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NO FEE-GC 6103

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A 6029

FILED
LOS ANGELES SUPERIOR COURT

JUN 25 2008

JOHN A. CLARKE, CLERK
BY ZONIA C. PEDRAZA, DEPUTY

11 SUPERIOR COURT OF THE STATE OF CALIFORNIA
 12 FOR THE COUNTY OF LOS ANGELES COUNTY
 13 NORTHWEST DISTRICT

15 THE PEOPLE OF THE STATE OF CALIFORNIA,

16 Plaintiff,

17 v.

18 COUNTRYWIDE FINANCIAL
 CORPORATION, a Delaware corporation;
 19 COUNTRYWIDE HOME LOANS, INC., a
 New York corporation; FULL SPECTRUM
 20 LENDING, INC., a California Corporation;
 ANGELO MOZILO, an individual; DAVID
 21 SAMBOL, an individual; and DOES 1-100,
 22 inclusive,

23 Defendants.

Case No.: LC081846

COMPLAINT FOR RESTITUTION,
INJUNCTIVE RELIEF, OTHER
EQUITABLE RELIEF, AND CIVIL
PENALTIES

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1 **COMPLAINT**

2 Plaintiff, the People of the State of California, by and through Edmund G. Brown Jr.,
3 Attorney General of the State of California, alleges the following, on information and belief:

4 **I. DEFENDANTS AND VENUE**

5 1. At all relevant times, defendant Countrywide Financial Corporation ("CFC"), a
6 Delaware corporation, has transacted and continues to transact business throughout the State of
7 California, including in Los Angeles County.

8 2. At all relevant times, defendant Countrywide Home Loans, Inc. ("CHL"), a New
9 York corporation, has transacted and continues to transact business throughout the State of
10 California, including in Los Angeles County. CHL is a subsidiary of CFC.

11 3. At all relevant times, until on or about December 15, 2004, Full Spectrum
12 Lending, Inc. ("Full Spectrum"), was a California corporation that transacted business throughout
13 the State of California, including in Los Angeles County, and was a subsidiary of CFC. On or
14 about December 15, 2004, Full Spectrum was merged into and became a division of CHL. For
15 all conduct that occurred on or after December 15, 2004, any reference in this complaint to CHL
16 includes reference to its Full Spectrum division.

17 4. Defendants CFC, CHL, and Full Spectrum are referred to collectively herein as
18 "Countrywide" or "the Countrywide Defendants."

19 5. At all times pertinent hereto, defendant Angelo Mozilo ("Mozilo") was Chairman
20 and Chief Executive Officer of CFC. Defendant Mozilo directed, authorized, and ratified the
21 conduct of the Countrywide Defendants set forth herein.

22 6. At all times pertinent hereto, defendant David Sambol ("Sambol") is and was the
23 President of CHL and, since approximately September, 2006, has served as the President and
24 Chief Operating Officer of CFC. Sambol directed, authorized and ratified the conduct of CHL,
25 and after, September, 2006, the Countrywide Defendants, as set forth herein. Defendant Sambol
26 is a resident of Los Angeles County.

27 7. Plaintiff is not aware of the true names and capacities of the defendants sued as
28 Does 1 through 100, inclusive, and therefore sues these defendants by such fictitious names.

1 Each of these fictitiously named defendants is responsible in some manner for the activities
2 alleged in this Complaint. Plaintiff will amend this Complaint to add the true names of the
3 fictitiously named defendants once they are discovered.

4 8. The defendants identified in paragraphs 1 through 7, above, shall be referred to
5 collectively as "Defendants."

6 9. Whenever reference is made in this Complaint to any act of any defendant(s), that
7 allegation shall mean that each defendant acted individually and jointly with the other
8 defendants.

9 10. Any allegation about acts of any corporate or other business defendant means that
10 the corporation or other business did the acts alleged through its officers, directors, employees,
11 agents and/or representatives while they were acting within the actual or ostensible scope of their
12 authority.

13 11. At all relevant times, each defendant committed the acts, caused or directed others
14 to commit the acts, or permitted others to commit the acts alleged in this Complaint.
15 Additionally, some or all of the defendants acted as the agent of the other defendants, and all of
16 the defendants acted within the scope of their agency if acting as an agent of another.

17 12. At all relevant times, each defendant knew or realized that the other defendants
18 were engaging in or planned to engage in the violations of law alleged in this Complaint.
19 Knowing or realizing that other defendants were engaging in or planning to engage in unlawful
20 conduct, each defendant nevertheless facilitated the commission of those unlawful acts. Each
21 defendant intended to and did encourage, facilitate, or assist in the commission of the unlawful
22 acts, and thereby aided and abetted the other defendants in the unlawful conduct.

23 13. At all relevant times, Defendants have engaged in a conspiracy, common
24 enterprise, and common course of conduct, the purpose of which is and was to engage in the
25 violations of law alleged in this Complaint. This conspiracy, common enterprise, and common
26 course of conduct continues to the present.

27 14. The violations of law alleged in this Complaint occurred in Los Angeles County
28 and elsewhere throughout California and the United States.

1 **II. DEFENDANTS' BUSINESS ACTS AND PRACTICES**

2 15. This action is brought against Defendants, who engaged in false advertising and
3 unfair competition in the origination of residential mortgage loans and home equity lines of
4 credit ("HELOCs").

5 16. Countrywide originated mortgage loans and HELOCs through several channels,
6 including a wholesale origination channel and a retail origination channel. The Countrywide
7 employees who marketed, sold or negotiated the terms of mortgage loans and HELOCs in any of
8 its origination channels, either directly to consumers or indirectly by working with mortgage
9 brokers, are referred to herein as "loan officers."

10 17. In Countrywide's wholesale channel, loan officers in its Wholesale Lending
11 Division ("WLD") and Specialty Lending Group ("SLG") (now merged into the WLD) worked
12 closely with a nationwide network of mortgage brokers to originate loans. In its wholesale
13 channel, Countrywide often did business as "America's Wholesale Lender," a fictitious business
14 named owned by CHL. In Countrywide's retail channel, loan officers employed by Countrywide
15 in its Consumer Markets Division ("CMD") sold loans directly to consumers. In addition, loan
16 officers employed by Full Spectrum up until December 14, 2004, and thereafter by
17 Countrywide's Full Spectrum Lending Division ("FSLD"), sold loans directly to consumers as
18 part of Countrywide's retail channel.

19 18. Countrywide maintained sophisticated electronic databases by means of which
20 corporate management, including but not limited to defendants Mozilo and Sambol, could obtain
21 information regarding Countrywide's loan production status, including the types of loan
22 products, the number and dollar volume of loans, the underwriting analysis for individual loans,
23 and the number of loans which were approved via underwriting exceptions. Defendants used this
24 information, together with data they received regarding secondary market trends, to develop and
25 modify the loan products that Countrywide offered and the underwriting standards that
26 Countrywide applied.

27 19. The mortgage market changed in recent years from one in which lenders
28 originated mortgages for retention in their own portfolios to one in which lenders attempted to

1 generate as many mortgage loans as possible for resale on the secondary mortgage market. The
2 goal for lenders such as Countrywide was not only to originate high mortgage loan volumes but
3 also to originate loans with above-market interest rates and other terms which would attract
4 premium prices on the secondary market.

5 20. In 2004, in an effort to maximize Countrywide's profits, Defendants set out to
6 double Countrywide's share of the national mortgage market to 30% through a deceptive scheme
7 to mass produce loans for sale on the secondary market. Defendants viewed borrowers as
8 nothing more than the means for producing more loans, originating loans with little or no regard
9 to borrowers' long-term ability to afford them and to sustain homeownership. This scheme was
10 created and maintained with the knowledge, approval and ratification of defendants Mozilo and
11 Sambol.

12 21. Defendants implemented this deceptive scheme through misleading marketing
13 practices designed to sell risky and costly loans to homeowners, the terms and dangers of which
14 they did not understand, including by (a) advertising that it was the nation's largest lender and
15 could be trusted by consumers; (b) encouraging borrowers to refinance or obtain purchase money
16 financing with complicated mortgage instruments like hybrid adjustable rate mortgages or
17 payment option adjustable rate mortgages that were difficult for consumers to understand; (c)
18 marketing these complex loan products to consumers by emphasizing the very low initial
19 "teaser" or "fixed" rates while obfuscating or misrepresenting the later steep monthly payments
20 and interest rate increases or risk of negative amortization; and (d) routinely soliciting borrowers
21 to refinance only a few months after Countywide or the loan brokers with whom it had "business
22 partnerships" had sold them loans.

23 22. Defendants also employed various lending policies to further their deceptive
24 scheme and to sell ever-increasing numbers of loans, including (a) the dramatic easing of
25 Countrywide's underwriting standards; (b) the increased use of low- or no-documentation loans
26 which allowed for no verification of stated income or stated assets or both, or no request for
27 income or asset information at all; (c) urging borrowers to encumber their homes up to 100% (or
28

1 more) of the assessed value; and (d) placing borrowers in "piggyback" second mortgages in the
2 form of higher interest rate HELOCs while obscuring their total monthly payment obligations.

3 23. Also to further the deceptive scheme, Defendants created a high-pressure sales
4 environment that propelled its branch managers and loan officers to meet high production goals
5 and close as many loans as they could without regard to borrower ability to repay. Defendants'
6 high-pressure sales environment also propelled loan officers to sell the riskiest types of loans,
7 such as payment option and hybrid adjustable rate mortgages, because loan officers could easily
8 sell them by deceptively focusing borrowers' attention on the low initial monthly payments or
9 interest rates. Defendants also made arrangements with a large network of mortgage brokers to
10 procure loans for Countrywide and, through its loan pricing structure, encouraged these brokers
11 to place homeowners in loans with interest rates higher than those for which they qualified, as
12 well as prepayment penalty obligations. This system of compensation aided and abetted brokers
13 in breaching their fiduciary duties to borrowers by inducing borrowers to accept unfavorable loan
14 terms without full disclosure of the borrowers' options and also compensated brokers beyond the
15 reasonable value of the brokerage services they rendered.

16 24. Countrywide received numerous complaints from borrowers claiming that they
17 did not understand their loan terms. Despite these complaints, Defendants turned a blind eye to
18 the ongoing deceptive practices engaged in by Countrywide's loan officers and loan broker
19 "business partners," as well as to the hardships created for borrowers by its loose underwriting
20 practices. Defendants cared only about selling increasing numbers of loans at any cost, in order
21 to maximize Countrywide's profits on the secondary market.

22 **III. THE PRIMARY PURPOSE OF DEFENDANTS' DECEPTIVE BUSINESS**
23 **PRACTICES WAS TO MAXIMIZE PROFITS FROM THE SALE OF LOANS TO**
24 **THE SECONDARY MARKET**

25 25. Defendants' deceptive scheme had one primary goal – to supply the secondary
26 market with as many loans as possible, ideally loans that would earn the highest premiums. Over
27 a period of several years, Defendants constantly expanded Countrywide's share of the consumer
28 market for mortgage loans through a wide variety of deceptive practices, undertaken with the

1 direction, authorization, and ratification of defendants Sambol and Mozilo, in order to maximize
2 its profits from the sale of those loans to the secondary market.

3 26. While Countrywide retained ownership of some of the loans it originated, it sold
4 the vast majority of its loans on the secondary market, either as mortgage-backed securities or as
5 pools of whole loans.

6 27. In the typical securitization transaction involving mortgage-backed securities,
7 loans were "pooled" together and transferred to a trust controlled by the securitizer, such as
8 Countrywide. The trust then created and sold securities backed by the loans in the pool. Holders
9 of the securities received the right to a portion of the monthly payment stream from the pooled
10 loans, although they were not typically entitled to the entire payment stream. Rather, the holders
11 received some portion of the monthly payments. The securitizer or the trust it controlled often
12 retained an interest in any remaining payment streams not sold to security holders. These
13 securitizations could involve the pooling of hundreds or thousands of loans, and the sale of many
14 thousands of shares.

15 28. Countrywide generated massive revenues through these loan securitizations. Its
16 reported securities trading volume grew from 647 billion dollars in 2000, to 2.9 trillion dollars in
17 2003, 3.1 trillion dollars in 2004, 3.6 trillion dollars in 2005, and 3.8 trillion dollars in 2006.
18 (These figures relate to the ostensible values given to the securities by Countrywide or investors,
19 and include securities backed by loans made by other lenders and purchased by Countrywide.)

20 29. For the sale of whole (i.e., unsecuritized) loans, Countrywide pooled loans and
21 sold them in bulk to third-party investors, often (but not exclusively) Wall Street firms. The sale
22 of whole loans generated additional revenues for Countrywide. Countrywide often sold the
23 whole loans at a premium, meaning that the purchaser paid Countrywide a price in excess of
24 100% of the total principal amount of the loans included in the loan pool.

25 30. The price paid by purchasers of securities or pools of whole loans varied based on
26 the demand for the particular types of loans included in the securitization or sale of whole loans.
27 The characteristics of the loans, such as whether the loans are prime or subprime, whether the
28

1 loans have an adjustable or fixed interest rate, or whether the loans include a prepayment penalty,
2 all influenced the price.

3 31. Various types of loans and loan terms earned greater prices, or "premiums," in the
4 secondary market. For example, investors in mortgages and mortgage backed securities have
5 been willing to pay higher premiums for loans with prepayment penalties. Because the
6 prepayment penalty deters borrowers from refinancing early in the life of the loan, it essentially
7 ensures that the income stream from the loan will continue while the prepayment penalty is in
8 effect. Lenders, such as Countrywide, typically sought to market loans that earned it higher
9 premiums, including loans with prepayment penalties.

10 32. In order to maximize the profits earned by the sale of its loans to the secondary
11 market, Countrywide's business model increasingly focused on finding ways to generate an ever
12 larger volume of the types of loans most demanded by investors. For example, Countrywide
13 developed and modified loan products by discussing with investors the prices they would be
14 willing to pay for loans with particular characteristics (or for securities backed by loans with
15 particular characteristics), and [REDACTED]
16 [REDACTED]. This enabled Countrywide to determine
17 which loans were most likely to be sold on the secondary market for the highest premiums.

18 33. Further, rather than waiting to sell loans until after they were made, Countrywide
19 would sell loans "forward" before loans were funded. In order to determine what loans it could
20 sell forward, Countrywide would both examine loans in various stages of production and
21 examine its projected volume of production over the next several months.

22 34. Loans that were sold forward were sold subject to a set of stipulations between
23 Countrywide and the purchaser. For example, in a sale of whole loans, Countrywide might agree
24 on October 1 that on December 1 it would deliver 2000 adjustable rate mortgage loans with an
25 average interest rate of 6.0%, half of which would be subject to a prepayment penalty, among
26 other characteristics. (None of these loans would have been made as of October 1.) Based on
27 these stipulations regarding the characteristics of the loans to be included in the pool, an investor
28 might agree to pay a price totaling 102.25% of the total face value of the loans. In other words,

1 the purchaser agreed in advance to pay a premium of 2.25%. Then, if the loans actually delivered
2 on December 1 had a slightly higher or lower average interest rate, the terms of the stipulation
3 would specify how much the final price would be adjusted.

4 35. The information regarding the premiums that particular loan products and terms
5 could earn on the secondary market was forwarded to Countrywide's production department,
6

7 [Redacted description of production department's responsibilities.]

8 36. Countrywide originated as many loans as possible not only to maximize its profits
9 on the secondary market, but to earn greater profits from servicing the mortgages it sold.
10 Countrywide often retained the right to service the loans it securitized and sold as pools of whole
11 loans. The terms of the securitizations and sales agreements for pools of whole loans authorized
12 Countrywide to charge the purchasers a monthly fee for servicing the loans, typically a
13 percentage of the payment stream on the loan.

14 37. Tantalized by the huge profits earned by selling loans to the secondary market,
15 Defendants constantly sought to increase Countrywide's market share: the greater the number
16 and percentage of loans it originated, the greater the revenue it could earn on the secondary
17 market. Countrywide executives, including defendant Mozilo, publicly stated that they sought to
18 increase Countrywide's market share to 30% of all mortgage loans made and HELOCs extended
19 in the country.

20 38. In its 2006 annual report, Countrywide trumpeted the fact that "[w]hile the overall
21 residential loan production market in the United States has tripled in size since 2000, from \$1.0
22 trillion to \$2.9 trillion at the end of 2006, Countrywide has grown nearly three times faster, going
23 from \$62 billion in loan originations in 2000 to \$463 billion in 2006."

24 39. In addition, Countrywide directly and indirectly motivated its branch managers,
25 loan officers and brokers to market the loans that would earn the highest premiums on the
26 secondary market without regard to borrower ability to repay. For example, the value on the
27 secondary market of the loans generated by a Countrywide branch was an important factor in
28 determining the branch's profitability and, in turn, branch manager compensation. Managers

1 were highly motivated to pressure their loan officers to sell loans that would earn Countrywide
2 the highest premium on the secondary market, which resulted in aggressive marketing of such
3 loans to consumers.

4 40. The secondary market affected Countrywide's pricing of products and, in order to
5 sell more loans on the secondary market, Countrywide relaxed its underwriting standards and
6 liberally granted exceptions to those standards. Countrywide managers and executives, including
7 but not limited to defendants Mozilo and Sambol, had access to information that provided
8 transparency and a seamless connection between secondary market transactions, the loan
9 production process, and managerial and sales incentives.

10 **IV. COUNTRYWIDE ENGAGED IN DECEPTIVE PRACTICES IN THE SALE OF**
11 **COMPLEX AND RISKY LOANS TO CONSUMERS**

12 41. Countrywide offered a variety of loan products that were both financially risky
13 and difficult for borrowers to understand, including in particular payment option and hybrid
14 adjustable rate mortgages and second loans in the form of home equity lines of credit.

15 **A. The Pay Option ARM**

16 42. Particularly after 2003, Countrywide aggressively marketed its payment option
17 adjustable rate mortgage ("Pay Option ARM") under the direction, authorization and ratification
18 of defendants Mozilo and Sambol. The Pay Option ARM, which Countrywide classified as a
19 "prime" product, is a complicated mortgage product which entices consumers by offering a very
20 low "teaser" rate – often as low as 1% – for an introductory period of one or three months. At
21 the end of the introductory period, the interest rate increases dramatically. Despite the short
22 duration of the low initial interest rate, Countrywide's Pay Option ARMs often include a one,
23 two or three-year prepayment penalty.

24 43. When the teaser rate on a Pay Option ARM expires, the loan immediately
25 becomes an adjustable rate loan. Unlike most adjustable rate loans, where the rate can only
26 change once every year or every six months, the interest rate on a Pay Option ARM can change
27 every month (if there is a change in the index used to compute the rate).
28

1 44. Countrywide's Pay Option ARMs were typically tied to either the "MTA,"
2 "LIBOR" or "COFI" index. The MTA index is the 12-month average of the annual yields on
3 actively traded United States Treasury Securities adjusted to a constant maturity of one year as
4 published by the Federal Reserve Board. The LIBOR (London Interbank Offered Rate) index is
5 based on rates that contributor banks in London offer each other for inter-bank deposits. Separate
6 LIBOR indices are kept for one month, six-month, and one-year periods, based on the duration of
7 the deposit. For example, the one-year LIBOR index reported for June 2008 is the rate for a
8 twelve-month deposit in U.S. dollars as of the last business day of the previous month. The
9 COFI (11th District Cost of Funds Index) is the monthly weighted average of the interest rates
10 paid on checking and savings accounts offered by financial institutions operating in the states of
11 Arizona, California and Nevada.

12 45. Although the interest rate increases immediately after the expiration of the short
13 period of time during which the teaser rate is in effect, a borrower with a Pay Option ARM has
14 the option of making monthly payments as though the interest rate had not changed. Borrowers
15 with Pay Option ARMs typically have four different payment options during the first five years
16 of the loan. The first option is a "minimum" payment that is based on the introductory interest
17 rate. The minimum payment, which Countrywide marketed as the "payment rate," is the lowest
18 of the payment options presented to the borrower. Most of Countrywide's borrowers choose to
19 make the minimum payment.

20 46. The minimum payment on a Pay Option ARM usually is less than the interest
21 accruing on the loan. The unpaid interest is added to the principal amount of the loan, resulting
22 in negative amortization. The minimum payment remains the same for one year and then
23 increases by 7.5% each year for the next four years. At the fifth year, the payment will be
24 "recast" to be fully amortizing, causing a substantial jump in the payment amount often called
25 "payment shock."

26 47. However, the loan balance on a Pay Option ARM also has a negative amortization
27 cap, typically 115% of the original principal of the loan. If the balance hits the cap, the monthly
28 payment is immediately raised to the fully amortizing level (i.e., all payments after the date the

1 cap is reached must be sufficient to pay off the new balance over the remaining life of the loan).
2 When that happens, the borrower experiences significant payment shock. A borrower with a
3 Countrywide Pay Option ARM with a 1% teaser rate, who is making the minimum payment, is
4 very likely to hit the negative amortization cap and suffer payment shock well before the standard
5 5-year recast date.

6 48. Instead of making the minimum payment, the borrower has the option of making
7 an interest-only payment for five years. The borrower then experiences payment shock when the
8 payment recasts to cover both principal and interest for the remaining term of the loan.
9 Alternatively, the borrower can choose to make a fully amortizing principal and interest payment
10 based on either a 15-year or a 30-year term.

11 49. The ever-increasing monthly payments and payment shock characteristic of Pay
12 Option ARMs are illustrated by the following example of a Countrywide loan. The loan had an
13 initial principal balance of \$460,000.00, a teaser rate of 1%, and a margin of 2.9% (such that
14 after the one-month teaser rate expired, the interest would be the 1-month LIBOR index plus
15 2.9%, rounded to the nearest 1/8th percent). After the teaser rate expired, based on the 1-month
16 LIBOR rate as of the date the borrower obtained the loan, the interest rate would increase to
17 7.00%. Assuming the 7.00% interest rate remained in place, and the borrower chose to make the
18 minimum payment for as long as possible, the payment schedule would be approximately as
19 follows:

- 20 a. \$1,479.54 per month for the first year;
21 b. \$1,590.51 per month for the second year;
22 c. \$1,709.80 per month for the third year;
23 d. \$1,838.04 per month for the fourth year;
24 e. \$1,975.89 per month for the first nine months of the fifth year; and
25 f. approximately \$3747.83 per month for the remaining twenty-five years
26 and three months on the loan.

27 50. Once the payments reach \$3747.83, this Pay Option ARM will have negatively
28 amortized such that the balance of the loan will have increased to approximately \$523,792.33.

1 At that point, the borrower will be faced with a payment more than two-and-a-half times greater
2 than the initial payment and likely will be unable to refinance unless his or her home has
3 increased in value at least commensurately with the increased loan balance. In addition,
4 increases in the LIBOR rate could cause the borrower to hit the negative amortization cap earlier,
5 and also could result in even higher payments. If the interest rate reached 8%, just 1% higher, the
6 negative amortization cap would be reached sooner and payments could reach \$4,000.00 per
7 month, or higher.

8 51. During the underwriting process, Countrywide did not consider whether
9 borrowers would be able to afford such payment shock. Further, depending on the state of the
10 his or her finances, even the interim increases in the minimum payment may well have caused
11 dramatic hardship for the borrower.

12 52. Even if the borrower elects to make interest-only payments, he or she still will
13 experience payment shock. Again assuming the interest rate stays constant at 7.00% over the life
14 of the loan, the borrower's initial payments would be approximately \$2,683.33 for five years.
15 Thereafter, the payment will increase to approximately \$3,251.18 per month, an increase of over
16 20%.

17 53. Nearly all Countrywide's Pay Option ARM borrowers will experience payment
18 shock such as that illustrated in paragraphs 49 through 52 above. As of December 31, 2006,
19 almost 88% of the Pay Option ARM portfolio held by Defendants consisted of loans that had
20 experienced some negative amortization. This percentage increased to 91% as of December 31,
21 2007.

22 54. Countrywide sold thousands of Pay Option ARMs, either through its branches or
23 through brokers. For example, on a national basis, approximately 19% of the loans originated
24 by Countrywide in 2005 were Pay Option ARMs. Countrywide made many of these loans in
25 California.

26 55. These loans were highly profitable. Countrywide had a gross profit margin of
27 approximately 4% on Pay Option ARMs, compared to 2% on mortgages guaranteed by the
28 Federal Housing Administration.

1 56. Countrywide retained ownership of a number of loans for investment purposes,
2 including thousands of Pay Option ARMs. Countrywide reported the negative amortization
3 amounts on these Pay Option ARMs (i.e., the amount by which the balances on those loans
4 increased) as income on its financial statements. The negative amortization "income" earned by
5 Countrywide totaled 1.2 billion dollars by the end of of 2007.

6 57. Moreover, Pay Option ARMs with higher margins could be sold for a higher
7 premium on the secondary market, because the higher margins would produce a greater interest
8 rate and therefore a larger income stream. To insure an abundant stream of such loans,
9 Countrywide pushed its loan officers to sell Pay Option ARMs and paid loan brokers greater
10 compensation for selling a Pay Option ARM with a higher margin, or above-par rate, thus
11 encouraging them to put consumers into higher cost loans. Countrywide also used a variety of
12 deceptive marketing techniques to sell its Pay Option ARMs to consumers.

13 58. Countrywide deceptively marketed the Pay Option ARM by aggressively
14 promoting the teaser rate. Television commercials emphasized that the payment rate could be as
15 low as 1% and print advertisements lauded the extra cash available to borrowers because of the
16 low minimum payment on the loan. Television advertisements did not effectively distinguish
17 between the "payment rate" and the interest rate on the loans, and any warnings about potential
18 negative amortization in Countrywide's print advertisements were buried in densely written small
19 type.

20 59. Borrowers, enticed by the low teaser rate, were easily distracted from the fine
21 print in the loan documents and did not fully understand the terms or the financial implications of
22 Countrywide's Pay Option ARMs.

23 60. When a borrower obtained a Pay Option ARM from Countrywide, the only initial
24 monthly payment amount that appeared anywhere in his or her loan documents was the minimum
25 payment amount. In other words, documents provided to the borrower assumed he or she would
26 make only the minimum payment. Thus, a borrower would not know the monthly payment
27 necessary to make a payment that would, for example, cover accruing interest, until he or she
28

1 received the first statement after the expiration of the teaser rate, well after all loan documents
2 were signed.

3 61. Countrywide and the brokers it accepted as its "business partners" misrepresented
4 or obfuscated the true terms of the Pay Option ARMs offered by Countrywide, including but not
5 limited to misrepresenting or obfuscating the amount of time that the interest rate would be fixed
6 for the loan, misrepresenting or obfuscating the risk of negative amortization and the fact that the
7 payment rate was not the interest rate, and misrepresenting or obfuscating that the minimum
8 payment would not apply for the life of the loan.

9 62. Countrywide and its business partner brokers also misrepresented or obfuscated
10 how difficult it might be for borrowers to refinance a Pay Option ARM loan. In fact, after
11 making only the minimum payment, because of negative amortization the borrower likely would
12 not be able to refinance a Pay Option ARM loan unless the home serving as security for the
13 mortgage had increased in value. This is particularly true in cases for borrowers whose loans
14 have a very high loan-to-value ratio.

15 63. Countrywide and its business partner brokers often misrepresented or obfuscated
16 the fact that a particular Pay Option ARM included a prepayment penalty and failed to explain
17 the effect that making only the minimum payment would have on the amount of the prepayment
18 penalty. If a borrower seeks to refinance after having made the minimum payment for an
19 extended period, but while a prepayment penalty is still in effect, the negative amortization can
20 cause the amount of the prepayment penalty to increase. Prepayment penalties typically equal six
21 months worth of accrued interest. As negative amortization causes the loan principal to
22 increase, it also causes an increase in the amount of interest that accrues that each month, thereby
23 increasing the prepayment penalty.

24 64. Countrywide and its business partner brokers also represented that the prepayment
25 penalty could be waived if the borrower refinanced with Countrywide. However, Countrywide
26 sells most of the loans it originates, and Countrywide has at most limited authority to waive
27 prepayment penalties on loans it does not own, even when it controls the servicing (and is often
28

1 required to pay the prepayment penalties on loans it does not own in the instances where it is not
2 able to collect the penalty from the borrower).

3 **B. Hybrid ARM Loans**

4 65. In addition to the Pay Option ARMs, Countrywide offered "Hybrid" ARM loans.
5 Hybrid ARMs have a fixed interest rate for a period of 2, 3, 5, 7, or 10 years, and then an
6 adjustable interest rate for the remaining loan term. The products described below were offered
7 with the approval, direction and ratification of defendants Sambol and Mozilo.

8 **(1) 2/28 and 3/27 ARMs**

9 66. Countrywide typically offered "2/28" Hybrid ARMs through its Full Spectrum
10 Lending Division. These 2/28 ARM loans have low, fixed interest rates for the first two years
11 (the "2" in "2/28"). The loans often only required interest-only payments during the period the
12 initial rate was in effect, or sometimes for the first five years of the loan.

13 67. After the initial rate expires, the interest rate can adjust once every six months for
14 the next 28 years (the "28" in "2/28"). During this period, the interest rate typically is
15 determined by adding a margin to the one-year LIBOR index, except that the amount the interest
16 rate can increase at one time may be limited to 1.5%. Because the initial rate is set independent
17 of the index, the payment increase can be dramatic, particularly if the loan called for interest-only
18 payments for the first two or five years.

19 68. Countrywide also offered "3/27" ARMs, which operate similarly to 2/28 ARMs,
20 except that the low initial rate is fixed for three rather than two years, and the interest rate then
21 adjusts for 27 rather than 28 years.

22 69. Countrywide underwrote 2/28 and 3/27 ARMs based on the payment required
23 while the initial rate was in effect, without regard to whether the borrower could afford the loan
24 thereafter. And, like Pay Option ARMs, Countrywide's 2/28 and 3/27 ARMs typically contain
25 prepayment penalties.

26 70. A borrower with a 2/28 ARM, like a borrower with a Pay Option ARM, is
27 subjected to steadily increasing monthly payments as well as payment shock. For example, a
28 Countrywide borrower obtained a 2/28 ARM for \$570,000, with an initial rate of 8.95% for the

1 first two years. Thereafter, the interest rate was to be calculated by adding a margin of 7.95% to
2 the six-month LIBOR index. The promissory note for this 2/28 ARM provides that the interest
3 rate can never be lower 8.95% and can go as high as 15.95%. Based on the LIBOR rate that
4 applied at the time the borrower received the loan and the terms of the note governing interest
5 rate (and therefore payment) increases, the anticipated payment schedule was:

- 6 a. \$4,565.86 per month for two years;
- 7 b. \$5,141.98 per month for six months;
- 8 c. \$5,765.48 per month for six months; and
- 9 d. payments of \$6,403.01 per month or more thereafter.

10 71. This borrower's monthly payments on this 2/28 ARM will thus increase by
11 approximately 40% just during the 12 months between the end of the second year and beginning
12 of the fourth year of the loan.

13 (2) 5/1, 7/1, and 10/1 ARMs

14 72. Countrywide also offered 5/1, 7/1, and 10/1 "interest-only" loans. Marketed as
15 having "fixed" or "fixed period" interest rates, these loans carried a fixed interest rate for the first
16 5, 7, or 10 years respectively. These loans were underwritten based on the initial fixed, interest-
17 only payment until at least the end of 2005. However, when the fixed rate period expires, the
18 interest rate adjusts once per year and is determined by adding a margin to an index. The
19 monthly payments dramatically increase after the interest-only period, because payments over the
20 remaining 25, 23, or 20 years are fully amortized to cover both principal and interest.

21 73. For example, if a borrower had a 5/1 loan for \$500,000 that remained constant at
22 7.5% for the life of the loan, the monthly payments during the five year interest-only period
23 would be \$3,125.00. The monthly payment would increase to approximately \$3,694.96 for the
24 remaining 25 years of the loan. If the interest rate increased to 8% over the remaining 25 years,
25 the payment would jump to \$3,859.08 per month.

26 74. Collectively, 2/28, 3/27, 5/1, 7/1, and 10/1 ARMs will be referred to herein as
27 "Hybrid ARMs."
28

1 **(3) Countrywide's Deceptive Marketing of its Hybrid ARMs**

2 75. Countrywide marketed Hybrid ARMs by emphasizing the low monthly payment
3 and low "fixed" initial interest rate. Countrywide and its business partner brokers misrepresented
4 or obfuscated the true terms of these loans, including but not limited to misrepresenting or
5 obfuscating the amount of time that the fixed rate would be in effect, misrepresenting or
6 obfuscating the fact that the interest rates on the loans are adjustable rather than fixed, and
7 obfuscating or misrepresenting the amount by which payments could increase once the initial
8 fixed rate expired.

9 76. Countrywide and its business partner brokers also often misrepresented or
10 obfuscated the fact that Hybrid ARMs, particularly 2/28 and 3/27 ARMs, included prepayment
11 penalties, or represented that the prepayment penalties could be waived when the borrowers
12 refinanced with Countrywide. However, most loans originated by Countrywide are sold on the
13 secondary market and, as described in paragraph 64, above, Countrywide generally cannot waive
14 the terms of loans it does not own, even when it controls the servicing.

15 77. Countrywide and its brokers also misrepresented or obfuscated how difficult it
16 might be for borrowers to refinance Hybrid ARMs. Although borrowers often were assured that
17 they would be able to refinance, those seeking to refinance Hybrid ARMs after the expiration of
18 the initial interest-only period likely would be able to do so unless the home serving as security
19 for the mortgage had maintained or increased its value. This was particularly true for borrowers
20 whose loans have very high loan-to-value ratios, as there would be no new equity in the
21 borrowers' homes to help them pay fees and costs associated with the refinances (as well as any
22 prepayment penalties that may still apply).

23 **C. Home Equity Lines of Credit**

24 78. Countrywide also aggressively marketed HELOCs, particularly to borrowers who
25 had previously obtained or were in the process of obtaining a first mortgage loan from
26 Countrywide. Defendants referred to such HELOCs as "piggies" or "piggyback loans," and
27 referred to simultaneously funded first loans and HELOCs as "combo loans." The first loan
28 typically covered 80% of the appraised value of the home securing the mortgage, while the

1 HELOC covered any of the home's remaining value up to (and sometimes exceeding) 20%.
2 Thus, the HELOC and the first loan together often encumbered 100% or more of a home's
3 appraised value.

4 79. Under the terms of the piggyback HELOCs, borrowers received monthly bills for
5 interest-only payments for the first five years of the loan term (which could be extended to ten
6 years at Countrywide's option), during which time they could also tap any unused amount of the
7 equity line. This was called the "draw period."

8 80. Because Countrywide offered HELOCs as piggybacks to Pay Option and Hybrid
9 ARMs, 100% or more of a property's appraised value could be encumbered with loans that
10 required interest-only payments or allowed for negative amortization.

11 81. Countrywide typically urged borrowers to draw down the full line of credit when
12 HELOCs initially funded. This allowed Countrywide to earn as much interest as possible on the
13 HELOCs it kept in its portfolio, and helped generate the promised payment streams for HELOCs
14 sold on the secondary market. For the borrower, however, drawing down the full line of credit at
15 funding meant that there effectively was no "equity line" available during the draw period, as the
16 borrower would be making interest-only payments for five years.

17 82. Upon the end of the draw period, the HELOC notes generally require borrowers to
18 repay the principal and interest in fully amortizing payments over a fifteen year period. A fully
19 drawn HELOC was therefore functionally a 20- or 25-year closed-end mortgage. However,
20 Countrywide did not provide borrowers with any documents or other materials to help them
21 calculate the principal and interest payments that would be due after the draw, or interest-only,
22 period.

23 83. Countrywide HELOCs were underwritten not to the fully amortizing payment, but
24 to the interest-only payments due during the draw period. Countrywide typically charged an
25 early termination fee for HELOCs closed before three years, and sometimes would charge a
26 monthly fee for HELOCs where the balance fell below a specified amount.

27 84. A borrower with an interest-only or a negatively amortizing loan faces even
28 greater payment shock if he or she also has a fully drawn HELOC. For example, a borrower

1 with a fully drawn \$100,000 HELOC at a 7.00% interest rate will have monthly interest-only
2 payments of approximately \$583.33. At the end of the draw period, the payment will increase to
3 \$898.83. This payment increase is in addition to whatever payment increase the borrower is
4 experiencing on his or her first mortgage. This potential dual payment shock is typically
5 obfuscated from or not explained to borrowers. Moreover, a borrower with a piggyback HELOC,
6 particularly a borrower whose first mortgage negatively amortized or allowed interest-only
7 payments, is even less likely to be able to refinance at the time of his or her payment shock
8 unless his or her home has increased in value.

9 **V. COUNTRYWIDE EASED AND DISREGARDED UNDERWRITING**
10 **STANDARDS IN ORDER TO INCREASE ITS MARKET SHARE**

11 85. Driven by its push for market share, Countrywide did whatever it took to sell
12 more loans, faster – including by easing its underwriting criteria and disregarding the minimal
13 underwriting criteria it claimed to require. By easing and disregarding its underwriting criteria,
14 Countrywide increased the risk that borrowers would lose their homes. Defendants Mozilo and
15 Sambol actively pushed for easing Countrywide's underwriting standards and documentation
16 requirements, allowed the liberal granting of exceptions to those already eased standards and
17 requirements, and received reports detailing the actual underwriting characteristics and
18 performance of the loans Countrywide funded.

19 **A. Countrywide's Low- and No-Documentation Loans**

20 86. Traditionally, lenders required borrowers seeking mortgage loans to document
21 their income, for example by providing W-2s or tax returns, as well as assets. Countrywide,
22 however, disregarded such documentation requirements with respect to its riskiest loan products
23 and introduced a variety of reduced or no documentation loan programs that eased and
24 quickened the loan origination process. The vast majority of the Hybrid ARMs and nearly all of
25 the Pay Option ARMs originated by Countrywide were reduced or no documentation loans.

26 87. As an example of one of its widespread no documentation programs, Countrywide
27 made Pay Option ARMs, Hybrid ARMs, and piggyback HELOCs, among other loans, pursuant
28 to its "Stated Income Stated Assets," or "SISA," program. The borrower's income and assets

1 were stated but not verified. Employment was verbally confirmed and income was supposed to
2 be roughly consistent with incomes earned in the type of job in which the borrower was
3 employed. Reduced documentation loans, in turn, allowed borrowers to document their income
4 through the provision of information that was less reliable than the information required of full
5 documentation loans, such as bank statements or verbal verification of employment.

6 88. These low- and no-documentation programs, such as SISA, enabled Countrywide
7 to process loans more quickly and therefore to make more loans. Stated income loans also
8 encouraged the overstating of income – loan brokers and officers either overstated the borrower's
9 income without his or her knowledge, or led the borrower into overstating his or her income
10 without explaining the risk of default that the borrower would face with a loan he or she could
11 not actually afford. According to a former Countrywide loan officer, for example, a loan officer
12 might say, "with your credit score of X, for this house, and to make X payment, X is the income
13 you need to make." Many borrowers responded by agreeing that they made X amount in income.

14 89. For stated income loans, it became standard practice for loan processors and
15 underwriters to check www.salary.com to see if a stated income was within a reasonable range,
16 with more tolerance on the upside for California salaries. Because loan officers knew about this
17 practice, they too would look at salary.com to figure out the parameters ahead of time and know
18 by how much they could overstate (or fabricate) income.

19 **B. Countrywide's Easing of Underwriting Standards**

20 90. Countrywide also relaxed, and often disregarded, the traditional underwriting
21 standards used to separate acceptable from unacceptable risk in order to produce more loans for
22 the secondary market. Initially, for example, a borrower had to have a credit score of ■ for a
23 stated income loan. As the secondary market's appetite for loans increased, Countrywide relaxed
24 its guidelines so that a borrower with a credit score of ■ could get a stated income loan with
25 100% financing.

26 91. Underwriting standards which Countrywide relaxed included qualifying interest
27 rates (the rate used to determine whether borrowers can afford loans), loan-to-value ratios (the
28 amount of the loan(s) compared to lower of the appraised value or sale price of the property), and

1 debt-to-income ratios (the amount of borrowers' monthly income compared to their monthly
2 indebtedness).

3 92. With respect to qualifying rates, while Countrywide offered loans with initial low
4 payments that would increase, loans were underwritten without regard to borrowers' long-term
5 financial circumstances. Until at least the end of 2005, Countrywide underwrote and approved
6 its Hybrid ARMs based on the fixed interest rate applicable during the initial period of the loan,
7 without taking into account whether the borrowers would be able to afford the dramatically
8 higher payments that would inevitably be required during the remaining term of the loan.

9 93. In addition, Countrywide's approach to underwriting and marketing Pay Option
10 ARMs diverged. Countrywide underwrote Pay Option ARMs based on the assumption that
11 borrowers would make a fully amortizing payment, rather than the minimum payment, and
12 therefore not experience negative amortization. In contrast, Countrywide marketed Pay Option
13 ARMs by emphasizing the minimum payments. Countrywide continued this underwriting
14 practice even though it knew that many of its Pay Option ARM borrowers would choose to make
15 only the minimum monthly payment and that a high percentage of such borrowers had
16 experienced negative amortization on their homes, as described in paragraph 53, above.

17 94. Countrywide also underwrote and approved HELOCs based on the borrower's
18 ability to afford the interest-only payments during the initial period of the loan, not based on the
19 borrower's ability to afford the subsequent, fully amortized principal and interest payments.

20 95. Countrywide eased other basic underwriting standards. Starting in 2003, as
21 Defendants pushed to expand market share, underwriting standards and verification requirements
22 became more flexible to enable underwriters to approve loans faster. Countrywide, for example,
23 allowed higher and higher loan-to-value ("LTV") and combined loan-to-value ("CLTV") ratios –
24 the higher the ratio, the greater the risk that a borrower will default and will be unable to
25 refinance in order to avoid default. Similarly, Countrywide approved loans with higher and
26 higher debt-to-income ("DTI") ratios – the higher ratio, the greater the risk the borrower will
27 have cash-flow problems and miss mortgage payments.

28

1 C. Countrywide's "Exception" Underwriting Compromised Standards

2 96. Countrywide approved loans that it knew to be high risk, and therefore highly
3 likely to end up in default, by ignoring its own minimal underwriting guidelines. Based on the
4 proposed loan terms and the borrower's financial and credit information, Countrywide's
5 computerized underwriting system ("CLUES") issued a loan analysis report that rated the
6 consumer's credit and ability to repay the loan, and also indicated whether a proposed loan was
7 in compliance with Countrywide's underwriting guidelines. Based on this analysis, the CLUES
8 report would recommend that the loan be approved, the loan be declined, or that the loan be
9 "referred" to manual underwriting. CLUES, for example, might flag a "rule violation" if the
10 borrower's LTV, CLTV or credit score fell outside the guidelines for a given loan product. In
11 such instances, CLUES would make a recommendation to "refer" the loan for further analysis by
12 a Countrywide underwriter.

13 97. The CLUES result was only a recommendation, not a final decision. The role of
14 the underwriter was basically to verify information and ultimately decide whether to approve a
15 loan based on Countrywide's underwriting criteria. Underwriters could overcome potential rule
16 violations or other underwriting issues flagged by CLUES by adding on "compensating factors,"
17 such as letters from the borrower that addressed a low FICO score or provided explanations
18 regarding a bankruptcy, judgment lien, or other issues affecting credit status.

19 98. Underwriters were under intense pressure to process and fund as many loans as
20 possible. They were expected to process 60 to 70 loans per day, making careful consideration of
21 borrowers' financial circumstances and the suitability of the loan product for them nearly
22 impossible.

23 99. As the pressure to produce loans increased, underwriters, their superiors, branch
24 managers, and regional vice presidents were given the authority to grant exceptions to
25 Countrywide's minimal underwriting standards and to change the terms of a loan suggested by
26 CLUES. Even if CLUES had recommended denying a loan, the underwriter could override that
27 denial if he or she obtained approval from his or her supervisor.

28 100. Because of the intense pressure to produce loans, underwriters increasingly had to

1 justify why they were not approving a loan or granting an exception for unmet underwriting
2 criteria to their supervisors, as well as to dissatisfied loan officers and branch managers who
3 earned commissions based on loan volume. Any number of Countrywide managerial employees
4 could override an underwriter's decision to decline a loan and request an exception to an
5 underwriting standard. Countrywide employees also could submit a request for an exception to
6 Countrywide's Structured Loan Desk in Plano, Texas, a department specifically set up by
7 Countrywide, at the direction of defendants Mozilo and Sambol, to grant underwriting
8 exceptions. According to a former employee, in 2006, 15,000 to 20,000 loans a month were
9 processed through the Structured Loan Desk.

10 101. Countrywide granted exceptions liberally, further diluting its already minimal
11 underwriting standards for making loans. Countrywide granted exception requests in a variety of
12 circumstances where one or more basic underwriting criteria of the borrower did not meet loan
13 product guidelines, including, for example, LTV or CLTV, loan amount and credit score.
14 Countrywide placed borrowers in risky loans such as Hybrid and Pay Option ARMs, based on
15 stated but not verified income and assets, and then overlooked its few remaining underwriting
16 indicia of risk.

17 102. To attract more business Countrywide promoted its relaxed underwriting
18 standards and ready grant of exceptions to brokers. For example, Countrywide promoted
19 "Unsurpassed Product Choices and Flexible Guidelines," including (a) "100% financing for
20 purchase or refinancing" loans; (b) "80/20 combo loans for stated Self-Employed and Non Self-
21 Employed;" (c) "Stated Self-Employed and Non Self-Employed loan programs with as low as a
22 500 credit score." Countrywide stated that its "Specialty Lending Group's experienced and
23 knowledgeable loan experts are empowered to review all loan packages, make sound credit
24 decisions and provide quality lending solutions - yes, even for 'hard to close' loans."

25 **D. Countrywide's Risk-Layering and Pressure to Sell "Piggyback" Loans**
26 **Further Loosened Underwriting Practices**

27 103. Countrywide compromised its underwriting standards even further by risk
28 layering, i.e., combining high risk loans with one or more relaxed underwriting standards.

1 Countrywide was well aware that layered risk created a greater likelihood that borrowers would
2 lose their homes.

3 104. As early as January 2005, Countrywide identified the following borrower/loan
4 characteristics as having a negative impact on the underwriting evaluation process: [REDACTED]

5 [REDACTED]
6 [REDACTED]
7 [REDACTED]. [Redacted description of risk factors
8 identified by Countrywide.]

9 105. Nonetheless, Countrywide combined these very risk factors in the loans it
10 promoted to borrowers. Countrywide introduced, for example, loan programs that allowed for
11 higher LTVs/CLTVs, less documentation and lower credit scores. A high risk loan such as a Pay
12 Option ARM could be sold to borrowers with increasingly lower credit scores. In addition, by
13 accepting higher DTI ratios and combining Pay Option ARMs with second mortgages that
14 allowed borrowers to finance a down payment, Countrywide would qualify borrowers with fewer
15 financial resources, and hence a higher likelihood of default.

16 106. With a second or "piggyback" mortgage, the borrower could get a first loan for
17 80% of the purchase price (i.e., an 80% LTV) and a second loan for 20% of the purchase price (a
18 20% LTV), for a combined loan-to-value ratio of 100%. This allowed the borrower to finance a
19 down payment and also avoid paying mortgage insurance (which typically is required if the LTV
20 on a first loan exceeds 80%). Such loans obviously were risky as the borrower had contributed
21 no funds whatsoever to the loan and, if the loan required no documentation, had only stated his or
22 her income and assets.

23 107. The following examples describe risk layering and underwriting exceptions
24 granted to several California borrowers to whom Countrywide sold Hybrid or Pay Option ARMs.
25 These examples represent only a small percentage of the large number of California residents
26 who are likely facing foreclosure due to Countrywide's widespread practice of risk-layering.

27 a. A Countrywide loan officer convinced a borrower to take a Pay Option
28 ARM with a 1-month teaser rate and a 3-year prepayment penalty, plus a full-draw

1 piggyback HELOC, based on the loan officer's representation that the value of the
2 borrower's home would continue to rise and he would have no problem refinancing. The
3 borrower's DTI was [REDACTED] % and FICO was [REDACTED]. An exception was granted for [REDACTED]

4 [REDACTED]
5 [REDACTED]
6 [REDACTED]
7 [REDACTED]
8 [REDACTED]

9 [REDACTED]. The loan closed in January 2006, and a Notice of Default issued in
10 June 2007. [Redacted example of underwriting exception approved by Countrywide.]

11 b. The CLUES report issued for a loan applicant in February 2005 stated that

12 [REDACTED]
13 [REDACTED]
14 [REDACTED]
15 [REDACTED]
16 [REDACTED]
17 [REDACTED]

18 [REDACTED]. [Redacted example of underwriting exception approved by
19 Countrywide.]

20 c. [REDACTED]
21 [REDACTED]
22 [REDACTED]
23 [REDACTED]
24 [REDACTED]
25 [REDACTED]

26 [REDACTED]. [Redacted example of underwriting exception approved
27 by Countrywide.]

1 **VI. COUNTRYWIDE ENGAGED IN DECEPTIVE MARKETING PRACTICES TO**
2 **SELL INCREASING NUMBERS OF LOANS**

3 108. Driven by its push for market share, Countrywide did whatever it took to sell
4 more loans, faster – including by engaging in a number of deceptive marketing practices under
5 the direction and with the ratification of defendants Mozilo and Sambol.

6 **A. Countrywide Deceptively Lulled Borrowers Into Believing That it Was a**
7 **“Trusted Advisor” Looking Out for the Borrowers’ Best Interests**

8 109. Countrywide sought to induce borrowers into believing that it was looking out for
9 their best interest through various types of solicitations. Countrywide published television, radio,
10 and print advertisements, for example, touting itself as “the company you can trust” and urging
11 consumers to “join the millions of homeowners who have trusted Countrywide.” Countrywide
12 capitalized on its status as the “number one mortgage lender” and claimed that it was a mortgage
13 loan expert capable of advising customers. For example, Countrywide claimed that it “had years
14 to perfect [its] craft” and offered “industry leading expertise” and that “[w]ith over 35 years of
15 service and one of the widest selections of loan programs, [it] is an expert at finding solutions for
16 all kinds of situations.” As another example, Countrywide offered “consultation[s] with our
17 home loan experts” and claimed it “would go the distance with you to help secure a loan program
18 to fit your financial needs and goals.”

19 110. Countrywide also engaged in extensive solicitation campaigns aimed at those
20 borrowers it was easiest for it to find -- existing Countrywide customers. Countrywide targeted
21 existing customers with tailored letters and e-mail solicitations, creating the impression that it
22 was a mortgage expert that advised its borrowers, at no cost, regarding the financial mortgage
23 options that were in their best interest. For example, Countrywide took advantage of Pay Option
24 ARM customers’ worries regarding potential future “steep payment adjustments,” by sending
25 them a “special invitation” to talk with “specially-trained consultants” regarding “your current
26 financial situation, at no charge, to see if refinancing may help put you in a better financial
27 position.”

28 111. Countrywide also created an annual “anniversary” campaign, by sending letters
and e-mails to existing customers offering a “free Anniversary Loan Review,” which it touted as

1 a "home loan analysis" with an "experienced Loan Consultant." Countrywide advertised itself in
2 these solicitations as, for example, an "expert at finding solutions" and "smart financial options"
3 that would best suit borrowers' financial needs.

4 112. Countrywide operated an extensive telemarketing operation, aimed both at new
5 potential customers and existing Countrywide customers, in which it touted its expertise and
6 claimed to find the best financial options for its customers. For example, Countrywide instructed
7 its Full Spectrum loan officers to memorize a script that instructed them to "build rapport" and
8 "gain trust" in conversations with potential customers, and to do so with existing customers by
9 "positioning" telephone calls, the true purpose of which was to sell refinance loans, as "Customer
10 Service loan check-up[s]." On these calls, loan officers were instructed to [REDACTED]

11 [REDACTED]
12 [REDACTED]. [Redacted description
13 of marketing training for loan officers.] Countrywide instructed FSLD loan officers to state, for
14 example, "I'm an experienced mortgage lending professional specializing in helping people
15 improve their financial situation." Countrywide even instructed loan officers to offer to provide
16 advice on other lender's mortgage loans and to tell potential customers, that "even if you're
17 working with someone else and just want a second opinion -- mortgages can be very complicated.
18 I'm here for that."

19 113. In addition, when handling initial calls from prospective customers, for example,
20 Countrywide instructed its FSLD loan officers to [REDACTED]

21 [REDACTED]
22 [REDACTED]
23 [REDACTED]. [Redacted description of marketing
24 training for loan officers.] Contrary to the kinds of representations described in this paragraph
25 and paragraphs 109 through 112, above, Countrywide often did not sell borrowers loans that
26 were in their best interest.

1 **B. Countrywide Encouraged Serial Refinancing**

2 114. In order to constantly produce more loans for sale to the secondary market,
3 Countrywide aggressively marketed refinance loans to those homeowners it had no trouble
4 finding -- Countrywide customers. Countrywide misled these borrowers regarding the benefits of
5 refinancing, including by using the deceptive marketing practices described in paragraphs 119
6 through 128 below. In addition, Countrywide created a perpetual market for its refinance loans
7 by selling Pay Option and Hybrid ARMs that borrowers would have to refinance because they
8 couldn't afford their current loans. Countrywide knew that borrowers who could not afford the
9 inevitable payment increase on such loans and who were unable to refinance would be at great
10 risk of losing their homes.

11 115. Countrywide provided lists of existing customers to its loan officers responsible
12 for outbound marketing. Defendants' loan officers hounded Countrywide customers by phone,
13 mail, and electronic mail with refinance loan offers. For example, [REDACTED]

14 [REDACTED]
15 [REDACTED]. [Redacted description of Countrywide's marketing plans for soliciting existing
16 Countrywide customers to refinance.] FSLD "leads" – telephone numbers for existing, eligible
17 customers – were uploaded into a telemarketing database on a weekly basis.

18 116. Countrywide even solicited customers who were having trouble making payments
19 or facing foreclosure, without regard to the risk that the customer would default on Pay Option
20 and Hybrid ARM refinance loans. FSLD solicited existing prime customers who had "recurring"
21 missed payments. Countrywide required its customer service representatives to market refinance
22 loans to borrowers who called with questions, including borrowers who were behind on their
23 monthly payments or facing foreclosure.

24 117. Countrywide also solicited existing customers on other occasions, including on
25 their annual loan "anniversaries" (see paragraph 111, above) and shortly before a rate or payment
26 was to reset on Pay Option or Hybrid ARMs, without regard to whether the loan had a
27 prepayment penalty period that had not yet expired. In doing so, the Countrywide Defendants
28

1 refinanced borrowers while the prepayment penalty on their prior Countrywide loan was still in
2 effect, often concealing the existence of the prepayment penalty.

3 118. Countrywide claims that approximately 60% of FSLD's business has been
4 comprised of refinancing Countrywide loans.

5 C. Countrywide Misled Borrowers About the True Terms of Pay Option and
6 Hybrid ARM Loans by Focusing the Borrowers' Attention on Low
7 Beginning Payments and Teaser Rates

8 119. Because Pay Option ARM and Hybrid ARMs start with lower monthly payments
9 and interest rates than most other types of loan products, and given their complex nature,
10 Countrywide was able to easily sell such loans to borrowers by focusing on the initial low
11 monthly payments and/or rates and by obscuring or misrepresenting the true risks of such loans.

12 120. With respect to Pay Option ARMs, the crux of Countrywide's sales approach was
13 to "sell the payment." When presenting a borrower with various loan options, for example,
14 Countrywide would "sell the payment" by showing the borrower the minimum monthly
15 payments for the Pay Option ARM in comparison to other loan products with larger payments.
16 Then, Countrywide would ask which payment the borrower preferred without discussing other
17 differences between the loan products. Naturally, in this situation, most borrowers chose the
18 option with the lowest payment, the Pay Option ARM, without realizing that the payment would
19 last for only a short time before it would begin to increase.

20 121. If, instead, Countrywide presented the Pay Option ARM as the only option, it
21 would "sell the payment" by emphasizing the low minimum payment and how much the
22 borrower would "save" every month by making such a low payment, without discussing the
23 payment shock and negative amortization that inevitably result when borrowers make minimum
24 payments. Given the complexity of Pay Option ARMs, such a presentation easily misled
25 borrowers regarding the long-term affordability of their loans.

26 122. Countrywide also represented that the initial monthly payment would last for the
27 entire term of the loan, or for some period longer than that provided for by the loan's terms.

28 123. Countrywide engaged in similar deceptive representations with respect to Hybrid
ARMs. For example, Countrywide focused its sales presentation on the interest-only payments

1 during the initial fixed-rate period, i.e. the 2-year period on a 2/28 ARM or the 3-year period on a
2 3/27 ARM, not on how the payment would adjust to include both principal and interest after the
3 initial fixed-rate period. It also represented that the payments would last for the entire term of the
4 loan, or for some period longer than that provided for by the loan's terms.

5 124. When selling Pay Option and Hybrid ARMs, Countrywide engaged in another
6 deceptive practice – rather than selling the payment, it would sell the rate. Countrywide either
7 focused exclusively on the initial one-month, two-year, or three-year “fixed” interest rate, for
8 example, without discussing that the rate would reset after the initial period to a potentially much
9 higher rate, or it represented that the initial interest rate would last for a much longer period than
10 it actually did or for the entire term of the loan.

11 125. Countrywide's letter and e-mail solicitations, as well as telemarketing calls, also
12 focused borrowers' attention on short-term low monthly payments. FSLD loan officers, for
13 example, were required to memorize scripts that marketed low monthly payments by focusing (a)
14 on the potential customer's dissatisfaction with his or her current monthly payments under his or
15 her current mortgage loan and/or (b) on so-called “savings” that result from minimum monthly
16 payments. As just one of many potential examples, to overcome a borrower's claim that he or
17 she already has a loan with a low interest rate, Countrywide required FSLD loan officers to
18 memorize the following response: “I certainly understand how important that is to you. But let
19 me ask you something Which would you rather have, a long-term fixed payment, or a short-
20 term one that may allow you to realize several hundred dollars a month in savings? I am able to
21 help many of my clients lower their monthly payments and it only takes a few minutes over the
22 phone to get started.” What the FSLD loan officer did not state was that the borrowers would, in
23 fact, not save money because the payment on the new loan would ultimately exceed the payment
24 on the borrower's current loan.

25 126. Borrowers subjected to any of the deceptive marketing practices described above
26 would not understand the true risks and likely unaffordability of their Pay Option or Hybrid
27 ARMs. Many borrowers did not read their loan documents and disclosures before signing
28 because Countrywide often made borrowers sign a large stack of documents without providing

1 the borrower with time to read them. Other borrowers were unable to read English. And, given
2 the complexity of Pay Option and Hybrid ARMs, many borrowers who managed to read their
3 loan documents did not understand the terms of the loans they were being sold.

4 127. As a result, many borrowers who obtained Pay Option and Hybrid ARMs did not
5 understand that their initial monthly payment would at some point "explode," that their initial
6 interest rate would increase and become adjustable, or that the principal amount of their loans
7 could actually increase. Countrywide received numerous complaints regarding these practices
8 from consumers, including over [REDACTED] complaints per year handled by the [REDACTED]
9 alone between approximately January 2005 and August 2007. Many borrowers complained that
10 they did not understand the terms of their Pay Option and Hybrid ARMs, including the potential
11 magnitude of changes to their monthly payments, interest rates, or loan balances. Many
12 borrowers also complained that Countrywide's loan officers either did not tell them about the
13 payment or rate increases on such loans or promised that they would have fixed-rate, fixed
14 payment loans, rather than adjustable rate mortgage loans with increasing payments.

15 128. Despite these complaints, Defendants did not alter their deceptive marketing
16 practices and did not address the hardship created by their practice of making Pay Option and
17 Hybrid ARMs with little or no regard to affordability. Defendants cared only about doing
18 whatever it took to sell increasing numbers of loans.

19 **D. Countrywide Misled Borrowers About their Ability to Refinance Before The**
20 **Rates or Payments on Their Pay Option and Hybrid ARMs Increased**

21 129. If a borrower was able to figure out that he or she had obtained a Pay Option or
22 Hybrid ARM *before* signing the loan documents, he or she may still have been misled by
23 Countrywide in another way – Countrywide's loan officers often overcame borrower concerns
24 about exploding monthly payments or increasing interest rates by promising that they would be
25 able to refinance with Countrywide into a loan with more affordable terms before the payments
26 or rate reset.

27 130. Countrywide often represented that the value of a borrower's home would
28 increase, thus creating enough equity to obtain a loan with better terms. However, borrowers

1 with interest-only or negatively amortizing loans that encumbered as much as, if not more than,
2 100% of their home's appraised value, were highly unlikely to be able to refinance into another
3 loan if their home did not increase in value. Additionally, any consumers who sought to
4 refinance a Countrywide mortgage would likely incur a substantial prepayment penalty, thus
5 limiting their ability to obtain a more favorable loan.

6 131. Countrywide loan officers often misrepresented or obfuscated the fact that a
7 borrower's loan had a prepayment penalty or misrepresented that a prepayment penalty could be
8 waived. Countrywide also promised borrowers that they would have no problem refinancing
9 their Pay Option or Hybrid ARMs, when in fact they might have difficulty refinancing due to the
10 existence of prepayment penalties. Prepayment penalties on Pay Option and Hybrid ARMs
11 essentially prevent many borrowers from refinancing such unaffordable loans before their
12 payments explode or rates reset.

13 132. Countrywide received numerous complaints from borrowers who claimed that
14 they had not been told about the prepayment penalty or that the loan officer promised they would
15 not have one. Again, despite receiving such complaints, Defendants turned a blind eye to
16 deceptive marketing practices regarding prepayment penalties and the resulting adverse financial
17 consequences to borrowers.

18 **E. Countrywide Misled Borrowers About the Cost of Reduced and No**
19 **Document Loans**

20 133. Countrywide touted its low documentation requirements, urging borrowers to get
21 "fastrack" loans so that they could get cash more quickly. However, many borrowers who
22 obtained these loans possessed sufficient documentation to qualify for full document mortgages,
23 and some submitted that documentation to their loan officer or to one of Countrywide's business
24 partner brokers. In emphasizing the ease, speed and availability of reduced or no document
25 loans, Countrywide and its brokers concealed the fact that borrowers could qualify for a lower
26 rate or reduced fees if they elected to apply for a mortgage by fully documenting their income
27 and assets.
28

1 **F. Countrywide Misled Borrowers Regarding the Terms of HELOCs**

2 134. Countrywide misrepresented the terms of HELOCs, including without limitation
3 by failing to inform the borrower that he or she would not have access to additional credit
4 because he or she was receiving a full draw or that the monthly payment on the HELOC was
5 interest-only and the borrower therefore would not be able to draw additional funds on the
6 HELOC at a later date.

7 135. Countrywide also misrepresented or obfuscated the payment shock that borrowers
8 would experience after the interest-only payment period on the HELOCs ended. Countrywide's
9 Call Center received large numbers of calls from borrowers complaining that they did not
10 understand that the payments on their full-draw HELOCs would only cover interest, or that the
11 interest rates on their HELOCs would adjust and increase.

12 **VII. IN ORDER TO INCREASE MARKET SHARE, DEFENDANTS CREATED A**
13 **HIGH-PRESSURE SALES ENVIRONMENT WHERE EMPLOYEES WERE**
14 **REWARDED FOR SELLING AS MANY LOANS AS THEY COULD, WITHOUT**
15 **REGARD TO BORROWERS' ABILITY TO REPAY**

16 136. Despite touting itself as a lender that cared about its borrowers, Countrywide was,
17 in essence, a mass production loan factory set up to produce an ever-increasing stream of loans
18 without regard to borrowers' ability to repay their loans and sustain homeownership. In order to
19 provide an endless supply of loans for sale to the secondary market, Defendants pressured
20 Countywide employees involved in the sale and processing of loans to produce as many loans as
21 possible, as quickly as possible, and at the highest prices.

22 137. Defendants created this pressure through a compensation system, which
23 predictably led employees to disregard Countrywide's minimal underwriting guidelines and to
24 originate loans without regard to their sustainability. Countrywide's compensation system also
25 motivated its loan officers to engage in the deceptive marketing practices described in the
26 preceding sections.

27 138. Defendants incentivized managers to place intense pressure on the employees they
28 supervised to sell as many loans as possible, as quickly as possible, at the highest prices possible.
Branch managers received commissions or bonuses based on the net profits and loan volume

1 generated by their branches. In most circumstances, however, branch managers were eligible for
2 such commissions or bonuses only if [REDACTED]

3 [REDACTED]. [Redacted descriptions regarding minimum requirements for commission
4 or bonus eligibility.] Branch managers were also rewarded for meeting production goals set by
5 corporate management, [REDACTED]

6 [REDACTED] – or penalized for failing to do so.

7 [Redacted description of the criteria Countrywide used to adjust branch managers' commissions
8 or bonuses.]

9 139. Countrywide provided branch managers with access to computer applications and
10 databases that allowed them to monitor loan sales on a daily basis and pressure employees to
11 "sell, sell, sell." A branch manager could input the type of loan (such as a Pay Option ARM), [REDACTED]

12 [REDACTED]
13 [REDACTED] and determine what price a
14 borrower would pay for that loan, as well as the amount of profit the loan would likely generate
15 for the branch. Branch managers could also monitor their branches' loan sales performance by
16 tracking loans that were in the process of being underwritten and the prices and characteristics of
17 loans sold by the branch and by particular loan officers, during any specified time period.

18 140. With such tools available, Countrywide's branch managers were able to
19 constantly pressure loan officers, loan processors, and underwriters to do their part in increasing
20 loan production – by hunting down more borrowers, selling more loans, and processing loans as
21 quickly as possible, thereby boosting loan production, branch profits, and branch manager
22 commissions and bonuses. This high-pressure sales environment invited deceptive sales
23 practices and created incentives for retail branch managers, other managers, loan officers, loan
24 specialists, and underwriters to jam loans through underwriting without regard to borrower
25 ability to repay.

26 141. Countrywide created additional pressure to engage in deceptive marketing
27 practices and sell loans without regard to their sustainability by paying its loan officers and
28 managers a modest base salary that could be supplemented by commissions or bonuses. In most

1 circumstances, the employees were eligible to receive these commissions or bonuses only if they,
2 or the employees they supervised, sold a minimum number or dollar volume of loans.

3 142. Not only did this compensation system create incentives for employees to sell as
4 many loans as possible, as quickly as possible, it also created incentives for retail employees to
5 steer borrowers into riskier loans. For example, Countrywide paid greater commissions and
6 bonuses to CMD managers and loan officers for selling [REDACTED]
7 [REDACTED]. [Redacted description of loan products.]

8 Countrywide also paid greater commissions and bonuses to FSLD managers and loan officers for
9 [REDACTED]. [Redacted description of loan products.]

10 143. Countrywide's compensation system also created incentives for wholesale loan
11 officers to steer brokers and their clients into riskier loans. Countrywide's wholesale loan
12 officers worked one-on-one with "business partner" brokers approved by Countrywide. The loan
13 officers cultivated relationships with brokers in order to persuade them to bring their business to
14 Countrywide and, in particular, to work with a particular loan officer so that he or she, and his or
15 her managers, could earn greater commissions. [REDACTED]

16 [REDACTED]
17 [REDACTED]
18 [REDACTED]
19 [REDACTED]
20 [REDACTED]. [Redacted description of compensation paid by Countrywide for the sale of particular loan
21 products.]

22 144. Countrywide's compensation system also rewarded employees for selling [REDACTED]
23 [REDACTED]
24 [REDACTED]
25 [REDACTED]
26 [REDACTED]
27 [REDACTED]

28

1 [REDACTED]. [Redacted description of compensation paid by Countrywide for the sale of
2 particular loan products.]

3 145. Countrywide's high-pressure sales environment and compensation system
4 encouraged serial refinancing of Countrywide loans. The retail compensation systems created
5 incentives for loan officers to churn the loans of borrowers to whom they had previously sold
6 loans, without regard to a borrower's ability to repay, and with the consequence of draining
7 equity from borrowers' homes. Although Countrywide maintained a policy that discouraged loan
8 officers from refinancing Countrywide loans within a short time period after the original loan
9 funded (Countrywide often changed this time period, which was as low as [REDACTED] months for some
10 loan products), loan officers boosted their loan sales by targeting the easiest group of potential
11 borrowers to locate - Countrywide borrowers - as soon as that period expired.

12 146. Countrywide management at all levels pressured the employees below them to sell
13 and approve more loans, at the highest prices, as quickly as possible, in order to maximize
14 Countrywide's profits on the secondary market. Defendant Sambol, for example, monitored
15 Countrywide's loan production numbers and pressured employees involved in selling loans or
16 supervising them to produce an ever-increasing numbers of loans, faster. Regional vice
17 presidents pressured branch managers to increase their branches' loan numbers. Branch
18 managers pressured loan officers to produce more loans, faster, and often set their own branch-
19 level production quotas.

20 147. Underwriters were also pressured to approve greater numbers of loans quickly and
21 to overlook underwriting guidelines while doing so. Defendant Sambol pressured underwriters
22 to increase their loan production and to increase approval rates by relaxing underwriting criteria.
23 Regional operations vice presidents, branch operations managers, branch managers, and loan
24 officers all pressured underwriters to rush loan approvals. Countrywide required underwriters to
25 meet loan processing quotas and paid bonuses to underwriters who exceeded them.

26 148. Customer service representatives at Countrywide's Call Center also were expected
27 to achieve quotas and received bonuses for exceeding them. Countrywide required service
28 representatives to complete calls in three minutes or less, and to complete as many as sixty-five

1 to eighty-five calls per day. Although three minutes is not sufficient time to assist the confused
2 or distressed borrowers who contacted them, Countrywide required service representatives to
3 market refinance loans or piggyback HELOCs to borrowers who called with questions --
4 including borrowers who were behind on their monthly payments or facing foreclosure. Using a
5 script, the service representatives were required to pitch the loan and transfer the caller to the
6 appropriate Countrywide division. Service representatives also received bonuses for loans that
7 were so referred and funded.

8 149. Countrywide employees from senior management down to branch managers
9 pressured the employees below them to sell certain kinds of products. Regional vice presidents,
10 area managers, and branch managers pushed loan officers to sell Pay Option ARMs, piggyback
11 HELOCs, and loans with prepayment penalties, primarily because such loans boosted branch
12 profits, manager commissions, and Countrywide's profits on the secondary market.

13 150. If any of these employees, including branch managers, loan officers, loan
14 processors, underwriters, and customer service representatives, failed to produce the numbers
15 expected, Countrywide terminated their employment.

16 **VIII. AS PART OF ITS DECEPTIVE SCHEME, COUNTRYWIDE COMPENSATED**
17 **ITS BUSINESS PARTNER BROKERS AT A HIGHER RATE FOR MORE**
18 **PROFITABLE LOANS, WITHOUT CONSIDERATION OF SERVICES**
19 **ACTUALLY PROVIDED BY THE BROKERS**

20 151. In California, a mortgage broker owes his or her client a fiduciary duty. A
21 mortgage broker is customarily retained by a borrower to act as the borrower's agent in
22 negotiating an acceptable loan. All persons engaged in this business in California are required to
23 obtain real estate licenses and to comply with statutory requirements. Among other things, the
24 mortgage broker has an obligation to make a full and accurate disclosure of the terms of a loan to
25 borrowers, particularly those that might affect the borrower's decision, and to act always in the
26 utmost good faith toward the borrower and to refrain from obtaining any advantage over the
27 borrower.

28 152. Countrywide paid brokers compensation in the form of yield spread premiums or
rebates to induce brokers to place borrowers in loans that would earn Countrywide the greatest

1 profit on the secondary market, regardless of whether the loans were in the best interest of, or
2 appropriate for, the borrowers. In fact, the mortgages that earned Countrywide the highest profit,
3 and therefore would pay the highest rebates or yield spread premiums to brokers, often were not
4 in the best interest of the borrower.

5 153. For example, Countrywide paid a yield spread premium to brokers if a loan was
6 made at a higher interest rate than the rate for which the borrower qualified and without regard
7 for the services actually provided by the broker. Countrywide paid a rebate to a broker if he or
8 she originated or negotiated a loan that included a prepayment penalty. A three-year prepayment
9 penalty resulted in a higher rebate to the broker than a one-year prepayment penalty.
10 Countrywide would pay this higher rebate even in instances where the loan did not include a
11 provision, such as a more favorable origination fee or interest rate, to counterbalance the
12 prepayment penalty, and where brokers did not perform any additional services in connection
13 with the loan.

14 154. Countrywide also would pay rebates in exchange for a broker providing an
15 adjustable rate loan with a high margin (the amount added to the index to determine the interest
16 rate). Countrywide would provide an additional rebate to brokers if they were able to induce a
17 borrower to obtain a line of credit.

18 155. Countrywide accepted loans from brokers in which the broker earned up to ■
19 points (i.e., ■ percent of the amount of the loan), whether in origination fees, rebates, or yield
20 spread premiums. This high level of compensation was well in excess of the industry norm and
21 encouraged brokers to sell Countrywide loans without regard to whether the loans were in their
22 clients' best interest. In addition, the compensation paid by Countrywide to brokers was well in
23 excess of, and not reasonably related to, the value of the brokerage services performed by
24 Countrywide's business partner brokers.

25 156. In order to maximize their compensation from Countrywide, brokers misled
26 borrowers about the true terms of Pay Option and Hybrid ARMs, misled borrowers about their
27 ability to refinance before the rates or payments on their loans increased, misled borrowers about
28 the cost of reduced and no document loans, and misled borrowers regarding the terms of

1 HELOCs by engaging in the same kinds of deceptive practices alleged at paragraphs 58 through
2 64, 75 through 77, 108 through 117, and 119 through 135 above.

3 157. Borrowers often did not realize that their loans contained terms that were
4 unfavorable to them and provided greater compensation to their brokers specifically as payment
5 for those unfavorable terms. An origination fee or other charges imposed by a broker are either
6 paid by the borrower or financed as part of the loan. In contrast, rebates and yield spread
7 premiums are not part of the principal of the loan and instead are paid separately by Countrywide
8 to the broker. Documentation provided to the borrower might indicate, at most, that a yield
9 spread premium or rebate was paid outside of closing (often delineated as "p.o.c." or "ysp poc"),
10 with no indication that the payment constituted compensation from Countrywide to the broker for
11 placing the borrower in a loan with terms that were not in the borrower's best interest, such as a
12 higher interest rate or lengthier prepayment penalty.

13 158. Countrywide closely monitored and controlled the brokers with whom it worked.
14 Countrywide required brokers it accepted as "business partners" to cooperate and provide all
15 information, documents and reports it requested so that Countrywide could conduct a review of
16 the broker and its operations. In addition, Countrywide required the broker to warrant and
17 represent that all loans were closed using documents either prepared or expressly approved by
18 Countrywide.

19 **IX. AS A RESULT OF DEFENDANTS' DECEPTIVE SCHEME, THOUSANDS OF**
20 **CALIFORNIA HOMEOWNERS HAVE EITHER LOST THEIR HOMES OR**
21 **FACE FORECLOSURE AS THE RATES ON THEIR ADJUSTABLE RATE**
22 **MORTGAGES RESET**

23 159. Due to Countrywide's lack of meaningful underwriting guidelines and risk-
24 layering, Countrywide's deceptive sales tactics, Countrywide's high-pressure sales environment,
25 and the complex nature of its Pay Option and Hybrid ARMs, a large number of Countrywide
26 loans have ended in default and foreclosure, or are headed in that direction. Many of its
27 borrowers have lost their homes, or are facing foreclosure, because they cannot afford the
28 payment shock and their properties are too heavily encumbered for them to be able to refinance
and pay prepayment penalties.

1 160. The national pace of foreclosures is skyrocketing. In the month of May 2008,
2 approximately 20,000 Californians lost their homes to foreclosure, and approximately 72,000
3 California homes (roughly 1 out of 183 homes) were in default. This represented an 81%
4 increase from May 2007, at which point the rate was roughly 1 out of every 308 households,
5 while the May 2007 rate represented a 350% increase from May 2006.

6 161. Countrywide mortgages account for a large percentage of these delinquencies and
7 foreclosures. Countrywide's 10-K filed in February, 2008, estimated that as of December 31,
8 2007, a staggering 27.29% of its non-prime mortgages were delinquent. As of that date,
9 approximately 26% of Countrywide's loans were secured by properties located in California.

10 162. These numbers have only worsened. As of April, 2008, [REDACTED] % of the mortgages
11 owned by Countrywide Home Loans were in some stage of delinquency or foreclosure, including
12 [REDACTED] % of originated non-prime loans, and [REDACTED] % of Pay Option ARMs.

13 163. In January and March, 2008, Countrywide recorded [REDACTED] notices of default in
14 Alameda, Fresno, Riverside, and San Diego counties alone. Those [REDACTED] notices of default
15 represented an aggregate total of delinquent principal and interest of more than [REDACTED]
16 dollars. An October 2007 report prepared by Credit Suisse estimated that Countrywide's
17 delinquency and foreclosure rates are likely to double over the next two years.

18 164. This may well understate the extent of the crisis facing California homeowners
19 with Countrywide mortgages, as more and more Pay Option ARMs go into delinquency.
20 Approximately 60% of all Pay Option ARMs (made by any lender) were made in California, and
21 many of these were made by Countrywide. Once the thousands of Pay Option ARMs sold by
22 Countrywide to California borrowers reach their negative amortization cap or otherwise reset to
23 require fully indexed principal and interest payments, which will occur over the next two years
24 for many such loans made between 2003 and 2006, the number of such loans in default is likely
25 to skyrocket even above their current high delinquency rate.

FIRST CAUSE OF ACTION AGAINST ALL DEFENDANTS

VIOLATIONS OF BUSINESS AND PROFESSIONS CODE SECTION 17500

(UNTRUE OR MISLEADING STATEMENTS)

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165. The People reallege and incorporate by reference all paragraphs above, as though fully set forth in this cause of action.

166. Defendants have violated and continue to violate Business and Professions Code section 17500 by making or disseminating untrue or misleading statements, or by causing untrue or misleading statements to be made or disseminated, in or from California, with the intent to induce members of the public to enter into mortgage loan or home equity line of credit transactions secured by their primary residences. These untrue and misleading statements include but are not necessarily limited to:

a. Statements that Countrywide was a mortgage loan expert that could be trusted to help borrowers obtain mortgage loans that were appropriate to their financial circumstances, as described in paragraphs 109 through 113, above;

b. Statements regarding the terms and payment obligations of Pay Option ARMs offered by Countrywide, including statements that the initial payment rate was the interest rate, statements regarding the duration of the initial payment, statements regarding the duration of the initial interest rate, and statements obfuscating the risks associated with such mortgage loans, as described in paragraphs 58 through 64, 119 through 122, and 124 through 128, above;

c. Statements regarding the terms and payment obligations of Hybrid ARMs offered by Countrywide, including statements regarding the duration of the initial interest-only payment, statements regarding the duration of the initial interest rate, and statements obfuscating the risks associated with such mortgage loans, as described in paragraphs 75 through 77, 119, and 123 through 128, above;

d. Statements regarding the terms and payment obligations of HELOCs, as described in paragraphs 134 through 135, above; and

1 e. Statements that borrowers with Pay Option and Hybrid ARMs offered by
2 Countrywide would be able to refinance the mortgage loans before the interest rates reset,
3 when in fact they most likely could not, as described in paragraphs 62, 76, 77, and 129
4 through 132, above;

5 f. Statements regarding prepayment penalties on Pay Option and Hybrid
6 ARMs offered by Countrywide, including statements that the mortgage loans did not have
7 prepayment penalties, when in fact they did, and statements that prepayment penalties
8 could be waived, when in fact they could not, as described in paragraphs 63, 64, 76, and
9 131 through 132, above;

10 g. Statements regarding the costs of reduced or no documentation mortgage
11 loans, as described in paragraph 133, above;

12 h. Statements regarding the benefits or advisability of refinancing mortgage
13 loans with Pay Option and Hybrid ARMs offered by Countrywide, as described in
14 paragraphs 110 through 118, above; and

15 i. Statements regarding the existence of prepayment penalties on mortgage
16 loans being refinanced with Countrywide mortgage loans, as described in paragraph 117,
17 above.

18 167. Defendants knew, or by the exercise of reasonable care should have known, that
19 these statements were untrue or misleading at the time they were made.

20 **SECOND CAUSE OF ACTION AGAINST ALL DEFENDANTS**

21 **VIOLATIONS OF BUSINESS AND PROFESSIONS CODE SECTION 17200**
22 **(UNFAIR COMPETITION)**

23 168. The People reallege and incorporate by reference all paragraphs above, as through
24 fully set forth in this cause of action.

25 169. Defendants have engaged in, and continue to engage in, acts or practices that
26 constitute unfair competition, as that term is defined in Section 17200 of the Business and
27 Professions Code. Such acts or practices include, but are not limited to, the following:

28 a. Creating and maintaining a deceptive scheme to mass produce loans for

1 sale on the secondary market, as described in paragraphs 15 through 164, above;

2 b. Making untrue or misleading representations that Countrywide could be
3 trusted to sell borrowers mortgage loans that were appropriate to their financial
4 circumstances, as described in paragraphs 109 through 113, above;

5 c. Making untrue or misleading representations regarding the terms and
6 payment obligations of Countrywide's Pay Option and Hybrid ARMs, including
7 representations regarding the payment rate, the duration of initial interest rates, the
8 duration of initial monthly payments, the inclusion of prepayment penalties, the
9 waivability of prepayment penalties, the payment shock that borrowers were likely to
10 experience, and the risks associated with such mortgage loans, as described in paragraphs
11 58 through 64, 75 through 77, and 119 through 132, above;

12 d. Making untrue or misleading representations regarding the terms and
13 payment obligations of Countrywide's HELOCs, as described in paragraphs 134 through
14 135, above;

15 e. Making untrue or misleading representations regarding the costs of
16 reduced or no documentation mortgage loans, as described in paragraph 133, above;

17 f. Making untrue or misleading representations regarding the true likelihood
18 or circumstances under which borrowers would be able to refinance Pay Option or Hybrid
19 ARMs offered by Countrywide, as described in paragraphs 62, 76, 77, and 129 through
20 132, above;

21 g. Soliciting borrowers to refinance mortgage loans by misrepresenting the
22 benefits of doing so or by misrepresenting or obfuscating the fact that in doing so the
23 borrowers will incur a prepayment penalty, as described in paragraphs 110 through 118,
24 above;

25 h. Making mortgage loans and extending HELOCs without regard to whether
26 borrowers would be able to afford monthly payments on those loans or HELOCs after the
27 expiration of the initial interest rates on the mortgage loans, or the draw periods on the
28 HELOCs, as described in paragraphs 85 through 107, above;

1 i. Aiding and abetting the breach of the fiduciary duty owed by mortgage
2 brokers to California borrowers, as described in paragraphs 151 through 158, above;

3 j. Failing to provide borrowers with documents sufficient to inform them of
4 their payment obligations with respect to fully drawn HELOCs, as described in
5 paragraphs 81 through 84, above;

6 k. Paying compensation to mortgage brokers that was not reasonably related
7 to the value of the brokerage services they performed, as described in paragraphs 152
8 through 155, above; and

9 l. Violating Section 17500 of the Business and Professions Code, as
10 described in the First Cause of Action, above.

11 **PRAYER FOR RELIEF**

12 WHEREFORE, Plaintiff prays for judgment as follows:

13 1. Pursuant to Business and Professions Code section 17535, that all Defendants, their
14 employees, agents, representatives, successors, assigns, and all persons who act in concert with
15 them be permanently enjoined from making any untrue or misleading statements in violation of
16 Business and Professions Codes section 17500, including the untrue or misleading statements
17 alleged in the First Cause of Action.

18 2. Pursuant to Business and Professions Code section 17203, that all Defendants,
19 their employees, agents, representatives, successors, assigns, and all persons who act in concert
20 with them be permanently enjoined from committing any acts of unfair competition, including
21 the violations alleged in the Second Cause of Action.

22 3. Pursuant to Business and Professions Code sections 17535, that the Court make
23 such orders or judgments as may be necessary to prevent the use or employment by any
24 Defendant of any practices which violate section 17500 of the Business and Professions Code, or
25 which may be necessary to restore to any person in interest any money or property, real or
26 personal, which may have been acquired by means of any such practice.

27 4. Pursuant to Business and Professions Code section 17203, that this court make
28 such orders or judgments as may be necessary to prevent the use or employment by any

1 Defendant of any practice which constitutes unfair competition or as may be necessary to restore
2 to any person in interest any money or property, real or personal, which may have been acquired
3 by means of such unfair competition.

4 5. Pursuant to Business and Professions Code section 17536, that Defendants, and
5 each of them, be ordered to pay a civil penalty in the amount of two thousand five hundred
6 dollars (\$2,500) for each violation of Business and Professions Code section 17500 by
7 Defendants, in an amount according to proof.

8 6. Pursuant to Business and Professions Code section 17206, that Defendants, and
9 each of them, be ordered to pay a civil penalty in the amount of two thousand five hundred
10 dollars (\$2,500) for each violation of Business and Professions Code section 17200 by
11 Defendants, in an amount according to proof.


12 7. That Plaintiff recover its costs of suit, including costs of investigation.

13 8. For such other and further relief that the Court deems just, proper, and equitable.

14
15 DATED: June 24, 2008

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