to notify the securitization trusts about the loan defects it had identified. Credit Suisse employed its "advice letter" practice broadly, and with respect to Loans securitized in the Transaction, without informing MBIA or the Trust that it had identified underwriting defects amongst the Loans.

VII. CREDIT SUISSE'S POST-LITIGATION RESPONSES TO MBIA EVIDENCE ITS MERITLESS DENIALS OF MBIA'S REPURCHASE DEMANDS

207. Since initiating this lawsuit, once it became clear that Credit Suisse had no intention of honoring valid repurchase demands, MBIA has continued to reunderwrite and issue repurchase demands to Credit Suisse for Loans that demonstrate material breaches of the Loan Warranties. Credit Suisse continued to deny MBIA's responses summarily until February 2012. MBIA has obtained disclosure through this action which confirms that Credit Suisse routinely identified similar underwriting and origination defects in its inventory as MBIA has asserted for the bases of its repurchase

demands. Repeatedly confronted by MBIA pointing out the inconsistency of its brazen denials to MBIA's repurchase demands, while harboring quality control results confirming those findings, and itself making repurchase demands on similar bases, in February 2012 Credit Suisse repurchased 11 Loans from the thousands of repurchase demands issued by MBIA, and has repurchased 38 more in response to MBIA's continuing evaluation of Loans and issuance of repurchase demands. Credit Suisse has provided no valid basis for accepting these 49 repurchase demands by MBIA and refusing the nearly 5,500 other demands by MBIA. Its response to MBIA's repurchase demands, when measured against its own repurchase demands for the same Loans and citing the same kinds of defects under virtually identical Loan Warranties, demonstrates Credit Suisse's blatant frustration of the Repurchase Protocol, and its material breach of the Insurance Agreement.

FIRST CAUSE OF ACTION
(FRAUDULENT INDUCEMENT AGAINST CS SECURITIES)

208. As set forth above, in response to MBIA's inquiries, and in communications and statements provided to MBIA prior to MBIA's agreement to issue the Policy, Credit Suisse made material false statements and concealed material facts concerning (i) Credit Suisse's business operations and (ii) the securitized Loans.

209. Credit Suisse intended for these fraudulent statements and omissions to induce MBIA's participation in the Transaction, execution of the Insurance Agreement, and issuance of the Policies.

210. MBIA obtained contractual warranties affirming the pre-contractual representations to assure that it could reasonably rely upon those representations.

211. MBIA reasonably relied upon Credit Suisse's fraudulent statements and omissions when it agreed to enter into the Insurance Agreement and issue the Policy. The Insurance Agreement is void and invalid as fraudulently induced by Credit Suisse.

212. By means of its fraudulent statements and omissions, Credit Suisse deprived MBIA of the ability to evaluate the actual risk that the Policy insured.

213. By issuing the fraudulently induced Policy, MBIA insured payments to be made by the trusts based upon far riskier loans than were represented by Credit Suisse.

214. As a result of issuing the Policy, MBIA has suffered, and will continue to suffer, damages including claims payments under the Policy, in an amount to be proved at trial.

215. Punitive damages are further warranted in an amount to be determined at trial.

SECOND CAUSE OF ACTION
(MATERIAL BREACH OF THE INSURANCE AGREEMENT AGAINST DLJ)

216. Credit Suisse induced MBIA to enter into the Transaction and to issue the Policy by making the Transaction Warranties and Loan Warranties, and committing to comply with its obligations under the Repurchase Protocol.

217. Credit Suisse's willful and pervasive breaches of the Transaction Warranties and Loan Warranties constitute a material breach of the Insurance Agreement, materially increase MBIA's risk of loss and damages within the coverage of the Policy, and are so substantial and fundamental as to defeat the object of the parties in entering into the Transaction.

218. Credit Suisse's frustration of the Repurchase Protocol also constitutes a material breach of the Insurance Agreement.

219. MBIA has incurred and will continue to incur damages, in an amount to be proved at trial, as a result of Credit Suisse's breach of the Insurance Agreements.

THIRD CAUSE OF ACTION
(BREACH OF THE REPURCHASE PROTOCOL AGAINST DLJ)

220. As of the close of the Transaction and thereafter, Credit Suisse had notice that the Loans it sold into the Transaction were replete with loans that breached the Loan Warranties.

221. In a series of letters, MBIA has provided notice to Credit Suisse of Loans that breach the Loan Warranties, along with descriptions of breaches sufficient to require Credit Suisse to repurchase the Loans from the Trust.

222. Credit Suisse has materially breached its obligations under Section 2.03(e) of the PSA, by failing to provide notice to the Trust and to MBIA of known Loans that breach the Loan Warranties, and by refusing to cure or repurchase the Loans that breach the Loan Warranties, pursuant to the terms of the Repurchase Protocol.

223. MBIA has been damaged and will continue to be damaged in an amount to be determined at trial.

FOURTH CAUSE OF ACTION
(BREACH OF ACCESS RIGHTS AND SERVICING OBLIGATIONS AGAINST SPS)

224. Pursuant to Section 3.07 of the PSA, SPS was required to provide MBIA reasonable access to all records and documentation regarding the Mortgage Loans.

225. In breach of its contractual obligations, SPS refused MBIA's

reasonable request to review the loan documents and records.

226. SPS further breached its contractual obligations by failing to adhere to prudent and accepted servicing standards, as required by Section 3.01 of the PSA, and by releasing charged-off loans without complying with the provisions set forth in Section 3.11 of the PSA for releasing such loans.

227. As a result of SPS's breaches, MBIA was delayed in obtaining access to certain documentation relating to the Mortgage Loans, and MBIA was delayed from terminating SPS, allowing SPS to earn unwarranted fees. In addition, SPS's improper servicing practices and tactics have made it impossible for MBIA to identify and seek to remedy promptly, and concealed Credit Suisse's pervasive misconduct with respect to the Transaction. MBIA has been damaged and will continue to be damaged in an amount to be determined at trial.

FIFTH CAUSE OF ACTION
(REIMBURSEMENT AGAINST DLJ)

228. Pursuant to Section 3.03(b) of the Insurance Agreement Credit Suisse agreed to reimburse MBIA for payments made under the Policy arising as a result of Credit Suisse's failure to repurchase any Mortgage Loan required to be repurchased by Credit Suisse, pursuant to the PSA.

229. Pursuant to Section 3.03(c) of the Insurance Agreement, Credit Suisse agreed to reimburse MBIA for any and all charges, fees, costs, and expenses paid or incurred in connection with, among other things, enforcing, defending, or preserving MBIA's rights under the Transaction Documents.

230. Pursuant to Section 3.03(d) of the Insurance Agreement, Credit Suisse agreed to pay MBIA interest on the amounts to be reimbursed under Section

3.03(b) and 3.03(c).

231. MBIA has made payments made under the Policy arising as a result of Credit Suisse's failure to repurchase any Mortgage Loan required to be repurchased by it, pursuant to the PSA, and has incurred numerous expenses, including attorneys' fees and expert fees, in order to enforce, defend, and preserve its rights under the relevant agreements.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff respectfully prays for the following relief:

- An award of all legal, equitable and punitive damages, to be proven at trial, for Credit Suisse's fraudulent inducement of MBIA's participation in the Transaction and issuance of its Policy;
- An award of compensatory, consequential, and/or equitable damages, and any other damages to be proven at trial, for Credit Suisse's pervasive and material breaches of its representations and warranties, and contractual repurchase obligation, constituting a material breach of the Insurance Agreement and frustration of the parties' bargain;
- An award of compensatory and/or consequential damages, and any other damages proven at trial, for SPS's pervasive and material breaches of its obligations under the PSA;
- An order compelling Credit Suisse to comply with its obligations under PSA § 2.03(e), to cure, repurchase, or substitute the loans that breach its representations and warranties;
- An order awarding reimbursement of MBIA's claim payments and attorneys' fees, and other costs and expenses incurred in enforcing, defending, or preserving its rights under the Transaction Documents, pursuant to Insurance Agreement § 3.03(b) and § 3.03(c), and interest thereon pursuant to § 3.03(d).
- An order of prejudgment interest; and
- An Order awarding MBIA such other and further relief as the Court deems just and proper.

JURY DEMAND

Plaintiff demands a trial by jury for all issues so triable as a matter of right.

Dated: New York, New York
January 30, 2013

Respectfully submitted,

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