

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75877 / September 10, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-15098

In the Matter of

Credit Suisse Securities USA (LLC);
DLJ Mortgage Capital, Inc.;
Credit Suisse First Boston Mortgage
Acceptance Corp.;
Credit Suisse First Boston Mortgage
Securities Corp.; and
Asset Backed Securities Corporation

Respondents.

ORDER ESTABLISHING FAIR
FUND AND APPROVING PLAN
OF DISTRIBUTION FIRST
PAYMENT DEFAULT PRACTICE

I.

On November 16, 2012, the Securities and Exchange Commission (“Commission”) issued an Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order (“Order”) against Credit Suisse Securities (USA) LLC (“Credit Suisse Securities”), DLJ Mortgage Capital, Inc., Credit Suisse First Boston Mortgage Acceptance Corp., Credit Suisse First Boston Mortgage Securities Corp., and Asset Backed Securities Corporation (collectively, “Credit Suisse” or “Respondents”).¹ In the Order, the Commission found that the Respondents engaged in misconduct including misrepresentations or omissions in the offer or sale of residential mortgage backed securities (“RMBS”) relating to

¹ Securities Act Rel. No. 9368 (Nov. 16, 2012), available at <http://sec.gov/litigation/admin/2012/33-9368.pdf>.

two undisclosed business practices that violated Sections 17(a)(2) and (3) of the Securities Act of 1933 (the “Securities Act”). 15 U.S.C. § 77q(a)(2) and (3).² The Commission ordered the payment of separate monetary sanctions for each set of business practices. The Order indicated that, pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, the Commission may create two separate Fair Funds, one for each group of investors harmed by the relevant sets of business practices.

This order pertains to one of those practices, the first payment default practice (“FPD Practice”). For the FPD Practice conduct, the Commission ordered Respondents Credit Suisse Securities and Asset Backed Securities Corporation to pay, jointly and severally, a total of \$18,256,561 in disgorgement, prejudgment interest and civil money penalties. All payments required by the Order have been made.

As set out in the Order, the Commission’s findings with respect to the FPD Practice relate to two RMBS offerings underwritten by Credit Suisse Securities in late 2006. The two RMBS offerings were collateralized by approximately \$1.9 billion of subprime mortgages (the “November 2006 securitizations”).

Structure of the November 26 Securitizations. The RMBS collateral consisting of residential mortgage loans was acquired by Credit Suisse and deposited into two trusts, one for each offering (“RMBS Trusts”). The trusts then issued numerous classes or “tranches” of debt securities (commonly referred to as “certificates”) backed by the RMBS collateral. Credit Suisse marketed and sold these certificates to investors using various offering documents. Each tranche of certificates held different rights to the mortgage payments and other defined funds (“cash

² The Commission also found that one respondent, Asset Backed Securities Corp., violated Section 15(d) of the Exchange Act, 15 U.S.C. § 78o(d), and Rules 12b-20, 15d-1, and 15d-14(d) thereunder, 17 C.F.R. §§ 240.12b-20, 15d-1, and 15d-14(d), as a result of materially misleading statements in certifications that had been attached to reports filed with the Commission.

flows”) going to the RMBS Trust, *e.g.*, to the principal and interest payments made on the underlying mortgages. In broad terms, the “senior tranches” of certificates held the first rights to cash flows to the RMBS Trust, and as a result paid a lower interest rate to investors; the “junior tranches” paid higher interest rates to investors and their cash flow rights were subordinated to the senior tranches. This cash-flow priority structure is commonly referred to as a “waterfall.”

The FPD Practice. In the offer and sale of the November 2006 securitizations, Credit Suisse informed potential investors about the protections afforded by a First Payment Default covenant (“FPD covenant”) and a First Payment Default backstop (“FPD backstop”). The FPD covenant required the mortgage originator (*i.e.*, the entity from which Credit Suisse purchased the mortgage collateral prior to securitization) to, among other things, repurchase certain delinquent loans held by the RMBS Trust. If the mortgage originator failed to repurchase the delinquent loans, the FPD backstop required Credit Suisse to step into the originator’s shoes and repurchase the mortgage from the RMBS Trust.

In marketing materials used in connection with the November 2006 securitizations, Credit Suisse promoted the FPD covenant and backstop provisions, stating that: 1) “all First Payment Default Risk” was removed from the securitizations, 2) it “enforced” the FPD covenant in order to “mitigate the effect” of fraudulent mortgages, and 3) its interests were aligned with investors’ interests.

In the Order, the Commission found that the FPD covenant and the FPD backstop were material to investors. The Commission also found that, in breach of the FPD covenant, Credit Suisse failed to put back to the mortgage originator more than 100 delinquent mortgages, and failed to disclose to the RMBS Trusts’ trustee or investors that these mortgages remained in the collateral pool for the November 2006 securitizations. The Commission found that Credit Suisse

mised investors because, among other things, it should have known at the time of the offering that all loans that breached the FPD covenant would not be put back to the mortgage originator. Credit Suisse further misled investors by representing that its interests were aligned with investors' interests by virtue of the FPD covenant. Credit Suisse was also found to have obtained money from underwriting fees on the November 2006 securitizations, and, on the closing date of the securitizations, through the sales of the mortgages to the trust that would hold the RMBS. The Order also found that Credit Suisse's failure to put back to the mortgage originator the mortgages that were in breach of the FPD covenant caused losses of approximately \$10 million to the November 2006 securitizations.³ These losses reflect an aggregate loss to the RMBS Trusts, which cannot be traced directly to the specific losses, if any, borne by individual investors who held RMBS Trust certificates.⁴

The Order stated that funds paid into each Fair Fund would be distributed pursuant to a distribution plan to be administered in accordance with the Commission's Rules of Practice governing Fair Fund and Disgorgement Plans (the "Commission's Rules"). On August 14, 2014, pursuant to the Order and Rule 1103 of the Commission's Rules, 17 C.F.R. § 201.1103, the Commission proposed the plan⁵ ("Proposed FPD Plan" or "Proposed Plan") and issued a notice

³ The \$10 million of losses were calculated by comparing the performance of the FPD mortgages that should have been removed from the collateral pool (the "FPD mortgages") to the performance of the balance of the mortgages held by the RMBS Trusts for the November 2006 securitizations. The FPD mortgages defaulted at a higher rate than the other mortgages held by the RMBS Trust, which contributed to approximately \$10 million of losses over the life of the securitizations.

⁴ While the losses incurred can be reasonably calculated in the aggregate by comparing the performance of the FPD mortgages to the balance of the mortgages in the collateral pool over a period of months or years, it is impossible to determine in hindsight precisely when a default of an FPD mortgage contributed to a direct loss to an investor, due to, among other things, the lack of regular pricing data for the RMBS certificates.

⁵ Available at <http://www.sec.gov/litigation/admin/34-72851-ppd-first-payment.pdf>.

of the Proposed Plan and opportunity for comment (the “Notice”).⁶ According to the Proposed Plan, the “purpose of this distribution is to compensate investors in the RMBS Trusts harmed by Credit Suisse’s misrepresentations and omissions in its offering materials regarding the FPD Practice.” (¶ 4.)⁷

The proposed distribution methodology allocates the Net Fair Fund among the RMBS Trusts based on the proportion of the mortgage collateral in each RMBS Trust that was originated by the Originator. (¶ 54.) The funds for each trust are then allocated⁸ to each trust’s Eligible Claimants⁹ on a *pro rata* basis determined by the Eligible Claimant’s investment in the specific trust divided by the sum of all Eligible Claimant’s investments in that trust. (¶ 55.)

The Commission received one comment on the Plan. This order addresses that comment.

After careful consideration, the Commission has determined to order a Fair Fund for the amounts paid by Respondents relating to the FPD Practice conduct (the “FPD Fair Fund”), and, for the reasons explained in this order, that the Proposed FPD Plan should be approved with technical modifications (hereinafter the “FPD Plan” or “Plan”).¹⁰

⁶ Exchange Act Rel. No. 72851 (Aug. 14, 2014), available at <http://www.sec.gov/litigation/admin/2014/34-72851.pdf>. The Notice provided all interested persons thirty days to submit written comments on the Proposed Plan. The Notice advised such persons that they could obtain a copy of the Proposed Plan from the Commission’s website or by submitting a written request to the Commission. The notice stated that all persons who desired to comment on the Proposed Plan could submit their comments no later than September 15, 2014.

⁷ Paragraph references in this order denoted by the symbol “¶” refer to the numbered paragraphs in the Proposed FPD Plan.

⁸ As explained in the Proposed FPD Plan, a preliminary allocation is made and any Eligible Claimant whose preliminary calculation is less than a *de minimis* amount is removed from the pool of Eligible Claimants. (¶ 56.) In the event that a particular Trust is undersubscribed such that a small number of Eligible Claimants would stand to receive disproportionately large recovery, the Fund Administrator, with agreement of the Commission staff, may use discretion in determining the final amount of the recovery. (¶ 58.)

⁹ The Proposed Plan defines “Eligible Claimants” as persons (other than Excluded Parties) who purchased Eligible Securities on Eligible Purchase dates. The Proposed Plan also defines the capitalized terms in the definition of Eligible Claimant.

¹⁰ The FPD Plan contains minor technical modifications to its Proposed FPD Plan. The technical modifications are: (i) the last sentence of ¶ 2 has been restated to more accurately reflect the Commission’s finding of loss stated in the Order; (ii) in ¶ 58, word changes were made to eliminate an undefined term, “Eligible Claim;” (iii) the modifier

II.

A. Public Comments on the FPD Plan

Chris Katopis, Executive Director, Association of Mortgage Investors Letter

Chris Katopis, the Executive Director of the Association of Mortgage Investors (“AMI”), submitted a comment (the “AMI Comment”)¹¹ that stated three concerns with the Proposed Plan: 1) that the Proposed Plan’s *pro rata* allocation “improperly override[s] the recognized payment priority or ‘waterfall’ established by the governing documents of the RMBS trust . . . thereby favoring senior certificate-holders, who may not in fact suffer losses, over more junior classes of certificate-holders”; 2) that the Proposed Plan arbitrarily excludes nearly all subsequent purchasers, potentially undermining the secondary market for RMBS; and 3) that by paying investors directly rather than paying the RMBS trustees, “the Proposed Plan fails to take advantage of [the RMBS waterfall,] a method of distribution that is more efficient, fair, and consistent with investor expectations.” The Commission has considered the AMI Comment and, for the reasons discussed below, is approving the Proposed FPD Plan with only technical modifications.¹²

“proposed” is deleted wherever it appeared in the FPD Plan because the Plan when adopted by the Commission is no longer “proposed;” and (iv) ¶ 85 was deleted because the FPD Plan when adopted by the Commission will not be published for further Notice and Comment. These technical modifications are minor. No substantive changes have been made to the methodology for calculating distributions or to the definition or eligibility criteria for Eligible Claimants. Commission staff does not deem these changes to be substantial or to require republication pursuant to Commission Rule 1103. Moreover, under Rule 1104, the Commission has complete discretion when considering whether to republish a plan for notice and comment, and the Commission is not required by Rule 1104 to republish a plan *even if* the Commission substantially modifies it prior to adoption.

¹¹ The three concerns raised in the AMI Comment have also been raised for the Commission’s distribution plan for the previously noted other undisclosed Credit Suisse business practice, the Bulk Settlement practice (“Bulk Settlement Practice”). Although these practices involved different conduct, the portion of this order responding to the AMI Comment and the corresponding portion of the order approving the distribution plan for Bulk Settlement Practice are nearly identical because the analysis of the concerns is the same for both plans.

¹² See fn. 10, *supra*.

First, AMI's contention that a *pro rata* allocation overrides the RMBS Trusts' waterfall, thereby favoring senior certificate-holders "who may not in fact [have] suffer[ed] losses," indicates that the harm that is the focus of AMI's concern is limited to the *investment losses* that flowed from the *eventual performance* of certificates held by investors. Subsequent investment performance losses, however, are distinct from the harm to investors addressed in the FPD Plan. A proportionate harm accrued to *all* investors *at the time of the initial offering* when, as a result of the misrepresentations and omissions in the offering documents and marketing materials, investors were deprived of the benefit of their bargain with Credit Suisse. The FPD Plan's purpose and design for addressing investor harm flow directly from the violations at issue in the Order. As noted in the Plan, the "purpose of this distribution is to compensate investors harmed by Credit Suisse's misrepresentations and omissions *in its offering materials* regarding the FPD Practice." (§ 4, emphasis added.) The Order found that Credit Suisse violated Sections 17(a)(2) and 17(a)(3) of the Securities Act because of material misstatements and omissions "in the offer or sale of securities." The misleading statements and omissions at issue in the Order were made in the securitizations' offering documents and in other materials Credit Suisse used to market the offering to potential investors. In those documents and materials, Credit Suisse misled investors by falsely asserting that 1) its interests were aligned with investors' interests with respect to FPD mortgages, and 2) all FPD mortgages would be removed from the collateral pool. Credit Suisse's misconduct was material to investors' decisions whether to invest in the November 2006 securitizations.

Had Credit Suisse disclosed *to potential initial investors* that its interests were not aligned with theirs, and that at its discretion, some as-yet-indeterminate number of FPD mortgages would remain in the collateral pool, it stands to reason that *all initial* investors would

have considered the information in their investment decisions. Investors may have decided to invest in different securities or demanded to be compensated (*e.g.*, to receive a higher interest rate) before assuming the as-yet-unquantifiable FPD-related risks. For that reason, even if there had been no losses from the failure of the mortgages underlying the November 2006 securitizations, there still would have been harm to *all initial* investors caused by the Respondents' conduct. Unlike an investment performance harm, the harm in the offer and sale affected senior and junior certificate-holders alike. It is this harm that the Commission's Plan seeks to address through a *pro rata* distribution. The Plan is reasonably designed to compensate investors for such harm.

The Commission's objective is to distribute the FPD Fair Fund in a fair and reasonable manner, taking into account the relevant facts and circumstances.¹³ In light of the factual and legal bases for Respondents' liability, the Commission exercises its discretion to distribute funds *pro rata* to all investors who purchased certificates in the RMBS Trusts' offerings or near the time of the offerings.

Closely related to AMI's first concern is AMI's third concern that the Proposed Plan fails to take advantage of the efficiencies, fairness and consistency with investor expectations associated with the waterfall priority of distributions. AMI's contention, however, that the Commission has "overlook[ed] the possibility that simply distributing proceeds through the trusts to flow through established waterfalls is a more fair and efficient means to compensate investors" is incorrect. The Commission staff carefully considered whether to distribute funds

¹³ See *Official Committee of Unsecured Creditors of WorldCom, Inc. v. SEC*, 467 F.3d 73, 82 (2d Cir. 2006) ("So long as the district court is satisfied that 'in the aggregate, the plan is equitable and reasonable,' the SEC may engage in the 'kind of line-drawing [that] inevitably leaves out some potential claimants'"), citing *SEC v. Wang*, 944 F.2d 80, 88 (2d Cir. 1991).

directly to the trustees for the RMBS Trusts as well as the significance of the RMBS Trusts' waterfalls. There are significant legal and practical barriers to a waterfall distribution, and the proceeds cannot be "simply" distributed through the RMBS Trusts. First, an RMBS Trust's waterfall generally determines the prioritization of defined cash flows from the collateral owned by the Trusts. However, AMI does not contend that the funds held by the Fair Fund - which consist of ill-gotten gains obtained by certain Respondents, civil money penalties, and prejudgment interest - constitute such a defined cash flow. If funds held by the Fair Fund were paid to an RMBS Trust, the Trusts' waterfall would not necessarily determine how such funds would be allocated. Second, assuming that, as noted by AMI, the governing documents of the RMBS trust "provide for the allocation of the losses on a mortgage pool," this fact does not necessarily determine how a Fair Fund payment would be allocated. As noted above, the funds placed in the FPD Fair Fund were ill-gotten gains obtained by certain Respondents, civil money penalties, and prejudgment interest, not payments for investor damages or restitution. Thus, the Commission concludes that, rather than being a "simple solution," distributing funds directly to the RMBS trusts would inject a great deal of uncertainty and complexity regarding how RMBS trustees would allocate funds to current or former investors in the RMBS Trusts due to the complex nature of the trusts and their waterfalls. The Commission's Plan avoids these uncertainties.

AMI's remaining concern is with the Proposed Plan's distribution of funds to investors who purchased securities at or near the time of the initial offerings, rather than investors who purchased certificates on the secondary market long after the initial offerings. This feature of the Proposed Plan is also derived from the factual and legal bases for Respondents' liability. Again, the Commission's Order found that the Respondents' liability stemmed from their conduct in the

“offer or sale of securities.” All initial investors in the RMBS Trusts experienced harm caused by Respondents’ material misrepresentations and omissions and other fraudulent acts depriving investors of the benefit of their bargain, including whether to decline to participate in the offering or to negotiate a more favorable purchase price. For that reason, the Proposed Plan distributes the FPD Fair Fund to investors who purchased certificates at or near the time of the initial offering.

The Commission staff is not aware of extant records that would allow the Fund Administrator unambiguously to identify investors who bought directly from Respondents in the offering. In the absence of such records, the Plan treats investors who purchased certificates within 30 days of the offering as “initial investors.” The 30-day cutoff reasonably ensures that distributions are made to those investors most likely to have been directly harmed by the conduct at issue in the Order. Investors whose purchases fall outside the 30-day cutoff (“secondary investors”) were more likely to have had access to extensive additional information about the RMBS collateral that was unavailable to initial investors at the time of the offering. Beginning approximately 30 days after the offering, and continuing each month thereafter, the RMBS trustee issued reports that provided updated performance data for the RMBS collateral. So, for example, a secondary investor who purchased several months after the offering would have typically had access to multiple trustee reports when making an investment decision. The trustee reports would have shown how the mortgages in the collateral pool performed during that time (e.g., how many mortgages were 30, 60, or 90 days delinquent, how many were in foreclosure, etc.). As a result, relative to an initial investor, a secondary investor was *less dependent* on Credit Suisse’s representations in the offering because the secondary investor had access to a larger data set of actual performance history. Therefore, by limiting distributions to initial

investors, the Proposed FPD Plan is reasonably designed to distribute funds to those investors whose harm is most closely linked to Respondents' misrepresentations and omissions *in the offering* itself.

B. Establishment of the FPD Fair Fund

The Proposed FPD Plan compensates investors using, in addition to the \$12,256,561 in disgorgement and prejudgment interest monies collected from Credit Suisse and Asset Backed Securities Corp., the \$6 million penalty also collected for the FPD Practice conduct. Under Section 308(a) of the Sarbanes-Oxley Act, as amended, a penalty ordered in an administrative action "shall, . . . at the direction of the Commission, be added to and become part of a disgorgement fund or other fund established for the benefit of [investor] victims." 15 U.S.C. § 7246(a). The Commission, in its discretion, concludes that the circumstances here justify the addition of the penalty money to other funds collected to create a Fair Fund for the FPD Practice.

Accordingly, IT IS HEREBY ORDERED that:

- A. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, the FPD Fair Fund is established; and
- B. Pursuant to Rule 1104 of the Commission's Rules, 17 C.F.R. § 201.1104, the FPD Plan is approved.

By the Commission.

Brent J. Fields
Secretary