

Securities Regulation Daily Wrap Up, SECURITIES OFFERINGS—S.D. N.Y.: Securities Act claims in RMBS action not timely, but Illinois and Texas claims may proceed, (Jan. 23, 2014)

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By Rodney F. Tonkovic, J.D.

Federal Securities Act claims brought by the National Credit Union Administration Board (NCUA) against Morgan Stanley & Co., Inc., were dismissed by a district court as untimely. The complaint asserts claims against Morgan Stanley arising out of the sale of residential mortgage-backed securities (RMBS) purchased by two credit unions. Claims brought under the Illinois and Texas securities laws were timely and allowed to proceed (*NCUA Board v. Morgan Stanley & Co, Inc.*, January 22, 2014, Cote, D.).

Background. This action is one of nine brought by the NCUA as liquidating agent of Southwest Corporate Federal Credit Union and Members United Corporate Federal Credit Union (collectively, the credit unions) against various financial institutions involved in the packaging, marketing, and sale of RMBS purchased by the credit unions between 2005 to 2007. According to the complaint, the credit unions purchased over \$400 million in RMBS issued, underwritten, or sold by Morgan Stanley. All but three of the RMBS were rated triple-A when issued.

NCUA claims that the offering documents for 28 of the 29 RMBS at issue, which were prepared by Morgan Stanley, contained materially false statements and omissions. Specifically, NCUA claimed that the offering documents stated that the underlying loans adhered to applicable underwriting guidelines and that the appraisals were accurate, the loans had certain "loan-to-value" ratios, and the borrowers had certain debt-to-income ratios. The credit unions suffered significant losses, the NCUA asserted, because the market value of the RMBS has declined.

Procedure. The court stated that the actions brought by the NCUA are marked as "related" to a series of actions brought by the Federal Housing Finance Agency (FHFA) as conservator of Fannie Mae and Freddie Mac. (See, for example, the *Securities Regulation Daily Wrap-up* for October 18, 2013, and July 1, 2013). The court noted that its analysis in the FHFA cases "has direct bearing" on many of the issues in this case.

Securities Act claims. The NCUA brought claims under Securities Act Secs. 11 and 12(a)(2) for 10 of the securities at issue. Both parties agreed that these claims were untimely under current Second Circuit precedent, but the court briefly discussed the claims since they were relevant to the complaint's state law claims.

The latest purchase date for the securities at issue is June 21, 2007, so under Sec. 13's statute of repose, a suit ordinarily must have been brought by June 20, 2010. NCUA, however, benefits from an "extender statute" codified in the Federal Credit Union Act. At this point, the court discussed the "materially identical" extender statute applied in the FHFA cases (see *Federal Housing Finance Agency v. UBS Americas Inc.*, (2d Cir. 2013), referred to by the court as *UBS II*), discussed in the *Securities Regulation Daily Wrap-up* for April 8, 2013). Applying the reasoning from *UBS II*, the court concluded that the NCUA extender statute applies to both state and federal claims and to any statute of repose contained in those claims.

In the FHFA cases, the court observed, the three year statute of repose had not expires when FHFA became conservator. As a result, FHFA could take advantage of its extender statute. Here, however, NCUA took over as conservator for the credit unions on September 24, 2010, more than three years since the last purchase on June 21, 2007. Because the Second Circuit has held that *American Pipe* tolling does not apply to the statute of repose for Securities Act claims, the NCUA's claims were untimely.

Illinois claims. NCUA asserts claims under the Illinois Blue Sky Law for seven of the securities. Morgan Stanley argued that NCUA failed to plead why its claims met the three-year statute of limitations, but the court found that the Illinois claims were not barred, because under the Federal Rules of Civil Procedure a plaintiff need not affirmatively plead the timeliness of its claims.

Morgan Stanley also contended that NCUA failed to comply with the six-month notice requirement of the Illinois Blue Sky Law for seeking rescission of a purchased security. Morgan Stanley argued that the credit unions had constructive notice that the securities were voidable "long before" the suit was filed. The court found that the extender statute preempts the notice requirement. The court then concluded that it was not apparent from the complaint when the credit unions acquired knowledge of the voidability of the securities and denied the motion to dismiss the Illinois claims.

Texas claims. NCUA alleged violations of the Texas Blue Sky Law for 21 securities. Morgan Stanley maintained that the claims were barred by the applicable five-year statute of repose and three-year statute of limitations. Regarding the statute of repose, the court found that the claims had not expired when NCUA was placed into conservatorship and declined to dismiss the claims on that basis.

Turning to the statute of limitations, Morgan Stanley argued that the credit unions were on inquiry notice more than three years before the case was filed. The court noted that the Texas law is modeled after the Securities Act and that Texas courts generally adopt federal securities law when analyzing "materially identical" provisions. According to the court, the earliest downgrade of the challenged securities took place in August 2008. The court accordingly determined that the statute of limitations was not triggered prior to NCUA becoming conservator.

Adequacy of the pleadings. Finally, Morgan Stanley argued that all of the securities claims were inadequately pleaded. The court found that the allegations in the complaint raised a plausible inference of material falsity by Morgan Stanley. Among other items in support of its allegations, NCUA pointed to a surge in mortgage delinquency for the loans in the RMBS shortly after the offerings were made; these allegations were sufficiently linked to government reports and other information showing that the originators failed to comply with their reported underwriting practices. Morgan Stanley countered that NCUA failed to support its assertions with a "forensic analysis," but the court, looking to the FHFA cases, found that the lack of such an analysis was not fatal to the complaint.

The case is No. 13 Civ. 6705.

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Companies: National Credit Union Administration Board; Morgan Stanley & Co., Inc.; Morgan Stanley Capital I Inc.

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