

MBIA INSURANCE CORPORATION,

Plaintiff,

-against-

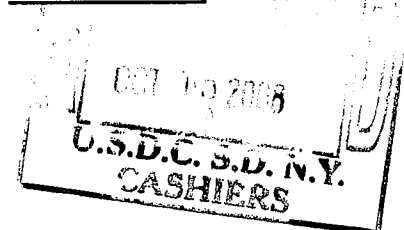
RESIDENTIAL FUNDING COMPANY, LLC,

Defendant.

Index No.

Judge Pauley

COMPLAINT



Plaintiff MBIA Insurance Corporation ("MBIA") for its Complaint against defendant Residential Funding Company, LLC ("RFC") alleges, on information and belief as to all facts other than as to itself, as follows:

NATURE OF THE ACTION

1. This action arises from defendant RFC's misleading inducement of plaintiff MBIA to provide financial guaranty insurance policies (each a "Policy" and, collectively, the "Policies") for five securitization transactions sponsored by RFC and RFC's breaches of contractual representations and warranties made to MBIA in connection with those five securitizations.

2. RFC, a Delaware limited liability company with its principal place of business in Minneapolis, Minnesota, is engaged in the business of, among other things, originating and acquiring residential mortgage loans and selling those loans through securitization programs. During 2006 and 2007, RFC sought to sell certain of its residential home equity loans by means of securitization transactions and approached MBIA to provide the Policies for certain of these securitization transactions. These policies were intended to insure

payments to investors who purchased certain of the securities that were issued through the securitization transactions.

3. Among other representations and warranties, RFC represented to MBIA, and also to the investors in the securitization transactions, that the mortgage loans underlying the securitization transactions were of a certain quality and had been underwritten in accordance with RFC's underwriting guidelines and policies. RFC made this representation to assure MBIA that for each individual mortgage loan there was a reasonable expectation that the borrower would be able to repay the mortgage debt.

4. In reality, and contrary to RFC's representations and warranties, the portfolios of mortgage loans that RFC included in the securitization transactions were of a fundamentally different quality and character than RFC represented to MBIA. In that regard, a material number of mortgage loans included in the mortgage loan pools underlying the securitizations were made to borrowers who could not reasonably have been expected to be able to repay the mortgage loans, and the risks inherent in the portfolios were significantly higher than what RFC represented to MBIA. Moreover, there were fundamental, material and consistent violations of RFC's purported underwriting guidelines and policies in connection with the underwriting of the mortgage loans that RFC included in the securitization transactions. The undisclosed and misrepresented risks were pervasive throughout the mortgage loan portfolios for the securitization transactions. Had MBIA been aware of the condition of the mortgage loan portfolios and RFC's material disregard of its underwriting guidelines and policies, MBIA would not have issued the Policies for the securitization transactions.

5. MBIA's agreement to provide the Policies with respect to the securitizations was based on representations and warranties from RFC that, at best, were negligently or recklessly made and, at worst, constituted an intentional scheme to defraud MBIA

into providing financial guaranty insurance in connection with the securitization transactions sponsored by RFC. MBIA, as the financial guaranty insurer, is now exposed to liability for the losses incurred by RFC's misrepresentations with respect to the mortgage loans.

6. RFC also has breached its contractual obligations and has acted in bad faith by refusing to cure or otherwise remedy the material deficiencies in respect of individual mortgage loans.

PARTIES

7. Plaintiff MBIA Insurance Corporation is a New York stock insurance corporation with its principal place of business in Armonk, New York.

8. Defendant Residential Funding Company, LLC is a Delaware limited liability company with its principal place of business in Minneapolis, Minnesota. Residential Funding Company, LLC is successor-in-interest to Residential Funding Corporation, a Delaware corporation with its principal place of business in Minneapolis, Minnesota.

JURISDICTION AND VENUE

9. This Court has diversity jurisdiction over this action pursuant to 28 U.S.C. § 1332(a).

10. The amount in controversy exceeds the sum of \$75,000, exclusive of interest and costs.

11. Venue is proper in this District under 28 U.S.C. § 1391(a) and (c) because a substantial part of the events giving rise to these claims occurred in this District. Defendant conducts operations from offices in New York. Further, Defendant has consented to jurisdiction in the United States District Court for the Southern District of New York.

FACTS

A. RFC

12. RFC is engaged in the acquisition of residential mortgage loans under several loan purchase programs from individual mortgage loan originators or sellers nationwide. RFC, through its affiliates, also originates residential mortgage loans. Further, RFC acts as a servicer for mortgage loans.

13. RFC's practice is to sell, by means of securitization transactions, mortgage loans that it has acquired, as well as mortgage loans it originated through its affiliates. RFC has sponsored securitizations of mortgage loans secured by first liens on one- to four- family residential properties since 1986. In 1995, RFC expanded its business to include second lien mortgage loans. In fact, from 2002 through the first quarter of 2007, RFC sponsored securitizations of 1,313,052 first lien mortgage loans with an aggregate principal balance of \$243,493,046,962. During the same period, RFC sponsored securitizations of 338,441 second lien mortgage loans with an aggregate principal balance of \$14,393,392,561.

14. RFC is a wholly-owned subsidiary of Residential Capital Corporation, which is itself a wholly-owned subsidiary of General Motors Acceptance Corporation.

B. The Securitization Of Residential Mortgage Loans

15. Acquirers and originators of mortgage loans may sponsor securitization transactions to sell mortgage loans and to enable the acquisition or origination of additional mortgage loans. Securitization is the act of using a financial asset, such as a mortgage loan, as security for another instrument.

16. Securitizations can take various forms. The most common form used for mortgage loans involves the creation of a trust, to which the sponsoring entity sells a portfolio of mortgage loans. The trust will then divide the portfolio of mortgage loans into various pieces or

tranches and issue securities, which are sold to investors. Those pieces or tranches underlying the securities have different economic rights to principal and interest, among other things, and have different attributes of repayment risk. As the United States Securities and Exchange Commission (“SEC”) has observed, in many instances the transfer of assets to the trust “is a two-step process: the financial assets are transferred by the sponsor first to an intermediate entity, often a limited purpose entity created by the sponsor for a securitization program and commonly called a depositor, and then the depositor will transfer the assets to the [trust] for the particular asset-backed transactions.” SEC Release “Asset-Backed Securities” (Regulation AB), SEC Release Nos. 33-8518; 34-50905, 70 Fed. Reg. 1,506-1,631.

17. Because the mortgage loans, and their underlying cash flows, are sold to an entity, such as a trust, in connection with the securitization, the appointment of a servicer is also necessary. The servicer is responsible for handling all administrative duties under the securitization agreements, including collecting mortgage payments and determining whether a mortgage loan is in default of the obligations established by the transaction documents. The servicer remits proceeds from the mortgage loans to the trustee of the trust. The trustee is responsible for administering the funds of the trust, determining the adequacy of the trust’s funds to satisfy the trust’s obligations in connection with the securities issued by the trust and making payments to the investors.

18. Mortgage loans may consist of, among others, closed-end mortgage loans (“Closed-End Mortgage Loans”) and home equity lines of credit (“Home Equity Loans”). For Closed-End Mortgage Loans, a borrower receives the full borrowed amount of the loan at the time of origination. For Home Equity Loans, a borrower receives the right to draw upon a line of credit, which is collateralized by a mortgage lien, at any time after origination of the Home

Equity Loan up to the full amount of the Home Equity Loan. The amount of a Home Equity Loan that has been drawn upon as of any date of determination is known as the "Utilization."

19. The financial viability of an investment in a securitization is based on the quality of the underlying mortgage loans. If, for instance, the lender that originated the mortgage loans employed substandard underwriting practices, risk increases. This risk manifests itself through delinquencies on mortgage loan payments eventually leading to defaults on these mortgage loans. After a mortgage loan is in default, if a servicer of a mortgage loan determines that net recoveries to be achieved by foreclosing upon, or comparably converting, the mortgage loan are unlikely to equal or exceed the outstanding principal balance of the delinquent mortgage loan, plus certain costs and expenses related thereto, the servicer will charge-off such delinquent mortgage loan, meaning that the servicer will write down or recognize the outstanding principal balance of such mortgage loan as zero, without a corresponding payment or receipt of principal. These delinquencies, defaults and charge-offs result in a shortfall of anticipated cash flows to the trust and, consequently, a shortfall in cash flows payable to the investors.

20. To increase marketability, lower interest costs and mitigate the risk to the investors of a potential shortfall in anticipated cash flows to the trust, many securitizations include the purchase of a financial guaranty insurance policy from a financial guaranty insurer, such as MBIA. Under the terms of such a policy, a financial guaranty insurer, in consideration of a premium and subject to the terms and conditions of the policy, will unconditionally and irrevocably guarantee to the investors that, in the event there is a shortfall in cash flows to the trust, the financial guaranty insurer will insure certain payments with respect to current interest and ultimate collection of principal to the trustee for the benefit of the investors. In this way, the risk to the investors of a shortfall in the anticipated cash flows to the trust is mitigated, thus increasing the marketability and pricing of the securities.

21. To satisfy both the investors and the financial guaranty insurer as to the quality of a particular portfolio of mortgage loans, the sponsor of a securitization typically makes disclosures and representations regarding the quality and character of the underlying mortgage loans and the underwriting standards used to underwrite the mortgage loans. While these disclosures and representations do not entirely remove the risk of default, they are intended to assure the financial guaranty insurer that risks are known to the insurer and that the financial guaranty insurer does not face additional, hidden risks.

22. A sponsor's disclosures and representations in a residential mortgage-backed securitization are extremely important. The sponsor's disclosures and representations regarding the quality and character of the mortgages included in the mortgage loan portfolios and the underwriting standards used to underwrite the mortgage loans are necessary because it is neither practical nor feasible for the financial guaranty insurer to review the many thousands of mortgage loans in the loan portfolios. Individual loan files are typically voluminous, containing mortgage applications, credit reports, income and employment verifications, the lender's internal documentation and many other forms of documentation necessary to support underwriting decisions.

23. Because the review of all the loan files underlying a securitization is impractical and infeasible, a sponsor will provide to the financial guaranty insurer and the rating agencies, among others, schedules and due diligence tapes that set forth general financial characteristics of the mortgage loans that will be transferred by the sponsor to the securitization trust. The rating agencies rely upon the data contained in the schedules and due diligence tapes to create expected loan level default and loss assumptions. The loan level default and loss assumptions are then used to create cash flow projections – that is, estimates of potential losses – for the securitizations. The rating agencies then provide shadow ratings for the securitization

transactions, which shadow ratings are based on the expected losses for the proposed securitization structure. A financial guaranty insurer must rely on the sponsor's representations and data with respect to the quality of the mortgage loan portfolio underlying the securitizations as well as the integrity of the sponsor's underwriting policies and practices. Further, the financial guaranty insurer must also rely on the shadow ratings provided by the ratings agencies, which are based on the same representations, warranties and data provided to the financial guaranty insurer. In addition, it is infeasible and impractical for a financial guaranty insurer to confirm based on schedules or due diligence tapes whether a sponsor has underwritten the mortgage loans in compliance with its underwriting criteria.

C. The RFC Transactions

24. RFC, through its subsidiaries and affiliates, originates mortgage loans that RFC then sells by means of securitization transactions, including the RFC Transactions. RFC also purchases mortgage loans from other entities, which it sells by means of securitization transactions. RFC is both the seller and the master servicer for the RFC Transactions. RFC outsources certain of its servicing functions to affiliated entities.

25. Starting in approximately June 2006, RFC contacted MBIA to provide the Policies with respect to five securitizations sponsored by RFC: Home Equity Loan Trust 2006-HSA4 ("2006-HSA4"), Home Equity Loan Trust 2006-HSA5 ("2006-HSA5"), Home Equity Loan Trust 2007-HSA1 ("2007-HSA1"), Home Equity Loan Trust 2007-HSA2 ("2007-HSA2") and Home Equity Loan Trust ("2007-HSA3," and collectively with 2006-HSA4, 2006-HSA5, 2007-HSA1 and 2007-HSA2, the "RFC Transactions").

26. 2006-HSA4 is a securitization that was issued on or about July 28, 2006. The 2006-HSA4 mortgage loan pool consists of adjustable rate, revolving Home Equity Loans. Approximately 99.05% of the Home Equity Loans in the 2006-HSA4 mortgage loan pool are

secured by second liens on one- to four- family residential properties with the remaining approximately 0.95% of the Home Equity Loans secured by first liens. As of July 1, 2006 (the “2006-HSA4 Cut-off Date”), the mortgage loan pool for 2006-HSA4 contained 8,954 Home Equity Loans with an approximate initial principal mortgage loan balance of \$402,118,000 as of the 2006-HSA4 Cut-off Date. The weighted average amount of Utilization of the Home Equity Loans as of the 2006-HSA4 Cut-off Date was 77.89% of the available credit limit.

27. 2006-HSA5 is a securitization that was issued on or about September 28, 2006. The 2006-HSA5 mortgage loan pool consists of adjustable rate, revolving Home Equity Loans. Approximately 99.2% of the Home Equity Loans in the 2006-HSA5 mortgage loan pool are secured by second liens on one- to four- family residential properties with the remaining approximately 0.80% of the Home Equity Loans secured by first liens. As of September 1, 2006 (the “2006-HSA5 Cut-off Date”), the mortgage loan pool for 2006-HSA5 contained 5,124 Home Equity Loans with an approximate initial principal mortgage loan balance of \$295,648,000 as of the 2006-HSA5 Cut-off Date. The weighted average amount of Utilization of the Home Equity Loans as of the 2006-HSA5 Cut-off Date was 87.98% of the available credit limit.

28. 2007-HSA1 is a securitization that was issued on or about February 27, 2007. The 2007-HSA1 mortgage loan pool consists of adjustable rate, revolving Home Equity Loans. Approximately 98.3% of the home equity loans in the 2007-HSA1 mortgage loan pool are secured by second liens on one- to four- family residential properties with the remaining approximately 1.7% of the Home Equity Loans secured by first liens. As of February 1, 2007 (the “2007-HSA1 Cut-off Date”), the mortgage loan pool for 2007-HSA1 contained 9,484 Home Equity Loans with an approximately initial mortgage loan principal balance of \$546,774,000 as of the 2007-HSA1 Cut-off Date. The weighted average amount of Utilization of the Home Equity Loans as of the 2007-HSA1 Cut-off Date was 85.84% of the available credit limit.

29. 2007-HSA2 is a securitization that was issued on or about April 27, 2007. The 2007-HSA2 mortgage loan pool consists of fixed rate Closed-End Mortgage Loans. Approximately 99.84% of the Closed-End Mortgage Loans in the 2007-HSA2 mortgage loan pool are secured by second liens on one- to four- family residential properties with the remaining approximately 0.16% of the Closed-End Mortgage Loans secured by first liens. As of April 1, 2007 (the “2007-HSA2 Cut-off Date”), the mortgage loan pool for 2007-HSA2 contained 24,092 Closed-End Mortgage Loans with an approximate initial mortgage loan principal balance of \$1,300,997,943 as of the 2007-HSA2 Cut-off Date.

30. 2007-HSA3 is a securitization that was issued on or about May 30, 2007. The 2007-HSA3 mortgage loan pool contains two mortgage loan groups. One loan group (“2007-HSA3 Loan Group 1”) contains 11,268 fixed rate Closed-End Mortgage Loans with an aggregate initial mortgage loan principal balance of \$590,465,000 as of May 1, 2007 (the “2007-HSA3 Cut-off Date”). The other loan group (“2007-HSA3 Loan Group 2”) contains 4,146 adjustable rate, revolving Home Equity Loans with an aggregate initial mortgage loan principal balance of \$239,848,476 as of the 2007-HSA3 Cut-off Date. Approximately 99.87% of the 2007-HSA3 Loan Group 1 loans and 99.26% of the 2007-HSA3 Loan Group 2 loans are secured by second liens on one- to four- family residential properties with the remaining approximately 0.13% and 0.74% of the respective group mortgage loans secured by first liens. As of the 2007-HSA3 Cut-off Date, the weighted average amount of Utilization of the Home Equity Loans in 2007-HSA3 Loan Group 2 was 86.0% of the available credit limit.

D. RFC’s Representations And Warranties

31. In connection with each RFC Transaction, MBIA and RFC entered into Insurance Agreements pursuant to which MBIA issued the Policies for the RFC Transactions. The Policies increased the marketability of the securities by mitigating the risk to potential

