ANNEX 1 – RBS STATEMENT OF FACTS

I. INTRODUCTION. Before the 2008 financial crisis, RBS was the world's third-largest underwriter of residential mortgage-backed securities ("RMBS") by dollar volume.[1] Between 2005 and 2008, RBS underwrote and issued RMBS that have, thus far, lost over $49 billion, with more than $5.6 billion in losses still forecast to occur. The world's two largest RMBS underwriters, Lehman Brothers and Bear Stearns, collapsed, while the British government rescued RBS with a $70 billion bailout.

Leading up to the rescue, RBS, through its executives at its United States subsidiaries ("RBS Executives"), underwrote RMBS backed by home mortgages with a high risk of default, and then made false and misleading representations to sell those RMBS to investors. RBS's RMBS contained, as RBS's chief credit officer in the United States ("Chief Credit Officer") put it, "total f***ing garbage" loans with "fraud [that] was so rampant . . . [and] all random," so "the loans are all disguised to, you know, look okay kind of . . . in a data file." These loans, a senior vice president in RBS's Asset-Backed Finance Department ("Senior Banker") explained to one of his colleagues, were the product of a broken mortgage industry: the mortgage lenders "raking in the money" had an "incentive . . . to bring in as many loans as possible," while "the [mortgage lenders' employees] that . . . have the incentive to hold the line don't give a sh** because they're not getting paid."

RBS and its executives, nevertheless, created and sold RMBS backed by such loans while concealing the risky nature of the RMBS from investors. They did not disclose agreements that limited both the scrutiny (*i.e.*, due diligence) RBS gave the loans and RBS's ability to remove (*i.e.*, "kick out") any loans with defects that reduced the likelihood of repayment. Nor did they disclose their knowledge of material deficiencies in mortgage lenders' lending practices. To the extent they performed diligence, they also changed due diligence results to make loans appear less risky than they were. At the same time, RBS falsely represented to investors and rating

[1] "RBS" as used herein means: RBS Securities Inc. (f/k/a Greenwich Capital Markets, Inc.), RBS Financial Products Inc. (f/k/a Greenwich Capital Financial Products, Inc.), RBS Acceptance Inc. (f/k/a Greenwich Capital Acceptance, Inc.), and Financial Assets Securities Corp.

agencies that each loan in its RMBS satisfied standards "intended to assess the value of the mortgaged property, to evaluate the adequacy of such property as collateral for the mortgage loan[,] and to assess the applicant's ability to repay the mortgage loan." RBS also falsely represented that it conducted "prudent and necessary diligence" to exclude from its RMBS any loans that failed to comply with these standards.

Through its scheme, RBS earned hundreds of millions of dollars in underwriting fees and ensured that it received repayment of billions of dollars it had lent to mortgage lenders of the faulty loans underlying the RMBS, while simultaneously pushing the risk of these loans and billions of dollars in subsequent losses onto investors across the globe.

II. BACKGROUND.

RMBS. RMBS are investments backed by a pool of residential mortgage loans (typically thousands). Prior to the 2008 financial crisis, investors generally considered these investments relatively safe because, in part, the structure of RMBS – such as issuing various classes of securities (called "tranches") organized in a hierarchical structure (called a "waterfall") with senior tranches generally receiving payment before lower tranches – ostensibly protected RMBS investors from suffering losses on their securities even if small numbers of borrowers stopped paying their loans and their property values were insufficient to cover the outstanding balances on the loans. During the financial crisis, however, even investors in the senior tranches suffered losses when large numbers of borrowers stopped paying their loans.

Underwriting Guidelines. Mortgage lenders (called "originators") made different types of loans (for example, subprime or Alt-A) based on a borrower's credit profile. In deciding whether to make a loan, originators typically evaluated applications from prospective borrowers pursuant to lending standards (called "underwriting guidelines"). Regardless of the type of loan, underwriting guidelines required originators to find that each borrower had the ability to repay (and was likely to repay) the loan, that the loan complied with lending laws, and that the property was worth enough to repay the loan if the borrower failed to repay the loan and the property was

sold in foreclosure. Loans that did not satisfy originators' underwriting guidelines were more likely to suffer losses and, accordingly, issuers did not include them in standard RMBS.

RBS's Relationship with Originators. RBS was not an originator and did not make mortgage loans. Instead, RBS made money by either (i) purchasing pools of loans from originators and issuing RMBS backed by those loans, or (ii) underwriting RMBS issued by originators. RBS also provided originators with billions of dollars in so-called "warehouse" lines of credit, which were secured by loans ostensibly worth more than the amount the originator had borrowed from RBS. The originators used this financing to make more residential loans, many of which they sold to RBS, which, in turn, securitized the loans into more RMBS.

RBS's Due Diligence. As discussed below, under federal securities laws, RBS had an obligation to provide complete and accurate offering materials to prospective investors. To meet this obligation, RBS's Credit Department conducted due diligence to confirm the nature and quality of the underlying loans. In conducting due diligence, credit officers in RBS's Credit Department oversaw teams of contract underwriters from third-party vendors.

Typically, an RBS credit officer would identify a sample of loans to be included in an RMBS, and the originator would make the files for those loans available for review. RBS's vendors then reviewed each loan file for, among other things, serious deviations or variances from (a) the originator's underwriting guidelines affecting the borrower's ability to repay the loan (called "credit" defects), (b) applicable laws affecting the enforceability of the loan (called "compliance" defects), (c) the property's appraised value determined during origination and the value subsequently determined by RBS during due diligence (called "valuation" defects), and (d) the data about the loan contained in spreadsheets or "loan tapes" that RBS provided to RMBS investors and rating agencies (called "data" defects). Loans with the most serious credit and compliance defects were typically classified as "Event Grade 3" or "EV3," while loans with the most serious valuation defects were typically classified as "Out-of-Tolerance." An RBS credit officer typically would kick out of an RMBS any loans graded as EV3 or Out-of-Tolerance.

Industry participants often described EV3 or Out-of-Tolerance loans using the terms "materially defective" or "scratch-and-dent." RBS and others considered scratch-and-dent loans riskier than loans that complied with an originator's underwriting guidelines, because the defects associated with scratch-and-dent loans decreased the likelihood of repayment on the loans and payment to any RMBS backed by them.

RBS's Disclosures. Federal laws required RBS, when issuing or selling RMBS, to disclose known risks – including those identified by way of due diligence – to investors, rating agencies, and regulators. RBS ostensibly attempted to satisfy these legal obligations by way of disclosures to investors and rating agencies in a series of documents known as "offering materials" – including a "base" prospectus (which describes the basic characteristics of RMBS to be sold in issuances off the shelf) and a prospectus supplement (which provides detailed descriptions of the loans and tranches in a specific RMBS) – that were supposed to detail risks associated with its RMBS. In its offering materials, RBS typically represented, among other things, that:

- Each originator used underwriting standards requiring the originator to determine that (a) each borrower had the ability and willingness to repay each loan on the specified terms, and (b) the value of each property was sufficient to repay the associated loan amount if the borrower defaulted.
- The loans backing its RMBS would comply with originator underwriting guidelines – in other words, the RMBS would not include scratch-and-dent loans.
- Each loan had certain data characteristics (for example, credit score, borrower's debt-to-income ratio, etc.) that were accurately summarized in charts or tables.
- "All loans acquired by [RBS] are subject to due diligence prior to purchase" and RBS "reviewed [the loans] for issues including, but not limited to, credit, documentation, litigation, default and servicing related concerns as well as a thorough compliance review with loan level testing."

Investors and rating agencies necessarily relied on RBS's disclosures to be complete and accurate, and not misleading, because neither potential investors nor rating agencies had access to the loan files or to due diligence results related to specific RMBS.

III. OVERVIEW OF RBS'S PRACTICES. Leading up to the 2008 financial crisis, RBS sold tens of billions of dollars in RMBS by making false and misleading representations to investors about the loans backing the RMBS. RBS, for example, represented that originators making the loans had determined that all the borrowers had the ability to repay the loans, properties were of sufficient value to support the loans, and data about the loans was correct. In fact, RBS had determined that many borrowers did not have the ability to repay, many appraisals of the properties vastly inflated their values, and data summarizing the loans' characteristics for investors and rating agencies greatly deviated from the loans' actual characteristics.

RBS sought to maintain close business relationships with originators, which supplied RBS with loans for its RMBS or selected RBS to underwrite their RMBS and paid RBS millions of dollars in fees. Accordingly, RBS engaged in a number of practices to reduce the number of the originators' loans that it removed from the RMBS and, as a result, RBS included materially defective loans in RMBS that it issued or underwrote. For example:

RBS failed to disclose systemic problems with originators' loan underwriting. Because RBS worked so closely with certain originators, it understood that the originators were issuing loans where the borrowers did not have the ability to repay and the appraisals of the underlying properties were inflated. As a Managing Director in RBS's Asset-Backed Trading Department responsible for subprime loan trading ("Senior Trader") explained in a May 2007 e-mail to his colleagues, "there was a tremendous amount of pressure [among originators] . . . to grow volume" and, "[a]s a result, loans that should not have been made were pushed through the approval process . . . when the underwriter [at the originators] should have stood up and rejected the loan[s]." RBS Executives acknowledged to internal bank committees that subprime originators, "[i]n an effort to keep production levels up . . . stretched loan underwriting guidelines which eventually led to elevated levels of early payment defaulted loans . . . and the high level of delinquencies" that ultimately resulted in losses being suffered by RMBS investors. As RBS's Chief Credit Officer said, "[T]he underwriters [at originators generally] don't use

common sense," and originators "knew that it was total f***ing garbage . . . [but] they basically said, 'Hey, we need more volume. We just don't care.'" By October 2007, RBS's Chief Credit Officer summarized loan underwriting to the Head of RBS's Asset-Backed Trading Department responsible for syndicates, whole loan trading, as well as agency and non-agency trading ("Head Trader") as follows:

> You can't get to these default levels without having every possible, you know, style of scumbag . . . it's like quasi organized crime. . . . [F]acilitated by brokers . . . and just a lot of bad people who just said, "Hey, there is a major flaw in this loan origination model. And we can fill it up like nobody's business. . . ." Nobody seems to care.

RBS never disclosed that these material risks existed and increased the likelihood that loans in its RMBS would default.

- **RBS employed flawed due diligence practices.** RBS often touted the quality of its due diligence despite knowing that its due diligence practices did not remove many fraudulent and high-risk loans from its RMBS.[2] As Senior Trader noted in a May 2006 self-evaluation, when compared to "the rest of [Wall S]treet, . . . we do the least amount of diligence and kickout the fewest loans." On occasion, RBS did not conduct any due diligence at all. RBS Executives openly (albeit internally) discussed how RBS's due diligence process was, as a senior bank analyst described, "just a bunch of bullsh**." RBS, however, did not improve its due diligence practices to remove risky loans. RBS Executives knew that more stringent due diligence would have hurt RBS's competitive position against others bidding on loans. For example, in a January 2007 e-mail, Senior Banker cautioned colleagues that, if RBS kicked out 15% of the loans in a

[2] RBS pitched the quality of its due diligence to investors and rating agencies. For example, at the American Securitization Forum conference for investors and rating agencies in January 2007, RBS promised that its "Loan Level Due Diligence" would "[d]etermine that the loans generally comply with the lender[']s underwriting guidelines," "[a]ssess the adequacy and condition of the property," and "[d]etermine whether there are significant concentrations of risk in the product which are not apparent from a review of the tape data prepared by the originator or from an analysis of the originator[']s guidelines and procedures." In presentations given to investors in 2007, RBS represented that, "[i]f the property value is not substantiated by [RBS's] appraisal and review, such loan will not be included in the trade." RBS also made detailed representations about its diligence practices in presentations to credit rating agencies that issued ratings for RMBS. For example, in May 2007, RBS represented to a credit rating agency that "[e]vent grade 3 loans are **not** purchased and securitized [in RMBS]," and, "[i]f any loans removed for due diligence issues [known as "fallout"] re-surface in future trades, [RBS] will perform due diligence on such loans again."

pool during due diligence, originator Option One would have "screwed" RBS "going forward" by making it more difficult for RBS to win bids for other loan pools.

- **RBS failed to disclose due diligence and kick-out caps.** Between 2005 and 2008, RBS agreed with certain originators to restrict its ability, not only to review loans during due diligence, but also to remove loans that its Credit Department graded as materially defective. These restrictions took the form of due diligence "caps" (*e.g.*, agreements with Countrywide not to review more than 5% of a loan pool during due diligence) and caps on the number of loans RBS could remove from a deal, regardless of due diligence results (called "pull-through rates" with First Franklin or "kick-out caps" with Option One). RBS did not disclose these agreements to rating agencies or investors, and instead assured them that it had conducted "prudent and necessary diligence" to exclude loans with excessive risk.

- **RBS changed due diligence findings without justification.** When RBS's due diligence vendors graded loans materially defective – *i.e.*, EV3 or Out-of-Tolerance – RBS frequently directed the vendors to "waive" the defects without justification. Thus, in some instances, due diligence vendors initially found loans to be materially defective (which ordinarily would have meant exclusion from a RMBS), but, at RBS's behest, upgraded them to a rating such as "EV2" or "In Tolerance" to allow the loans to be included in a RMBS. One due diligence vendor, which tracked waivers by most major participants in the RMBS industry, concluded that RBS waived EV3s 30% more frequently than the industry average. RBS's waiver of material defects resulted in the securitization of loans with excessive risk. Yet, RBS never included enhanced "scratch-and-dent" disclosures indicating that loans with excessive risks were in its RMBS.

- **RBS left loans in RMBS that were materially defective.** When RBS did kick out loans it deemed to be materially defective from a sample of loans, it took no steps to determine whether the same defects affected other loans in the larger pool from which the sample had been drawn. As a result, thousands of materially defective loans remained in RBS's RMBS. In other instances, RBS failed even to kick out the materially defective loans that it had identified within

its samples. For example, in the process of securitizing Harborview 2006-9, RBS performed so-called Automated Valuation Models ("AVMs") on the entire loan pool and identified 990 loans (14% of the entire loan pool) to be "Out-of-Tolerance." RBS nonetheless securitized about 940 of these loans without disclosing the material risks associated with their valuations. As of today, over half of those Out-of-Tolerance loans have defaulted, resulting in more than $160 million in losses in that RMBS alone.

- **RBS passed along inaccurate loan data.** RBS's due diligence frequently found the originators' loan data riddled with errors. Some inaccuracies made the loans look less risky than they actually were by, for example, representing that borrowers had higher credit scores than they did. RBS, however, typically did not require originators to correct the data errors. In one deal, where RBS identified over 600 data errors associated with 563 loans (including debt-to-income ratios understated by as much as 2700%), RBS failed to disclose these errors even to the originator, instead reassuring the originator that RBS had not required originators to correct data errors in the past and did not anticipate doing so for that deal. Despite not correcting these errors, RBS continued to represent to investors and rating agencies that the data were complete and accurate. RBS also used the error-filled data to create summary charts and tables that it incorporated into its RMBS offering materials.

- **RBS made misrepresentations regarding loan repurchases.** RBS falsely represented in offering materials that originators or RBS would repurchase loans discovered to violate representations about the quality of the loans in the RMBS. But Senior Trader wrote in an April 2007 e-mail to colleagues, "I think most originators will keep denying claims until the lawsuits start flowing in from the street . . . [and] will deal with the lawsuit settlements in a couple of years when that bill comes due, if they are still around." Likewise, RBS itself, even after determining that specific loans subject to demands violated representations concerning loan quality, refused to honor repurchase demands. For example, after concluding that several hundred loans should have been repurchased as a result of fraud, RBS filed reports with the SEC

(called ABS-15Gs) stating that, after "performing a diligent search of our records for all relevant information," RBS had not identified a single loan – out of over 17,900 loans, worth in excess of $5.15 billion, subject to repurchase demands – that should be repurchased.

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Because of the above practices, RBS's RMBS were more speculative and risky than its offering materials represented. Despite such significant risks, RBS said in its offering materials that "nothing has come to the attention of [RBS] that would lead [it] to believe that the Final Prospectus [that is, the prospectus and prospectus supplement issued by RBS] contains any untrue statement of a material fact or omits to state any material fact."

IV. TWO EXAMPLES OF RBS'S MISCONDUCT. RBS's misconduct reached its height in the fall of 2007 in two RMBS, Soundview 2007-OPT4 ("OPT4") and Soundview 2007-OPT5 ("OPT5," and together with OPT4, the "Deals"), that were backed by loans originated by Option One. RBS failed to disclose not only the low quality of these loans, but also that, in the Deals, RBS had agreed to strict kick-out caps. As a result, each of the Deals had hundreds of loans that did not meet Option One's underwriting standards, that posed a high risk of default, and that would cause substantial losses for investors in the RMBS backed by the loans.

A. Concerns and Risks Leading up to the Deals. In the run up to the Deals, RBS Executives had concerns about RBS's financial exposure to Option One.

RBS Did Not Want to Own Option One Loans and Knew that Securitization of the Loans Removed that Risk. For many years, RBS provided Option One with a warehouse line of credit of up to $3 billion that enabled Option One to make residential mortgage loans. Option One made money to pay down the warehouse line by selling its loans to RBS and other investment banks, or by issuing its own RMBS with the loans. Loans that Option One originated served as security for Option One's repayment of the RBS warehouse line; if Option One failed to repay, RBS would own the loans.

By the summer of 2007, RBS Executives believed that Option One soon would go out of business and be unable to repay the warehouse line. In an August 29, 2007 call, a senior RBS executive told RBS's Head Trader, "I'm very nervous about Option One. It's over basically in my opinion . . . so I think there's a pretty good chance we're going to own those loans."

To avoid owning Option One's loans, many of which RBS knew were risky, RBS offloaded them to RMBS investors, thus enabling Option One to pay down the warehouse line. As an RBS Credit Department memo explained: "[RBS] has entered into two whole loan purchase transactions with [Option One] totaling approximately $1.8bn. . . . [RBS's] exit strategy for the loans purchased will be [the Deals] . . . . Proceeds from the associated whole loan transaction will repay outstandings under the warehouse."

RBS Executives Anticipated Poor Quality Loans in the Pool. As RBS prepared to implement its "exit strategy," some RBS Executives raised concerns about the poor quality of Option One loans that would be going into the Deals. On September 12, 2007, for example, the Chief Credit Officer asked Senior Trader if the loans were "a cleanup pool" with a "lot of leftovers and other crap in it," and expressed his view that "their [Option One's] loans suck." The same day, a senior analyst at RBS commented to his colleagues that he "suspect[ed] that this [OPT5] pool will still have a fair share of fraud in it." Two days later, while discussing a specific example of a loan he thought was defective, the senior analyst opined to Senior Banker that the "appraisal is bullsh**" and said "how in God's name [Option One could claim that] the thing appreciated 21 percent" in a year.

RBS Senior Executive and RBS Attorneys Warned Against Kick-Out Caps. When negotiating the sale of loans that would be in the Deals, Option One sought a commitment that RBS would limit the number of loans it could kick out of the pools for any reason – including due diligence findings. RBS Executives recognized that RBS's willingness to limit its due diligence was worth "a lot" to Option One. RBS Executives also knew, however, that they should not agree to a kick-out cap. On August 8, 2007, for example, a senior executive warned

RBS's Head Trader and Senior Banker that "we will not agree to any – to a limit on kick-outs because we can't do that." RBS Executives, however, ultimately agreed to such caps – a 5% cap in OPT4 and a 10% cap in OPT5 – in exchange for a lower price on the pools, and did so without seeking approval from RBS's Credit Department, which was responsible for identifying and removing loans with material risks from the pools being considered for the Deals.

As the RBS Executives agreed to the kick-out caps, they received legal advice about the need to add additional "scratch-and-dent" disclosures if the Deals contained loans that RBS otherwise would have removed as materially defective. The executives had sought advice from RBS counsel after an Option One executive asked if RBS could "reprice . . . and keep . . . in the deal" "the loans that [RBS] would normally kick out." On September 10, 2007, a vice president in RBS's Asset-Backed Finance Department ("Banker") asked an RBS attorney in a non-privileged communication, "What[']s the best way to go about identifying the kicks which are securitizable?" The attorney responded:

> We'll have to go loan-by-loan and probably add s&d ["scratch-and-dent"] type disclosure if we're dealing w/ material amounts. We'll definitely need to kick true compliance violations to the extent they can't be remedied.

Banker forwarded the attorney's advice to other executives working on the Deals, who understood it meant that "scratch-and-dent" disclosures would be necessary if RBS included kick-outs in the Deals. For example, in a call with a hedge fund trader on September 10, 2007, Senior Trader said, "On those diligence kick-outs . . . I talked to our lawyers. And, you know, they were saying it's, you know, going to complicate the deal. We have to put scratch-and-dent language in the deal if we put those in." Senior Trader added, "I ran that by [RBS's Head Trader] . . . he didn't think that was a good idea."

B. Soundview 2007-OPT4 Specific Conduct. In OPT4, RBS's Credit Department concluded that about 33% of all the loans – over 680 loans – had materially inflated appraisals, and that RBS should kick those risky loans from the RMBS. As discussed below, however, RBS securitized nearly all of those loans because of a 5% kick-out cap side agreement with Option One.

July 27, 2007 to August 22, 2007: Due diligence conducted. During the summer of 2007, RBS submitted several offers to purchase a pool of about $562 million in loans from Option One. After receiving what it considered insufficient bids, Option One sought to securitize the loans itself. Option One asked RBS to serve as lead underwriter, and RBS, in that capacity, conducted what its executives internally referred to as "light" diligence on the loans – a less thorough form of due diligence involving a significantly smaller sample of loans than RBS typically would review when issuing its own Soundview RMBS.

A Managing Director in RBS's Asset-Backed Trading Department responsible for loan trading ("Trader") described the loans as the "same sh**" Option One had been originating recently. The pool also contained "fallout" loans that other investment banks had removed from other RMBS during due diligence reviews. In an August 2, 2007 e-mail, an RBS credit officer told Banker that, of the loans that were older than six months, "the majority of those are dili fallout." When the credit officer questioned if the offering materials disclosed the "composition of the pool that's dili fallout," Banker answered that "[b]ased upon conversations with legal, our responsibility as a lead [underwriter] in the transaction really hovers around doing appropriate [due] diligence," and "[w]e should certainly be looking at 100% of these prior kicks to make sure we are comfortable now including them in the transaction. . . ." RBS Executives, however, never attempted to identify the loans that they knew other investment banks had kicked out.

On August 22, 2007, when RBS completed its "light" due diligence review for the loans that would ultimately be included in OPT4, it concluded that about 16% of the loans it reviewed were EV3s (that is, 69 loans out of a 420-loan sample), and about 20% of the loans had inflated appraisals (that is, 20 loans out of a 100-loan random sample). While it removed the defective loans from the samples, RBS did not attempt to identify or eliminate any loans from the rest of the pool, which was much larger than the sample and likely contained similar percentages of defective loans.

August 23, 2007 to September 5, 2007: Valuation kick-out cap of 5% set. After RBS completed its "light" diligence, Option One changed its tack and decided to sell the loans to RBS, which then decided to include the loans in a Soundview RMBS. Even though its prior review of the sample revealed that about 20% of the pool likely had material defects, RBS agreed not to conduct further due diligence concerning the borrowers' ability to repay the loans or the loans' compliance with lending laws. RBS also agreed that it would not kick out more than 5% of the loans based on limited additional valuation diligence. As Banker wrote in an August 27, 2007 e-mail to RBS credit officers, "Because we have presold the residual [lower tranches of the RMBS], we will be doing no additional loan file dili, but instead will be doing 100% AVM review on the loans. . . . Their [*sic*] will be a trade stip of max 5% kicks on this AVM review."

September 6, 2007 to September 18, 2007: Over a third of the loans had materially inflated appraisals. RBS's additional valuation diligence showed 37% of loans in the pool (over 760 loans) had materially inflated appraisals. Ultimately, Senior Trader, not an RBS credit officer, selected the defective loans to include in OPT4. In a September 7, 2007 call discussing the results with a colleague, Senior Trader admitted, "Those are pretty sh**ty results. . . . Let's just shoot for . . . somewhere between 5 and 6 percent [diligence kick-outs]." When his colleague asked about removing loans with "high variances," that is, differences between the property values determined by RBS's due diligence and Option One's claimed values, Senior Trader instructed his colleague to remove "any variance over 50 percent," among others, and remarked "those [results] are pretty grim, right?" Ultimately, RBS kicked out only about 4% of the loans with materially inflated appraisals, even though due diligence showed that another 33% had materially inflated appraisals.

In other words, one-third of the loans in OPT4 carried substantially more risk than RBS disclosed. For example, RBS represented in the OPT4 prospectus supplement that the loans had a weighted average loan-to-value ratio of 80.9%, when in fact it was over 88.4%. RBS also claimed that no loans in the pool had loan-to-value ratios over 90% (meaning all borrowers had

at least 10% equity in the properties), even though its own due diligence determined that 41% of the loans were to borrowers with less than 10% equity in their properties and that 20% of the loans were to borrowers who had no or negative equity (*i.e.*, were underwater) in their properties.

C. Soundview 2007-OPT5 Specific Conduct. In OPT5, because of a 10% kick-out cap side agreement with Option One, RBS securitized over 470 excessively risky loans – about 13% of the loan pool by dollar volume – that were EV3s or had materially inflated appraisals.

September 12, 2007 to September 24, 2007: RBS Executives expressed concerns about poor loan quality. As due diligence on OPT5 began, and the early kick-out rate was high, the RBS Credit Department decided to conduct increased diligence on the loans. On September 12, 2007, RBS's Chief Credit Officer told Senior Trader, "I just think you've got to ratchet [that is, increase due diligence] up because the problem is it's – the fraud is just random. You know, it's just basically bad underwriting where . . . the underwriters don't use common sense" and "it's not like what we were doing [in diligence] was working." Senior Banker, upon learning about the increased diligence, lamented, "Oh, God. Does anyone want to make money around here anymore?"

As due diligence continued, the number of due diligence kick-outs mounted. Option One, however, held firm in enforcing the 10% kick-out stipulation. On September 24, 2007, Trader emailed his colleagues that Option One:

> [E]xpects 10% [kick-outs]. No more. [Option One executive said,] "These are high risk loans, not systemic issues with origination. That's why you are paying 90 cents [per dollar for the loans]. You priced that in."

In response, Senior Banker told Trader, "I warned [Senior Trader, who had agreed to the kick-out cap] against this." The same day, a RBS credit officer informed Banker, who relayed to Senior Trader, Senior Banker, and Trader that "10% kick[-]outs is not happening." Senior Trader, nonetheless, attempted to convince his colleagues to proceed with the deal, despite the high number of loans failing due diligence, by saying RBS did not have any risk to itself from the defective loans:

> [T]his trade is essentially between [O]ption [O]ne and [a hedge fund] ([the hedge fund] can not buy whole loans as such we are involved to settle the loans and structure the bonds). At this point, [RBS] has no risk on this deal . . . .[3]

As a senior RBS analyst explained, "Nobody cares . . . . What people are telling me is that we're not going to have any risk on [OPT5] . . . we're just going to make money on this thing." On the same call when he later added, "[Senior Trader] just says that we're getting the residual for free, so [he] doesn't really care," another RBS executive replied,

> Good. He can testify when we get subpoenaed on all this. So we can say, "We got the residual for free. So it doesn't matter. Don't worry about it."

September 25, 2007 to September 30, 2007: RBS Executives debated, and then decided, that the deal should proceed. With the due diligence exceptions so high, RBS Executives discussed how to deal with the RBS Credit Department. On September 25, Banker told Trader, "I feel pretty strongly the way this needs to get done is, you know, [Senior Trader] or somebody has just got to tell these guys [in the Credit Department] to back off. They are going to blow up the trade."

RBS's Head Trader, in fact, had called the Chief Credit Officer on September 25, 2007, to try to convince him to allow OPT5 to proceed, arguing in part:

> [Y]ou know, I think it is relevant, which is, you know, we only paid 90 [cents per dollar] for these loans. And I think that, you know, to a certain extent, we weren't expecting and I think the bonds are being priced to reflect a – certainly not a pristine pool. . . . We weren't expecting it to be, you know, too – you know, like a scratch and dent pool by any means, but, on the other hand, it is being priced at like the lowest level, where we have seen, you know, this type of paper trade. . . .

The Head Trader also emphasized what RBS would make on the trade. When summarizing this call later that day for his boss, RBS's Head Trader said, "I also reminded [the Chief Credit Officer] that we think there's $20 million in the trade. So, I said, 'Take that into account as well.'" His boss responded, while laughing, "Please don't f***in' blow this one. We need every dollar we can get our hands on."

[3] The hedge fund actually was but one of many investors in OPT5. Unlike the other investors, the hedge fund knew about RBS's kick-out cap agreement with Option One and accordingly had negotiated a lower price for portions of tranches it purchased.

Later that day, after learning from Senior Banker that the Chief Credit Officer would not agree to the 10% cap, RBS's Head Trader made another call to the Chief Credit Officer. This time, the Head Trader explained Option One's position: "The whole point of this trade was apparently the 10% due diligence stip[ulation] . . . I think their view is simply that, you know, 'Kick out the 10% and let's move on,'" since "they feel that we priced that element into the trade." RBS's Chief Credit Officer replied, "You've got to f***ing tell us about [a kick-out cap] up front because, you know, to have to deal with it after the trades are done just puts us in a spot where we shouldn't be."

After this call, despite concerns about the cap and a belief that Option One's "appraisals suck," RBS's Chief Credit Officer appeared to accept the 10% kick-out cap – provided RBS was given additional time to identify, as Senior Banker described it, the "worst 10 percent." RBS then set about deciding which of the materially defective loans would stay in OPT5 to comply with the 10% kick-out limitation.

October 1, 2007 to October 2, 2007: RBS adhered to the 10% kick-out cap, which left hundreds of materially defective loans in the pool. As the additional time expired, RBS could not get the number of loans with excessive risk under the cap. On October 2, 2007, the Credit Department concluded due diligence and reported that "the total kick[-]outs are at 23%" or about 950 loans. The stipulation that RBS struck with Option One allowed RBS to exceed the 10% kick-out cap only if the loans showed a "systemic" issue with Option One's underwriting process, which the parties construed to mean an issue that affected many loans in the pool the same way. RBS's credit officer concluded that he did not find such a "systemic issue," and, therefore, RBS had to abide by the 10% limitation.

RBS traders and bankers were concerned about whether the Chief Credit Officer would allow OPT5 to proceed given the large number of defective loans above the 10% cap. For example, when Option One requested a list of loans that would be securitized, Banker told Trader he was "going to go the route of beating up [the RBS credit officer]." Trader replied,

"That's funny. I mean, we're not waiting for f***ing permission to do 10%, right?" Banker said, "I agree. I mean, it is what it is. What the f*** else are you going to do at this point?"

Ultimately, RBS Executives – including Senior Trader, Trader, and Banker – implemented what they described as a "methodology" to decide which materially defective loans RBS would remove from OPT5, and which it would keep in, in compliance with the 10% kick-out cap. According to RBS's own due diligence findings, about 13% of the loans (or about 470 loans) RBS included in the final OPT5 loan pool were materially defective.

D. RBS's Efforts to Conceal the Issues with the Deals.

False and Misleading Offering Materials: RBS's offering materials never disclosed the kick-out limitations RBS had agreed to and implemented, and they misrepresented that the loans in both Deals complied with Option One's underwriting guidelines. RBS represented in the offering materials that "[t]he Mortgage Loan(s) [were] underwritten in accordance with the underwriting standards of [Option One] in effect at the time the Mortgage Loan was originated." Although Option One's guidelines did not allow for loans with EV3-type defects or materially inflated appraisals, because of the kick-out caps, at least 33% and 13% of the loans securitized in OPT4 and OPT5, respectively, had such defects.

Moreover, despite RBS's in-house counsel advising the RBS Executives that "scratch-and-dent" disclosures should be added to an RMBS that included loans that RBS's Credit Department designated for kick-out, none of the offering materials for the Deals contained "scratch-and-dent" disclosures to warn about the increased risks associated with the types of defective loans that RBS included in both Deals. Rather, the offering materials assured investors and rating agencies that RBS's disclosures were true, accurate, and complete, with statements such as:

> [N]othing has come to the attention of the signer hereof on behalf of [RBS] that would lead said signer to believe that the Final Prospectus contains any untrue statement of a material fact or omits to state any material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading.

Misrepresentations to Investors on Calls: In sales calls, RBS also made false and misleading statements to conceal material risks about the Deals. For example,

- ***California-Based Asset Management Company:*** In an October 4, 2007 telephone conversation with RBS's Head Trader about OPT5, a portfolio manager of an asset management company ("Investor A") asked, "Have you guys done anything differently when you actually look at the LTVs [that is, loan-to-value ratios that compare the principal amount of a loan with the value of the underlying property]?" Even though RBS had refrained from kicking out of the RMBS hundreds of loans with inflated appraisals, and included in OPT5 loans with LTVs much higher than the LTVs disclosed, RBS Head Trader assured him: "No. I mean, we've done a tremendous amount of BPOs ["broker price opinions," a realtor's valuation of a property], and, you know, verification, as much verification, as we can with respect to the underlying values. . . . And most of our – most of our due diligence, to be honest, has been centered around appraisals."

In an October 5, 2007 call with another executive at Investor A, Banker claimed:

> On [OPT5], we did kind of a three-tiered credit approach on it. We did, one hundred percent of the loans, we did AVM review. To the extent the AVM results on those were outside a particular variance on the loans, we did a BPO. If it was outside of a particular variance on the BPO, we kicked it from the pool. So it's no longer in the securitization.

The executive from Investor A then asked, "And out of the 20 percent [of the loans where you performed a BPO on the property], how much did you actually kick out of the pool?" Banker replied, "It looks like 3 percent." In fact, RBS had conducted BPOs on 1770 loans – or 40% of the entire pool – and had determined that 590 of those loans – or 33% of all loans that received BPOs – should have been kicked out due to material valuation risk. Investor A purchased over $76.2 million in OPT5 securities on October 30, 2007.

- ***Belgium-based Financial Guaranty Subsidiary of a Financial Institution***: On a September 13, 2007 call, a trader at a financial guaranty subsidiary of a Belgium-based financial institution ("Investor B") asked Senior Trader about the quality of loans in OPT4. Senior Trader, who had personally negotiated the OPT4 kick-out cap and then, to comply with the cap, selected

hundreds of loans with materially inflated valuations for inclusion in the deal, responded, "I mean, it's – you know, it's pretty clean." Investor B did not invest in OPT4, but, after additional efforts by Senior Trader, invested $25 million in OPT5.

- ***Failed California-Based Financial Institution:*** On an October 4, 2007 call, the chief investment officer of a now-failed financial institution based in Solvang, California ("Investor C"), inquired about how the "reps and warrants" would work in OPT5. Even though RBS's due diligence confirmed that hundreds of loans in the deal violated the OPT5 representations and warranties, a RBS sales executive replied, "We're making – because it's under our shelf. . . . You know, that's what they're paying us for. . . so, so and we're doing all the reps." Investor C then purchased $5 million in OPT5 securities. By March 2010, Investor C had taken losses of $4.46 million – or 84% of the value it originally paid – on the OPT5 securities. In August 2010, Investor C failed and went into receivership due, in part, to high concentrations of investments in RMBS.

Internal RBS Deal Documentation: When Option One asked RBS executives to add the kick-out cap agreement to a written "trade confirmation," Banker said in a September 26, 2007 call to Trader, "They want us to put all this sh** in writing. And I think our play on this is pretend you never got the f***ing e-mail. There's nothing here that we can, you know, acknowledge." Consistent with their plan, the final trade confirmations for both Deals did not include any description of the kick-out cap agreement. As a result, other RBS executives not involved in putting together the Deals were unaware that RBS had, in fact, applied the kick-out limitations.

E. RBS Profited Off Its RMBS at the Expense of Others. RBS not only made over $26.1 million, including fees, from the Deals, but it avoided hundreds of millions in losses through enabling Option One to sell hundreds of defective loans and to use the proceeds to pay off the warehouse line of credit. Internally, RBS executives celebrated the Deals, especially given the imminent demise of Option One. For example, on a September 4, 2007 call, Banker joked about the end of Option One calling it "the golden goose," while Senior Trader remarked,

"it's unfortunate for us; it was a good run while it lasted." Meanwhile, on October 12, 2007, when discussing the revenue generated by OPT5, Banker wrote to Senior Banker, "There is that last big trade I was hoping for." Shortly after the Deals, when responding to Banker's observation that, as a result of losses it had recently experienced, Option One failed to make any money during its existence, Senior Trader described RBS's relationship with Option One as being a "[r]edistribution of wealth to [Wall S]treet. It[']s like that sceen [*sic*] in [G]oodfellas where they buy the guy[']s bar[,] take ever[y]thing and then light it on fire."

The Deals almost immediately performed poorly, in line with the poor diligence results RBS had found. In November 2007, just weeks after the Deals closed, RBS learned that 248 loans, representing nearly 5% of the Deals by loan balance, already had defaulted. RBS's due diligence process had identified 64 of these defaulted loans as EV3s and/or having inflated appraisals, but RBS had securitized all of them to comply with the undisclosed kick-out caps.

Today, the Deals, which had a combined value of approximately $1.52 billion, already have suffered more than $481 million in losses, or roughly 31% of their combined value. Lower tranches, which were supposed to protect the higher ones against losses, have been wiped out completely. The higher tranches, which received the rating agencies' highest ratings, now are rated equivalent to "junk" bonds. Investors who lost money in the Deals include, for example, non-profits, administrators of retirement funds, investment management companies that were investing on behalf of individuals and groups (including a retirement fund for a Midwest-based congregation of nuns that lost over 96% of its investment in OPT5), and financial institutions.

Throughout the Deals (and over the course of 2005 to 2008), RBS's executives showed little regard for their misconduct and, internally, made light of it. For example, after RBS's Head Trader received an e-mail from a friend stating "[I'm] sure your parents never imagine[d] they'd raise a son who [would] destroy the housing market in the richest nation on the planet," the Head Trader answered, "I take exception to the word 'destroy.' I am more comfortable with 'severely damage.'"