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BofA Seeks to Knock Out MBIA Claims Tied to Countrywide

By David McLaughlin and Chris Dolmetsch - Dec 12, 2012

Bank of America Corp., the second- biggest U.S. lender, began an effort today to defeat bond insurer MBIA Inc. (MBI)'s bid to force the bank to pay billions of dollars over home loans.

Bank of America's Countrywide Financial unit and MBIA, which have been locked in litigation since 2008, appeared before New York state Supreme Court Justice Eileen Bransten in Manhattan today seeking judgments on claims in MBIA's lawsuit over loans packaged into securities during the real estate boom.

The case is among mortgage lawsuits Charlotte, North Carolina-based Bank of America is contending with four years after acquiring Countrywide, the home lender whose lax loan standards helped fuel the housing bubble. Chief Executive Officer Brian T. Moynihan has spent more than $40 billion to clean up defective mortgages and improper foreclosures.

An $8.5 billion settlement with investors over Countrywide mortgage bonds is tied up in court. In October, the U.S. sued Bank of America over loans sold by Countrywide to Fannie Mae and Freddie Mac that the government estimates led to more than $1 billion in losses for the companies.

In the MBIA case, Bank of America's strategy is to delay the litigation and push the insurer "to the brink of insolvency," said Isaac Gradman, an attorney at Perry, Johnson, Anderson, Miller & Moskowitz LLP in Santa Rosa, California, who isn't involved in the case.

Settlement Pressure

"They want to try to drag this out as long as possible because they know MBIA is relying on these recoveries," Gradman said. "The longer they delay giving in to them, the weaker MBIA's balance sheet looks and the more pressure they'll have to settle for a pittance."

MBIA, based in Armonk, New York, says Countrywide committed fraud by securitizing loans that were riskier than promised. MBIA, which guaranteed payments to investors in the securities, claims 56 percent, or more than 200,000 loans, were "materially defective," according to a court filing.

At least $12.7 billion in loans are materially defective, Philippe Selendy, an attorney with Quinn Emanuel Urquhart & Sullivan representing MBIA, said in court today.

MBIA has to show that breaches caused an increased risk of loss, and not that they led to defaults on the loans, Selendy said.

‘Exceptionally High’

“That risk should never have been passed to the insurer in the first place,” Selendy said. “The loans should have never been in there. The probability of default is exceptionally high.”

Selendy pointed to two examples of loans in the securitizations where borrowers had misrepresented their earning power -- one where a borrower said they earned $7,000 a month as head of a funeral home whose actual income turned out to be a little more than $400 a month and another mortgage where the borrower claimed to earn $6,800 a month as manager of a grocery store yet was actually earning about $1,200 a month as a self- employed limousine driver.

Loan files were missing key documents, which increase risk because incomplete or improper documentation can prevent ownership of mortgages from being transferred to the trust and thwart foreclosure proceedings, Selendy said.

Repurchase Obligation

Countrywide had an obligation to repurchase mortgages within 90 days of becoming aware of issues with the loans, yet it never made any buybacks within that time frame despite “rampant and systemic” defects, Selendy said.

Countrywide isn’t honoring its obligation to repurchase defective loans and is “frustrating efforts” to enforce that remedy, including creating processes specifically targeted at monoline insurers, Selendy said.

“It fundamentally frustrated and repudiated contracts by dishonoring repurchase obligations,” Selendy said. “These pervasive breaches and misrepresentations warrant an award of repurchase.”

MBIA has paid more than $3 billion in claims to investors under the insurance policies, according to spokesman Kevin Brown. The company seeks to recover those payments, plus future payments and interest, he said. MBIA’s claims against Bank of America total more than $4.5 billion, MBIA Chief Financial Officer Chuck Chaplin said on an earnings call in November.

MBIA wants Bransten to rule that Countrywide misrepresented the quality of loans underlying the securities and is liable for refusing to buy back faulty loans.

Riskier Loans

Countrywide contends MBIA insured the securitizations, which were issued between 2004 and 2007, even though it knew the lender’s loans were becoming riskier. The insurer also didn’t review loan files and disregarded results of Countrywide’s third-party review, Countrywide said in court papers. MBIA says it paid for and relied on Countrywide's representations about the loans.

"Rather than accepting responsibility for the insurance policies it wrote, MBIA seeks to walk away from its contracts," Countrywide said.

A hearing on whether Bank of America should also be held liable is scheduled for January. Bank of America argues that MBIA's argument for making the bank pay would "severely undermine the vital, long-established" principle that parent companies aren't liable for the conduct of subsidiaries.

'No Basis'

"There is no basis in settled doctrine for MBIA to now punish BAC for rescuing Countrywide by exposing BAC's assets to MBIA's claims against Countrywide -- claims that long preceded BAC's appearance on the scene," Bank of America said in court papers.

Lawrence Grayson, a Bank of America spokesman, declined to comment on the dispute before the hearing.

MBIA's request for more than $3 billion in damages and the repurchase more than $12 billion in loans is "remarkable," "extraordinary" and possibly "unprecedented," David Apfel, an attorney with Goodwin Proctor LLP who is representing Countrywide, said in court today.

MBIA is misconstruing the information in loan files, including one instance where it said documents showed that a borrower was out of work while they were still employed, Apfel said. The insurer has sued nearly every lender whose mortgages it insured, alleging they were "engaged in some sort of conspiracy to underwrite bad loans," Apfel said.

Separate Litigation

"Countrywide loans have outperformed and indeed have performed extremely well given the economic conditions we have gone through since 2007," Apfel said.

MBIA and Bank of America are battling in separate litigation over the bond insurer's 2009 restructuring, which the bank claims hurt holders of financial guaranty policies by transferring assets out of MBIA Insurance.

The bank argued at a trial earlier this year that New York's approval of the transaction was based on misleading information and should be reversed. The judge in that case hasn't yet ruled.

The case is MBIA Insurance Corp. v. Countrywide Home Loans Inc., 602825-2008, New York State Supreme Court (Manhattan).

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