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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

1 than 10%. Of those, 69% had an income variance of greater than 50%. These
2 material facts were never disclosed to investors.

3 3. Warnings Regarding the Matching Strategy

4 41. McMurray repeatedly provided explicit and ominous warnings about
5 Countrywide's matching strategy. In a June 25, 2005 email to Sambol concerning
6 guideline expansion and the company's growing credit risks, McMurray addressed
7 the matching strategy and explained that "because the matching process includes
8 comparisons to a variety of lenders, our [guidelines] will be a composite of the
9 outer boundaries across multiple lenders[,]” and that because comparisons are only
10 made to competitor guidelines where they are more aggressive and not used where
11 they are less aggressive, **Countrywide's "composite guides [sic] are likely
12 among the most aggressive in the industry."** (emphasis added.)

13 42. On November 2, 2006, McMurray sent an email to Countrywide's
14 chief investment officer ("CIO"), which the CIO forwarded to Sambol, stating that
15 the matching strategy had caused Countrywide to cede its underwriting standards
16 to the most aggressive lenders in the market. In the email, McMurray asked: "**Do
17 we want to effectively cede our policy and is this approach "saleable" from a
18 risk perspective to those constituents who may worry about our risk profile?"**
19 (emphasis added.)

20 43. In a November 16, 2006 email to Sambol, McMurray complained
21 about guidelines and products being introduced in contravention of credit policy.
22 As an example, McMurray cited the fact that Extreme Alt-A loans were being
23 offered by the loan production divisions, even though that program had not been
24 officially approved in the guideline review process. The proposed guidelines
25 would have permitted 100% financing, layered with additional credit risk factors
26 such as stated income, lower than average FICO scores, or non-owner occupied
27 investment properties.

1 44. In a February 11, 2007 email to Sambol, McMurray noted that the
2 production divisions continued to advocate for, and operated pursuant to, an
3 approach based upon the matching strategy alone, and repeated his concern that the
4 strategy would cause Countrywide's guidelines to be a composite of the riskiest
5 offerings the market. Additionally, McMurray warned that, "**I doubt this**
6 **approach would play well with regulators, investors, rating agencies etc.** To
7 some, this approach might seem like we've simply ceded our risk standards and
8 **balance sheet to whoever has the most liberal guidelines.**" (emphasis added.)

9 4. Warnings Regarding Guideline Expansion and Disruptions
10 in the Secondary Market

11 45. By no later than 2006, Mozilo and Sambol were on notice that
12 Countrywide's exotic loan products might not continue to be saleable into the
13 secondary market, yet this material risk was not disclosed in Countrywide's
14 periodic filings.

15 46. In September 2006 Mozilo wrote an email to Sambol warning that he
16 believed that the Pay-Option loan was "mispriced" in the secondary market and
17 that the pricing spread could disappear quickly if there were a negative event in the
18 market. On February 2, 2007, Risk Management warned Sambol that guideline
19 expansions could disrupt the secondary market for subprime mortgage backed
20 securities ("MBS"). Later in that quarter, the MBS market for subprime loans
21 experienced a disruption that forced Countrywide to write down loans that it had
22 previously intended to sell into that market. Then, in August 2007, the entire
23 market for MBS experienced a severe disruption, which effectively crippled the
24 ability of Countrywide, as well as other mortgage lenders, to sell non-GSE
25 securitizations into the secondary markets and contributed to Countrywide's
26 liquidity problems.

1 **5. Warnings Regarding 100% (a.k.a. 80/20 loans) Financing**

2 47. The seriousness of Risk Management's warnings on guideline
3 expansion and the consequences of Countrywide's failure to heed such warnings
4 are vividly demonstrated by the company's experience with "80/20" subprime
5 loans. An 80/20 subprime loan is a loan where a borrower with a subprime FICO
6 score simultaneously takes out two loans to purchase a home: a first lien loan
7 (typically 80% of the purchase price), and a second lien loan (typically 20% of the
8 purchase price). As a result of having 100% financed the purchase, the borrower
9 has no initial equity in the home. Pursuant to Risk Management's "Policy on High
10 Risk Products," subprime 80/20 loans could not be originated via the exceptions
11 process, and could only be originated if Countrywide could totally extinguish the
12 credit risks (e.g., residual interests or corporate guarantees) resulting from such
13 loans. But the policy was ignored by the production divisions.

14 48. Mozilo knew of the risks Countrywide incurred by originating
15 subprime 80/20 loans and repeatedly questioned the wisdom of continuing to offer
16 the product. Mozilo became concerned about the loans in the first quarter of 2006,
17 when HSBC, a purchaser of Countrywide's 80/20 loans, began to contractually
18 force Countrywide to "buy back" certain of these loans that HSBC contended were
19 defective. On March 28, 2006, Mozilo sent an e-mail to Sambol and others,
20 directing them to implement a series of corrective measures to "avoid the errors of
21 both judgment and protocol that have led to the issues that we face today caused by
22 the buybacks mandated by HSBC." Mozilo further stated that the 100% loan-to-
23 value (also known as 80/20) subprime product is "**the most dangerous product in**
24 **existence and there can be nothing more toxic** and therefore requires that no
25 deviation from guidelines be permitted irrespective of the circumstances."

26 49. Then, in an April 13, 2006 email, Mozilo informed Sambol, Sieracki,
27 and others that there were numerous issues that they must address relating to the
28 100% subprime second business in light of the losses associated with the HSBC

1 buyback. One issue in particular that Mozilo identified was the fact that the loans
2 had been originated “through our channels with disregard for process [and]
3 compliance with guidelines.” Mozilo went on to write that he had “**personally**
4 **observed a serious lack of compliance within our origination system as it**
5 **relates to documentation and generally a deterioration in the quality of loans**
6 **originated** versus the pricing of those loan [sic].” Mozilo noted that, “[i]n my
7 **conversations with Sambol he calls the 100% sub prime seconds as the ‘milk’**
8 **of the business. Frankly, I consider that product line to be the poison of**
9 **ours.**” (emphasis added.)

10 50. Furthermore, in an April 17, 2006 email to Sambol concerning
11 Countrywide’s subprime 80/20 loans, Mozilo fumed:

12 In all my years in the business I have never seen a more toxic product.
13 [sic] It’s not only subordinated to the first, but the first is subprime. In
14 addition, the FICOs are below 600, below 500 and some below 400[.]
15 With real estate values coming down...the product will become
16 increasingly worse. There has [sic] to be major changes in this
17 program, including substantial increases in the minimum FICO. . . .
18 Whether you consider the business milk or not, I am prepared to go
19 without milk irrespective of the consequences to our production.

20 51. Echoing Mozilo’s criticisms of the 80/20 product, in April 2006 Risk
21 Management recommended increasing the minimum FICO score on the product by
22 20 points. Sambol, then still the head of the production divisions, opposed this
23 recommendation, and noted that such an increase would make Countrywide
24 uncompetitive with subprime lenders such as New Century, Option One, and
25 Argent.

26 52. On December 7, 2006, Mozilo circulated a memorandum drafted for
27 him by McMurray to the board of directors and all Countrywide managing
28

1 directors, including Sambol and Sieracki. In the memorandum, Mozilo made the
2 following observations, among others:

- 3 • Countrywide had expanded its subprime
4 underwriting guidelines in every conceivable area,
5 lowering minimum FICOs, raising maximum loan
6 size and LTV, and making interest only, stated
7 income, and piggyback second loans available to
8 subprime borrowers;
- 9 • Countrywide expected that subprime loans
10 originated in 2006 (the "2006 Vintage") would be
11 the worst performing on record, driven by wider
12 guidelines and the worsening economic
13 environment, which included rising interest rates and
14 declining home values;
- 15 • the percentage of 60- and 90-day delinquencies in
16 the 2006 Vintage (at 8.11% and 4.03% respectively),
17 exceeded the percentages from each of the previous
18 six years, and the company expected these
19 percentages to rise; and
- 20 • 62% of Countrywide's subprime originations in the
21 second quarter of 2006 had a loan to value ratio of
22 100%.

23 53. In April 2006, Mozilo wrote that no premium, no matter how high,
24 could justify underwriting a loan for a borrower whose FICO score was below 600.
25 Yet Countrywide failed to disclose to investors the serious deficiencies in its
26 underwriting of these "toxic" loans.

27 **6. Warnings Regarding Exception Loans**

28 54. Mozilo, Sambol, and Sieracki were aware of significant lapses in
Countrywide's underwriting processes and the resulting risk to Countrywide. On
May 22, 2005, McMurray warned Sambol of the likelihood of significantly higher
default rates in loans made on an exception basis: "[t]he main issue is to make sure
everyone's aware that we will see higher default rates." McMurray explained that

1 “exceptions are generally done at terms more aggressive than our guidelines,” and
2 continued that “[g]iven the expansion in guidelines and the growing likelihood
3 that the real estate market will cool, this seems like an appropriate juncture to
4 revisit our approach to exceptions.” (emphasis added.) McMurray also warned
5 that increased defaults would cause repurchase and indemnification requests to rise
6 and the performance of Countrywide-issued MBS to deteriorate.

7 55. The poor quality of the loans originated through the exception process
8 became even more obvious in the first quarter of 2007. In fact, in materials
9 distributed at a March 12, 2007 meeting of the credit risk committee attended by
10 Sambol and Sieracki, Risk Management reported that nearly 12% of the loans
11 reviewed by Countrywide in an internal quality control process were rated
12 “severely unsatisfactory” or “high risk.” The causes for such a rating included
13 findings that such loans had debt-to-income, loan to value, or FICO scores outside
14 of Countrywide’s already wide underwriting guidelines. By the second quarter of
15 2007, Risk Management began to report a serious deterioration in the performance
16 of exception loans.

17 56. In a December 13, 2007 memo that was sent to Mozilo in his capacity
18 as Countrywide’s chairman of the board, Countrywide’s enterprise risk assessment
19 officer noted that:

20 Countrywide had reviewed limited samples of first- and
21 second-trust-deed mortgages originated by Countrywide
22 Bank during the fourth quarter of 2006 and the first
23 quarter of 2007 in order to get a sense of the quality of
24 file documentation and underwriting practices, and to
25 assess compliance with internal policies and procedures.
26 The review resulted in . . . the finding that **borrower**
27 **repayment capacity was not adequately assessed by**
28 **the bank during the underwriting process for home**

1 equity loans. More specifically, **debt-to-income (DTI)**
2 **ratios did not consider the impact of principal**
3 **[negative] amortization or an increase in interest.**

4 (emphasis added)

5 57. These material deficiencies in Countrywide's underwriting were never
6 disclosed to investors in Countrywide's Forms 10-Q or 10-K for 2005 through
7 2007.

8 **F. Pay-Option Arms and the Discrepancy Between the Internal and**
9 **External Portrayals of Credit Risk**

10 **1. The External Story**

11 58. Countrywide began originating Pay-Option ARM loans in 2004; by
12 the second quarter of 2005 21% of Countrywide's loan production was Pay-Option
13 ARMS. Pay-Option ARMs allowed borrowers to choose between four payment
14 options: (1) a minimum payment which was insufficient to cover accruing interest;
15 (2) an interest-only payment; (3) a fully amortizing payment with a 30 year pay-
16 off; and (4) a fully amortizing payment with a 20 year pay-off. If the minimum
17 payment was selected, then the accruing interest would be added to the loan's
18 principal balance, a phenomenon known as negative amortization. Countrywide's
19 Pay-Option ARM loans typically allowed for negative amortization until the
20 principal balance reached 115% of the original loan balance, at which time the
21 payment would reset to the amount necessary to repay principal and interest in the
22 term remaining on the loan. This resulted in a much higher monthly payment and
23 "payment shock" to many borrowers. Even if the borrower never reached the
24 115% threshold, the loan would typically reset after five years to a fully amortizing
25 payment. Because Countrywide began to offer Pay-Option loans in 2004,
26 Countrywide's first wave of automatic resets were scheduled to occur in 2009.
27 Unlike many other loans that Countrywide originated, most of the Pay-Option
28 loans were held for investment by Countrywide Bank.

1 59. Countrywide publicly heralded Pay-Option loans as a safe product
2 offering. For instance, in its 2006 Form 10-K, Countrywide proclaimed that it had
3 “prudently underwritten” its Pay-Option ARMs. On May 31, 2006, Mozilo gave a
4 speech in which he stated, “Pay-Option loans represent the best whole loan type
5 available for portfolio investment from an overall risk and return perspective,” that,
6 “[t]he performance profile of this product is well understood because of its twenty
7 year history, which includes stress tests in difficult environments[,]” and that
8 Countrywide “actively manages credit risk through prudent program
9 guidelines...and sound underwriting.”

10 **2. The Internal View**

11 60. Contrary to such public statements extolling the virtues of the Pay-
12 Option ARM product, Mozilo, along with several of Countrywide’s senior
13 executives, had concluded that the product’s risks to the company were severe, and
14 they were scrambling to identify ways to mitigate them. Sambol and Sieracki were
15 aware of these concerns.

16 **a. Negative Amortization and Payment Shock**

17 61. In June 2005, Risk Management warned senior executives, including
18 Sieracki, that action was needed to address the increasing pace of negative
19 amortization and the potential for payment shock associated with Pay-Option
20 ARMs. Specifically, in a June 28, 2005 meeting of the credit risk committee,
21 which was attended by Sieracki, Risk Management recommended that the rate
22 used to calculate the minimum payment on Pay-Option ARMs (“start rate”) be
23 raised to reduce negative amortization and the severity of payment shock. Risk
24 Management explained that while the start rate remained constant at 1%, short
25 term rates (upon which borrowers’ fully amortizing payments were based) had
26 risen steadily, thereby increasing the pace of negative amortization and the severity
27 of the resulting payment shock.

1 62. At a June 22, 2006 credit risk committee meeting, attended by Sambol
2 and Sieracki, Risk Management noted that the median time to reset on the pay
3 option loans was getting shorter as negative amortization was accruing at a faster
4 than expected pace.

5 **b. Mozilo's Pointed Concerns About**
6 **Pay-Option ARMs**

7 63. On April 4, 2006, Mozilo received an e-mail regarding Pay-Option
8 loans which informed him that "72% of [Pay-Option] customers chose Minimum
9 Payment selection in February 06, up from 60% in August 05." In response to this
10 information Mozilo sent an email to Sambol that reflected how well he understood
11 the negative ramifications of the information for Countrywide: "Since over 70%
12 have opted to make the lower payment it appears that **it is just a matter of time**
13 **that we will be faced with much higher resets and therefore much higher**
14 **delinquencies.**"

15 64. About six weeks later, on May 18, 2006, Mozilo sent another e-mail to
16 Sambol and Sieracki again sounding the alarm about the Pay-Option portfolio.
17 Stating that "the Bank faces potential unexpected losses because higher [interest]
18 rates will cause the loans to reset much earlier than anticipated and as a result
19 causing mortgagors to default due to the substantial increase in their payments,"
20 Mozilo directed the management team to reduce "balance sheet risk" by
21 refinancing Pay-Options into interest-only loans and improving consumer
22 education about the consequences of resets. Mozilo concluded his e-mail by
23 stating that "there is much more that we can do to manage risk much more
24 carefully during this period of uncertainty both as to the rate environment and
25 untested behavior of payoptions." The very next day, May 19, 2006, Mozilo wrote
26 another email to Sambol and Sieracki, noting that Pay-Options loans presented a
27 long term problem "unless [interest] rates are reduced dramatically from this level
28 and there are no indications, absent another terrorist attack, that this will happen."

1 c. **Mozilo's Concerns Mount**

2 65. Mozilo received more dire news regarding the Pay-Option loan
3 portfolio in June 2006. On June 1, 2006, **one day** after he gave a speech publicly
4 praising Pay-Option ARMs, Mozilo sent an email to Sambol and other executives,
5 in which he expressed concern that the majority of the Pay-Option ARM loans
6 were originated based upon stated income, and that there was evidence of
7 borrowers misrepresenting their income. Mozilo viewed stated income as a factor
8 that increased credit risk and the risk of default. In his email, Mozilo reiterated his
9 concern that in an environment of rising interest rates, resets were going to occur
10 much sooner than scheduled, and because at least 20% of the Pay-Option
11 borrowers had FICO scores less than 700, **borrowers "are going to experience a**
12 **payment shock which is going to be difficult if not impossible for them to**
13 **manage."** Mozilo concluded that the company needed to act quickly to address
14 these issues because "[w]e know or can reliably predict what's going to happen in
15 the next couple of years." Mozilo directed Countrywide Bank to (1) stop
16 accumulating loans with FICO scores below 680 unless the loan-to-value ratio was
17 75% or lower, (2) assess the risks that the Bank faced on loans with FICO scores
18 below 700 and determine if they could be sold out of the Bank and replaced with
19 higher quality loans, and (3) take a careful look at the reserves and "begin to
20 assume the worst."

21 66. On July 10, 2006, Mozilo received an internal monthly report, called a
22 "flash report," that tracked the delinquencies in the Pay-Option portfolio, as well as
23 the percentage of borrowers electing to make the minimum payment and the
24 amount of accumulated negative amortization on each loan. Mozilo learned that
25 from September 2005 through June 2006, the percentage of Pay-Option borrowers
26 choosing to make the minimum payment had nearly doubled, from 37% to 71%.
27 Mozilo believed that these statistics were significant enough that he requested that
28 the company include a letter in bold type with every new Pay-Option loan to

1 inform borrowers of the dangers of negative amortization and to encourage full
2 payment.

3 67. About a month later, on August 16, 2006, Mozilo received an e-mail
4 from a fellow member of Countrywide's board of directors, asking whether the
5 company anticipated any significant problems with the Pay-Option portfolio.
6 Mozilo responded by reiterating the ongoing concerns he had shared with senior
7 management earlier in 2006. By this point in time, over 75% of the Pay-Options
8 borrowers were opting for the minimum payment, which, along with rising interest
9 rates, continued to accelerate negative amortization. Mozilo explained that, as a
10 result, the loans would reset much faster than the borrowers expected with
11 accompanying payment shock. The only solution, Mozilo wrote, was to refinance
12 the loans before reset, but this would be difficult in light of decreasing home values
13 and rising interest rates. Mozilo wrote that only "unlikely" events, such as a
14 dramatic rise in home values or a dramatic drop in interest rates, would alleviate
15 future payment shock.

16 d. Internally, Mozilo Urges Selling the Pay-Option
17 Portfolio

18 68. Mozilo met with Sambol the morning of September 25, 2006 to
19 discuss the Pay-Option ARM loan portfolio. The next day Mozilo sent an e-mail
20 to Sambol and Sieracki expressing even greater concern about the portfolio. In
21 that e-mail, Mozilo wrote:

22 **[w]e have no way, with any reasonable certainty,**
23 **to assess the real risk of holding these loans on**
24 **our balance sheet.** The only history we can look to
25 is that of World Savings however their portfolio was
26 fundamentally different than ours in that their focus
27 was equity and our focus is fico. In my judgement,
28 as a long time lender, I would always trade off fico

1 for equity. The bottom line is that **we are flying**
2 **blind** on how these loans will perform in a stressed
3 environment of higher unemployment, reduced
4 values and slowing home sales. (emphasis added)

5 69. In his September 26, 2006 email Mozilo further stated that “**pay**
6 **options are currently mispriced in the secondary market, and that spread**
7 **could disappear quickly** if there is an foreseen [sic] headline event such as
8 another lender getting into deep trouble with this product or because of negative
9 investor occurrence [sic].” (emphasis added.) He urged that the “timing [wa]s
10 right” to sell Countrywide Bank’s portfolio of loans. To mitigate these anticipated
11 losses, Mozilo proposed that the Bank “sell all newly originated pay options and
12 begin rolling off the bank balance sheet, in an orderly manner, pay options
13 currently in their port[folio].”

14 70. McMurray responded to Mozilo’s September 26, 2006 email, agreeing
15 that Countrywide “should be shedding rather than adding Pay Option risk to the
16 portfolio.” In the fall of 2006, Countrywide’s CIO went further, and recommended
17 to Mozilo, Sambol, Sieracki, and others that all Pay-Option ARMs be sold from
18 Countrywide Bank because Countrywide was not receiving sufficient
19 compensation on these loans to offset the risk of retaining them on its balance
20 sheet.

21 71. Mozilo never became comfortable with the risk presented by the Pay-
22 Option loan. Indeed, on January 29, 2007, Mozilo wrote an email in which he
23 instructed the president of Countrywide Bank to “to explore with KPMG the
24 potential of selling out (one time transaction because of the tarred reputation of
25 Payoptions) the bulk to the Payoptions on the Bank's balance sheet and replace
26 them with HELOCS.” Then, on November 3, 2007, Mozilo instructed the
27 president of the Bank and Sambol that he did not “want any more Pay Options
28 originated for the Bank. I also question whether we should touch this product

1 going forward because of **our inability to properly underwrite these** combined
2 with the fact that these loans are inherently unsound unless they are full doc, no
3 more than 75% LTV and no piggys” (emphasis added). Finally, on November 4,
4 2007, Mozilo advised the president of the Bank and Sambol that “[p]ay options
5 have hurt the company and the Bank badly. . . . World Savings culture permits
6 them to make these loans in a sound manner and our culture does not fico
7 scores are no indication of how these loans will perform.”

8 72. Despite the repeated warnings of Mozilo, McMurray, and the CIO, the
9 Pay-Option ARMs were never sold, and the clearly identified risks to Countrywide
10 were not disclosed to investors. Mozilo recognized as early as August 2006 that
11 Pay-Option ARM loans were one of the “only products left with margins [profit].”

12 **G. Mozilo, Sambol, and Sieracki Were Responsible for**
13 **Countrywide’s Periodic Filings**

14 73. Mozilo, Sambol, and Sieracki each bore responsibility for
15 Countrywide’s periodic filings. In April 2004, Countrywide promulgated a set of
16 written “Disclosure Controls and Procedures (“Disclosure Guidelines”)” which
17 established the procedures governing the preparation of the company’s periodic
18 reports. The Disclosure Guidelines were revised in December 2005 and again in
19 September 2006. The Disclosure Guidelines established a disclosure committee at
20 Countrywide, which Sieracki joined at least as early as December 2005. The
21 Disclosure Guidelines required Countrywide “to disclose on a timely basis any
22 information that would be expected to affect the investment decision of a
23 reasonable investor or to alter the market price of the Company’s securities.”

24 Countrywide’s financial reporting staff was required to:

25 seek input from and discuss with the Divisional Officers information
26 pertaining to the past and current performance and prospects for their
27 business unit, known trends and uncertainties related to the business
28

1 unit, [and] significant risks and contingencies that may affect the
2 business unit. . .

3 The Disclosure Guidelines also required that Countrywide's accounting division,
4 among others, assist the officers involved in the preparation of the company's
5 periodic reports in gaining a reasonable understanding of the applicable rules and
6 regulations, including the disclosure requirements set forth in Regulation S-K and
7 the relevant SEC staff guidance and interpretive materials.

8 74. The preparation of the periodic reports at Countrywide began with a
9 review of the pertinent report from the prior period. The senior vice president for
10 financial reporting circulated to the head of each Countrywide division (1) a
11 memorandum setting forth Countrywide's disclosure obligations and (2) a template
12 ("MD&A Questionnaire") that contained questions concerning the applicable
13 officer's division and that portion of the prior period's filing that concerned the
14 officer's division.

15 75. Starting in the first quarter of 2006, the MD&A Questionnaire for
16 credit risk management was sent to McMurray and solicited information pertaining
17 to a number of topics related to credit risk, including (1) changes in the
18 management of credit risks, (2) environmental risks and uncertainties, (3)
19 deterioration in loan quality and (4) changes in underwriting guidelines.

20 76. After circulating the draft MD&A Questionnaires to the divisions, the
21 financial reporting group compiled them and generated the first draft of the
22 periodic report, which was reviewed and edited by the chief accounting officer and
23 the deputy CFO. The revised draft then went to the legal department and the
24 senior managing directors responsible for signing sub-certifications, as well as
25 Sieracki, Sambol, and Mozilo.

26 77. From the certifiers and the senior officers, the draft went to the board
27 of directors. When all of the certifications had been compiled, Sieracki and Mozilo
28 were notified and they signed Sarbanes-Oxley certifications. Sieracki also signed

1 all of the Forms 10-Q and 10-K starting in the first quarter of 2005 and throughout
2 2007. Sambol signed the Forms 10-Q for the third quarter of 2006 and all of the
3 quarters in 2007, as well as the Form 10-K for the year ended 2007. Mozilo signed
4 the Forms 10-K for the years ended 2005, 2006, and 2007.

5 **H. Sambol and Sieracki Refused Suggestions to Disclose**
6 **Countrywide's Increased Credit Risk**

7 78. Sambol and Sieracki actively participated in decisions to exclude
8 disclosures regarding Countrywide's widened underwriting guidelines in the
9 periodic filings. Throughout 2006, McMurray unsuccessfully lobbied to the
10 financial reporting department that Countrywide disclose more information about
11 its increasing credit risk, but these disclosures were not made.

12 79. In January 2007, McMurray sent an email to Sieracki, which he
13 subsequently incorporated by reference in his MD&A questionnaire, explaining
14 that Countrywide's delinquencies would increase in the future due to a weakening
15 real estate market and what McMurray characterized as credit guidelines that were
16 "wider than they have ever been." On January 29, 2007 McMurray provided
17 Sambol and others with an outline of where credit items impacted Countrywide's
18 balance sheet. McMurray then forwarded the email to the financial reporting staff,
19 and specifically requested that a version of the outline be included in the 2006
20 Form 10-K. The information was not included in the 2006 Form 10-K.

21 80. In August 2007, McMurray exchanged a series of emails with the
22 managing director of financial reporting suggesting revisions to the Form 10-Q for
23 the second quarter of 2007. McMurray again specifically asked financial reporting
24 to include information regarding widened underwriting guidelines in the
25 prospective trends section of the Form 10-Q for the second quarter of 2007. In
26 response, the managing director of financial reporting wrote back to McMurray,
27 stating that he did not make McMurray's changes because he "expect[ed] those
28

1 **changes to be trumped by certain reviewers.”** One of those reviewers was
2 Sambol.

3 81. When McMurray’s request that Countrywide disclose its widened
4 underwriting guidelines was not included in the draft filing, he sent a “qualified”
5 certification to the company’s Sarbanes-Oxley officer, along with an email
6 articulating his concerns. That email was forwarded to the deputy CFO, who then
7 spoke with McMurray about his concerns. She took his suggestions to Sieracki
8 and Sambol, who directed her not to include them in the Form 10-Q.

9 82. Despite McMurray’s repeated requests, Countrywide never made any
10 disclosures in its Forms 10-Q or 10-K for 2005, 2006, or 2007 about the
11 unprecedented expansion of its underwriting guidelines.

12 **I. Mozilo, Sambol, and Sieracki Made Affirmative**
13 **Misrepresentations to Investors**

14 83. As set forth in detail above, Mozilo, Sambol, and Sieracki were all
15 aware that Countrywide had increasingly widened its underwriting guidelines year
16 after year from 2004 through 2006, and that Countrywide Bank’s held for
17 investment portfolio included loans that were underwritten based on reduced
18 documentation, with loan to value ratios above 95%, and with subprime FICO
19 scores. Despite that knowledge, Mozilo, Sambol, and Sieracki failed to include
20 these material facts in Countrywide’s Forms 10-K and 10-Q for 2005, 2006, and
21 2007. Indeed, Mozilo, Sieracki, and Sambol each made public statements from
22 2005 through 2007 that were intended to mislead investors about the increasingly
23 aggressive underwriting at Countrywide and the financial consequences of those
24 widened underwriting guidelines.

25 **1. Misrepresentations in Countrywide’s Periodic Reports**

26 84. From 2005 through 2007, all of the proposed defendants participated
27 in preparing Countrywide’s periodic reports. These documents contained
28 misrepresentations as follows:

1 85. First, Countrywide's Forms 10-K for 2005, 2006, and 2007 stated that
2 Countrywide "manage[d] credit risk through credit policy, underwriting, quality
3 control and surveillance activities" and touted the Company's "proprietary
4 underwriting systems . . . that improve the consistency of underwriting standards,
5 assess collateral adequacy and help to prevent fraud." These statements were false,
6 because defendants knew that a significant portion of Countrywide's loans were
7 being made as exceptions to Countrywide's already extremely broad underwriting
8 guidelines.

9 86. Second, Countrywide stated in its 2005 Form 10-K: "We ensure our
10 ongoing access to the secondary mortgage market by consistently producing
11 quality mortgages. . . . We make significant investments in personnel and
12 technology to ensure the quality of our mortgage loan production." A virtually
13 identical representation appears in Countrywide's 2006 Form 10-K. These
14 statements were false, because, as set forth in detail above, Mozilo, Sambol, and
15 Sieracki were aware that Countrywide was originating increasing percentages of
16 poor quality loans that did not comply with Countrywide's underwriting
17 guidelines.

18 87. Third, the descriptions of "prime non-conforming" and "subprime"
19 loans in Countrywide's Forms 10-K were misleading because they failed to
20 disclose what types of loans were included in those categories. The definition of
21 "prime" loans in Countrywide's 2005, 2006, and 2007 Forms 10-K was:

22 Prime Mortgage Loans include conventional mortgage loans,
23 loans insured by the Federal Housing Administration ("FHA")
24 and loans guaranteed by the Veterans Administration ("VA").
25 A significant portion of the conventional loans we produce
26 qualify for inclusion in guaranteed mortgage securities backed
27 by Fannie Mae or Freddie Mac ("conforming loans"). Some of
28 the conventional loans we produce either have an original loan

1 amount in excess of the Fannie Mae and Freddie Mac loan limit
2 for single-family loans (\$417,000 for 2006) or otherwise do not
3 meet Fannie Mae or Freddie Mac guidelines. Loans that do not
4 meet Fannie Mae or Freddie Mac guidelines are referred to as
5 “nonconforming loans.

6 88. Nothing in that definition informed investors that Countrywide
7 included in its prime category loans with FICO scores below 620. Nor did the
8 definition inform investors that the “prime non-conforming” category included
9 loan products with increasing amounts of credit risk, such as (1) reduced and/or no
10 documentation loans; (2) stated income loans; or (3) loans with loan to value or
11 combined loan to value ratios of 95% and higher. Finally, it did not disclose that
12 Countrywide’s riskiest loan product, the Pay-Option ARM, was classified as a
13 “prime loan,” and to the extent that the loan amount was below the loan limits
14 established by the GSEs, would have been reported in Countrywide’s Forms 10-K
15 as a prime conforming loan. Significantly, in 2005 and 2006, Countrywide’s Pay-
16 Option ARMs ranged between 17% and 21% of its total loan originations, the
17 majority of which were held for investment at Countrywide Bank.

18 89. Fourth, the Countrywide periodic filings noted that Countrywide
19 originated “non-prime” loans, but failed to disclose that these loans were not
20 merely issued to borrowers with blemished credit, but also included significant
21 additional risk factors, such as (1) subprime piggyback seconds, also known as
22 80/20 loans; (2) reduced documentation loans; (3) stated income loans; (4) loans
23 with loan to value or combined loan to value ratios of 95% and higher; or (5) loans
24 made to borrowers with recent bankruptcies and late mortgage payments.

25 90. Finally, Countrywide’s 2006 Form 10-K contained the
26 misrepresentation that “[w]e believe we have prudently underwritten” Pay-Option
27 ARM loans -- despite Mozilo’s resounding internal alarms regarding these loans
28

1 and his and Sambol's knowledge that a significant percentage of borrowers were
2 misstating their incomes on stated income loans.

3 2. **Mozilo and Sambol Made Additional Affirmative**
4 **Misstaterments to Investors**

5 91. Mozilo and Sambol made affirmative misleading public statements in
6 addition to those in the periodic filings that were designed to falsely reassure
7 investors about the nature and quality of Countrywide's underwriting.

8 92. Mozilo repeatedly emphasized Countrywide's underwriting quality in
9 public statements from 2005 through 2007. For example, in an April 26, 2005
10 earnings call, Mozilo falsely stated that Countrywide's Pay-Option portfolio at the
11 bank was "all high FICO." In that same call, in response to a question about
12 whether the company had changed its underwriting practices, Mozilo stated, "We
13 don't see any change in our protocol relative to the quality of loans that we're
14 originating."

15 93. In the July 26, 2005 earnings call, Mozilo claimed that he was "not
16 aware of any change of substance in [Countrywide's] underwriting policies" and
17 that Countrywide had not "taken any steps to reduce the quality of its underwriting
18 regimen." In that same call, Mozilo touted the high quality of Countrywide's Pay-
19 Option ARM loans by stating that "[t]his product has a FICO score exceeding 700.
20 . . . the people that Countrywide is accepting under this program . . . are of much
21 higher quality. . . that [sic] you may be seeing . . . for some other lender." On
22 January 31, 2006, Mozilo stated in an earnings call "It is important to note that
23 [Countrywide's] loan quality remains extremely high."

24 94. On April 27, 2006, Mozilo stated in an earnings call that
25 Countrywide's "pay option loan quality remains extremely high" and that
26 Countrywide's "origination activities [we]re such that, the consumer is
27 underwritten at the fully adjusted rate of the mortgage and is capable of making a
28 higher payment, should that be required, when they reach their reset period."

1 These statements were false when made, because on April 4, 2006, Mozilo wrote
2 of the bank's pay-option portfolio, "[s]ince over 70% [of borrowers] have opted to
3 make the lower payment it appears that **it is just a matter of time that we will be**
4 **faced with much higher resets and therefore much higher delinquencies.**"

5 95. Then, on May 31, 2006, at the Sanford C. Bernstein Strategic
6 Decisions Conference, Mozilo addressed investors and analysts and made
7 additional false statements that directly contradicted the statements he was making
8 internally within Countrywide. Specifically addressing Pay-Option loans, Mozilo
9 told the audience that despite recent scrutiny of Pay-Option loans, "Countrywide
10 views the product as a sound investment for our Bank and a sound financial
11 management tool for consumers." At the May 31 conference, Mozilo added that
12 the "performance profile of this product is well-understood because of its 20-year
13 history, which includes 'stress tests' in difficult environments."

14 96. Mozilo's statements at the Sanford Bernstein Conference were false,
15 because at the time that he made them he had just written to Sambol and Sieracki
16 in a May 19, 2006 email that **Pay-Option loans would continue to present a**
17 **long-term problem "unless rates are reduced dramatically from this level and**
18 **there are no indications, absent another terrorist attack, that this will**
19 **happen."** Moreover, on June 1, 2006, Mozilo advised Sambol in an email that he
20 knew that the Pay-Option portfolio was largely underwritten on a reduced
21 documentation basis, and believed there was evidence that borrowers were lying
22 about their income in the application process. Mozilo concluded: (1) in an
23 environment of rising interest rates, borrowers would reach the 115% negative
24 amortization cap sooner than they expected; (2) **borrowers would suffer payment**
25 **shock because of the substantially higher payments upon reset, particularly**
26 **those with FICO scores below 700 who "are going to experience a payment**
27 **shock which is going to be difficult if not impossible for them to manage"; and**
28 (3) **"we know or can reliably predict what's going to happen in the next couple**

1 **of years**” so the company must act quickly to address these issues. In addition,
2 Mozilo failed to disclose that by the time he made the statement about the 20-year
3 history of pay-options, the history that he was referring to, that of World Savings,
4 no longer provided him any comfort about the future performance of the portfolio.

5 97. At a Fixed Income Investor Forum on September 13, 2006, Mozilo
6 upheld Countrywide as a “role model to others in terms of responsible lending.”
7 He went on to remark that “[t]o help protect our bond holder customers, we engage
8 in prudent underwriting guidelines” with respect to Pay-Option loans. These
9 statements were false when made because:

- 10 • On July 10, 2006, after reviewing data on an internal flash report,
11 Mozilo learned that, from September 2005 through June 2006, the
12 percentage of Pay-Option borrowers choosing to make the minimum
13 payment had nearly doubled, from 37% to 71%. This was the key
14 metric by which Mozilo measured the performance of the Pay-Option
15 portfolio;
- 16 • On August 16, 2006 Mozilo received an e-mail asking whether the
17 company anticipated any significant problems with the Pay-Option
18 portfolio. Mozilo responded that rising interest rates would cause the
19 loans to reset much faster than the borrowers expected with
20 accompanying payment shock. The only solution, Mozilo wrote, was
21 to refinance the loans before reset, but this would be difficult, in light
22 of decreasing home values and rising interest rates. Only unlikely
23 events, such as a dramatic rise in home values or a dramatic drop in
24 interest rates, would alleviate future payment shock; and
- 25 • On September 26, 2006 Mozilo advised Sambol and Sieracki in an
26 email that “[w]e have no way, with any reasonable certainty, to assess
27 the real risk of holding [Pay-Option] loans on our balance sheet. The
28 only history we can look to is that of World Savings however their
portfolio was fundamentally different than ours in that their focus was
equity and our focus is fico. In my judgement, [sic] as a long time
lender, I would always trade off fico for equity. The bottom line is
that **we are flying blind** on how these loans will perform in a stressed
environment of higher unemployment, reduced values and slowing
home sales.” (emphasis added)

1 98. In the January 30, 2007 earnings conference call, Mozilo attempted to
2 distinguish Countrywide from other lenders by stating “we backed away from the
3 subprime area because of our concern over credit quality.” On March 13, 2007, in
4 an interview with Maria Bartiromo on CNBC, Mozilo said that it would be a
5 “mistake” to compare monoline subprime lenders to Countrywide. He then went
6 on to state that the subprime market disruption in the first quarter of 2007 would
7 “be great for Countrywide at the end of the day because all of the irrational
8 competitors will be gone.”

9 99. Sambol also made misleading statements that were designed to
10 reassure investors. For example, at a May 24, 2005 investor day presentation,
11 Sambol reassured analysts that Countrywide addressed the higher credit risk
12 associated with adjustable rate mortgage programs by requiring different
13 underwriting criteria such as “higher credit scores or lower loan to value ratios.”
14 At the September 13, 2006 Fixed Income Investor Forum, Sambol downplayed
15 Countrywide’s participation in originating subprime loans by falsely stating that
16 Countrywide had been “on the sidelines” of the risky subprime market.

17 100. The statements in Countrywide’s periodic filings and statements by its
18 chief executives were materially false when made, because Mozilo and Sambol
19 were well aware that Countrywide had increasingly widened its underwriting
20 guidelines year over year from 2004 through 2006, and Countrywide’s loan quality
21 had deteriorated as a result.

22 **J. Countrywide’s Collapse**

23 101. In the first quarter of 2007, subprime 80/20s experienced high levels
24 of defaults and delinquencies, which caused severe disruptions in the secondary
25 market for subprime loans. On January 31, 2007, two members of Countrywide’s
26 Risk Management participated in the annual meeting of the American
27 Securitization Forum (“ASF”), which was attended by sophisticated investors who
28 purchased mortgage backed securities in the secondary market. They reported

1 back in a February 2, 2007 email, which was forwarded to Sambol, and noted that,
2 “[t]he obvious big topic of concern was 2006 vintage performance, both prime and
3 nonprime. **All recognize that 80/20’s (and the layered risk on top of them) are**
4 **definitely the main culprit** and are concerned that the rating agencies sized it
5 wrong. All want to know when we are pulling back guidelines...and why we
6 haven’t already.” (emphasis added.) They went on to note that, “[i]nvestors
7 **believed that 100% financing and layered risk is the driver.**” (emphasis
8 added.)

9 102. One of the Countrywide employees attending the conference observed
10 that higher than expected losses on 80/20 loans caused investors to fear
11 increasingly high losses and the possibility that their investments, which, in many
12 cases, had received AAA ratings, would be downgraded. The secondary market
13 for 80/20 loans essentially evaporated after the conference. In 2007, as a result of
14 the increasingly risky loans that it had been underwriting, Countrywide began to
15 report extensive credit problems. In May 2007, Countrywide disclosed in its Form
16 10-Q for the first quarter of 2007 that its consolidated net earnings for the quarter
17 were \$434 million, a 37% **decrease** from net earnings in the first quarter of 2006.
18 Countrywide indicated that its first quarter results had been negatively impacted by
19 higher delinquencies related to its subprime lending, which had caused the company
20 to (1) take a write down of \$217.8 million due to its inability to sell certain of its
21 subprime loans into the secondary market; (2) reduce the estimated value of its
22 retained servicing rights by \$429.6 million; and (3) increase its allowance for loan
23 losses on loans held for investment by \$95.9 million.

24 103. Then, on August 9, 2007, Countrywide disclosed in its Form 10-Q for
25 the second quarter of 2007 that its consolidated net earnings for the quarter were
26 \$485 million, a 33% net decrease from the second quarter of 2006. Countrywide
27 attributed the decline to credit-related costs, specifically, a \$417.2 million
28 impairment loss on its retained interests, including \$388.1 million related to home

1 equity loans, and a \$231 million increase in its allowance for loan losses. On July
2 24, 2007, in the earnings release teleconference, Countrywide disclosed for the first
3 time that its definition of “prime” loans included loans made to borrowers with
4 FICO scores as low as 500, and that 80% of its portfolio of Pay-Option loans held
5 for investment were underwritten based upon reduced documentation. After the
6 disclosures regarding its credit risk on July 24, 2007, Countrywide’s share price
7 dropped from the previous day’s close of \$34.06 to \$30.50 on July 24, an 11%
8 decline.

9 104. Concurrent with its rising credit losses, Countrywide experienced a
10 liquidity crisis in August 2007. Revenues from Countrywide’s capital markets
11 loan sales and securitizations had dropped from \$553.5 million in pre-tax earnings
12 in 2006 to \$14.9 million in 2007, and Countrywide found itself unable to access
13 the short term credit markets by issuing commercial paper. As a result, on August
14 16, 2007, Countrywide announced that it had drawn down its entire \$11.5 billion
15 credit facility to supplement its cash position. Following that announcement, the
16 ratings agencies downgraded Countrywide’s securities, and Countrywide’s stock
17 declined from \$21.29 per share to \$18.95, another approximately 11% decline.

18 105. On August 23, 2007, Countrywide announced that Bank of America
19 had invested \$2 billion in Countrywide in exchange for non-voting preferred
20 securities.

21 106. On October 26, 2007, Countrywide reported a quarterly loss of \$1.2
22 billion. The company’s Form 10-Q, filed on November 9, 2007, disclosed that
23 Countrywide had taken a \$1 billion impairment loss on its loans held for sale and
24 mortgage backed securities, and had taken \$1.9 billion in credit charges related to its
25 allowance for loan losses and its provision for representations and warranties on
26 loans it had securitized and sold. In the October earnings call, Mozilo nevertheless
27 assured investors that the company would return to profitability in the fourth quarter
28 of 2007 - a representation that caused Countrywide’s share price to rise from its

1 previous day's close of \$13.07 to \$17.30 after the call, despite its poor performance
2 in that quarter.

3 107. Thereafter, Countrywide's share price continued to trend downward,
4 driven in part by bankruptcy rumors, until it closed at \$8.94 on December 31, 2007.
5 Then, on January 8, 2008, Countrywide's shares dropped 28%, from \$7.64 to \$5.47,
6 again on rumors that the company intended to file for bankruptcy. On January 11,
7 2008, prior to reporting its year-end 2007 results, Countrywide announced that it
8 was being acquired by Bank of America in an all stock transaction estimated to
9 have an approximate value of \$4 billion.

10 108. On March 29, 2008, in its Form 10-K for the year ended December 31,
11 2007, Countrywide disclosed that the contraction of the secondary market for its
12 loans had increased its financing needs because it was required to hold loans for
13 longer periods pending sale and certain loans had become unmarketable and had to
14 be held for investment. In response to these funding needs, Countrywide disclosed
15 that it had: (1) speeded integration of mortgage banking activities into
16 Countrywide Bank to reduce its dependency on the secondary markets; (2) taken a
17 \$2 billion infusion from Bank of America in exchange for shares of preferred
18 stock; (3) drawn down an \$11.5 billion credit line to maintain liquidity; and (4)
19 revised its product offerings and underwriting guidelines, such that the majority of
20 its loan production was again eligible for sale to the government sponsored entities.

21 **K. Stock Sales of Mozilo and Sambol**

22 109. Both Mozilo and Sambol realized profits on sales of Countrywide
23 stock in 2005, 2006, and 2007, through stock sales pursuant to various 10b5-1
24 plans. From May 9, 2005, when the Form 10-Q for the first quarter of 2005 was
25 filed, through the end of 2007, Mozilo exercised stock options and sold the
26 underlying shares for total proceeds of at least \$260 million, and Sambol exercised
27 stock options and sold the underlying shares for total proceeds of at least \$40
28 million.

1 **L. Mozilo, Sambol, and Sieracki Participated in Several Offerings of**
2 **Countrywide Securities While the Misleading Periodic Reports**
3 **Were Outstanding**

4 110. On February 9, 2006, Countrywide filed a registration statement on
5 Form S-3ASR that registered a then indeterminate amount of common stock,
6 preferred stock, stock purchase contracts, stock purchase units, and debt securities
7 of Countrywide. Thereafter, Countrywide filed 180 prospectus supplements
8 identifying the securities it was offering for sale, including a Post-Effective
9 Amendment to that Form S-3ASR dated October 30, 2006. On November 16,
10 2007, Countrywide filed a registration statement on Form S-3ASR that registered
11 \$2 billion worth of Series A Floating Rate Convertible Senior Debentures and \$2
12 billion worth of Series B Floating Rate Convertible Senior Debentures. Sieracki,
13 Sambol and Mozilo signed all of these offerings, each of which incorporated one
14 of the false Form 10-Ks by reference.

15 **M. Insider Trading By Mozilo**

16 111. Mozilo also engaged in insider trading in Countrywide securities.
17 Mozilo established four sales plans pursuant to Rule 10b5-1 of the Exchange Act
18 in October, November, and December 2006 while in possession of material, non-
19 public information concerning the operations and financial condition of
20 Countrywide.

21 **C. Countrywide's Insider Trading Policy**

22 112. During the relevant period, Countrywide had an insider trading policy
23 in effect, dated as of June 24, 2005, which prohibited trading in Countrywide
24 securities on the basis of material non-public information. The policy included a
25 section entitled "Material Information" that stated:

26 3.2 **Material Information**

27 U.S. federal securities laws prohibit
28 transactions while aware of material
 nonpublic information. "Material"
 information means information relating to the

1 company with publicly traded securities,
2 which, if publicly disseminated, would likely
3 affect the market price of any of its securities,
4 or which would likely be considered
5 important by a reasonable investor in
6 determining whether to buy, sell, or hold such
7 securities.

8 In addition, the policy included a section regarding 10b5-1 sales plans that stated:

9 4.3 10b5-1 Trading Arrangements

10 A. Section 10b5-1 of the Exchange Act creates
11 an exception to the prohibition against trading
12 while in the possession of material nonpublic
13 information. In order to take advantage of the
14 exception set forth in Section 10b5-1 of the
15 Exchange Act, Directors and Executives
16 Officers must enter into a 10b5-1 Trading
17 Plan; provided that such Trading Plan:

18 i. specifies the amount of shares to be
19 purchased or sold and the price at
20 which and the date on which the shares
21 are to be purchased or sold; or

22 ii. includes a written formula or
23 algorithm, or computer program, for
24 determining the amount of shares to be
25 purchased or sold and the price at
26 which and the date on which the shares
27 are to be purchased or sold; or

28 iii. does not permit the individual to
exercise any subsequent influence over
how, when or whether to effect
purchases or sales; provided, in
addition, that any other person who,
pursuant to the contract, instruction, or
plan, did exercise such influence must
not be aware of the material nonpublic
information when doing so; and

iv. was acknowledged by Countrywide in
writing and pre-cleared by the Office of
the Chief Legal Officer.

113. Mozilo knew about and understood the Countrywide insider trading
policy. In addition, prior to the execution of each 10b5-1 sales plan,
Countrywide's legal department was required to review and approve the sales plan

1 and Mozilo was required to orally represent to Countrywide's general counsel that
2 he was not in possession of material non-public information.

3 2. **Mozilo Established His 2006 10b5-1 Sales Plans While**
4 **In Possession of Material, Nonpublic Information**

5 114. As set forth in section E. above, in 2006, Mozilo possessed material
6 non-public information regarding the characteristics and performance of Pay-
7 Option ARM loans as well as increasing credit risks associated with this product.
8 None of this information was disclosed to the public prior to the establishment of
9 Mozilo's sales plans in October, November, and December 2006.

10 115. As set forth in section F. above, in 2006, Mozilo learned of red flags
11 concerning Countrywide's expanded underwriting guidelines and concluded that
12 certain of Countrywide's mortgage loans would have a future detrimental financial
13 impact on the company. In response to this information, beginning in early 2006,
14 Mozilo raised his concerns with other members of senior management and
15 instructed them to take action to mitigate risks associated with lower quality loans.

16 116. While in possession of this material, non-public information, Mozilo
17 established four different Rule 10b5-1 plans.

18 117. On October 27, 2006, Mozilo established a sales plan that directed his
19 broker to exercise 3,989,588 stock options and sell the underlying shares on
20 specific days set forth in the plan beginning on November 1, 2006 and ending no
21 later than October 5, 2007 (the "October 2006 Plan").

22 118. Mozilo gave final approval to create the October 2006 Plan during a
23 meeting with his financial advisor on September 25, 2006, one day before sending
24 an e-mail to Sambol and Sieracki, as described in paragraphs 68 and 69 above, that
25 stated among other things, that **"we are flying blind on how these loans will**
26 **perform in a stressed environment of higher unemployment, reduced values**
27 **and slowing home sales."** (emphasis added).

1 119. Also on October 27, 2006, Mozilo established a sales plan in the name
2 of the Mozilo Family Foundation, a charitable organization that he chaired, that
3 directed the broker to sell 91,999 shares of Countrywide stock held by the
4 Foundation: 23,000 shares to be sold on November 1, 6, and 16, 2006 and 22,999
5 shares to be sold on November 21, 2006 (the "Foundation Plan").

6 120. On November 13, 2006, Mozilo established a sales plan for the Mozilo
7 Living Trust, a revocable trust created for the benefit of his family, that directed
8 the broker to sell 100,000 shares of Countrywide stock in lots of 25,000 shares on
9 November 16, 21, 29, and December 4, 2006 (the "Trust Plan").

10 121. On December 12, 2006, Mozilo established a sales plan that directed
11 his broker to exercise 1,389,580 stock options and sell the underlying shares on
12 specific days set forth in the plan beginning on January 5, 2007 and ending no later
13 than December 14, 2007 (the "December 2006 Plan").

14 122. Mozilo executed the December 2006 Sales Plan five days after he
15 circulated a memorandum, described in paragraph 52 above, to all managing
16 directors and the board of directors that analyzed subprime mortgages.

17 123. On February 2, 2007, Mozilo amended the December 2006 Plan
18 ("February Amendment") by directing the exercise of an additional 2,467,777
19 stock options and selling the underlying shares on the schedule already set forth in
20 the December 2006 Plan.

21 124. From November 2006 through October 2007, Mozilo exercised over
22 five million stock options and sold the underlying shares pursuant to the four sales
23 plans, realizing gains of over \$139 million.

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1 **FIRST CLAIM FOR RELIEF**

2 **FRAUD IN THE OFFER OR SALE OF SECURITIES**

3 **Violations of Section 17(a) of the Securities Act**

4 **(Against All Defendants)**

5 125. The Commission realleges and incorporates by reference ¶¶ 1 through
6 124 above.

7 126. Defendants, and each of them, by engaging in the conduct described
8 above, directly or indirectly, in the offer or sale of securities by the use of means or
9 instruments of transportation or communication in interstate commerce or by the
10 use of the mails:

- 11 a. with scienter, employed devices, schemes, or artifices to
12 defraud;
- 13 b. obtained money or property by means of untrue statements of a
14 material fact or by omitting to state a material fact necessary in
15 order to make the statements made, in light of the
16 circumstances under which they were made, not misleading; or
17 c. engaged in transactions, practices, or courses of business which
18 operated or would operate as a fraud or deceit upon the
19 purchaser.

20 127. By engaging in the conduct described above, Defendants violated, and
21 unless restrained and enjoined will continue to violate, Section 17(a) of the
22 Securities Act, 15 U.S.C. § 77q(a).

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1 **SECOND CLAIM FOR RELIEF**

2 **FRAUD IN CONNECTION WITH THE PURCHASE**

3 **OR SALE OF SECURITIES**

4 **Violations and Aiding and Abetting Violations of Section 10(b) of the**
5 **Exchange Act and Rule 10b-5 thereunder**

6 **(Against All Defendants)**

7 128. The Commission realleges and incorporates by reference ¶¶ 1 through
8 124 above.

9 129. Defendants, and each of them, by engaging in the conduct described
10 above, directly or indirectly, in connection with the purchase or sale of a security,
11 by the use of means or instrumentalities of interstate commerce, of the mails, or of
12 the facilities of a national securities exchange, with scienter:

- 13 a. employed devices, schemes, or artifices to defraud;
- 14 b. made untrue statements of a material fact or omitted to state a
15 material fact necessary in order to make the statements made,
16 in the light of the circumstances under which they were made,
17 not misleading; or
- 18 c. engaged in acts, practices, or courses of business which
19 operated or would operate as a fraud or deceit upon other
20 persons.

21 130. By engaging in the conduct described above, Defendants violated, and
22 unless restrained and enjoined will continue to violate, Section 10(b) of the
23 Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. §
24 240.10b-5.

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1 **THIRD CLAIM FOR RELIEF**

2 **VIOLATIONS OF COMMISSION PERIODIC REPORTING**

3 **REQUIREMENTS**

4 **Aiding and Abetting Violations of Section 13(a) of the Exchange Act, and**

5 **Rules 12b-20, 13a-1, and 13a-13 thereunder**

6 **(Against All Defendants)**

7 131. The Commission realleges and incorporates by reference ¶¶ 1 through
8 124 above.

9 132. Countrywide violated Section 13(a) of the Exchange Act and Rules
10 12b-20, 13a-1, and 13a-13 thereunder, by filing with the Commission annual
11 reports on Form 10-K for fiscal years 2005, 2006, and 2007 and quarterly reports
12 on Form 10-Q for each quarter in 2005, 2006, and 2007 that were materially false
13 and failed to include material information necessary to make the required
14 statements, in light of the circumstances under which they were made, not
15 misleading.

16 133. Mozilo, Sambol, and Sieracki knowingly provided substantial
17 assistance to Countrywide in its violation of Section 13(a) of the Exchange Act and
18 Rules 12b-20, 13a-1, and 13a-13 thereunder in connection with Countrywide's
19 annual reports for fiscal years 2005, 2006, and 2007 and its quarterly reports for
20 each quarter in 2005, 2006, and 2007.

21 134. By engaging in the conduct described above and pursuant to Section
22 20(e) of the Exchange Act, 15 U.S.C. § 78t(e), Mozilo, Sambol, and Sieracki aided
23 and abetted Countrywide's violations, and unless restrained and enjoined will
24 continue to aid and abet violations, of Section 13(a) of the Exchange Act, and
25 Rules 12b-20, 13a-1, and 13a-13 thereunder.

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1 and Rules 10b-5 and 13a-14 thereunder, and from aiding and abetting violations of
2 Section 13(a) of the Exchange Act, and Rules 12b-20, 13a-1, and 13a-13
3 thereunder.

4 **III.**

5 Issue judgments, in a form consistent with Fed. R. Civ. P. 65(d),
6 permanently enjoining Defendant Sambol and his agents, servants, employees,
7 attorneys, and those persons in active concert or participation with any of them,
8 who receive actual notice of the order by personal service or otherwise, from
9 violating Section 17(a) of the Securities Act, and Section 10(b) of the Exchange
10 Act, and Rule 10b-5 thereunder, and from aiding and abetting violations of Section
11 13(a) of the Exchange Act, and Rules 12b-20, 13a-1, and 13a-13 thereunder.

12 **IV.**

13 Issue judgments, in a form consistent with Fed. R. Civ. P. 65(d),
14 permanently enjoining Defendant Sieracki and his agents, servants, employees,
15 attorneys, and those persons in active concert or participation with any of them,
16 who receive actual notice of the order by personal service or otherwise, from
17 violating Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act,
18 and Rules 10b-5 and 13a-14 thereunder, and from aiding and abetting violations of
19 Section 13(a) of the Exchange Act, and Rules 12b-20, 13a-1, and 13a-13
20 thereunder.

21 **V.**

22 Enter an order, pursuant to Section 21(d)(2) of the Exchange Act, 15 U.S.C.
23 § 78u(d)(2), prohibiting defendants Mozilo, Sambol, and Sieracki from acting as
24 officers or directors of any issuer that has a class of securities registered pursuant
25 to Section 12 of the Exchange Act, 15 U.S.C. § 78l, or that is required to file
26 reports pursuant to Section 15(d) of the Exchange Act, 15 U.S.C. § 78o(d).

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1 **VI.**

2 Order defendants Mozilo and Sambol to disgorge all ill-gotten gains from
3 their illegal conduct, together with prejudgment interest thereon.

4 **VII.**

5 Order defendants Mozilo, Sambol, and Sieracki to pay civil penalties under
6 Section 21(d)(3) of the Exchange Act, 15 U.S.C. § 78u(d)(3).

7 **VIII.**

8 Order defendant Mozilo to pay a civil penalty under Section 21A(a) of the
9 Exchange Act, 15 U.S.C. § 78u-1(a).

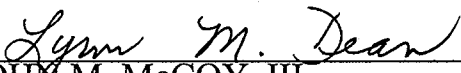
10 **IX.**

11 Retain jurisdiction of this action in accordance with the principles of equity
12 and the Federal Rules of Civil Procedure in order to implement and carry out the
13 terms of all orders and decrees that may be entered, or to entertain any suitable
14 application or motion for additional relief within the jurisdiction of this Court.

15 **X.**

16 Grant such other and further relief as this Court may determine to be just and
17 necessary.

18
19 DATED: June 4, 2009



JOHN M. McCOY, III
SPENCER E. BENDELL
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Securities and Exchange Commission

1 **DEMAND FOR JURY TRIAL**

2 Plaintiff hereby demands trial by jury.

3
4 DATED: June 4, 2009

Lynn M. Dean

5 JOHN M. McCOY, III
6 SPENCER E. BENDELL
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8 SAM PUATHASNANON
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