Buckley Sandler LLP

InfoBytes

FINANCIAL SERVICE HEADLINES & DEADLINES FOR OUR CLIENTS AND FRIENDS

July 16, 2010

Topics In This Issue

- Federal Issues
- State Issues
- Courts
- Firm News
- Mortgages
- Banking
- Consumer Finance
- Securities
- Insurance
- Litigation

Federal Issues

FHFA Issues 64 Subpoenas for Documents Related to Private-label Mortgage-backed Securities. On July 12, the Federal Housing Finance Agency (FHFA), acting in its capacity as the conservator of Fannie Mae and Freddie Mac, announced that it had issued 64 subpoenas to trustees and servicers holding or controlling documentation pertaining to private-label mortgage-backed securities (PLS) in which Fannie Mae and Freddie Mac invested. The subpoenas seek the contents of loan files, including loan applications, appraisals, and other documents used in the underwriting process, which secure the PLS. The FHFA indicated that it will analyze these documents to assess whether PLS counterparties made misrepresentations, breached warranties, or committed other acts or omissions that would require repurchase of loans underlying the PLS or other appropriate remedies. The FHFA characterized this matter as a "financial inquiry" and stated that it was premature to speculate as to whether it would bring lawsuits based on the information obtained. The FHFA also indicated that it may expand its inquiry beyond the scope of the present subpoenas. The subpoenaed parties have 30 days from receipt of the subpoena to produce all applicable documents. For a copy of the press release, please click here.

Goldman Sachs Agrees to Pay Landmark $550 Million to Settle SEC Charges. On July 15, the U.S. Securities and Exchange Commission (SEC) announced that Goldman, Sachs & Co. (Goldman) has agreed to pay $550 million to settle securities fraud charges related to its marketing of a synthetic collateralized debt obligation (CDO) that was tied to the performance of subprime residential mortgage-backed securities. This settlement constitutes the largest penalty ever assessed against a financial services firm in the history of the SEC and would resolve an enforcement action initiated by the SEC in which Goldman was charged with misstating and omitting material information about the synthetic CDO (as reported in *InfoBytes*, April 16, 2010). According to the SEC, Goldman failed to disclose to investors that the hedge fund Paulson & Co. Inc. (Paulson) participated in the portfolio selection process and that Paulson had effectively taken a short position against the CDO by entering into credit default swaps with Goldman. While Goldman neither admitted nor denied the SEC's allegations, Goldman agreed to entry of a final judgment that permanently enjoins the firm from

violations of the antifraud provisions of the Securities Act of 1933. As part of the settlement, Goldman also agreed to reform its business practices. Goldman will take remedial action that requires the firm's compliance personnel and legal counsel to scrutinize written marketing materials for mortgage offerings. It admitted it was a "mistake" for its marketing materials to omit material information about the role of Paulson in the portfolio selection process. For a copy of the press release, please see http://www.sec.gov/news/press/2010/2010-123.htm.

HUD Issues Notice and Requests Comment on Initiatives to Manage Risk and Increase Capital Reserves. On July 15, the Department of Housing and Urban Development (HUD) issued a notice and request for comments on new guidelines designed to bolster the Federal Housing Administration (FHA) Mutual Mortgage Insurance Fund, which recent economic conditions have threatened. These new guidelines would effect three significant changes. First, they would reduce the permissible amount of seller concessions to 3% of the lesser of a home's sales price or appraised value. Seller concessions exceeding 3% would trigger a dollar-for-dollar reduction in the sales price for purposes of calculating the maximum FHA loan amount. Second, they would require FHA borrowers to have a credit score of at least 500 and limit the maximum loan-to-value ratio to 90% for borrowers with a credit score below 580, with a temporary exemption available to certain borrowers seeking to refinance. Third, they would impose new limits on manually underwritten loans. Under the proposal, FHA would no longer accept manually underwritten loans with a housing ratio above 31%, a debt-to-income ratio above 43%, or cash reserves of less than one month's principal, interest, tax, and insurance payments, with certain exceptions for borrowers with a credit score of 620 or higher. HUD welcomes comments on the guidelines through August 16, 2010. For a copy of the *Federal Register* notice, please click here.

FDIC Gets Greater Back-up Supervisory Power over Insured Depository Institutions. On July 12, the Board of Directors of the Federal Deposit Insurance Corporation (FDIC) voted to revise its Memorandum of Understanding (MOU) with the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Reserve Board to expand the FDIC's supervisory authority over certain Insured Depository Institutions (IDIs). The MOU ensures that the FDIC has sufficient access to the information that it needs from IDIs in order to evaluate the risks that they may pose to the deposit insurance fund. Specifically, the MOU authorizes the FDIC to conduct special examinations of (i) problem IDIs, (ii) IDIs that have a heightened risk to the Deposit Insurance Funds, (iii) large, complex IDIs, and (iv) IDIs that are affiliated with entities that have borrowed more than $5 billion under the FDIC Temporary Liquidity Guarantee Program. Of note, the FDIC will establish "a continuous on-site full-time staff presence" at IDIs in categories (iii) and (iv). The MOU also ensures that the FDIC will coordinate and share work and information with the primary federal banking regulators, so as to avoid the "unnecessary duplication of efforts." For a copy of the MOU, please see http://www.fdic.gov/news/board/2010July12no1.pdf.

FTC Issues Report on Debt Collection Litigation and Arbitration Reform. On July 12, the Federal Trade Commission issued a press release announcing the publication of new report which recommends significant litigation and arbitration reforms to improve efficiency and consumer fairness in the systems used for resolving consumer debt collection disputes. Specific issues addressed by the report titled "Repairing a Broken System: Protecting Consumers in Debt Collection Litigation and

Arbitration" include decreasing the prevalence of default judgments, ensuring sufficient evidence of indebtedness before a suit is filed, eliminating bias and/or the appearance of bias against consumers in arbitration, and increasing the transparency and affordability of the arbitration process. For a copy of the press release, please see http://www.ftc.gov/opa/2010/07/debtcollect.shtm. For a copy of the report, please see http://www.ftc.gov/os/2010/07/debtcollectionreport.pdf.

Revised FAQs on HAMP Supplemental Directives Available. On July 15, a revised Frequently Asked Questions (FAQs) document, directed at servicers participating in the Home Affordable Modification Program (HAMP), was released to clarify existing Supplemental Directives issued for HAMP. For a copy of the revised FAQs, please see https://www.hmpadmin.com/portal/docs/hamp_servicer/hampfaqs.pdf.

State Issues

Oregon Regulator Takes Action Against Mortgage Lenders for Violations of Mortgage Lender Law. Recently, the Oregon Department of Consumer and Business Services (Department) issued final enforcement orders in three actions against mortgage lending companies for violations of the Oregon Mortgage Lender Law (Law). In one matter, a company was ordered to pay a civil fine and agreed to voluntarily surrender its mortgage lender license in order to settle charges that it violated the Law by mailing advertisements to borrowers that were false, misleading, or deceptive. Among other things, the advertisements used the name of the borrowers' existing mortgage lender without including certain disclosures required under the Law (*e.g.*, "This offer is not related to your existing mortgage lender or holder of your loan"). In another matter, the Department imposed a suspended fine on a company and revoked the company's mortgage lender license after the company, among other things, failed to notify the Department of a change of control and a felony indictment involving its president within the timeframe designated under the Law. In a third matter, a company was issued a cease-and-desist order and charged a $2,000 examination fee after the owner failed to disclose that the building used as collateral in a loan he brokered between a business associate and a third party was subject to a pending legal action. For a copy of the enforcement orders, please see http://bit.ly/nqI9m3, http://bit.ly/qDtGIk, and http://bit.ly/pQhEe2.

Courts

Summary Judgment Awarded to Bank in FCRA Firm Offer Case. On July 7, the U.S. District Court for the Eastern District of Michigan awarded summary judgment to the defendant bank in a case in which the plaintiff alleged that the bank violated the Fair Credit Reporting Act (FCRA) by using his credit report without a permissible purpose. *Wilson v. First Bank of Del.*, No. 10-11345, 2010 WL 2696981 (E.D. Mich. Jul. 7, 2010). In *Wilson*, the Bank engaged in a direct mail program that sent "firm offers" of credit to a target population whose credit reports were pre-screened by Trans Union on behalf of the bank. The bank also developed post-screen criteria for accepting applications that came in from the pre-qualified firm offers. The post-screen qualification criteria included potential fraud, excessive inquiries, excessive usage, and delinquencies. The plaintiff received a firm offer of credit from the bank, but the bank denied the plaintiff credit when its post-screen review revealed a

charge-off in the plaintiff's credit history that did not show up during the pre-screen. The plaintiff claimed that the bank had no permissible purpose under FCRA to review his credit report after the firm offer was made and that, in any event, the charge-off did not make him ineligible for the firm offer pursuant to the bank's post-screen criteria. The court disagreed, finding that charge-offs are included in "delinquencies" and that the bank thus complied with its post-screen criteria. The court also examined the definition of "firm offer" under FCRA, 15 U.S.C. § 1681(l), and held that the pre-screening and post-screening by the bank satisfied the definition, and that the bank obtained the plaintiff's credit report in compliance with FCRA. For a copy of the opinion, please click here.

Fourth Circuit Finds Lower Court Abused Discretion in Denying Class Certification in FACTA Case. On July 1, the U.S. Court of Appeals for the Fourth Circuit vacated and remanded a decision by the U.S. District Court of Maryland to deny the plaintiffs' motion for class action certification in connection with a claim that the retail store Weis Markets, Inc. ("Weis") violated the Fair and Accurate Credit Transactions Act by failing to properly truncate consumer's credit and debit card numbers on printed receipts provided at the point of sale. *Stillmock v. Weis Markets, Inc.*, No. 09-1632, 2010 WL 2621041 (4th Cir. Jul. 1, 2010). The district court held that the putative class action satisfied the four certification criteria of Federal Rule of Civil Procedure 23(a). However, the district court denied class certification on the grounds that (i) the calculation of damages for each class member required individualized determinations in contravention of Rule 23(b)(3), and (ii) a class action was "inferior" to having the plaintiffs proceed with individual actions. As to the district court's first assertion, the Fourth Circuit stated: "[W]here, as here, the qualitatively overarching issue by far is the liability issue of the defendant's willfulness, and the purported class members were exposed to the same risk of harm every time the defendant violated the statute in the identical manner, the individual statutory damages issues are insufficient to defeat class certification under Rule 23(b)(3)." The Fourth Circuit found no support for the district court's second assertion and, instead, cited factors such as the lack of interest among plaintiffs to file individual actions and the consistency of results as favoring class action certification in the matter. For a copy of the opinion, please click here.

Michigan Supreme Court Invalidates State Rules Prohibiting the Practice of Insurance Scoring. On July 8, the Michigan Supreme Court struck down rules issued by the state's Commissioner of Financial and Insurance Regulation (Commissioner) banning the use of credit reports to determine automobile and homeowners insurance premiums, a practice known as "insurance scoring."*Ins. Inst. of Mich. v. Comm'r, Fin. & Ins. Servs.*, 2010 WL 2696342, No. 137400 (Mich. Jul. 8, 2010). The court held that the Commissioner's rules were contrary to Michigan's Insurance Code, which allows insurers to establish premium discount plans and rating systems based on factors that reasonably reflect an insurer's anticipated reduction in losses, and, thus, exceeded the statutory scope of the Commissioner's rule-making authority. The court based its determination largely on evidence in the record indicating that individuals with higher insurance scores pose a lower risk of loss to the insurer. Based on that evidence, the court found that there was "little difference between providing a discount for anti-lock brakes, for example, and providing a discount based on high insurance scores." The court separately rejected an argument by the Commissioner that credit reports are unreliable and, therefore, their use violates an Insurance Code prohibition on "unfairly discriminatory" rates. In the course of its opinion, the court also noted that the Michigan Legislature had at one time considered legislation that would ban the use of credit scores in insurance

underwriting. However, this legislation was abandoned by the Legislature after the governor made clear her intention to veto the legislation. For a copy of the opinion, please see http://bit.ly/qCL8bX.

Florida Federal Court Finds That Appraisers Cannot Be Held Liable by Bank That Engaged in Reckless Mortgage Lending. On July 3, the U.S. District Court for the Middle District of Florida granted a motion for summary judgment filed by the defendants, a certified appraiser and a trainee appraiser, in a case in which the plaintiff bank alleged that the appraisers were liable for the bank's damages following a borrower's default on two mortgage loans because the appraisers provided the bank with a faulty appraisal of the property securing the mortgage loans. *Fed. Deposit Ins. Corp. v. Nwaneri*, No. 6:08-cv-1791 (M.D. Fla. Jul. 3, 2010). In *Nwaneri*, the bank originated two "stated-income" mortgage loans totaling $1,448,750 to a borrower for the purpose of acquiring residential property. The appraisers estimated the value of the property acquired by the borrower to be $1,525,000. The borrower never made a payment on the mortgage loans and the property was foreclosed upon. The bank brought negligence and negligent misrepresentation claims against the appraisers, based on the assertion that the property's worth was at least $400,000 less than its appraised value. In reaching its decision, the court concluded that the bank could not establish that its damages were caused by an allegedly faulty appraisal. Instead, according to the court, it was the bank's reckless behavior that caused the bank's losses, and the bank must accept the consequences of its own risky lending. The court specifically found that it was reckless behavior for the bank to originate a "stated-income" mortgage loan for more than $1 million and based on a 95 percent loan-to-value ratio. For a copy of the opinion, please click here.

Colorado Federal Court Grants Class Certification in Truth in Lending Case. On June 21, the U.S. District Court for the District of Colorado granted class certification to 516 consumers in Colorado who were allegedly overcharged by Spring Automotive Group on title filing fees. *Maez v. Springs Auto. Group, LLC*, No. 09-cv-01159, 2010 WL 2543553 (D. Colo. Jun. 21, 2010). The case stems from a used car transaction that took place on February 24, 2009. The plaintiff purchased a car from the defendant and was charged $189.20 for a government certificate of title fees, when the actual cost to file such documents was only $17.20. The plaintiff argues that the overcharge (i) violates the Truth in Lending Act, and (ii) amounts to civil theft under Colorado state law. For a copy of the opinion, please click here.

Michigan Federal Court Holds Report Misleading under FCRA Only When Consumer of Report Is Misled. On July 12, the U.S. District Court for the Eastern District of Michigan held that, in determining whether or not a report is clear and not misleading under the Fair Credit Reporting Act (FCRA), the relevant analysis is whether a consumer of the report is actually misled, and not whether a layperson may have been misled. The court also held that "[a]t most, the FCRA provides consumers with a right to reports that are accurate and not misleading. It does not give consumers a right to edit and dictate the terms of reports before they are sent." *Elsady v. Rapid Global Bus. Solutions, Inc.*, No. 09-11659, 2010 WL 2740154 (E.D. Mich. Jul. 12, 2010). In so holding, the court granted the motion for summary judgment of a former employer of the plaintiff, and a furnisher of information under the FCRA on the facts of the case, with respect to claims of willful and negligent violation of the FCRA. The court found that the defendant furnisher had satisfied its obligation to

correct inaccurate information reported by another defendant, reporting agency Carco Group, Inc. (Carco), following its receipt of notice from the plaintiff that items of information provided by Carco with regard to the circumstances of his termination by the defendant furnisher were inaccurate. The court discussed, but did not resolve, the question of the appropriate standard of accuracy under the FCRA—whether that be (i) a mere "technical accuracy" standard (*i.e.*, accuracy of the report on its face), or (ii) a standard requiring a report to not be incomplete or misleading—by finding that the plaintiff's claim "fails under either test." However, the court did directly address whether the "not misleading" component of the latter, more plaintiff-friendly standard means not misleading in the abstract, or rather not actually misleading to the party receiving and relying on the report based on the facts presented. The court's analysis favored the latter formulation, with the court further finding that even if the defendant furnisher's reports may have misled a lay person, they were clear and not misleading to those in receipt of the reports. In reaching this conclusion, the court approved of the principle that "a plaintiff's mere assertion that a report was misleading, or even his proof that a lay person would be mislead, is insufficient to establish that a report was misleading and, therefore, inaccurate. At a minimum, a plaintiff must prove that a creditor or consumer of credit reports would be misled." The case goes forward with respect to defendant Carco. For a copy of the opinion, please see http://bit.ly/nojEtB.

Firm News

BuckleySandler LLP was named as one of the "20 law firms that have thrived the downturn" in the 2010 Midsize Hot List published by *The National Law Journal*. The article notes that BuckleySandler has "scored a series of high-profile victories" and "has spent the past year racking up wins for clients, particularly banks facing suits over subprime lending practices." *The National Law Journal* compiled this list by "select[ing] firms that experienced a string of successes and that showed innovative ways to run their operations despite the economy." To read the full article, please click here.

An article by Ben Fischer in *Washington Business Journal* discusses BuckleySandler's impressive growth: "Jerry Buckley and Andy Sandler had a feeling their timing was right, but they didn't dare dream it would be this right." To read more, please click here.

Andrew Sandler will participate in three webinars offered by the Financial Services Roundtable taking place at 12:15 p.m. ET on July 15, July 22, and July 29. The topic is "The Restoring American Financial Stability Act of 2010: Legislative Reform Meets Regulatory Reality."

Christopher Witeck will be speaking on the "Securitization and Secondary Market" panel at ACI's Reverse Mortgage Conference in New York on July 23.

Jonice Gray Tucker will be speaking on issues related to fair servicing at the American Bar Association's Annual Meeting on August 7.

Jonice Gray Tucker will be speaking at the California Mortgage Bankers Association's Servicing Conference on August 9, on the topic of enforcement activity related to loan modifications and default servicing.

Andrew Sandler will be the chairperson for the Banking Crisis Fallout 2010 Program at the PLI New York Center in New York City on November 4. The topic will be "Emerging Enforcement Trends."

An article by Jonathan Cannon entitled “Field Services Introduce Compliance Concerns” appeared as the cover story in*Servicing Management* (July 2010).

An article by John Kromer and Heidi Bauer entitled “The SAFE Act’s Unlevel Playing Field” appeared in *Mortgage Banking* (July 2010).

An article by Andrew Sandler entitled “The Financial Services Reform Act: Leading or Following Enhanced Consumer Protection?” appeared in *The Consumer Financial Services Law Report* (July 21).

Ben Klubes spoke at the American Financial Services Association’s (AFSA) Law Committee Meeting in Indianapolis on July 13 regarding fair lending litigation and the Department of Justice.

Jerry Buckley and Mark Olson presented a free A.S. Pratt audio conference, “The Financial Reform Act: What You Need to Know,” on July 13 and July 15.

Jerry Buckley presented “Coping with the Bank Regulatory Environment” at the Massachusetts Executive Officers Conference in New Castle, New Hampshire on June 25.

Katy Ryan, Melissa Klimkiewicz, and Clint Rockwell presented a webinar, “New Challenges – FHA Compliance and Enforcement and Multi-State Examination Process,” on June 23 for West Professional Development and on June 24 for the California Mortgage Bankers Association.

Mortgages

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Fourth Circuit Finds Lower Court Abused Discretion in Denying Class Certification in FACTA Case. On July 1, the U.S. Court of Appeals for the Fourth Circuit vacated and remanded a decision by the U.S. District Court of Maryland to deny the plaintiffs' motion for class action certification in connection with a claim that the retail store Weis Markets, Inc. ("Weis") violated the Fair and Accurate Credit Transactions Act by failing to properly truncate consumer's credit and debit card numbers on printed receipts provided at the point of sale. *Stillmock v. Weis Markets, Inc.*, No. 09-1632, 2010 WL 2621041 (4th Cir. Jul. 1, 2010). The district court held that the putative class action satisfied the four certification criteria of Federal Rule of Civil Procedure 23(a). However, the district court denied class certification on the grounds that (i) the calculation of damages for each class member required individualized determinations in contravention of Rule 23(b)(3), and (ii) a class action was "inferior" to having the plaintiffs proceed with individual actions. As to the district court's first assertion, the Fourth Circuit stated: "[W]here, as here, the qualitatively overarching issue by far is the liability issue of the defendant's willfulness, and the purported class members were exposed to the same risk of harm every time the defendant violated the statute in the identical manner, the individual statutory damages issues are insufficient to defeat class certification under Rule 23(b)(3)." The Fourth Circuit found no support for the district court's second assertion and, instead, cited factors such as the lack of interest among plaintiffs to file individual actions and the consistency of results as favoring class action certification in the matter. For a copy of the opinion, please click here.

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Securities

Goldman Sachs Agrees to Pay Landmark $550 Million to Settle SEC Charges. On July 15, the U.S. Securities and Exchange Commission (SEC) announced that Goldman, Sachs & Co. (Goldman) has agreed to pay $550 million to settle securities fraud charges related to its marketing of a synthetic collateralized debt obligation (CDO) that was tied to the performance of subprime residential mortgage-backed securities. This settlement constitutes the largest penalty ever assessed against a financial services firm in the history of the SEC and would resolve an enforcement action initiated by the SEC in which Goldman was charged with misstating and omitting material information about the synthetic CDO (as reported in *InfoBytes*, April 16, 2010). According to the SEC, Goldman failed to disclose to investors that the hedge fund Paulson & Co. Inc. (Paulson) participated in the portfolio selection process and that Paulson had effectively taken a short position against the CDO by entering into credit default swaps with Goldman. While Goldman neither admitted nor denied the SEC's allegations, Goldman agreed to entry of a final judgment that permanently enjoins the firm from violations of the antifraud provisions of the Securities Act of 1933. As part of the settlement, Goldman

also agreed to reform its business practices. Goldman will take remedial action that requires the firm's compliance personnel and legal counsel to scrutinize written marketing materials for mortgage offerings. It admitted it was a "mistake" for its marketing materials to omit material information about the role of Paulson in the portfolio selection process. For a copy of the press release, please see http://www.sec.gov/news/press/2010/2010-123.htm.

Insurance

Michigan Supreme Court Invalidates State Rules Prohibiting the Practice of Insurance Scoring. On July 8, the Michigan Supreme Court struck down rules issued by the state's Commissioner of Financial and Insurance Regulation (Commissioner) banning the use of credit reports to determine automobile and homeowners insurance premiums, a practice known as "insurance scoring."*Ins. Inst. of Mich. v. Comm'r, Fin. & Ins. Servs.*, 2010 WL 2696342, No. 137400 (Mich. Jul. 8, 2010). The court held that the Commissioner's rules were contrary to Michigan's Insurance Code, which allows insurers to establish premium discount plans and rating systems based on factors that reasonably reflect an insurer's anticipated reduction in losses, and, thus, exceeded the statutory scope of the Commissioner's rule-making authority. The court based its determination largely on evidence in the record indicating that individuals with higher insurance scores pose a lower risk of loss to the insurer. Based on that evidence, the court found that there was "little difference between providing a discount for anti-lock brakes, for example, and providing a discount based on high insurance scores." The court separately rejected an argument by the Commissioner that credit reports are unreliable and, therefore, their use violates an Insurance Code prohibition on "unfairly discriminatory" rates. In the course of its opinion, the court also noted that the Michigan Legislature had at one time considered legislation that would ban the use of credit scores in insurance underwriting. However, this legislation was abandoned by the Legislature after the governor made clear her intention to veto the legislation. For a copy of the opinion, please see http://bit.ly/qCL8bX.

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Florida Federal Court Finds That Appraisers Cannot Be Held Liable by Bank That Engaged in Reckless Mortgage Lending. On July 3, the U.S. District Court for the Middle District of Florida granted a motion for summary judgment filed by the defendants, a certified appraiser and a trainee appraiser, in a case in which the plaintiff bank alleged that the appraisers were liable for the bank's damages following a borrower's default on two mortgage loans because the appraisers provided the bank with a faulty appraisal of the property securing the mortgage loans. *Fed. Deposit Ins. Corp. v. Nwaneri*, No. 6:08-cv-1791 (M.D. Fla. Jul. 3, 2010). In *Nwaneri*, the bank originated two "stated-income" mortgage loans totaling $1,448,750 to a borrower for the purpose of acquiring residential property. The appraisers estimated the value of the property acquired by the borrower to be $1,525,000. The borrower never made a payment on the mortgage loans and the property was foreclosed upon. The bank brought negligence and negligent misrepresentation claims against the appraisers, based on the assertion that the property's worth was at least $400,000 less than its appraised value. In reaching its decision, the court concluded that the bank could not establish that its damages were caused by an allegedly faulty appraisal. Instead, according to the court, it was the bank's reckless behavior that caused the bank's losses, and the bank must accept the consequences of its own risky lending. The court specifically found that it was reckless behavior for the bank to originate a "stated-income" mortgage loan for more than $1 million and based on a 95 percent loan-to-value ratio. For a copy of the opinion, please click here.

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