The Sub-Prime Mortgage Crisis: Is 2013 the Beginning or End?

Investor: Nobody would give a loan to a homeless guy, right?
Banker: Of course not. There are *standards*, after all.
Investor: Well, as long as these people have good credit scores…
Banker: Oh, they all do. They're homeowners.
Investor: Okay, I'll take 10,000 shares of that Mortgage Backed Security.
Banker: *Cha-ching!* See you next week. I'll have some more.

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I. INTRODUCTION

One of the groundbreaking discoveries in Rachel Carson's best-selling book, *Silent Spring,*[1] is how mercury intensifies as it moves up the food chain. From fish to bird to human, the toxicity increases. Similarly, the impact of fraud intensifies as a bad mortgage moves along the investment chain, from broker to lender to investment bank to institutional investor, as "shitty deals" are consolidated, they create toxic failures of epic proportions.[2]

Toxicity in the mortgage sector once valued at $11 trillion was at the root of the 2008 financial collapse. This paper provides an overview of subprime litigation, focusing on the preliminary rulings over the past several years that have pointed to loan originators as the (very large) tip of a gigantic pyramid scheme. Due to relevant statutes of limitations, the opportunity to pursue new litigation is receding. Recent developments suggest an end is in sight.

[1] RACHEL CARSON, SILENT SPRING, (Houghton Mifflin, 1962). *The New Yorker* serialized the book prior to publication, and the book is widely credited with founding the contemporary American environmental movement.

[2] Goldman Sachs internal memo: the "Shitty Deal." Senator Carl Levin (D-MI) famously repeatedly referenced the phrase in a televised hearing with Goldman Sachs executives (4/27/2010). Not to be confused with the "Sack of Shit" characterization of securities Bear Stearns were selling to investors. (*See Below*).

II. EXECUTIVE SUMMARY

When the first subprime mortgage securities fraud cases were filed in the wake of the 2008 meltdown, few met the adequate particularity required for pleading fraudulent misrepresentations, omissions, and loss causation. After being subjected to heightened pleading requirements by Rule 9(b) and the Private Securities Litigation Reform Act (PSLRA), courts sent plaintiffs' counsel back to the drawing board.[3] Subsequent amended complaints and new filings began to hone in on exactly how subprime lending operated, and what courts require to survive motions for dismissal and summary judgment.

Consolidation in the financial sector has both complicated and simplified the landscape. For example, the world's largest bank, Bank of America (BoA), bought the world's largest loan originator, Countrywide. As a result, BoA is the most highly-targeted subprime litigation defendant.[4] Post-crisis mergers and acquisitions create fewer litigants, and more centralized control over discovery documents and settlement strategies.[5] J.P. Morgan, who bought up Bear Stearns (the EMC Mortgage umbrella) and Washington Mutual, appear less willing to settle at the moment… but it remains to be seen how courts will rule on certain discovery motions. Full disclosure regarding the subprime lending details may never be revealed.

Most allegations focus on mortgage originators' disregard for underwriting standards, issuing high-interest loans to people with low (or no) income, and then

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[3] Fed.R.Civ.Pro. Rule 9(b). Fraud requires specific allegations, as opposed to general pleading standard of Rule 8.

[4] Countrywide merged with a subsidiary BoA created for the purpose of merger. Two theories of liability have emerged: (1) de-facto liability, that they essentially merged; (2) Assumption of liabilities, implicitly or by admission. New York courts ask if BoA intended to merge to continue operations, while Delaware looks for some form of bad faith or intent to defraud. *See*: MBIA v. Countrywide; Allstate v. Countrywide (*infra*).

[5] Loan files are in exclusive possession of loan servicers. The intra-corporation conflicts that exist are epidemic, as many institutions might naturally be suing subsidiaries and parents.

providing representations and warranties that the mortgage backed securities (MBS) are fiscally sound investments. Pension shareholders are suing their fund managers. Fund managers are suing investment banks. Investment banks are suing insurers. Insurers are suing loan originators… and the losses trickle back upstream to the source. The tide has turned in securities fraud actions, as it seems the "Nobody's Fault" defense has been overruled by an "Everyone's Fault" offense.

Mortgage insurers have had success against the lenders because of blatant violations of the written underwriting standards. This indicates that investors might see similar results, except that showing a violation of these internal standards falls short of demonstrating fraudulent intent or gross recklessness. Defendants who did not originate loans (such as trusts, investment banks and insurers) are in better position to shift blame, showing reliance on the reps and warranties of lenders.

Although not the earliest litigants into the fray, government actors have the potential to be the most effective plaintiffs. The Federal Housing Finance Agency (FHFA), as conservator of Fannie Mae and Freddie Mac, has sixteen actions currently pending in the Southern District of New York.[6] A recent ruling in the Southern District of NY, that FHFA has a credible theory of fraud, indicates few (if any) of the other FHFA cases will be dismissed at summary judgment. A trial is scheduled with Deutsche Bank for September,

[6] The sixteen cases are: FHFA v. UBS Americas, Inc., et al., 11 Civ. 5201(DLC); FHFA v. JPMorgan Chase & Co., et al., 11 Civ. 6188(DLC); FHFA v. HSBC North America Holdings, Inc., et al., 11 Civ. 6189(DLC); FHFA v. Barclays Bank PLC, et al., 11 Civ 6190(DLC); FHFA v. Deutsche Bank AG, et al., 11 Civ. 6192(DLC); FHFA v. First Horizon National Corp., et al., 11 Civ 6193(DLC); FHFA v. Bank of America Corp., et al., 11 Civ. 6195(DLC); FHFA v. Citigroup Inc., et al., 11 Civ. 6196(DLC); FHFA v. Goldman, Sachs & Co., et al., 11 Civ. 6198(DLC); FHFA v. Credit Suisse Holdings (USA), Inc., et al., 11 Civ. 6200(DLC); FHFA v. Nomura Holding America, Inc., et al., 11 Civ. 6201(DLC); FHFA v. Merrill Lynch & Co., Inc., et al., 11 Civ. 6202(DLC); FHFA v. SG Americas, Inc., et al., 11 Civ. 6203(DLC); FHFA v. Morgan Stanley, et al., 11 Civ. 6739(DLC); FHFA v. Ally Financial Inc., et al., 11 Civ. 7010(DLC); FHFA v. General Electric Co., et al, 11 Civ. 7048(DLC). The FHFA has also brought two similar actions, which are pending in federal courts in California and Connecticut. *See:* FHFA v. Countrywide Financial Corp., et al., No. 12 Civ. 1059(MRP) (C.D.Cal.); FHFA v. Royal Bank of Scotland, No. 11 Civ. 1383(AWT) (D.Conn).

2014. In that case, choice of law is highly contested, and the court ruled FHFA's claims are viable under Virginia and District of Columbia law, as the jurisdictions host the headquarters of Freddie Mac and Fannie Mae, respectively. Furthermore, the court also ruled the defendants will find no protection under New York's Martin Act: although the Act creates no private right of action, it does not preclude it either.[7] The FHFA case against Goldman Sachs has interpreted the Supreme Court's holding in Janus (the person who "makes" a statement must have control over it) does not apply to state court, and there is no reason to believe that the Supreme Court's holding will cause New York to retreat from its long-held position regarding the scope of common law fraud liability.[8]

Meanwhile, the various Federal Home Loan Banks have also filed a slew of actions in their jurisdictions.[9] With support from the SEC and FDIC, they have the added impact of credibility before courts and legislators. State Attorneys General are also involved with litigation on behalf of homeowners, as banks are accused both of "predatory lending" and allowing their massive stock of properties to fall into disrepair.

2013 is poised to become the most important year of the subprime aftermath. The five year statute of repose, the window within which cases are arguably eligible under the

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[7] FHFA v. Deutsche Bank AG, 2012 WL 5471864 (S.D.N.Y. Nov. 12, 2012), *citing* Assured Guar. v. J.P. Morgan Inv. Mgmt., 962 N.E.2d at 770. The bank attempted claimed (1) NY law applied, and (2) NY law does not allow a private right of action.

[8] FHFA v. Goldman, Sachs & Co., 2012 WL 5494923 (S.D.N.Y. Nov. 12, 2012). Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2302, (2011). "For purposes of Rule 10b–5, the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it."

[9] Federal Home Loan Bank Act of 1932 ("FHLB Act"). FHLB charters provide that it "shall have the power to ... sue and be sued, [ ] complain and [ ] defend, in any court of competent jurisdiction, State or Federal." 12 U.S.C. § 1432(a). Cases remanded back to state court include: Fed. Home Loan Bank of Indianapolis v. Banc of Am. Mortg. Sec., Inc., 1:10-CV-1463-WTL-DML, 2011 WL 2133539 (S.D. Ind. May 25, 2011); Fed. Home Loan Bank of Chicago v. Banc of Am. Sec. LLC, 448 B.R. 517 (C.D. Cal. 2011); Fed. Home Loan Bank of San Francisco v. Deutsche Bank Sec., Inc., 10-3039 SC, 2010 WL 5394742 (N.D. Cal. Dec. 20, 2010); Fed. Home Loan Bank of Seattle v. Barclays Capital, Inc., C10-0139 RSM, 2010 WL 3662345 (W.D. Wash. Sept. 1, 2010).

Securities Act, will close. Expect every potential plaintiff, including foreign investors and government entities, to fill the court dockets as precedent continues to be written.

III. BACKGROUND

EVALUATING RISK IN THE MORTGAGE MARKET

When extending credit to a potential property buyer a lender typically considers the borrower's credit profile, the amount requested, and the value of the property being mortgaged. The credit-worthiness of home buyers is determined by a review of various factors, including the buyer's Fair Isaac and Company ("FICO") credit score. A borrower with a high FICO score is more likely to receive a "prime" mortgage with a low interest rate. Lenders also consider the loan amount as a portion of the value of the property being mortgaged. This relationship is known as the loan to value ("LTV") ratio. A buyer with a high FICO score would likely qualify for a mortgage with a higher LTV ratio than a buyer who is less credit worthy. Thus, a credit worthy borrower is, generally speaking, able to borrow an amount closer to the actual total value of the property mortgaged. The more credit worthy the buyer, the more likely that the mortgage extended would be one with a high LTV ratio. Because LTV ratios are determined by comparing the amount of the loan to the value of the mortgaged property, an accurate property appraisal is critical. If an appraisal is wrongfully inflated, a loan may appear to have a low LTV ratio, whereas in reality, the true value of the home makes the real LTV ratio higher.

Borrowers with high FICO scores, but who are unable to provide income documentation have been able to receive mortgages known as "low-doc," "Alt–A" or "liar" loans. Such loans are extended, but with less favorable interest terms than prime

mortgages. Buyers with lower FICO scores are typically referred to as "sub-prime" borrowers. Such borrowers are considered to be at higher risk of default, and have been extended mortgages that carry a higher rate of interest than that extended to a prime borrower.

CHANGES TO TRADITIONAL MODEL AND GROWTH OF MORTGAGE BACKED SECURITIES

Traditionally, an underwriter evaluates the risk of lending, as described above, decides whether or not to recommend that the lender extend the loan, and the terms to be imposed on the borrower. If the loan is approved, the loan originator lends money in exchange for a promissory note pursuant to which the borrower agrees to repay the principle, plus an agreed upon interest. In this traditional model, the loan originator is the holder of the promissory note as well as a lien on the real property underlying the mortgage. That lien is released upon full payment of the loan.

The mortgage industry began to move away from this traditional model in the 1990's, when low interest rates and low inflation led to an increasing demand for mortgages. The market evolved into one where loan originators did not continue to hold loans they extended but, instead, sold mortgages into the financial markets to third party financial institutions. The fees generated by selling mortgages into the secondary market allowed loan originators to amass capital to finance the growing demand for mortgages.

Mortgages sold into the financial markets were grouped together and securitized, *i.e.,* transformed into securities known as "mortgage backed securities" (MBS). The securitization process refers to the packaging of pools of loans into a trust. The trust originator sells interests in the trust to finance the purchase of the pools of mortgages. Interests in the trusts are sold to investors in the form MBS. The value of sub-prime MBS

grew from $10 billion in 1991, to more than $60 billion in 1997 and to over $620 billion in 2005.

Investors in MBS receive monthly payments, representing payments made to the mortgages. Interests in trusts are often grouped into different sections or "tranches," which represent different levels of risk. The most senior tranche is the group that is paid first, and is the one that carries the highest rating. The most junior tranche, on the other hand, has the lowest rating, and is paid last.[10]

MISALIGNED INCENTIVES FOR ORIGINATING LOANS

Loan originators had incentives to provide loans regardless of the creditworthiness of the borrower. These originators, including brokers, lenders, and their agents, are in the best position to assess the worthiness of the loan. They are the only people in the financial spectrum with the opportunity to meet the borrowers and require documentation. Furthermore, many investors in MBS were operating under the traditional mortgage model and rely upon the lender to have an interest in the loans and adhere to a lender's underwriting and risk management standards. Originators, however, faced a fiscal/ethical dilemma: the opportunity for commissions on every loan application. Grant the loan, and receive the commission. Deny the loan, and receive nothing. The SEC Task Force recognized this conflict of interest in their subprime crisis report, considering it a major flaw in the system.[11]

Originators, both brokers and bankers, earn a commission and then sell the loan. As loans become securitized, rated by Moody's or Standard & Poor, then sold, there is more

[10] City of Ann Arbor Employees' Ret. Sys. v. Citigroup Mortg. Loan Trust Inc., 703 F. Supp. 2d 253, 254-56 (E.D.N.Y. 2010). Similar overviews appear in nearly every subprime litigation ruling.
[11] Technical Committee of the International Organization of Securities Commission, "Report on the Subprime Crisis – Final Report," at 13, May, 2008.

pressure to create new loans (or product) to sell.[12] In the world of finance it is easy to infer that there are a finite number of solvent borrowers and at some point the number is reached. The subprime and Alt-A loans continued to grow. By the third quarter of 2006, IndyMac was a top Alt-A lender with approximately $49 billion in Alt-A production representing 77.5% of IndyMac's total origination volume. [13] With subprime mortgages come higher rates, as well as increased commissions, thus many people who qualified for prime rate loans were given subprime. More importantly, hardly anyone who applied for a mortgage were turned away.[14]

Some lenders were homebuilders. The builder, usually working with an outside lender, offers incentives to the buyer to borrow directly. The loans, particularly the second loan, tend to be punitively expensive. For example, Monica Saavedra was given two loans in a setup known as an 80-20: One covers 80 percent of the cost, while the "piggyback mortgage" covers the balance.[15] These are marketed to people lacking money for a down payment. Ultimately, high interest rates and onerous terms tend to run their course.

The Saavedras' first loan had an interest rate of 7.375%, and was interest-only for the first ten years. The payments started at $3,518 a month, and would go up to $4,260 a

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[12] A separate yet intertwined issue in the subprime crisis was whether the ratings agencies broke their own standards in reviewing these proposed securities. Some litigation and reports have pointed out, for instance, the agencies vied for commissions (in a race-to-the-bottom) and at times did not downgrade a security until well after it had collapsed. Defendants are able to point to ratings agencies for support that they believed their MBS was solvent. That litigation is not discussed herein.

[13] *See:* Zelman Credit Suisse Analyst Report, "Mortgage Liquidity du Jour: Underestimated No More," (March 12, 2007). IndyMac was a spin-off of Countrywide, the largest loan originator.

[14] Countrywide's exception standard (CWALT 2006-9T1) reads: "Exceptions to Countrywide Home Loans' underwriting guidelines may be made if compensating factors are demonstrated by a prospective borrower." In several cases, exceptions were widely granted yet factors were never documented. Allstate Ins. Co. v. Countrywide Fin. Corp., 824 F. Supp. 2d 1164 (C.D. Cal. 2011) (fact issues remained as to when purchaser became aware that issuer had misrepresented quality of underlying loans; BoA was dismissed as a defendant in separate proceeding); Dexia Holdings, Inc. v. Countrywide Fin. Corp., 2:11-CV-07165-MRP, 2012 WL 1798997 (C.D. Cal. Feb. 17, 2012). 23% of Countrywide's subprime first-lien loans were exceptions.

[15] ACLU, "Justice Foreclosed- How Wall Street's Appetite for Subprime Mortgages Ended Up Hurting Black and Latino Communities," at 16-17, (Oct. 2012).

month when the principal kicked in. The piggyback loan had an interest rate of 11.875%. That loan required them to pay the full $87,000 after 15 years.[16]

Monica Saavedra, who speaks little English, said she didn't understand the terms of the loan. This is not surprising considering how many English speakers had trouble understanding what was designed as a ruse. She gave the loan officer pay stubs and tax forms to document her income, yet later discovered that he never filled in the income box on her loan application. He also reassured her that she could lower her monthly payments by refinancing the loans. When a $9,000 bill arrived, she realized the monthly payments didn't include taxes.[17]

IV. RELEVANT REGULATIONS, STATUTES, AND OVERSIGHT

Three federal bodies hold considerable authority over the financial dealings at stake: Congress and two agencies it empowered to promulgate rules, the Securities Exchange Commission (SEC) and Federal Deposit Insurance Corporation (FDIC).[18] The strength of securities laws is that no intent or reliance is required to prove a claim of fraud (only that the acts or omissions materially and adversely affects the value of the loan), but they are only available to immediate purchasers of the security. Proving increased risk has not been difficult at the summary judgment stage.

[16] Id.
[17] Id.
[18] State laws, referenced in part below, should not be overlooked. Litigants should familiarize themselves with the relevant laws, which will be where the defendant is incorporated and/or conducting business. Actions of the FDIC are not referenced here.

State laws provide jurisdiction for contractual claims, particularly the repurchase agreements (or "putbacks") within MBS.[19] (i.e., who gets stuck owning the defaulted mortgages). Here, the loan files provide direct evidence of breaching the representations and warranties. A plaintiff does not need to prove damages, yet rescission will generally provide only partial relief. Additionally, the statute of limitations for breach of contract is considerably longer, often up to ten years. Thus, the 2013 date may not be as solid a barrier as some would believe. Those filing tort claims will have an opportunity for extra damages, yet may find them difficult to prove and potentially limited within the contract itself.

SECURITIES ACTS OF 1933 and 1934

The bulk of subprime litigation falls within these Congressional responses to the Stock Market Crash of 1929.[20] Some key provisions include:

§ 77k. Civil liabilities on account of false registration statement;
§ 77l(2). Civil liabilities arising in connection with prospectuses and communications. Untrue statement of a material fact or omits to state a material fact;
§ 77o. Liability of controlling persons;
§ 78j(b). Manipulative and deceptive devices.

§ 78u-4 (**Commonly known as "Section 10-b")**
1) Misleading statements and omissions In any private action arising under this chapter in which the plaintiff alleges that the defendant--
(A) made an untrue statement of a material fact; or
(B) omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading;
the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on

[19] Five putback cases were filed in 2011, while 31 were filed in 2012. 30 are pending in state court (26 in New York). 32 of them were filed by trustees at the direction of bondholders.
[20] Sections 15 U.S.C.A. §77 and §78, respectively.

information and belief, the complaint shall state with particularity all facts on which that belief is formed.

(2) Required state of mind [Scienter].

The SEC creates codes under authority of the Securities Act of 1934:[21]
SEC Rule 10b-5[22] Employment of manipulative and deceptive devices.

PRIVATE SECURITIES LITIGATION REFORM ACT of 1995 (PSLRA)

Congress created the PSLRA,[23] by enacting section 21D(b) of the Securities Exchange Act.[24] The purpose was to resolve conflicts among the circuit courts regarding appropriate pleading requirements in securities fraud actions under section 10(b) of the Exchange Act.[25] Section 21D(b)(1) provides that in any private action based on allegedly false or misleading statements, "the complaint shall specify each statement alleged to have been misleading, [and] the reason or reasons why the statement is misleading."[26] Section 21D(b)(2) further provides that the complaint must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."[27] Together, these provisions resolve conflicts among the circuits by adopting the Ninth Circuit's requirements for pleading falsity and the Second Circuit's requirements for pleading scienter in securities fraud cases.

[21] 17 C.F.R. § 240, General Rules and Regulations, Securities Exchange Act of 1934.
[22] 17 C.F.R. § 240.10b–5.
[23] Pub. L. No. 104-67, 109 Stat. 737 (1995).
[24] 15 U.S.C. s 78u-4(b).
[25] 15 U.S.C. s 78j(b).
[26] 15 U.S.C. s 78u-4(b)(1).
[27] 15 U.S.C. s 78u-4(b)(2).

V. PLAINTIFFS

CLASS ACTIONS

Although class actions are not the required route to litigate securities fraud, the high litigation costs nearly mandate this process. Typically, various investors are alleging the same claims, having bought securities under the same scenario, reading the same prospectus, and receiving the same executive reports. Investors in a trust need to amass a 25% interest to direct the trustee to act and file suit.[28] Most of the requirements for class certification will be easily alleged: **(1)** the class is so numerous that joinder of all members is impracticable; **(2)** there are questions of law or fact common to the class; **(3)** the claims or defenses of the representative parties are typical of the claims or defenses of the class; and **(4)** the representative parties will fairly and adequately protect the interests of the class.[29]

Although easily alleged, they will not always easily be met. Because investors are buying at different times, under varying market forces, and purchasing various classes of securities from the same defendant. However, a theory of "Fraud on the Market" is likely to incorporate a broader fraud allegation that can impact a broader class. District courts had previously established that class members only have standing regarding the specific MBS purchased,[30] and only regarding the specific tranches purchased within that MBS.[31]

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[28] Next steps are to (1) Petition the Trustee to take action and provide reasonable indemnity, (2) Cite specific evidence of breech, including specific loans, (3) Wait 30-90 days for Trustee to take action before investors can sue on their own behalf, (4) Wait 60-120 days for nonperforming party to cure, (5) Assert event of default.

[29] Fed. R. Civ. P. 23. The PSLRA presumes the lead plaintiff will be that with "the largest financial interest in the relief sought by the class." In re Countrywide Fin. Corp. Sec. Litig., 273 F.R.D. 586, 590 (C.D. Cal. 2009); *In re Cavanaugh,* 306 F.3d 726, 729 n. 2, 730 (9th Cir.2002).

[30] Plumbers' Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp., 632 F.3d 762 (1st Cir. 2011); Me. State Ret. Sys. v. Countrywide Fin. Corp., 722 F. Supp. 2d 1157, 1164 (C.D. Cal. 2010) ("Maine State I")

However, the Second Circuit recently ruled that there is a common interest as long as the mortgages stem from the same originator, and the tranche differences are not so distinct as to defeat the class.[32] One of the largest cases, involving Countrywide, resulted in three sub-classes rather than a solitary class.[33]

It is in the interests of the courts and defendants to consolidate claims to conserve resources. Plaintiffs benefit from their own consolidation of resources, including expert witnesses, who must sift through an immense amount of documentation. Defendants have been forced to litigate against separate classes where they bought separate products, where one allegation is that a product failed, while a different allegation is the company failed. Class actions also increase the potential for defendants to reduce their overall payouts. The $4.5 billion spent since 2010 by just three banks on legal expenses provides perspective as to the impact securities litigation can have on the global economy.[34]

INSTITUTIONAL INVESTORS

The predominant characterization of a Subprime Litigation plaintiff has been an institutional investor. The subprime securities were bundled and marketed to institutional insiders, rather than offered up for public offerings. This allowed for a lower threshold of disclosure. However, where professional investors are plaintiffs, such as a teachers'

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[31] Me. State Ret. Sys. v. Countrywide Fin. Corp., No. 10-cv-0302, 2011 WL 4389689, at *5-6 (C.D. Cal. May 5, 2011) ("Maine State III").

[32] NECA-IBEW Health & Welfare Fund v. Goldman, Sachs & Co., 693 F.3d 145 (2d Cir. 2012). Critically, however, many of the appropriate claims have either settled or are time-barred. Goldman filed Certiorari to the U.S. Supreme Court. Like other outstanding circuit holdings, it remains to be seen if the Court puts its stamp on subprime litigation.

[33] In re Countrywide Fin. Corp. Sec. Litig., 273 F.R.D. 586, 589 (C.D. Cal. 2009).

[34] Reilly, David, "The Big Banks' $29 Billion Cookie Jar," The Wall Street Journal (Sept. 4, 2012). Citigroup, Bank of America, and J.P. Morgan have set aside a third of their profits in that time, $19 billion to build litigation reserves. The three have acknowledged they are subject to investigations related to the London interbank offered rate (Libor). In addition, they are subject to private lawsuits related to trillions of dollars in loans, securities, and derivatives. Analysts estimate such lawsuits could cost those firms and other big, international banks anywhere from under $10 billion to nearly $200 billion, collectively.

retirement fund manager, a defendant is in better position to argue that the purchaser knew what they were getting into- they should be following market trends. Some have thus won claims against their fund manager, such as PRIAC v. State Street Bank, based on the theory that a breech of fiduciary duty caused their loss.[35]

TRUST INDENTURE ACT of 1939

Some investors are taking yet another angle, arguing trustees fall under the Trust Indenture Act's heightened demands for oversight.[36] They likened the current situation to the period after the Great Depression when the TIA was enacted to outlaw trustee misconduct. In April, the New York federal district court held that trustee Bank of New York was subject to the TIA, which covers debt, but not equity.[37] The TIA is also a point of contention in a case brought this year by the same plaintiffs against Bank of America.

BONDHOLDERS GROUPS

The most impactful of all plaintiffs, thus far, appear to be the growing bondholders groups. One in particular, represented by Gibbs & Bruns, LLP, has taken aim on apparently every institution where they hold a collective 25% interest in the trusts issuing MBS. This threshold allows them to order trustees to conduct an internal investigation and/or file suit. Their settlement with Countrywide/BoA (*see below*) has the potential to impact an even larger class, and is now facing intervention after being removed to federal court. This bondholder group has JP Morgan and Wells Fargo both in their sights, and potentially could

[35] In re State St. Bank & Trust Co. Fixed Income Funds Inv. Litig., 842 F. Supp. 2d 614, 659-60 (S.D.N.Y. 2012). State Street was assessed $76,733,879 in damages.
[36] Trust Indenture Act of 1939, 15 U.S.C. § 77aaa, *et seq.*
[37] Ret. Bd. of the Policemen's Annuity & Ben. Fund of City of Chicago v. Bank of New York Mellon, 11 CIV. 5459 WHP, 2012 WL 1108533 (S.D.N.Y. Apr. 3, 2012). Many courts suggest that certificates similar to those issued by the New York trusts are debt, not equity. Ellington Credit Fund, Ltd. v. Select Portfolio Servicing, Inc., ––– F.Supp.2d ––––, 2011 WL 6034310, at *7 (S.D.N.Y.2011). LaSalle Bank Nat'l Ass'n v. Nomura Asset Capital Corp., 424 F.3d 195, 200 (2d Cir.2005); *see* also CWCapital Asset Mgmt., LLC v. Chi. Props., LLC, 610 F.3d 497, 499 (7th Cir.2010) (Posner, J.) (describing mortgage-backed securities governed by PSAs as "giant bond[s]").

be at the heart of negotiating a universal end to litigation; an end that some believe may be suspiciously favorable to the banks.[38]

BORROWERS

Plaintiffs with the largest growth potential are the borrowers themselves. The "American Dream" is to own a house, and millions of dreamers were required to create the subprime lending crisis. Were these people victims, or perpetrators? A groundbreaking lawsuit filed by the ACLU claims Morgan Stanley pushed New Century to make the risky loans.[39] The case brings into question the causal link between the loan originators and the firms who bundle them for sale, and is poised to test doctrines of *respondeat superior* and "controlling persons." Discovery motions will likely target the scienter of Wells Fargo, particularly any communications made to New Century. As Anthony Romero of the ACLU argues, "it really is the first case of Main Street holding Wall Street accountable for the financial crisis."[40]

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[38] Tempkin, Adam, "Wells Fargo in the crosshairs of mortgage-bond investors," Reuters, (1/25/12).

[39] Beverly Adkins, et. al. v. Morgan Stanley, CA No, ____, (S.D.N.Y. Oct. 15, 2012). The suit alleges that Morgan Stanley encouraged New Century to make "stated-income" loans, in which borrowers provided no verification of their income when they applied for mortgages. Those loans allowed mortgage brokers to inflate borrowers' income and make them appear more credit-worthy. Morgan bought the vast majority of New Century's loans. One plaintiff said her mortgage broker falsified her loan application in 2006 and turned her part-time work into a full-time job on the application and tripled the amount of money she received in weekly child support to $100. The broker also told her that she had to buy the house within 30 days or she and her six children would be evicted. To buy a house appraised at $89,000, New Century gave McCoy a $79,200 adjustable-rate mortgage with a starting interest rate of 12.1 percent. The initial loan payment amounted to more than half her monthly income and began rising within months. She made her last payment in May 2011, according to the complaint. Complaint and supplemental materials can be reviewed at: http://www.nclc.org/issues/mortgage-securitization-discrimination-litigation.html

[40] Horowitz, Jed, "ACLU Sues Morgan Stanley for racial bias over mortgages," Reuters (10/15/12). During August of 2007, foreclosure notices were served on 260 homes per day.

VI. STATUTES OF LIMITATIONS AND REPOSE

Litigation regarding the Subprime Crisis will face sturdier time-bars in 2013: five years after the "storm" of widespread financial collapse, and an end to the statute of repose. This is five years after AIG, Lehman Brothers, and other collapses put the world on notice that they should look into their investments to see if fraud made them worthless; however, the actual date of inquiry will likely be considered the ratings downgrades in February and March, 2008, as the downgrades link the origination problems with defective underwriting standards.

The bulk of MBS claims filed in 2011 related to offerings in 2005, while most 2012 filings were based on MBS issued in 2006. 2013 is likely to address those for 2007. Depending upon the claim, the limitations period can differ. And although the shorter period can be tolled, the statute of repose is a firm date that cannot be tolled.

SARBANES-OXLEY ACT of 2002

The Sarbanes-Oxley Act extended the statute of limitations for claims of securities fraud *to the earlier of:* two years after the discovery of the facts constituting the violation, or five years after such violation.[41] Where the alleged fraud was in connection with the purchase or sale of a security, the date of the purchase or sale would be the applicable date to begin counting the five-year period of repose. These dates of purchase will typically be some time prior to the economic collapse, thus many of these federal claims will be time-barred. Purchasers in the after market who are influenced by a false or misleading prospectus are not limited by the initial trade date, however. Defendants might try to date

[41] See Pub. L. No. 107-204, 116 Stat. 745, Title VIII, § 804(a) (2002). Plumbers, Pipefitters & MES Local Union No. 392 Pension Fund v. Fairfax Fin. Holdings Ltd., 11 CIV. 5097 JFK, 2012 WL 3283481 (S.D.N.Y. Aug. 13, 2012) (Five year "statutes of repose" were not subject to equitable tolling.)

the latest onset of the statute of repose to September of 2007, when HSBC took a $945 million loss on subprime mortgages.[42] One could logically question their own Mortgage Backed Securities across the industry. Most analysts, however, believe 2008 to be the operational date.

Determining the onset of the two-year limitation can be complicated because it is difficult to determine the precise moment of "discovery of the facts constituting the violation." The Second Circuit recently held that a fact is not deemed "discovered" until "a reasonably diligent plaintiff would have sufficient information about that fact to adequately plead it in a complaint."[43] This indicates that the heightened pleading requirements for fraud, under Rule 9(b) and the PSLRA, cannot be held against a plaintiff who diligently attempted to uncover the specific misstatements of fact or omissions required to survive a Rule 12(b) motion for dismissal. Although this shifts many statutes of limitations inquiries along a slider within the subprime fallout, it still cannot extend beyond the statute of repose.

The Seventh Circuit has held that a statute of limitations bar is an affirmative defense that must be proven by the defendant.[44] However, the First and Third Circuits have applied a burden-shifting analysis.[45] Subprime defendants can potentially put themselves in a contradictory position where asserting (a) their lack of awareness that any

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[42] Quinn, James, "HSBC hit by sub-prime crisis," The Telegraph, (9/22/07).

[43] City of Pontiac Gen. Employees' Ret. Sys. v. MBIA, Inc., 637 F.3d 169, 175 (2d Cir. 2011), *citing Merck & Co. v. Reynolds,* 130 S.Ct. 1784 (2010).

[44] Law v. Medco Research Co., 113 F.3d 781, 786 (7th Cir. 1997) ("On the record compiled so far, the defendants in this case, who have the burden of proving an affirmative defense, such as that the statute of limitations has run, have failed to show that a reasonably diligent investor would have brought suit before this suit was actually filed.")

[45] Young v. Lepone, 305 F.3d 1,at 8-9 (1st Cir. 2002). *See also* Mathews v. Kidder, Peabody & Co., Inc., 260 F.3d 239, 252 (3d Cir. 2001) (noting that, if defendants establish the existence of storm warnings, burden shifts to plaintiffs to show that they exercised reasonable due diligence).

fraud was afoot, while (b) arguing that a reasonable investor should have discovered this fraud sooner.[46]

SECTION 11 OF THE SECURITES ACT

A one-year statute of limitations, rather than those under the Sarbanes-Oxley Act, applies to claims regarding registration statements, prospectuses, and control person liability, which do not require proof of fraud as an element of the cause of action, "even if underlying claims sounded in fraud."[47] The statute of repose is three years from the date of sale, and most new claims will be barred.[48] The period is "one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by reasonable diligence."[49] Establishing "reasonable" discovery is a two-step process. First, a court must determine when a reasonable investor could learn of facts sufficient to indicate the probability that he has been defrauded, known as "inquiry notice."[50] These circumstances are referred to as "storm warnings."[51] However, storm warnings do not place investors on inquiry notice when accompanied by "reliable words of comfort from management" such that an investor of ordinary intelligence would reasonably have relied

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[46] In re Ambac Fin. Group, Inc. Sec. Litig., 693 F. Supp. 2d 241, 275-77 (S.D.N.Y. 2010), certificate of appealability denied (Apr. 29, 2010).

[47] In re Alstom SA, 406 F.Supp.2d 402 (S.D.N.Y.2005) (§ 13 of the Securities Act includes a statute of limitations provision that governs claims under § 11 of the Act.) *See also:* In re IndyMac Mortgage-Backed Sec. Litig., 718 F. Supp. 2d 495, 507 (S.D.N.Y. 2010); In addition to the one year statute of limitations period, the Securities Act contains a three year statute of repose. No Section 11 claim may be brought "more than three years after the security was bona fide offered to the public," and no Section 12(a)(2) claim may be brought "more than three years after the sale."

[48] Dexia Holdings, Inc. v. Countrywide Fin. Corp., 2:11-CV-07165-MRP, 2012 WL 1798997 (C.D. Cal. Feb. 17, 2012) Offering was March, 2006, and claims were first brought on January 28, 2011. They are therefore barred by the statute of repose unless they are tolled by an earlier class action complaint.

[49] 15 U.S.C. § 77m.

[50] *Dodds v. Cigna Securities, Inc.,* 12 F.3d 346, 350 (2d Cir.1993), *cert. denied,* 511 U.S. 1019, 114 S.Ct. 1401, 128 L.Ed.2d 74 (1994).

[51] Id.

on the statements to allay his or her concern."[52] If a defendant shows a duty to inquire arose, the second step assesses when, with reasonable diligence, a plaintiff should have discovered the facts underlying the alleged fraud.[53] The limitations period runs from this moment of constructive notice.

FAIR HOUSING ACT of 1968

Plaintiffs who file under the Fair Housing Act may likely experience an extended window, depending upon how long they hold onto the fraudulently induced mortgage. An aggrieved person may commence a civil action "not later than 2 years after the occurrence or the termination of an alleged discriminatory housing practice, or the breach of a conciliation agreement entered into under this subchapter, whichever occurs last, to obtain appropriate relief with respect to such discriminatory housing practice or breach."[54]

FALSE CLAIMS ACT

In a sign of things to come, the DOJ recently filed its first civil fraud lawsuit. The strongest authority arises under the False Claims Act, which provides three times the amount of damages which the Government sustains.[55] The FCA also provides a six year statute of limitations period from the time of the false claim.[56] The (allegedly) fraudulent

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[52] In re Ambac Fin. Group, Inc. Sec. Litig., Id., Despite several traditional signs of trouble the Defendant said Ambac has "maintained the same conservative standards over the years" and "a little turmoil in the market, to be honest, that's actually a good thing for financial guarantors." The court found it reasonable such statements may allay concerns about performance, as these words of reassurance by management formed the the basis for lawsuit. "Defendants' argument that plaintiffs were on inquiry notice before July 25, 2007, implies that Ambac's investors should have been aware of the company's financial troubles at a time when Ambac's own officers deny knowing that anything was wrong. While we acknowledge the permissibility of arguing in the alternative under the Federal Rules, this glaring contradiction exposes defendants' inquiry notice argument as trivial at best."

[53] Rothman v. Gregor, 220 F.3d 81, 97 (2d Cir.2000).

[54] 42 U.S.C.A. § 3613 (West).

[55] 31 U.S.C.A. § 3729 (West).

[56] 31 U.S.C.A. § 3731(b)(1) (West). Some dispute exists as to the precise moment of accrual, whether the application or the payout of the claim. *See:* 139 A.L.R. Fed. 645 (Originally published in 1997)

representations made by Countrywide/BoA to Fannie and Freddie resulted in the U.S. Treasury paying $183 billion by the end of 2011 to support those entities. How much of this can be attributed to the defendants may be a challenge to prove, but treble damages may be a substantial sum. U.S. ex rel. O'Donnell capitalizes on a whistleblower within Countrywide, a former vice president, who was a lone voice opposing the company's "Hustle" program of eliminating speed bumps on a loan and fast-tracking them through the oversight process.[57] Edward O'Donnell negotiated a sealed settlement, and then the DOJ intervened. Particularly damning in this suit is evidence that BoA continued the "Hustle" after acquiring Countrywide. This alone could sabotage hundreds of limited liability positions BoA has regarding a company that has already cost them $40 billion in payouts.[58]

HOUSING AND ECONOMIC RECOVERY ACT OF 2008

Perhaps the most significant controversy in this area is an interlocutory appeal regarding the FHFA. The district court rejected UBS' contention that the Securities Act claims are time-barred, whether the statute had expired before Congress created the FHFA, or whether Congress did not intend to extend the statute of repose.[59] A victory by UBS, as unlikely as it may be considering Congressional intent to initiate litigation on behalf of Fannie Mae and Freddie Mac, could save tens of billions for the biggest banks.

(The majority rule is that the limitations period begins when a claim is presented to an agency of the federal government for payment. Other cases state that an action does not accrue until the government pays the false claim.)

[57] U.S. ex rel. O'Donnell v. Bank of America Corp et al, No. 12-01422, (S.D.N.Y). "Hustle" is jargon for HSSL ("High Speed Swim Lane"), a program where defaults approached 40%. BoA acquired Countrywide by merging a subsidiary in July 2008. HSSL proceeded through 2009.

[58] Coincidentally, Congress awarded BoA $45 billion in Troubled Asset Relief Program (TARP) funds.

[59] Fed. Hous. Fin. Agency v. UBS Americas, Inc., 11 CIV. 5201 DLC, 2012 WL 2400263 (S.D.N.Y. June 26, 2012). The Housing and Economic Recovery Act of 2008 ("HERA") prescribes a three-year statute of limitations, running from the date of the GSEs' conservatorship, for "any action" that the FHFA might bring on their behalf. 12 U.S.C. § 4617(b)(12).

Presuming they lose the statute of limitations issue, defendants in the FHFA cases will defend with a theory that Fannie and Freddie are the most sophisticated investors regarding MBS. However, the full details of the subprime loans were not disclosed, making it reasonable that the Plaintiffs relied upon statements of these largest banks. The trial is scheduled for May, 2014.

NEW YORK STATE LAW: BREACH OF CONTRACT

Many contracts with Wall Street firms are drafted under New York law and, relevant to subprime litigation, involve the reps, warranties, and "put backs" to repurchase the defaulted loan assets. The statute of limitations is six years from the time of breach, and will not be tolled due to intervening legislation- thus, serving as a statute of repose. The "cause of action for breach of contract accrues, and the statute of limitation begins to run, at the time of the breach."[60]

VII. LITIGATION CHALLENGES

After the financial collapse, several allegations were filed quickly in the courts. Many of the subprime cases have reached summary judgment, with several of those reaching circuit court review. The facts plaintiff counsel may have hoped to elicit in discovery, however, were of no use in a 12(b)(6) motion for failure to state a claim. Courts found many filings to be overly broad and dismissed the cases without prejudice.

Cases surviving summary judgment can require amended (or multiple-amended) complaints. This latitude suggests courts' general recognition that there is some level of

[60] Structured Mortg. Trust 1997-2 v. Daiwa Fin. Corp., 02 CIV. 3232 (SHS), 2003 WL 548868 (S.D.N.Y. Feb. 25, 2003). Every other state and D.C. explicitly create a private right of action.

chicanery at play, but courts have put plaintiffs on clear notice that general allegations will not suffice.

One challenge to defenses will be a long held bar to indemnification for fraud, specifically, an "underwriter which had actual knowledge of omission of material facts from the prospectus could not enforce indemnity agreement against an issuing corporation, its president or treasurer."[61]

REQUIREMENTS TO PROPERLY PLEAD A SECURITIES FRAUD ACTION

Section 10(b) of the Securities Exchange Act of 1934 forbids the:

> "[U]se or employ, in connection with the purchase or sale of any security ..., [of] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors."[62]

SEC Rule 10b-5 implements § 10(b) by declaring it unlawful:

> (a) To employ any device, scheme, or artifice to defraud,
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made ... not misleading, or
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[63]

Under the heightened pleading requirements of the PSLRA, any private securities complaint alleging that the defendant made a false or misleading statement must:

> (1) "specify each statement alleged to have been misleading [and] the reason or reasons why the statement is misleading,[64] and
> (2) "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."[65]

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[61] Globus v. Law Research Serv., Inc., 418 F.2d 1276 (2d Cir. 1969).
[62] 15 U.S.C. § 78j(b).
[63] 17 C.F.R. § 240.10b-5.
[64] 15 U.S.C. § 78u-4(b)(1).
[65] § 78u-4(b)(2). Tripp v. Indymac Fin. Inc., CV07-1635GW, 2007 WL 4591930 (C.D. Cal. Nov. 29, 2007).

THE CHALLENGES OF SCIENTER

Pleading a Section 10(b) and Rule 10b-5 claim requires a precise statement of the material omissions or fraudulent statements that were relied upon to purchase the security. Furthermore, plaintiffs must allege knowledge ("scienter") of the defendant, an element that can vary between the company and the controlling persons. Finally, there must be a differentiation between the fault of "the market" and that of the defendant.

Defendants have been most successful in arguing that plaintiffs have failed to establish the required scienter, or "strong inference" of fraudulent intent. Specifically, Defendants have relied upon the Supreme Court's ruling in Tellabs, Inc. v. Makor Issues & Rights, Ltd., which requires that "a [district] court must consider plausible nonculpable explanations for the defendant's conduct, as well as inferences favoring the plaintiff." Defendants, understandably, put forth a "Nobody saw this coming" explanation. Such a passive culprit sentiment is consistent with the role played by a deregulating American government.[66]

Although not part of the subprime litigation, Tellabs served to interpret the heightened class action pleading requirement of the PSLRA. Investors who fail to plead allegations of fraudulent misstatements with requisite particularity must, in the alternative, submit a proposed amended complaint to the court to preserve their right to

[66] Sen. Barack Obama pointed to "Republican and Democratic administrations" who "failed to guard against practices that all too often rewarded financial manipulation instead of productivity and sound business practices," Powell, Zeleny, "Obama Casts Wide Blame for Financial Crisis and Proposes Homeowner Aid," The New York Times, (March 28, 2008). According to Pres. Bush, "The financial crisis was ignited when booming housing markets began to decline. As home values dropped, many borrowers defaulted on their mortgages, and institutions holding securities backed by those mortgages suffered serious losses." President G.W. Bush, Speech on the Economic Crisis, (Nov. 13, 2008). Interestingly, President Bush does not acknowledge the loans that would be defaulted on, regardless of home values, nor that he created the American Dream Down Payment Fund, $35 million for homeowner education, and an intended $2 billion in tax credits for home construction, to encourage an additional 5.5 million minority homeowners. *See* "President George W. Bush addresses the White House Conference on Increasing Minority Homeownership," at The George Washington University (Oct. 15, 2002).

amend. A prime example of a dismissal is where the Eighth Circuit dismissed a complaint that *generally* alleged the company (1) lacked internal controls, rendering its projections inaccurate, (2) failed to properly account for its loan loss allowance, (3) should have revised underwriting guidelines based on the downturn in the subprime mortgage market, (4) had no basis on which to predict that it could maintain its status as a real estate investment trust, and (5) was at a higher risk of default based on deviations from the company's underwriting standards.[67]

General allegations may be true, but courts refuse to sift through generalities to find the specifics. This analysis of a complaint's scienter allegations makes unnecessary any determination as to the remaining elements of § 10(b) and Rule 10b–5 claims. If any one of the five required elements is missing, the claim fails.[68]

USE OF FORMER EMPLOYEES AND CONFIDENTIAL WITNESSES

One straightforward method of alleging scienter is to utilize former employees, including confidential witnesses. For example, a former IndyMac vice president states their former CEO sought to make his short-term goals for IndyMac "at all costs." To this end, he put immense pressure on subordinates to "push loans through," even if it meant consistently making "exceptions" to IndyMac's guidelines and policies. Other confidential witnesses reported an atmosphere of "organized chaos" where loan closings were done on an "anything goes" basis. According to these witnesses, the following practices were employed to close loans: (a) intentionally manipulating software used to compute loan

[67] In re 2007 Novastar Fin. Inc., Sec. Litig., 579 F.3d 878 (8th Cir. 2009).
[68] New York State Teachers' Ret. Sys. v. Fremont Gen. Corp., 460 F. App'x 642, 643 (9th Cir. 2011) (Plaintiffs failed to allege violations with the specificity required by the Private Securities Litigation Reform Act, 15 U.S.C. § 78u–4(b)(1) and Federal Rule of Civil Procedure 9(b)).

eligibility; (b) violating stated rate lock protocols and controls; and (c) disregarding underwriting guidelines generally.[69]

Tripp v. IndyMac is one of the first subprime cases filed and, consistent with the pleading challenges mentioned above, required *six* amended complaints over the course of three years. The Court ruled in the first amended complaint that

> "Plaintiffs failed to allege that the individual Defendants shared these beliefs and opinions or even that they were aware of them and found them to be reliable and justified. Had Plaintiffs sufficiently alleged the individual Defendants' knowledge and/or agreement with these assessments, the allegations (taken as true) might ordinarily have described a 'cogent and compelling' case for their securities fraud action."[70]

LIMITED LIABILITY IN PRIVATE OFFERINGS

Where fraudulent statements or omissions are alleged, it is important as to what degree of liability was on the part of the seller, as it changes in various circumstances. For example, plaintiffs have failed where the claim is based on a prospectus the defendant has no obligation to distribute, even if they in fact did so, as is the case of a private offering in the secondary market. Among several reasons to dismiss Luminent Mortgage Capital, Inc. v. Merrill Lynch, is reliance on this precedent.[71] Since the Second Circuit announced their decision in 2005, courts have repeatedly dismissed actions under Section 12(a)(2) when

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[69] Tripp v. IndyMac Bancorp, Inc., 2010 WL 1323239 (C.D.Cal.). Federal prosecutors investigated IndyMac (a Countrywide Financial Corp. spinoff) for criminal liability, yet did not produce an indictment. The SEC garnered a settlement from one executive for $125,000 without admitting any wrongdoing. Former-CEO Perry recently settled with the SEC, without admitting wrongdoing, for $80,000. SEC v. Perry, 11-1309, (C.D. Cal., Los Angeles). Perry has his own website aggressively promoting his innocence regarding the loss of $13 billion. http://nottoobigtofail.org.

[70] Tripp v. Indymac Fin. Inc., CV07-1635GW, 2007 WL 4591930 (C.D. Cal. Nov. 29, 2007). The company went bankrupt and the FDIC sold its assets, leaving Michael Perry as the sole defendant. After five years of litigation, the parties settled for $5.5 million, paid by the insurance company that covers executive liability. Sven Mossberg, et. al. v. IndyMac BanCorp, Inc., et. al., Case 2:07-cv-01635-GW –VBK (06/26/2012). Class Members are all persons who purchased or otherwise acquired IndyMac common stock from March 1, 2006 to March 1, 2007 (excluding company directors and their families).

[71] Luminent Mortg. Capital, Inc. v. Merrill Lynch & Co. 652 F.Supp.2d 576 (E.D. Pa. 2009); relying upon Yung v. Lee, 432 F. 3d 142, 145 (2d Cir. 2005).

the plaintiffs relied on a prospectus that the defendants were under no obligation to distribute.[72]

LOSS CAUSATION

A leading defense on subprime litigation is "it wasn't me, it was the Market." Some plaintiffs have hired experts to show the difference in losses between a particular company and the overall market, while others have focused on the company's violation of its own internal controls which led directly to the defaults leading to the plummeting (if not implosion) of the security. Where there are widespread losses, however, the case diminishes.[73]

The best illustration of "Individual v. The Market" liability is perhaps found in litigation concerning Ambac Financial Group. The district court found the pleadings on scienter and loss causation to be adequate, noting that "the conduct that plaintiffs' allege, if true, would make Ambac an active participant in the collapse of their own business, and of the financial markets in general, rather than merely a passive victim."[74] Ambac, like many of the subprime defendants, went bankrupt.[75] Perhaps more interesting than Ambac

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[72] In Yung, the plaintiffs purchased securities from the defendants in a private sale in reliance on a prospectus that the defendants prepared for a public offering. The defendants "relied heavily" on the Prospectus in their marketing of the securities. The court affirmed the dismissal of the plaintiffs' Section 12(a) (2) action, holding that a Section 12(a)(2) action cannot be maintained by a plaintiff who acquires securities through a private transaction, whether primary or secondary. The court reasoned that a private offering is not effected 'by means of a prospectus' because ... Section 12(a)(2) liability cannot attach unless there is an 'obligation to distribute a prospectus,' and there is no 'obligation' to distribute a document that describes a public offering to a private purchaser."

[73] Luminent Mortg. Capital, Inc. v. Merrill Lynch & Co., 652 F. Supp. 2d 576, 592-93 (E.D. Pa. 2009)(*quoting* First Nationwide Bank v. Gelt Funding Corp., 27 F.3d 763, 772, R.I.C.O. Bus. Disp. Guide (CCH) ¶8575 (2d Cir. 1994)); Patel v. Patel, 761 F. Supp. 2d 1375 (N.D. Ga. 2011)(*citing* In re HomeBanc Corp. Securities Litigation, 706 F. Supp. 2d 1336 (N.D. Ga. 2010)).

[74] In re Ambac Fin. Group, Inc. Sec. Litig., 693 F. Supp. 2d 241, 269-70 (S.D.N.Y. 2010), certificate of appealability denied (Apr. 29, 2010). Among the most glaring alleged practices within the company, were the undisclosed lowering of underwriting standards to drive short-term profits.

[75] A settlement was ultimately reached in 2011 against the directors' insurance policy, for $24.6 million; this is well short of the "in excess of $1.7 billion" required for potential recovery. In re Ambac Fin. Group, Inc., 457

defending against investors, however, is cases of Ambac suing loan originators.

Ambac blames its losses on EMC and Bear Stearns (now subsidiaries of J.P. Morgan). Ambac has filed similar lawsuits against its other securitization counterparties, including DLJ Mortgage Capital, Credit Suisse and Countrywide, claiming it was "duped" into insuring the mortgage default risks that materialized in the wake of the global economic downturn. Their case against EMC went viral when, after significant discovery related to representations and warranties, they added "fraudulent inducement," and the court allowed Bear Stearns to be added as a defendant. This ruling destroyed diversity, and is currently on appeal to the Second Circuit.[76]

Non-litigant analysis tends to support that an interconnectedness of factors led to the overall crisis, giving some credence to both arguments. In 2008, The President's Working Group on Financial Institutions Report found the following causes:

- Breakdown in underwriting standards for subprime mortgages;
- Significant erosion of market discipline by those involved in the securitization process, including originators, underwriters, credit rating agencies, and global investors, related in part to failures to provide or obtain adequate risk disclosures;
- Flaws in credit rating agencies' ratings of MBSs and other complex structured credit products, especially collateralized debt obligations (CDOs) that held MBSs and other asset-backed securities (CDOs of ABSs);
- Risk management weaknesses at some large U.S. and European financial institutions; and
- Regulatory policies, including capital and disclosure requirements, that failed to mitigate risk management

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B.R. 299, 306 (Bankr. S.D.N.Y. 2011) aff'd, 10-B-15973 SCC, 2011 WL 6844533 (S.D.N.Y. Dec. 29, 2011) aff'd, 11-4643 LEAD, 2012 WL 2849748 (2d Cir. July 12, 2012).

[76] Ambac Assurance Corp. v. EMC Mortgage Corp., 2011 WL 1746134 (C.A.2). This case involves the famous email Bear deal manager Nicolas Smith wrote on August 11th, 2006 to Keith Lind, a Managing Director on the trading desk, referring to a particular bond, SACO 2006-8, as "SACK OF SHIT [2006-]8" and said, "I hope your [sic] making a lot of money off this trade." Buhl, Teri, E-mails Suggest Bear Stearns Cheated Clients Out of Billions, The Atlantic, (01/25/2011).

weaknesses.

This spreading-the-blame is consistent with the multi-directional litigation throughout the financial industry.

VIII. JURISDICTION

CLASS ACTION FAIRNESS ACT OF 2005 (CAFA)

Section 22(a) of the Securities Act of 1933 creates concurrent jurisdiction in state and federal courts over claims arising under the Act. It also specifically provides that such claims brought in state court are not subject to removal to federal court. There is a dispute as to precisely how the Class Action Fairness Act's general removal provision trumps coincides with the Securities Act's specific bar to removal.

This year the Second Circuit held a case falls within CAFA's securities exception as one that solely involves a claim that "relates to the rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to" a security; meaning CAFA does not cover these claims. They dismissed the petition for lack of jurisdiction, reversed the order of the district court, and instructed it to remand the matter to the state court.[77] This is a broader interpretation than the Seventh Circuit,[78] yet consistent with the Ninth Circuit.[79]

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[77] BlackRock Fin. Mgmt. Inc. v. Segregated Account of Ambac Assur. Corp., 673 F.3d 169, 173 (2d Cir. 2012).

[78] Katz v. Gerardi, 552 F.3d 558, 561-62 (7th Cir. 2009) (Claims at issue were not eligible for exception, otherwise they would have been barred from removal under the Securities Act. Specific trumps the general only applies when they are subsets of each other.)

"§1453(d) This section shall not apply to any class action that solely involves—

(1) a claim concerning a covered security as defined under section 16(f)(3) of the Securities Act of 1933 (15 U.S.C. [77p(f)(3)]) and section 28(f)(5)(E) of the Securities Exchange Act of 1934 (15 U.S.C. 78bb(f)(5)(E));

EDGE ACT

In what may be the largest single action, AIG filed for $10 billion in damages against Countrywide/BoA in state court. The case was removed under the Edge Act,[80] and this decision is currently certified for appeal to the Second Circuit.[81] The exact parameters of the Edge Act are imprecise as to which actions are "arising out of transactions involving international or foreign banking." The Sixth Circuit found that a whistleblower's firing did not apply, although the activity in question were international transactions.[82]

STATE COURTS

New York state courts continue to play a leading role in securities, as many contracts are drafted there under state law. A recent ruling regarding N.Y. Insurance Law held that Syncora Guarantee Inc. must establish (for its claim of fraud) that misrepresentations by Countrywide induced Syncora to issue mortgage insurance policies on terms to which it otherwise would not have agreed. The preliminary ruling further held that Syncora is not required to establish a direct causal link between Countrywide's misrepresentations and Syncora's claims payments made pursuant to the insurance

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(2) a claim that relates to the internal affairs or governance of a corporation or other form of business enterprise and arises under or by virtue of the laws of the State in which such corporation or business enterprise is incorporated or organized; or

(3) a claim that relates to the rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to any security (as defined under section 2(a)(1) of the Securities Act of 1933 (15 U.S.C. 77b(a)(1)) and the regulations issued thereunder)." Katz, at 562.

[79] Luther v. Countrywide Home Loans Servicing LP, 533 F.3d 1031 (9th Cir. 2008) (General grant of the right of removal of high-dollar class actions under CAFA did not trump the specific bar to removal of cases arising under the Securities Act of 1933, and action was not removable.)

[80] 12 U.S.C. § 632.

[81] Am. Int'l Group, Inc. v. Bank of Am. Corp., 11 CIV. 6212 BSJ, 2011 WL 6778473 (S.D.N.Y. Dec. 20, 2011). The jurisdiction-granting provision of the Edge Act states that a case "arise[s] under the laws of the United States if (1) the case is civil in nature, (2) one of the parties is a corporation organized under the laws of the United States, and (3) the suit arises out of transactions involving ... international banking or international financial operations." Jana Master Fund, Ltd. v. JP Morgan Chase & Co., 490 F.Supp.2d 325, 328 (S.D.N.Y.2007).

[82] Sollitt v. KeyCorp, 463 F. App'x 471, 473 (6th Cir. 2012) cert. denied, 11-1479, 2012 WL 2050507 (U.S. Oct. 1, 2012)

policies. And perhaps most importantly, the court ruled that Rescission Damages were applicable where simple rescission of the contract is impracticable.[83] The parties then reached a settlement.[84] This follows a ruling against MBIA, though the MBIA case is expected to be of much greater magnitude.[85]

Although the MBIA case sets a new standard that a direct causal link is not required, and that showing a material increase to "risk" suffices, the Syncora ruling goes a step further. The court ruled that truthfulness in representations and guarantees are "conditions precedent" to the mortgage repurchasing agreements. This could have far-reaching impact in forcing loan originators to buy back all of their fraudulent loans, without requiring plaintiffs to prove these representations caused the loans to default.

The California Supreme Court is currently reviewing an appeals court conflict as to what duty a lender has to the borrower under common law.[86] Similar to New York in terms of impact, many subprime borrowers in America's largest jurisdiction await the decision.

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[83] Syncora Guarantee Inc. v. Countrywide Home Loans, Inc., 36 Misc. 3d 328, 345, 935 N.Y.S.2d 858, 871 (Sup. Ct. 2012). Syncora insured the imprudently granted home loans and had already paid $145 million in claims, and been notice of another $245 million in claims.

[84] Bank of America agreed to pay (as Countrywide successor) $375 million cash, and transfer certain assets from Syncora to BoA. Syncora press release, (July 17, 2012), available on their website: http://phx.corporate-ir.net/phoenix.zhtml?c=198015&p=irol-newsArticle&ID=1715608&highlight=.

[85] MBIA Ins. Corp. v. Countrywide Home Loans, Inc., 93 A.D.3d 574, 941 N.Y.S.2d 56 (2012). MBIA argues New York law should apply; BoA argues for Delaware law. A hearing is expected in December. The DOJ filed suit against Countrywide, mirroring MBIA claims, and cites the ongoing funding of Countrywide liabilities.

[86] Bank of America Corp., Countrywide Fin. Corp., et. al. v. Superior Court of the State of California, Cty of Los Angeles, et. al., 2011 WL 5089736 (Cal.)

IX. CRIMINAL CHARGES v. PRIVATE PROSECUTORS

Many Americans await the imprisonment of an executive in response to the largest financial scandal in history.[87] It is not likely to happen, even with recent criminal filings by the Department of Justice against several major firms- none of which name an individual defendant.[88] Civil litigants are surely hopeful that Attorney General Eric Holder's Financial Crimes Task Force, along with the New York state attorney general, can provide more firepower for their own cases. Settlements for Wall Street, it appears, are the destined course of action.

CHALLENGES TO CRIMINAL PROCEEDINGS

It is reasonable that a 2009 jury decision has given prosecutors cold feet. Two Bear Stearns executives had been charged with three counts of securities fraud and two counts of wire fraud. One was also charged with insider trading. After the not guilty verdict, some jurors told reporters that they concluded the evidence was flimsy and contradictory. Others suggested the pair were being blamed for market forces beyond their control. "How much can two men do?" said one juror. Another said, "They were scapegoats for Wall Street."[89]

Criminal charges have yielded limited settlements and no convictions, with the most high profile being against former Countrywide CEO Anthony Mozillo. He paid the SEC $67.5 million in 2012, and the criminal probe was dropped a year later.

The SEC is having modest success with civil penalties, although they are not pursuing any individuals nor requiring admissions of wrongdoing. Goldman Sachs ($550

[87] The infamous Bernie Madoff ponzi scheme did not involve MBS.
[88] Infra.
[89] Hays, Tom, "Ralph Cioffi, Matthew Tannin Verdict: Ex-Bear Stearns Hedge Fund Managers NOT GUILTY On All Fraud Charges" Huffington Post (11/10/09).

million), J.P. Morgan ($296.9m), CitiGroup ($285m), and Credit Suisse ($120m) are some of the most high-profile cases. J.P. Morgan and Credit Suisse, who settled just last week, include facts that these sellers of MBS received settlement payments from loan originators yet refused to pass along that indemnification to investors who bought (and own) the failed mortgages.[90]

The SEC lost its first trial against an individual this July, a Citigroup mid-tier executive who played a role in the sale of $1 billion in MBS. The jury, interestingly, also issued a statement: "This verdict should not deter the S.E.C. from continuing to investigate the financial industry, review current regulations and modify existing regulations as necessary," said the statement, which was read aloud by Judge Jed S. Rakoff in Federal District Court in Manhattan on Tuesday.[91] "I wanted to know why the bank's C.E.O. wasn't on trial," said Mr. Brendler, who served as the jury's foreman. "Citigroup's behavior was appalling."[92]

Prosecutors need to assess what is the best allocation of their resources considering the number of substance abusers, mentally ill people, and blue collar criminals that come through the police station doors. The threatened collapse of the entire global economy is inconsistent with issues such as domestic violence or drug possession. California had, for example, a four-year statute of limitations for felony fraud they might have brought against dozens of individual Countrywide brokers.[93] New York passed an act in 2008 that simplified and strengthened residential mortgage fraud laws, including making frauds of

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[90] SEC v. JPMorgan Securities, LLC et al, No. 12-01862, (D. D.C.); In re: Credit Suisse Securities (USA) LLC, et al, No. 3-15098, U.S. Securities and Exchange Commission. *See*: Viswanatha, Aruna, and Stempel, Jonathan, "JPMorgan, Credit Suisse settle with SEC for $417 million" Chicago Tribune (11/16/2012).
[91] Lattman, Peter, "SEC Gets Encouragement Fom Jury That Ruled Against It." The New York Times (8/03/23).
[92] Id.
[93] Cal. Penal Code § 532a (West).

over $1 million as a Class B felony, yet these (and preexisting laws) are only useful when used.[94]

LOCAL OFFICIALS HAVE SUCCESS

When the Mayor of Baltimore first sued Wells Fargo for, essentially, dragging down the property values of the entire city, the court dismissed for a failure to adequately plead the causal link between the loans and the foreclosure epidemic. That changed with the third complaint, where loan files and statements showed that people eligible for prime rates, which they could afford, were steered into subprime mortgages, which they defaulted on. "These allegations clearly provide the missing causal link between Wells Fargo's alleged steering and the vacant properties identified by the City."[95]

Similarly, the city of Memphis survived a challenge to their standing under the FHA and the Tennessee Consumer Protection Act. The court cited "well-pled claims for two types of damages where Wells Fargo loans resulted in foreclosure and vacancy: (1) the cost of increased government services; and (2) the loss of property tax revenue."[96] Wells Fargo is only one originator in a city that lost 93,000 homes to foreclosure in just a few years time.

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[94] CREATING NEW CRIMES RELATED TO MORTGAGE FRAUD—DISTRESSED PROPERTY CONSULTING CONTRACTS, 2008 Sess. Law News of N.Y. Ch. 472 (S. 8143–A) (McKINNEY'S); N.Y. Penal Law § 187.00, et. seq. (McKinney) "Residential mortgage fraud is committed by a person who, knowingly and with intent to defraud, presents, causes to be presented, or prepares with knowledge or belief that it will be used in soliciting an applicant for, applying for, underwriting or closing a residential mortgage loan, or filing with a county clerk of any county in the state arising out of and related to the closing of a residential mortgage loan, any written statement which: (a) contains materially false information concerning any fact material thereto; or (b) conceals, for the purpose of misleading, information concerning any fact material thereto."

[95] Mayor & City Council of Baltimore v. Wells Fargo Bank, N.A., CIV. JFM-08-62, 2011 WL 1557759 (D. Md. Apr. 22, 2011). The complaint includes a former Wells Fargo employees explaining how they were directed to conceal the true terms of the mortgage, and ensure the higher rate (and higher commission) loans.

[96] City of Memphis v. Wells Fargo Bank, N.A., 09-2857-STA, 2011 WL 1706756 (W.D. Tenn. May 4, 2011).

New York Attorney General Eric Schneiderman is, obviously, a key figure in financial crimes. Among his busy caseload, he recently filed against J.P. Morgan for fraud involving the $212 billion in MBS Bear Stearns sold between 2003 and 2006. Schneiderman calls the filing a "template" for future litigation across the financial industry.[97]

Massachusetts Attorney General Martha Coakley has found repeated success under their own consumer protection laws.[98] Coakley filed against Fremont Investment & Loan, and continued pursuing other lenders after the court ruled that any mortgage should be "presumed to be structurally unfair" if the loan possesses four characteristics:

1. The loan is an adjustable rate mortgage, known in the lending industry as an "ARM," with an introductory period of three years or less;
2. The loan has an introductory or "teaser" rate for the initial period that is at least 3 percent lower than the fully indexed rate;
3. The borrower has a debt-to-income ratio ("DTI") that would have exceeded 50 percent if the lender's underwriters had measured the debt, not by the debt due under the introductory rate, but by the debt due under the fully indexed rate;
4. The loan-to-value ratio ("LTV") is 100 percent *or* the loan carries a substantial - prepayment penalty *or* a prepayment penalty that extends beyond the introductory period.[99]

The presumption of unfairness would likely have solid footing before a jury under similar legal grounds in other states. Plaintiffs can likely put forth ample evidence of early defaults where loans possess such characteristics, particularly for "liar loans" with no documentation, and yet the loaners kept on loaning. Although these suits (and settlements) appear to be easy pickings, it is clear that politics plays a considerable role in the actions of state attorneys general.

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[97] McLaughlin, David, and Dolmetsch, Chris, "NY Attorney General Says More Suits Will Follow JPMorgan," Bloomberg (Oct. 12, 2012).
[98] G.L. c. 93A.
[99] Commonwealth v. Fremont Investment & Loan, CA 07-4373-BLSI (Sulfolk Co. June 9, 2009). Fremont settled for $10 million, including $8 million in consumer compensation. *See also*: Com. v. H&R Block, Inc., 2008 WL 5970550. In the latter case, the lender lost a preliminary injunction, settled for $9.8 million, and provide mortgage relief up to $115 million for those with loans serviced by American Home Loan Mortgage.

NATIONAL SETTLEMENT IN *MERS*

The Obama Administration has coordinated a settlement signed by 49 states attorneys general, expected to be $25 billion and new protections for people facing foreclosure. New York, however, has filed their own suit against the largest banks for the use of MERS (Mortgage Electronic Registration System).[100] It will be interesting to see if New York fares better than other plaintiffs who have failed to convince courts that the speedy system is an illegal end-run around laws that require property transfers to be filed at local town halls.[101] If not for the cyber-trading in lien ownership, there may not have been a Mortgage Backed Security industry.

Ultimately, Wall Street has always advocated for a self-regulating market. It should be expected that an industry that appropriated a trillion dollars in capital from the American people will have a certain level of leeway, if not immunity.

X. UNSETTLING SETTLEMENTS

When Bank of America, the world's largest bank, purchased Countrywide (the largest originator of subprime loans), "Too Big to Fail" took on the Biggest Failure. The implications on litigation are monumental. A forthcoming hearing regarding a pending $8.5 billion settlement has come under fire due to some plaintiffs' demands to unseal

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[100] Berlin, Loren, "Eric Schneiderman Sues BofA, Wells Fargo, JPMorgan Chase Over Electronic Mortgage Fraud," HuffPost Business (3/20/12).

[101] Blaylock v. Wells Fargo Bank, N.A., CIV. 12-693 ADM/LIB, 2012 WL 2529197 (D. Minn. June 29, 2012) (Sanctions are warranted because of Butler's repeated attempts to assert the rejected "show me the note" theory, as well as his baseless quiet title claims and meritless slander of title arguments.) Many MERS cases have been brought by homeowners facing foreclosure; government plaintiffs have fared better. Bain v. Metro. Mortg. Group, Inc., 175 Wash. 2d 83, 89, 285 P.3d 34, 37 (2012) (MERS has no power to foreclose if it does not possess deed; homeowner may sue under Consumer Protection Act, but only if MERS has causal connection to the injury.)*See also:* Doug Welborn, et. al. v. BNYM, et. al., CA 3:12-CV-220, (M.D. La, April 17, 2012) (Louisiana Clerks of Court filed under RICO, that MERS is an end run around filing fees).

confidential documents.[102] This settlement was designed to avoid litigation altogether, and considers the limited "successor liability" of BoA, and the ability of Countrywide to pay settlements. Furthermore, the New York and Delaware Attorneys General are among the interveners (obtaining "*parens patriae*" standing), claiming the possibility that fraud is afoot; particularly where the trustee (Bank of NY Mellon) may be receiving a side deal from Countrywide/BoA.

Observers are left to wonder whether secrecy or laziness drives the typical unwillingness to review every loan file, to check just how many loans complied with underwriting standards. The intervening investors' group is calling for a statistical sample of roughly 5,000 random loans.[103] The A.G.s' involvement raise the risk that damaging information is released to the public, showing perhaps that BNYM has been as fraudulent as Countrywide/BoA. The banks may need to significantly increase the pay-out to buy the approval, and silence, of government entites who some have seen as less than effective.

In the same vein, BoA settled with bond guarantor Assured Guaranty, Ltd., for $1.1 billion, and 80% of further collateral losses up to $8.6 billion.[104] The latter settlement indicates that loan originators are accepting liability, especially when they often have provisions to buy back the bad loans yet systematically have failed to do so.

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[102] In re Bank of New York Mellon, 651786-2011, New York State Supreme Court, New York County (Kapnick, J.) A hearing is scheduled for May, 2013. Intervening investors include AIG. There are 530 Countrywide MBS trusts at stake, with $424 billion in face value bonds. With over $100 bn in losses at the time of the deal announced, this is 8 cents on the dollar. Investor supporters include the NY Fed, Blackrock, and PIMCO. This would not release fraud or securities claims, nor claims against BoA or Merrill Lynch.

[103] NY state court ordered a sample (6000 out of 368,000 loans) will be sufficient in MBIA v. Countrywide. The Judge and defense will review the methodology. Bank executives had previously stated that a loan-by-loan analysis will favor their superior resources. Syncora v. EMC will also allow a statistical sample of over 9,000 loans. Assured v. Flagstaff is deferring a ruling until end of trial.

[104] "Assured Guaranty, Ltd. Announces Settlement with Bank of America," April 15, 2011. Available at: http://assuredguaranty.newshq.businesswire.com/press-release/transactions/assured-guaranty-ltd-announces-settlement-bank-america

Finally, it is difficult to say how foreign law can impact these transactions, particularly in financial centers such as London, Berlin, Hong Kong, and Tokyo. Some have filed suit here, such as nineteen foreign investment banks who bring causes of action, under §§ 11, 12(a)(2), and 15 of the Securities Act, against Citigroup for CDO's sold after securitization.[105] These foreign plaintiffs split off from a shareholders' suit.[106] The international implications of the subprime crisis is an appropriate subject for another paper or series thereof.

XI. CONCLUSION

It is myopic to see the subprime litigation as only representative of a financial collapse. Although many small-time investors may never recover, others will re-establish their position in the industry. The true fallout of this economic scandal can be found in the 3.5 million households who have already lost their homes, and millions more in foreclosure. Many are people who were induced into a subprime refinancing and "reverse equity" mortgages, representing about 5% of all homes seeing evictions.

Pressure mounts upon elected officials to stop foreclosures and force loan modifications. There are signs of success, but it does not change the fact that many areas are now seeing boarded-up homes and overgrown yards. It isn't clear how the bank-owned properties will play out, both on a financial or social level. Property values plummet while lending is more constricted. Overall, nearly 8% of Black and Latino borrowers have lost homes, compared to 4.5% of White borrowers.

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[105] Int'l Fund Mgmt. S.A. v. Citigroup Inc., 822 F. Supp. 2d 368, 376 (S.D.N.Y. 2011).

[106] *See:* In re Citigroup Inc. Sec. Litig., 753 F. Supp. 2d 206 (S.D.N.Y. 2010); shareholders adequately alleged misstatements and omissions; materiality and loss causation; and particularized facts giving rise to strong inference of scienter. *See also*: In re CitiGroup Inc. Bond Litig., 723 F. Supp. 2d 568 (S.D.N.Y. 2010).

The negative media could prove more costly to a financial institution than the litigation fees and restitution. Settlements will set few legal precedents beyond standards for pleading, as no trials appear likely. It remains to be seen if the next wave of litigation is municipalities making general allegations of creating desolation, or specific allegations of racial discrimination, or if these claims are suppressed with comprehensive settlements.

Banks are now the largest property owners and in some cases are being ordered to collect rent rather than evict. The national economy could use the injection of money from millions of new mortgages. Affordable rates for lower values may provide a stable stream rather than a rapacious windfall, but it is important to remember that the products are homes for American families.