SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

In the Matter of the Application of THE BANK OF NEW YORK MELLON, (as Trustee under various Pooling and Servicing Agreements and Indenture Trustee under various Indentures)	Index No. 651786/2011 **CHICAGO POLICE'S MEMORANDUM IN SUPPORT OF THE ADMISSIBILITY OF REPORTS ISSUED BY THE INSPECTOR GENERAL OF THE FEDERAL HOUSING FINANCE AGENCY** Assigned to: Hon. Kapnick, J.

The Retirement Board of the Policemen's Annuity & Benefit Fund of the City of Chicago and other members of the Public Pension Fund Committee ("Chicago Police") respectfully submit this memorandum of law in support of their offer into evidence at trial of two reports issued by the Office of the Inspector General of the Federal Housing Finance Agency (the "OIG" or "OIG Reports"):

INTRODUCTION

Chicago Police offers in evidence the following two OIG Reports[1]:

(1) Trial Ex. No. R-201: Evaluation of the Federal Housing Finance Agency's Oversight of Freddie Mac's Repurchase Settlement with Bank of America, Evaluation Report EVL-2011-006, September 27, 2011 (the "2011 OIG Report"); and

(2) Trial Ex. No. R-567: Follow-up on Freddie Mac's Loan Repurchase Process, Evaluation Report EVL-2012-007, September 13, 2012 (the "2012 OIG Report").

The OIG Reports are admissible because they are relevant and satisfy well-recognized exceptions to the rule against hearsay. Under McKinney's Civil Practice Law and Rule ("CPLR") 4520, a public officer certification or affidavit is admissible. The New York courts have generally interpreted this rule by looking to the exception in Federal Rule of Evidence

[1] The OIG Reports are attached as Exhibits A and B.

("FRE") for public records, now codified in Rule 803(8)(A)(iii), as guidance. Under FRE 803(8)(A)(iii), the findings of a duly authorized government investigation are presumed to be admissible in a civil proceeding, unless there are circumstances indicating that the investigation or results are not trustworthy.

Because the OIG findings which the Chicago Police seek to offer into evidence were made pursuant to a full and professionally conducted factual investigation by investigators and experts acting pursuant to their legal authority, the reports satisfy the requirements for the hearsay exception under the state and federal rules. These reports bear on the reliability of Mr. Scrivener's "repurchase rate" analysis that was used as the support for Bank of America's ("BOA's") negotiating position that 86% of the mortgage loans in the Covered Trusts were free of underwriting defects. *See* Scrivener 6/14/13 Tr. at 1251. As the evidence at this trial will show, the Trustee and its expert, Brian Lin, accepted this analysis at face value in recommending the $8.5 billion settlement – so that this evidence is both relevant and important to this Court's evaluation of the settlement and should be admitted.

ARGUMENT

I. The Findings of the OIG Investigation are Relevant.

As described in the 2011 and 2012 OIG Reports, immediately following a December 2010 bulk settlement by Freddie Mac of its outstanding and future repurchase claims against Countrywide (and Bank of America) for mortgage loans Countrywide had originated and sold to Freddie Mac, the Office of the Inspector General for the Federal Housing Finance Agency ("FHFA"), Freddie Mac's receiver, opened an investigation into the methodology that Freddie Mac had used to select mortgage loans for review for possible put-backs to Countrywide, and to settle those repurchase claims.

The OIG found that the process that Freddie Mac had engaged in to select loans for a put-back review (and then requesting origination files to conduct the review) -- particularly its selecting loans for a put-back review based on a bucketing of the defaulted loans by the number of borrower payments -- was flawed, and had reduced Freddie Mac's rightful repurchase revenues. As the 2012 OIG Report explained:

> FHFA's Office of Inspector General (FHFA-OIG) undertook an evaluation of FHFA's oversight of the settlement and issued a report on September 27, 2011. The report raised concerns about the method that Freddie Mac used to review non-performing loans for repurchase claims for Bank of America and more generally for other loan sellers. ***In essence, Freddie Mac followed a practice of examining for repurchase claims those loans that had become non-performing within two years of origination or with payment problems in the first two years. But the FHFA-OIG report found that -- for a variety of reasons -- Freddie Mac's practice effectively excluded from the repurchase claim review process many loans that the Enterprise had purchased or guaranteed during the housing boom years of 2005 to 2007, even though those loans have been defaulting at high levels.*** This practice limited Freddie Mac's potential recoveries from repurchase requests. In addition, Freddie Mac's internal auditors questioned the governance, business rationale, and objectives of the historical foreclosed loan review process.

(Emphasis added).

The 2011 OIG Report further explained that through use of Freddie Mac's flawed loan review selection process, "over 93%" of foreclosed 2005 and 2006 mortgage loans had been excluded from the loan repurchase review, amounting to, for 2006, approximately 100,000 defaulted loans that had been omitted from consideration for put-backs to Countrywide. Ex. R-201 at 19.

As Mr. Scrivener testified, he used the number of Freddie Mac's loan file requests as the first of three steps in developing the underwriting defect "rate" expressed as a percentage of the universe of loans in the Covered Trusts (Scrivener 6/14/13 Tr. at 1257). To arrive at this percentage, he used the number of Freddie Mac put-back claim requests (which were, of course, a sub-set of the loan files that Freddie Mac had reviewed), as proof for his logic that later

defaulting loans defaulted for reasons that were unrelated to the loans' underwriting. *See* PTX25 at 13 ("Repurchase Claim and Approval Rates Demonstrate Importance of Payments Made"). In reality, however, as the OIG Reports show, the reason there were fewer Freddie Mac claims for later defaulting loans is that Freddie Mac was not even looking at most of these loans for potential put-backs.[2]

Among the reasons given to Freddie Mac's Board of Directors for use of a mortgage loan review methodology -- that had already been flagged as flawed by a senior FHFA examiner -- to calculate the amount of the proposed December 2010 settlement, were considerations that demonstrate the fallacy of relying on the GSE settlement and put-back process to determine damages for the settlement in this case:

- The settlement would reduce Freddie Mac's counterparty exposure to Bank of America, which was consistently greater than Freddie Mac's internal risk management policy permitted;
- Lower levels of potential Bank of America counterparty exposure could permit Freddie Mac to do more "capital markets" business with Bank of America (such as issuing MBS and corporate debt); and
- The settlement [i]mproves [Freddie Mac's] ongoing relationship with Bank of America.

Ex. R-201 at 25.

Omissions from the pool of put-back claims for defaulted repurchase loans of the magnitude that had occurred at Freddie Mac, and which were tolerated for the business

[2] The extraordinary magnitude of this error on Scrivener's part can be seen from PTX25 at 13. It shows that for ***more than half*** of the GSE defaulted/delinquent loans, the borrower defaulted ***after*** he/she had made 24 payments: 57,802 (31,860 + 25,942) versus 47,014 (15,503 + 31,511). The failure of the GSE's to review these bad loans for put-backs explains why the percentages for "Claimed as a % of Def/Del" are so much lower for the buckets where the borrowers made 24 or more payments before defaulting.

relationship reasons described above, show Mr. Scrivener's approach of using the GSE experience as a proxy for the private trusts' loan defect rates was wholly misplaced. As such, these reports are relevant and should be admitted -- provided they satisfy the hearsay exception for government findings, which, as described below, they do.

II. The OIG Reports Satisfy the Hearsay Exceptions in the State and Federal Rules

A. The Admissibility of Government Investigative Reports under the CPLR

Bogdan v. Peekskill Community Hosp., 168 Misc. 2d 856, 860, 642 N.Y.S.2d 478, 481-82 (N.Y. Sup. Ct. 1996), when surveying cases analyzing the public document exceptions to the hearsay rule for governmental reports under CPLR 4520 (and FRE 803), generally summarized the applicable opinions of the New York state and federal courts as follows:

(1) Factual findings and inferences which reasonably flow therefrom are admissible.

(2) Opinions may be admissible, if sufficiently supported by the facts, and provided by a qualified declarant.

(3) The report may not be used as a vehicle to admit into evidence information which would otherwise be inadmissible.

(4) Conclusions of law are not admissible.

(5) The court must be satisfied that the factual findings are supported by evidence which is trustworthy, and result from an investigative process which is free of bias. In order to make this determination it is necessary that the report contain sufficient detail.

(6) The trial court has broad discretion in determining issues of trustworthiness and relevance, and must exercise such discretion in deciding whether a report, or portions thereof, should be admitted.

Detailed reports by government agents and agencies, like the OIG Reports at issue here, have been held to be trustworthy, and thus admissible, by New York state courts. *See, e.g.*, *Fruit & Vegetable Supreme, Inc. v. The Hartford Steam Boiler Inspection & Ins. Co.*, 28 Misc. 3d 1128, 1134, 905 N.Y.S.2d 864, 870 (N.Y. Sup. Ct. 2010) (finding New York State Public

Service reports sufficiently reliable on the grounds that they were based on investigations conducted by skilled professionals at the directive of federal members of the executive branch).

While the New York courts have not definitively resolved the extent to which a government investigative report may be admitted under CPLR 4520's hearsay exception for public documents, they have generally looked to the Federal Rules of Evidence, and particularly 803(8) for guidance. *See, e.g.*, NY CPLR 4520, cmt. 3; *Fruit & Vegetable*, 28 Misc. 3d at 1133, 905 N.Y.S.2d at 870; *Donovan v. W. Indian Am. Day Carnival Ass'n, Inc.*, 6 Misc. 3d 1016(A), 800 N.Y.S.2d 345, 2005 WL 236404, at *10 (N.Y. Sup. Ct. 2005); *Kaiser v. Metro. Transit Auth.*, 170 Misc. 2d 321, 325, 648 N.Y.S.2d 248, 250 (N.Y. Sup. Ct. 1996). As described below, OIG Reports such as those offered here, are routinely admitted into evidence under the federal rules.

B. <u>Admissibility of Government Investigative Reports under Fed. R. Evid. 803</u>

Fed. R. Evid. 803 states:

> The following are not excluded by the rule against hearsay, regardless of whether the declarant is available as a witness: [. . .]
>
> **(8) Public Records**. A record or statement of a public office if:
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> **(A)** it sets out:
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> **(i)** the office's activities;
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> **(ii)** a matter observed while under a legal duty to report, but not including, in a criminal case, a matter observed by law-enforcement personnel; or
>
> **(iii)** in a civil case or against the government in a criminal case, factual findings from a legally authorized investigation; and
>
> **(B)** neither the source of information nor other circumstances indicate a lack of trustworthiness.

The Supreme Court, in *Beech Aircraft Corp. v. Rainey*, 488 U.S. 153 (1988), held that the trustworthiness of an evaluative report determines its admissibility under Fed. R. Evid. 803(8), rejecting the argument that "an arbitrary distinction between 'fact' and 'opinion'" should determine the admissibility of such reports. *Id.* at 167. Under *Beech Aircraft*, all elements of a report – "whether narrow 'factual' statements or broader 'conclusions'" – are admissible subject to the trial judge's determination that they are trustworthy. *Id.* To determine whether a report is trustworthy, *Beech Aircraft* adopted the four factors in the Advisory Committee Notes on Fed R. Evid. 803(8):

(1) the timeliness of the investigation;

(2) the investigator's skill or experience;

(3) whether a hearing was held; and

(4) possible bias when reports are prepared with a view to possible litigation

Id. at n.11. The burden to show "a lack of trustworthiness" is on any party opposing admission. *Bridgeway Corp. v. Citibank*, 201 F.3d 134, 143 (2d Cir. 2000).

C. The OIG Reports Satisfy the Standards for Admissibility Under Both CPLR 4520 and FRE 803

The Office of the Inspector General of the FHFA was explicitly established to oversee the FHFA and to prevent and detect fraud and abuse related to FHFA activities, including the loans at issue in the OIG Reports. The employees of the Office of the Inspector General of the FHFA routinely investigate, evaluate and recommend changes to FHFA's (and Freddie Mac's) practices. The Office of the Inspector General of the FHFA are thus highly skilled and experienced at performing audits, evaluations and investigations of its operations.

Here, the investigation of Freddie Mac's put-back practices began immediately after its December 2010 settlement, and the first OIG Report issued in September 2011. The 2012

"follow-up" report issued only one year later. The team conducting these reviews included a senior investigator, a director of special projects and a statistician. R-567 at 6. The 2012 OIG Report recounts that, in 2011, the FHFA-OIG staff "for its review had multiple meetings over the course of nine months with senior executives and staff at FHFA and Freddie Mac and reviewed a considerable amount of paper and electronic documents." R-567 at 8. Factual findings, such as those contained in fn. 7 of the 2012 report, show that the reports' findings were not generic but rather based on specific detailed evidence.

OIG reports based on investigations, such as the OIG reports offered in this case, which include interviews of persons and evaluations of documents from the entity being investigated, are the classic type of government report that has been recognized as trustworthy and routinely admitted into evidence under the hearsay exception in FRE 803(8). *See, e.g.*, *D'Olimpio v. Crisafi*, 718 F. Supp. 2d 357, 373-74 & n.12 (S.D.N.Y. 2010).

CONCLUSION

As the OIG reports are admissible under exceptions to the hearsay rule, and are relevant, they should be admitted.

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Respectfully submitted,

/s/ Beth A. Kaswan

Beth A. Kaswan
Max R. Schwartz
SCOTT+SCOTT, Attorneys at Law, LLP
The Chrysler Building
405 Lexington Avenue, 40th Floor
New York, NY 10174
Telephone: 212-223-6444
Facsimile: 212-223-6334
E-mail: bkaswan@scott-scott.com
mschwartz@scott-scott.com

Counsel for the Retirement Board of the Policemen's Annuity & Benefit Fund of the

City of Chicago and other members of the Public Pension Fund Committee