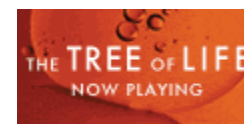


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U.S. Is Set to Sue a Dozen Big Banks Over Mortgages

By **NELSON D. SCHWARTZ**

The federal agency that oversees the mortgage giants **Fannie Mae** and **Freddie Mac** is set to file suits against more than a dozen big banks, accusing them of misrepresenting the quality of mortgage securities they assembled and sold at the height of the housing bubble, and seeking billions of dollars in compensation.

The Federal Housing Finance Agency suits, which are expected to be filed in the coming days in federal court, are aimed at **Bank of America**, JPMorgan Chase, **Goldman Sachs** and **Deutsche Bank**, among others, according to three individuals briefed on the matter.

The suits stem from subpoenas the finance agency issued to banks a year ago. If the case is not filed Friday, they said, it will come Tuesday, shortly before a deadline expires for the housing agency to file claims.

The suits will argue the banks, which assembled the mortgages and marketed them as securities to investors, failed to perform the due diligence required under securities law and missed evidence that borrowers' incomes were inflated or falsified. When many borrowers were unable to pay their mortgages, the securities backed by the mortgages quickly lost value.

Fannie and Freddie lost more than \$30 billion, in part as a result of the deals, losses that were borne mostly by taxpayers.

In July, the agency filed suit against UBS, another major mortgage securitizer, seeking to recover at least \$900 million, and the individuals with knowledge of the case said the new litigation would be similar in scope.

Private holders of mortgage securities are already trying to force the big banks to buy back tens of billions in soured mortgage-backed bonds, but this federal effort is a new chapter in a huge legal fight that has alarmed investors in bank shares. In this case, rather than demanding that the banks buy back the original loans, the finance agency is seeking reimbursement for losses on the securities held by Fannie and Freddie.

The impending litigation underscores how almost exactly three years after the collapse of Lehman

Brothers and the beginning of a financial crisis caused in large part by subprime lending, the legal fallout is mounting.

Besides the angry investors, 50 state attorneys general are in the final stages of negotiating a settlement to address abuses by the largest mortgage servicers, including Bank of America, JPMorgan and Citigroup. The attorneys general, as well as federal officials, are pressing the banks to pay at least \$20 billion in that case, with much of the money earmarked to reduce mortgages of homeowners facing foreclosure.

And last month, the insurance giant American International Group filed a \$10 billion suit against Bank of America, accusing the bank and its Countrywide Financial and Merrill Lynch units of misrepresenting the quality of mortgages that backed the securities A.I.G. bought.

Bank of America, Goldman Sachs and JPMorgan all declined to comment. Frank Kelly, a spokesman for Deutsche Bank, said, "We can't comment on a suit that we haven't seen and hasn't been filed yet."

But privately, financial service industry executives argue that the losses on the mortgage-backed securities were caused by a broader downturn in the economy and the housing market, not by how the mortgages were originated or packaged into securities. In addition, they contend that investors like A.I.G. as well as Fannie and Freddie were sophisticated and knew the securities were not without risk.

Investors fear that if banks are forced to pay out billions of dollars for mortgages that later defaulted, it could sap earnings for years and contribute to further losses across the financial services industry, which has only recently regained its footing.

Bank officials also counter that further legal attacks on them will only delay the recovery in the housing market, which remains moribund, hurting the broader economy. Other experts warned that a series of adverse settlements costing the banks billions raises other risks, even if suits have legal merit.

The housing finance agency was created in 2008 and assigned to oversee the hemorrhaging government-backed mortgage companies, a process known as conservatorship.

"While I believe that F.H.F.A. is acting responsibly in its role as conservator, I am afraid that we risk pushing these guys off of a cliff and we're going to have to bail out the banks again," said Tim Rood, who worked at Fannie Mae until 2006 and is now a partner at the Collingwood Group, which advises banks and servicers on housing-related issues.

The suits are being filed now because regulators are concerned that it will be much harder to make claims after a three-year statute of limitations expires on Wednesday, the third anniversary of the

federal takeover of Fannie Mae and Freddie Mac.

While the banks put together tens of billions of dollars in mortgage securities backed by risky loans, the Federal Housing Finance Agency is not seeking the total amount in compensation because some of the mortgages are still good and the investments still carry some value. In the UBS suit, the agency said it owned \$4.5 billion worth of mortgages, with losses totaling \$900 million. Negotiations between the agency and UBS have yielded little progress.

The two mortgage giants acquired the securities in the years before the housing market collapsed as they expanded rapidly and looked for new investments that were seemingly safe. At issue in this case are so-called private-label securities that were backed by subprime and other risky loans but were rated as safe AAA investments by the ratings agencies.

In the years before 2007, "the market was so frothy then it was hard to find good quality loans to securitize and hold in your portfolio," said David Felt, a lawyer who served as deputy general counsel of the finance agency until January 2010. "Fannie and Freddie thought they were taking AAA tranches, and like so many investors, they were surprised when they didn't turn out to be such quality investments."

Fannie and Freddie had other reasons to buy the securities, Mr. Rood added. For starters, they carried higher yields at a time when the two mortgage giants could buy them using money borrowed at rock-bottom rates, thanks to the implicit federal guarantee they enjoyed.

In addition, by law Fannie and Freddie were required to back loans to low-to-moderate income and minority borrowers, and the private-label securities were counted toward those goals.

"Competitive pressures and onerous housing goals compelled them to operate more like hedge funds than government-sponsored guarantors," Mr. Rood said.

In fact, Freddie was warned by regulators in 2006 that its purchases of subprime securities had outpaced its risk management abilities, but the company continued to load up on debt that ultimately soured.

As of June 30, Freddie Mac holds more than \$80 billion in mortgage securities backed by more shaky home loans like subprime mortgages, Option ARM and Alt-A loans. Freddie estimates its total gross losses stand at roughly \$19 billion. Fannie Mae holds \$38 billion of securities backed by Alt-A and subprime loans, with losses standing at nearly \$14 billion.

