

1 JOHN M. McCOY, III, Cal. Bar No. 166244
Email: mccoymj@sec.gov
2 SPENCER E. BENDELL, Cal. Bar No. 181220
Email: bendells@sec.gov
3 LYNN M. DEAN, Cal. Bar No. 205562
Email: deanl@sec.gov
4 SAM PUATHASNANON, Cal. Bar No. 198430
Email: puathasnanons@sec.gov
5 PARIS WYNN, Cal. Bar No. 224418
Email: wynnp@sec.gov

6 Attorneys for Plaintiff
7 Securities and Exchange Commission
Rosalind R. Tyson, Regional Director
8 Michele Wein Layne, Associate Regional Director
5670 Wilshire Boulevard, 11th Floor
9 Los Angeles, California 90036
Telephone: (323) 965-3998
10 Facsimile: (323) 965-3908

11 **UNITED STATES DISTRICT COURT**
12 **CENTRAL DISTRICT OF CALIFORNIA**

13 SECURITIES AND EXCHANGE
14 COMMISSION,

15 Plaintiff,

16 vs.

17 ANGELO MOZILO, DAVID SAMBOL,
18 AND ERIC SIERACKI,

19 Defendants.

Case No.

**COMPLAINT FOR VIOLATIONS
OF THE FEDERAL SECURITIES
LAWS**

DEMAND FOR JURY TRIAL

1 Plaintiff Securities and Exchange Commission (“Commission”) alleges as
2 follows:

3 **JURISDICTION AND VENUE**

4 1. This Court has jurisdiction over this action pursuant to Sections 20(b),
5 20(d)(1), 20(e) and 22(a) of the Securities Act of 1933 (“Securities Act”), 15
6 U.S.C. §§ 77t(b), 77t(d)(1), 77t(e), and 77v(a), and Sections 21(d)(1), 21(d)(2),
7 21(d)(3)(A), 21(e), and 27 of the Securities Exchange Act of 1934 (“Exchange
8 Act”), 15 U.S.C. §§ 78u(d)(1), 78u(d)(2), 78u(d)(3)(A), 78u(e) & 78aa.

9 Defendants have directly or indirectly made use of the means or instrumentalities
10 of interstate commerce, of the mails, or of the facilities of a national securities
11 exchange in connection with the transactions, acts, practices and courses of
12 business alleged in this complaint.

13 2. Venue is proper in this district pursuant to Section 22(a) of the
14 Securities Act, 15 U.S.C. § 77v(a), and Section 27 of the Exchange Act, 15 U.S.C.
15 § 78aa, because defendants reside and transact business within this district and
16 certain of the transactions, acts, practices and courses of conduct constituting
17 violations of the federal securities laws alleged in this complaint occurred within
18 this district.

19 **SUMMARY**

20 3. This matter involves a disclosure fraud by the three most senior
21 executives of Countrywide Financial Corporation, a mortgage lender formerly
22 based in Calabasas, California, and insider trading by Countrywide’s former
23 chairman of the board and chief executive officer, Angelo Mozilo.

24 4. From 2005 through 2007, Mozilo, along with David Sambol, chief
25 operating officer and president, and Eric Sieracki, chief financial officer, held
26 Countrywide out as primarily a maker of prime quality mortgage loans,
27 qualitatively different from competitors who engaged primarily in riskier lending.
28 To support this false characterization, Mozilo, Sieracki, and Sambol hid from

1 investors that Countrywide, in an effort to increase market share, engaged in an
2 unprecedented expansion of its underwriting guidelines from 2005 and into 2007.
3 Specifically, Countrywide developed what was referred to as a “supermarket”
4 strategy, where it attempted to offer any product that was offered by any
5 competitor. By the end of 2006, Countrywide’s underwriting guidelines were as
6 wide as they had ever been, and Countrywide was writing riskier and riskier loans.
7 Even these expansive underwriting guidelines were not sufficient to support
8 Countrywide’s desired growth, so Countrywide wrote an increasing number of
9 loans as “exceptions” that failed to meet its already wide underwriting guidelines
10 even though exception loans had a higher rate of default.

11 5. Countrywide was more dependent than many of its competitors on
12 selling loans it originated into the secondary mortgage market, an important fact it
13 disclosed to investors. But Mozilo expected that the deteriorating quality of the
14 loans that Countrywide was writing, and the poor performance over time of those
15 loans, would ultimately curtail the company’s ability to sell those loans in the
16 secondary mortgage market. Mozilo and the company’s chief risk officer warned
17 Sambol and Sieracki about the increased risk that Countrywide was assuming.
18 Thus, each of the defendants was aware, but failed to disclose, that Countrywide’s
19 current business model was unsustainable.

20 6. Mozilo, Sambol, and Sieracki were responsible for Countrywide’s
21 fraudulent disclosures. From 2005 through 2007, these senior executives misled
22 the market by falsely assuring investors that Countrywide was primarily a prime
23 quality mortgage lender which had avoided the excesses of its competitors.
24 Countrywide’s Forms 10-K for 2005, 2006, and 2007 falsely represented that
25 Countrywide “manage[d] credit risk through credit policy, underwriting, quality
26 control and surveillance activities,” and the 2005 and 2006 Forms 10-K falsely
27 stated that Countrywide ensured its continuing access to the mortgage backed
28 securities market by “consistently producing quality mortgages.”

1 7. In fact, the credit risk that Countrywide was taking was so alarming to
2 Mozilo that he internally issued a series of increasingly dire assessments of various
3 Countrywide loan products and the risks to Countrywide in continuing to offer or
4 hold those loans, while at the same time he, Sambol, and Sieracki continued to
5 make public statements obscuring Countrywide's risk profile and attempting to
6 differentiate it from other lenders. In one internal email, Mozilo referred to a
7 particularly profitable subprime product as "toxic," and in another he stated that
8 the company was "flying blind," and had "no way" to predict the performance of
9 its heralded product, the Pay-Option ARM loan. Mozilo believed that the risk was
10 so high and that the secondary market had so mispriced Pay-Option ARM loans
11 that he repeatedly urged that Countrywide sell its entire portfolio of those loans.
12 Despite their awareness of, and Mozilo's severe concerns about, the increasing risk
13 Countrywide was undertaking, Mozilo, Sambol, and Sieracki hid these risks from
14 the investing public.

15 8. Defendants misled investors by failing to disclose substantial negative
16 information regarding Countrywide's loan products, including:

- 17 • the increasingly lax underwriting guidelines used by the company in
18 originating loans;
- 19 • the company's pursuit of a "matching strategy" in which it matched the
20 terms of any loan being offered in the market, even loans offered by
21 primarily subprime originators;
- 22 • the high percentage of loans it originated that were outside its own already
23 widened underwriting guidelines due to loans made as exceptions to
24 guidelines;
- 25 • Countrywide's definition of "prime" loans included loans made to
26 borrowers with FICO scores well below any industry standard definition
27 of prime credit quality;
- 28 • the high percentage of Countrywide's subprime originations that had a
 loan to value ratio of 100%, for example, 62% in the second quarter of
 2006; and

- Countrywide's subprime loans had significant additional risk factors, beyond the subprime credit history of the borrower, associated with increased default rates, including reduced documentation, stated income, piggyback second liens, and LTVs in excess of 95%.

Mozilo, Sambol, and Sieracki knew this negative information from numerous reports they regularly received and from emails and presentations prepared by the company's chief credit risk officer. Defendants nevertheless hid this negative information from investors.

9. During the course of this fraud, Mozilo engaged in insider trading in Countrywide's securities. Mozilo established four sales plans pursuant to Rule 10b5-1 of the Securities Exchange Act in October, November, and December 2006 while in possession of material, non-public information concerning Countrywide's increasing credit risk and the risk that the poor expected performance of Countrywide-originated loans would prevent Countrywide from continuing its business model of selling the majority of the loans it originated into the secondary mortgage market. From November 2006 through August 2007, Mozilo exercised over 5.1 million stock options and sold the underlying shares for total proceeds of over \$139 million, pursuant to 10b5-1 plans adopted in late 2006 and amended in early 2007.

DEFENDANTS

10. **Angelo Mozilo**, age 70, is a resident of Thousand Oaks, California. Mozilo was a founder of Countrywide and was its chairman and chief executive officer ("CEO") from its formation in 1969 until Countrywide was acquired by Bank of America in 2008.

11. **David Sambol**, age 49, is a resident of Hidden Hills, California. He was Countrywide's president and chief operating officer ("COO") from September 2006 until its acquisition by Bank of America in 2008. Sambol was Countrywide's executive managing director, business segment operations from April 2006 until September 2006, and executive managing director and chief of mortgage banking

1 and capital markets from January 2004 until April 2006. Sambol was a member of
2 the Countrywide board of directors from 2007 until July 2008. Sambol also held
3 executive positions at certain Countrywide subsidiaries, including Countrywide
4 Bank.

5 12. **Eric Sieracki**, age 52, is a resident of Lake Sherwood, California.
6 Sieracki was Countrywide's chief financial officer ("CFO") from the first quarter
7 of 2005 until its acquisition by Bank of America in 2008.

8 **RELATED PARTY**

9 13. **Countrywide Financial Corporation**, a Delaware corporation, was a
10 mortgage lender based in Calabasas, California. During all times relevant to this
11 complaint, its stock was registered pursuant to Section 12(b) of the Exchange Act
12 and was listed on the New York Stock Exchange, and, until the demise of the
13 Pacific Stock Exchange, it was listed on that Exchange as well. On July 1, 2008,
14 Countrywide merged with Bank of America and is now a wholly owned subsidiary
15 of Bank of America. Countrywide's remaining operations and employees have
16 been transferred to Bank of America, and Bank of America ceased using the
17 Countrywide name in April 2009. On July 1, 2008, the NYSE filed a Form 25 to
18 deregister and delist Countrywide's common stock, and on July 22, 2008
19 Countrywide filed a Form 15 deregistering its common stock under Section 12(g)
20 of the Exchange Act.

21 **FACTS**

22 14. From 2005 through 2007, in Countrywide's periodic filings with the
23 Commission and in other public statements, Mozilo, Sambol, and Sieracki held
24 Countrywide out as primarily a maker of prime quality mortgage loans,
25 qualitatively different from competitors who engaged primarily in riskier lending.
26 To support this false characterization, the proposed defendants hid from investors
27 that Countrywide was engaged in an effort to increase market share and sustain
28

1 revenue generation through unprecedented expansions of its underwriting
2 guidelines, taking on ever-increasing credit risk.

3 **A. Countrywide's Business**

4 15. Countrywide originated, sold, and serviced both prime and subprime
5 (which Countrywide's periodic filings referred to as "nonprime") mortgage loans.
6 By 2005, Countrywide was the largest U.S. mortgage lender in the United States,
7 originating over \$490 billion in mortgage loans in 2005, over \$450 billion in 2006,
8 and over \$408 billion in 2007. Countrywide recognized pre-tax earnings of \$2.4
9 billion and \$2 billion in its loan production divisions in 2005 and 2006,
10 respectively, and a pre-tax loss of \$1.5 billion in its loan production division in
11 2007.

12 16. Countrywide pooled most of the loans it originated and sold them in
13 secondary mortgage market transactions. Countrywide sold the pooled loans either
14 through whole loan sales or securitization. In whole loan sales, Countrywide sold
15 the loans to investors and recorded gains on the sales. In securitizations,
16 Countrywide sold interests in the pooled loans, i.e., mortgage-backed securities.
17 Countrywide's loan sales were run out of its capital markets division. In 2005,
18 Countrywide reported \$451.6 million in pre-tax earnings from capital market sales,
19 representing 10.9% of its pre-tax earnings; in 2006, it recognized \$553.5 million in
20 pre-tax earnings from that division, representing 12.8% of its pre-tax earnings, and
21 in 2007 it recognized a mere \$14.9 million in pre-tax earnings from that division,
22 reporting a pre-tax loss overall.

23 17. Historically, Countrywide's primary business had been originating
24 prime conforming loans that were saleable to the Government Sponsored Entities
25 ("GSEs"). In the fiscal years 2001, 2002, and 2003, Countrywide's prime
26 conforming originations were 50%, 59.6%, and 54.2% of its total loan originations,
27 respectively. In 2003, United States residential mortgage production reached a
28 record level of \$3.8 trillion. Countrywide experienced record earnings in that year,

1 with net earnings of \$2.4 billion, an increase of \$1.5 billion, or 182%, over 2002.
 2 In 2004, in a market where originations were declining overall, Countrywide
 3 maintained net earnings of \$2.1 billion, and increased its market share from 11.4%
 4 to 12.7%.

5 18. Countrywide achieved this result in large part by moving away from
 6 its historical core business of prime mortgage underwriting to aggressively
 7 matching loan programs being offered by other lenders, even monoline subprime
 8 lenders. As a result, as reported in Countrywide's periodic filings and reflected in
 9 the chart below, in 2004, 2005, and 2006, Countrywide wrote more non-
 10 conforming, subprime, and home equity loans than in any prior period:

	2001	2002	2003	2004	2005	2006
Prime Conforming	50%	59.6%	54.2%	38.2%	32%	31.9%
Prime Non-Conforming	16.5%	24.5%	31.4%	38.7%	47.2%	45.2%
Home Equity	6.8%	4.6%	4.2%	8.5%	9.0%	10.2%
Nonprime (Subprime)	7.8%	3.7%	4.6%	11.0%	8.9%	8.7%
FHA/VA	18.9%	7.6%	5.6%	3.6%	2.1%	2.8%
Commercial	0.0%	0.0%	0.0%	0.0%	0.8%	1.2%

19
 20 19. In 2004, Countrywide's reported production of conventional
 21 conforming loans dropped to 38.2%, its production of subprime loans had risen to
 22 11%, its production of home equity loans had risen to 8.5%, and its production of
 23 conventional non-conforming loans had risen to 38.7%. By 2006, Countrywide
 24 had turned its prior business model on its head: a mere 31.9% of its originations
 25 were conforming, 45.2% were non-conforming, 8.7% were subprime, and 10.2%
 26 were home equity.

27 ///

28 ///

1 **B. Countrywide's Deceptive Description of Its Loans**

2 20. Countrywide's Form 10-Ks deceptively described the types of loans
3 upon which the Company's business depended. While Countrywide provided
4 statistics about its originations which reported the percentage of loans in various
5 categories, such as those noted in the table in paragraph 18, the information was
6 misleading because its descriptions of "prime non-conforming" and "nonprime"
7 loans in its periodic filings were insufficient to inform investors what types of
8 loans were included in those categories. "Prime" loans were described in
9 Countrywide's 2005, 2006, and 2007 Forms 10-K as follows:

10 Prime Mortgage Loans include conventional mortgage loans,
11 loans insured by the Federal Housing Administration ("FHA")
12 and loans guaranteed by the Veterans Administration ("VA").
13 A significant portion of the conventional loans we produce
14 qualify for inclusion in guaranteed mortgage securities backed
15 by Fannie Mae or Freddie Mac ("conforming loans"). Some of
16 the conventional loans we produce either have an original loan
17 amount in excess of the Fannie Mae and Freddie Mac loan limit
18 for single-family loans (\$417,000 for 2006) or otherwise do not
19 meet Fannie Mae or Freddie Mac guidelines. Loans that do not
20 meet Fannie Mae or Freddie Mac guidelines are referred to as
21 "nonconforming loans."

22 21. Nothing in that description informed investors that Countrywide's
23 "prime non-conforming" category included loan products with increasing amounts
24 of credit risk. While guidance issued by the banking regulators referenced a credit
25 score ("FICO score") at 660 or below as being an indicator of a subprime loan,
26 some within the banking industry drew the distinction at a score of 620 or below.
27 Countrywide, however, did not consider **any** FICO score to be too low to be
28 categorized within "prime." Nor did Countrywide's definition of "prime" inform

1 investors that its "prime non-conforming" category included so-called "Alt-A"
2 loan products with increasing amounts of credit risk, such as (1) reduced or no
3 documentation loans; (2) stated income loans; and (3) loans with loan to value or
4 combined loan to value ratios of 95% and higher. Finally, it did not disclose that
5 Pay-Option ARM loans, including reduced documentation Pay-Option ARM loans,
6 were included in the category of prime loans. Moreover, to the extent these
7 extremely risky loans were below the loan limits established by the government
8 sponsored entities that purchased these loans ("GSEs"), they would have been
9 reported by Countrywide as prime conforming loans. In 2005 and 2006,
10 Countrywide's Pay-Option ARMs ranged between 17% and 21% of its total loan
11 originations. It maintained the majority of these loans in the held for investment
12 portfolio at Countrywide Bank.

13 22. Significantly, the Countrywide periodic filings do not define
14 "nonprime" in any way, and Countrywide's periodic filings failed to disclose that
15 loans in the category of subprime were not merely issued to borrowers with
16 blemished credit, but that this category included loans with significant additional
17 layered risk factors, such as (1) subprime piggyback seconds, also known as 80/20
18 loans; (2) reduced or no documentation loans; (3) stated income loans; (4) loans
19 with loan to value or combined loan to value ratios of 95% and higher; and (5)
20 loans made to borrowers with recent bankruptcies and late mortgage payments.

21 23. By increasing its origination of non-conforming and subprime loans
22 between 2003 and 2006, Countrywide was able to originate many more loans in
23 those years and increase its market share, even as the residential real estate market
24 declined in the United States. As of December 31, 2003, based on its own internal
25 estimates, Countrywide had an 11.4% share of the United States mortgage market.
26 By September 30, 2006, it had a 15.7% share of the market. While Countrywide
27 boasted to investors that its market share was increasing, company executives did
28 not disclose that its market share increase came at the expense of prudent

1 underwriting guidelines. As a result, Countrywide's share price rose from \$25.28
2 on December 31, 2003 to \$42.45 on December 29, 2006, the last trading day of
3 that year.

4 **C. Countrywide's Market Strategy Caused it To Take On**
5 **Increasing Credit Risk**

6 **1. Countrywide's Undisclosed Expansion of Underwriting**
7 **Guidelines and the Matching Strategy**

8 24. By the end of 2006, Countrywide's underwriting guidelines were
9 wider and more aggressive than they had ever been. The company's aggressive
10 guideline expansion was deliberate, and began as early as 2003. Indeed, from
11 January 2003 until well into 2006, Countrywide's credit risk management
12 department ("Risk Management") spent approximately 90% of its time processing
13 requests for expansions of Countrywide's underwriting guidelines.

14 25. Countrywide's "matching strategy," also known as the "supermarket
15 strategy," was a key driver of the company's aggressive expansion of underwriting
16 guidelines. The strategy committed the company to offering any product and/or
17 underwriting guideline available from at least one "competitor," which included
18 subprime lenders. Thus, if Countrywide did not offer a product offered by a
19 competitor, Countrywide's production division invoked the matching strategy to
20 add the product to Countrywide's menu. For example, if Countrywide's minimum
21 FICO score for a product was 600, but a competitor's minimum score was 560, the
22 production division invoked the matching strategy to reduce the minimum required
23 FICO score at Countrywide to 560.

24 26. The impact of the matching strategy was intensified by Countrywide's
25 "no-brokering" policy, which precluded Countrywide's loan officers from referring
26 loan applicants to other brokers and/or institutions. Prior to its implementation,
27 loan officers could engage in a practice known as "brokering," in which the loan
28 officer would refer those borrowers deemed too risky for Countrywide to another

1 lender, which in turn paid a commission to the Countrywide loan officer. The no-
2 brokering policy increased the incentives for Countrywide's retail sales force to be
3 aggressive in finding ways for Countrywide to underwrite a loan, regardless of
4 whether the loan satisfied the underwriting guidelines Countrywide repeatedly
5 touted to investors.

6 27. Mozilo, Sambol, and Sieracki knew that the company was taking on
7 increased risk of defaults and delinquencies as a result of its widened underwriting
8 guidelines and matching strategy, yet Countrywide's periodic filings concealed the
9 unprecedented expansion of underwriting guidelines and the attendant increased
10 credit risk.

11 2. Exception Loans Magnified Countrywide's Credit Risk

12 28. Though Countrywide proclaimed in its Forms 10-K for 2005, 2006,
13 and 2007 that it managed credit risk through its loan underwriting, the company's
14 increasingly wide underwriting guidelines and exceptions process materially
15 increased Countrywide's credit risk during that time. Countrywide used an
16 automated underwriting system known as "CLUES" to actually underwrite loans.
17 The CLUES system applied the principles and variables set forth in the
18 Countrywide underwriting manuals and its loan program guide. CLUES applied a
19 device known as the "underwriting scorecard," which assessed borrower credit
20 quality by analyzing several variables, such as FICO scores, loan to value ratios,
21 documentation type (*e.g.*, full, reduced, stated) and debt-to-income ratios. These
22 variables were weighted differently within the scorecard, depending upon their
23 perceived strength in predicting credit performance. In underwriting a loan,
24 Countrywide loan officers entered an applicant's information into CLUES, which
25 would (1) approve the loan; (2) approve the loan with caveats; or (3) "refer" the
26 loan to a loan officer for further consideration and/or manual underwriting.

27 29. The CLUES program typically did not "reject" a loan if a requirement
28 of Countrywide's guidelines had not been met or if CLUES calculated that the loan

1 presented an excessive layering of risk. Instead, CLUES “referred” the loan,
2 indicating that the loan application would have to be reviewed manually prior to
3 approval. In these circumstances, to proceed with the loan, the loan officer would
4 request an “exception” from the guidelines from more senior underwriters at
5 Countrywide’s structured lending desk (“SLD”). Countrywide’s level of
6 exceptions was higher than that of other mortgage lenders. The elevated number
7 of exceptions resulted largely from Countrywide’s use of exceptions as part of its
8 matching strategy to introduce new guidelines and product changes.

9 30. Further, the actual underwriting of exceptions was severely
10 compromised. According to Countrywide’s official underwriting guidelines,
11 exceptions were only proper where “compensating factors” were identified which
12 offset the risks caused by the loan being outside of guidelines. In practice,
13 however, **Countrywide used as “compensating factors” variables such as**
14 **FICO and loan to value, which had already been assessed by CLUES in**
15 **issuing a “refer” finding.** Countrywide underwriting manuals were amended to
16 explicitly prohibit this practice in mid-2007, but this serious deficiency was in
17 place from early 2006 through early 2007, when a large volume of obviously
18 deficient exception loans were originated by Countrywide.

19 **D. Countrywide’s Business Model Became Unsustainable**

20 31. As described above, Countrywide depended on its sales of mortgages
21 into the secondary market as an important source of revenue and liquidity. As a
22 result, Countrywide was not only directly exposed to credit risk through the
23 mortgage-related assets on its balance sheet, but also indirectly exposed to the risk
24 that the increasingly poor quality of its loans would prevent their continued
25 profitable sale into the secondary mortgage market and impair Countrywide’s
26 liquidity. Rather than disclosing this increasing risk, Mozilo, Sambol, and Sieracki
27 gave false comfort, again touting Countrywide’s loan quality. For example,
28 Countrywide stated in its 2005 Form 10-K: “We ensure our ongoing access to the

1 secondary mortgage market by consistently producing quality mortgages. . . . We
2 make significant investments in personnel and technology to ensure the quality of
3 our mortgage loan production.” A virtually identical representation appears in
4 Countrywide’s 2006 Form 10-K. Accordingly, Countrywide’s failure to disclose
5 its widening underwriting guidelines and the prevalence of exceptions to those
6 guidelines in 2005 and 2006 constituted material omissions from Countrywide’s
7 periodic reports.

8 **E. Mozilo, Sambol, and Sieracki Were Aware of the Increased**
9 **Credit Risk Created By Expanded Underwriting Guidelines and**
10 **Exception Loans**

11 32. Countrywide’s increasingly wide underwriting guidelines materially
12 increased the company’s credit risk from 2004 through 2007, but this increased
13 risk was not disclosed to investors. In 2007, as housing prices declined,
14 Countrywide began to suffer extensive credit problems as the inherent credit risks
15 manifested themselves.

16 **1. The September 2004 Warning**

17 33. The credit losses experienced by Countrywide in 2007 not only were
18 **foreseeable** by the proposed defendants, they were in fact **foreseen** at least as early
19 as September 2004. Risk Management warned Countrywide’s senior officers that
20 several aggressive features of Countrywide’s guidelines (e.g., high loan to value
21 programs, ARM loans, interest only loans, reduced documentation loans, and loans
22 with layered risk factors) significantly increased Countrywide’s credit risk.

23 34. Countrywide was taking on more risk as a direct result of the lower
24 credit quality of the loans it was originating. Countrywide’s strategy of reducing
25 risk through loan sales was being frustrated as the company produced smaller
26 percentages of loans eligible for sale on a nonrecourse basis (e.g., FHA, VA and
27 conforming loans), and larger percentages of loans (e.g., subprime and
28

1 nonconforming loans) where it retained credit risk in the form of residual interests.

2 By September 2004, defendants knew the following trends:

- 3 • 66% of Countrywide's production was conforming in July 2003,
4 but conforming originations **had fallen** to 35% by July 2004;
- 5 • 21% of Countrywide's production was nonconforming in July
6 2003, but non-conforming originations **had risen** to 40% by July
7 2004; and
- 8 • 2% of Countrywide's July 2003 production was subprime, but
9 subprime originations **had risen** to 10% by July 2004.

10 35. The credit risk described in the September 2004 warning **worsened**
11 from September 2004 to August 2007. Risk Management continuously had
12 discussions with Countrywide's loan production division, which reported to
13 Sambol, about the credit concerns identified in the September 2004 warning. In
14 fact, Risk Management conducted studies to identify relationships among certain
15 credit variables and their effect upon the probability that a loan would go into
16 serious delinquency or default. One finding of these studies, the results of which
17 were shared with Sambol and Sieracki, was that the less documentation associated
18 with a loan, the higher the probability of default. Nevertheless, Countrywide
19 continued to expand its underwriting guidelines, and to liberally make exceptions
20 to those guidelines, through the end of 2006. These facts were never disclosed to
21 investors.

22 2. **Credit Risk Management Repeatedly Alerted the**
23 **Defendants to Increases in Credit Risk**

24 36. Both Sambol and Sieracki were members of the Countrywide credit
25 risk committee. The credit risk committee had quarterly meetings. At these
26 meetings, the members were provided with detailed presentations highlighting
27 Countrywide's increased credit risk. For example, at an April 6, 2005 meeting of
28 the credit risk committee attended by Sambol, McMurray reported that (1)

1 Countrywide non-conforming loans originated in May 2002 were twice as likely to
2 default as loans originated in January 2000; (2) the risk of home equity lines of
3 credit defaulting had doubled over the past year, mainly due to the prevalence of
4 reduced documentation in those loans; and (3) Countrywide was now a leader in
5 the subprime market in four of six categories, whereas in December 2004
6 Countrywide had only been a leader in two of six categories.

7 37. Similarly, Sieracki attended a June 28, 2005 meeting at which the
8 chief operating officer noted that Countrywide was taking on "too much" balance
9 sheet risk in home equity lines of credit ("HELOCs") and subprime loans, and had
10 taken on "unacceptable risk" from non-owner occupied loans made at 95%
11 combined loan to value ratios, which were an exception to Countrywide's then-
12 existing underwriting guidelines. Risk Management also reported at that meeting
13 that non-conforming loan programs accounted for 40% of Countrywide's loan
14 originations and that subprime production had tripled, rising from 4% to 14% of
15 total production. Finally, at that same meeting, Risk Management reported to the
16 committee on evidence of borrowers misrepresenting their income and occupation
17 on reduced documentation loan applications, and the increasing credit risks
18 associated with Pay-Option ARM loans, for example, negative amortization,
19 payment shock, and the necessity of raising the initial interest rate to reduce the
20 speed of negative amortization on the loans.

21 38. Sambol and Sieracki also learned of the risks associated with the
22 company's aggressive guideline expansion in meetings of other company
23 committees. For example, Sieracki was a member of the asset and liability
24 committee, and Sambol attended certain of its meetings. If a proposed guideline
25 expansion had a modeled expected default rate in excess of 8%, the proposal had to
26 be submitted to this committee for approval. All proposed expansions to
27 Countrywide's subprime menu from late 2005 through 2006 presented an expected
28 default rate in excess of 8% and required approval of that committee. In June

1 2005, Sambol and McMurray engaged in a lengthy email exchange regarding the
2 impact of Countrywide's underwriting guideline expansion related to requests for
3 subprime product expansions that had been taken up by the asset and liability
4 committee in the first and second quarters of 2005. In that exchange, McMurray
5 warned Sambol that "as a consequence of [Countrywide's] strategy to have the
6 widest product line in the industry, we are clearly out on the 'frontier' in many
7 areas." McMurray went on to note that the frontier had "high expected default
8 rates and losses."

9 39. Additionally, proposals with high expected defaults or that were
10 otherwise controversial were referred to the Countrywide responsible conduct
11 committee for approval. Sambol was a member of this committee, which had
12 repeatedly approved guideline expansions. For instance, in late 2006
13 Countrywide's production divisions proposed expanding Countrywide's guidelines
14 to match certain guidelines offered by Bear Stearns and Lehman Brothers,
15 programs that were known within Countrywide as "Extreme Alt-A." Risk
16 Management was concerned about the risks associated with these guidelines, and
17 referred the request to the responsible conduct committee. Sambol, in his capacity
18 as a member of that committee, approved the expansion.

19 40. Finally, both Mozilo and Sambol were aware as early as June 2006
20 that a significant percentage of borrowers who were taking out stated income loans
21 were engaged in mortgage fraud. On June 1, 2006, Mozilo advised Sambol in an
22 email that he had become aware that the Pay-Option ARM portfolio was largely
23 underwritten on a reduced documentation basis and that there was evidence that
24 borrowers were lying about their income in the application process. On June 2,
25 2006, Sambol received an email reporting on the results of a quality control audit
26 at Countrywide Bank that showed that 50% of the stated income loans audited by
27 the bank showed a variance in income from the borrowers' IRS filings of greater
28

