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DRAFT MEMORANDUM

TO: File
FROM: Mina Simhai
DATE: January 21, 2009
RE: Telecon w/ Christine Napolitano) (h) 36 CFR 1256.56 - Privacy [redacted] Former Employee of First Franklin and former contractor for Clayton Holdings and other due diligence firms

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On Wednesday, January 20, 2010 Tom Krebs and I phoned Christine Napolitano, a former employee of First Franklin Financial Corporation and former contractor for Clayton Holdings and other due diligence firms. Ms. Napolitano worked as a paralegal in foreclosure litigation for about 5 years at the law firm of Berkman, Hoech, Peterson & Peddy, and for about 2 years at another law firm on Long Island. She then worked as a commercial real estate paralegal for about a year at Sullivan & Cromwell in New York, NY. In 2001 she worked as a temp in Citigroup's private banking division where she processed and closed loans originated by Citi. Next she joined First Franklin Financial Corporation as underwriter, working in the correspondent lending division, then the Westchester, NY branch and later transferring to the Long Island branch. After First Franklin, Ms. Napolitano worked for PCI Group, an HR outsourcing business that would place her with various due diligence firms for weekly assignments reviewing loan files. She worked mainly for Clayton Holdings, but also for Opus Capital Market, Hanover Capital and CIT. After working for PCI Group she accepted a permanent position with Societe General reviewing loan repurchase requests.

First Franklin – Correspondent Lending Division

Ms. Napolitano started in the correspondent lending division, which is based in New York and Boca Raton, Florida. Ms. Napolitano went to Boca on a weekly basis and also traveled to client sites. Brokers based in NY would originate a loan, close it in the broker's name using First Franklin funds, and then transfer the loan to First Franklin. Ms. Napolitano's job was to ensure that the loans the brokers originated met First Franklin's lending guidelines. She stated that the problems began in the loan origination.

2-3 months after Ms. Napolitano started working in First Franklin's correspondent lending division the division was sold to Deutche Bank and she was let go.

First Franklin – Westchester Branch

Although Ms. Napolitano was let go by the correspondent lending division, she was hired by First Franklin's Westchester Branch, with the understanding that she would be transferred to the Long Island branch once it was open.

Ms. Napolitano was hired to underwrite loans. She would receive the files from loan officers and accept or decline them. After a period of time, and after she had underwritten 25-35 loans, she received a delegation that allowed her to sign off on loans below $400,000, or below $600,000 in California. For loans over these amounts, she needed a second signature to sign off on the loan. All of the loans Ms. Napolitano reviewed would be sent to the corporate office in California, where her recommendations would either be approved or declined.

Ms. Napolitano advised that she would decline a loan if it did not meet First Franklin's lending guidelines, for example, if the amount of the loan substantially exceeded the maximum allowed amount under the guidelines. The corporate division in CA would review Ms. Napolitano's approve or decline recommendations on the loans. Ms. Napolitano advised that the problem was that the branch manager could override corporate, and he could also override Ms. Napolitano. If Ms. Napolitano declined a loan, the loan officer would often go to the branch manager and the branch manager would approve the loan. The branch manager received a monthly bonus depending on how many loans were originated in his branch. Christine's nickname around the office was "1-800-KILL-A-DEAL".

Ms. Napolitano also advised that another problem was "junk properties," where the appraisers would work with loan officers to inflate home prices. For example, the appraiser would get comparables ("comps") from a different, more expensive neighborhood, and base the appraisal on those comps, rather than on comps from another house in the same neighborhood as the home being appraised.

First Franklin – Long Island Branch

Ms. Napolitano and one other colleague from the Westchester Branch transferred to the Long Island Branch, which Ms. Napolitano described as more crooked than the Westchester office. Ms. Napolitano's experience in the Long Island branch, and the problems she observed while there, were similar to her experiences in the Westchester branch. She stated the many of the loans were "terrible" and loan officers didn't care if she declined their loans because they knew the branch manager would override her and approve their loans.

According to Ms. Napolitano, the loans originated by First Franklin were sold in the secondary market to firms including Bear Stearns, Lehman, UBS, Deutche Bank and Merrill Lynch. The loans were subprime, and the lending guidelines were relaxed to the point they allowed loans to people with FICO scores of 520.

By the time Ms. Napolitano left First Franklin in 2004 her salary was about 36 CFR 1256.56 - Privacy plus a minimum guaranteed bonus of 36 CFR 1256.56 - Privacy She worked in the Long Island branch for about 7 months.

Ms. Napolitano stated she was fired from First Franklin for trying to do the right thing. Ms. Napolitano reported the bad practices she had witnessed to 36 CFR 1256.56 - Privacy the people based in the corporate office in California who handled internal issues and were supposed to keep their conversations with employees confidential. Two days after this conversation she was told she was being let go because she was not productive and was not a team player.

Because she was fired, Ms. Napolitano retained a lawyer, and her lawyer communicated with Musette T. Vincent, VP and Senior Attorney for National City (the parent company of First Franklin). Ultimately this lawsuit did not go anywhere. However, Ms. Napolitano did sue First Franklin in Small Claims Court in Nassau county New York for legal fees and bonuses she was owed. She received an award against First Franklin of approximately $5,000.

Contractor for Clayton Holdings and other Due Diligence Firms

Next, Ms. Napolitano was hired by PCI Group. PCI Group provided temporary workers to due diligence firms, including Clayton Holdings ("Clayton"), Hanover Capital, Opus Capital Markets and CIT. Ms. Napolitano stated she mainly worked for Clayton. At Clayton, she reviewed loans contained in loan pools that Clayton's clients were considering purchasing. The PCI Group temporary workers would receive their work assignments and would usually fly to the site where the loan files to be reviewed were located. Ms. Napolitano worked on jobs in CA, MI, NJ, VA, MD and RI. Travel and hotel expenses were covered.

Ms. Napolitano attended 2 weeks of training at the Atrium hotel in Orange City, CA before she began reviewing loans for Clayton. There were about 30 people in her class, and Clayton held these training courses every 2 weeks. The training focused on learning Clayton's due diligence system. According to Ms. Napolitano, all due diligence companies had their own proprietary due diligence systems.

Per Ms. Napolitano, Clayton would ship laptops and a server to the job sites. Each laptop would be loaded with Clayton's proprietary software class the "CLAS System" (Clayton Loan Analysis System). The loans in the pool to be reviewed were also pre-loaded onto the laptops. Hard copies of the loan files were available on site for the loan reviewers. Based on her review of the loans, Ms. Napolitano's job was to input 2 types of data for each loan into the system: (1) credit data and (2) compliance data. The credit portion included information obtained from the Fannie Mae form 1003, the standard loan application. It was more subjective and required a determination whether the loan met the loan guidelines when it was originated. The loans would receive a score of 1, pass, 2, marginally pass, or 3, fail. There was a 3 step process for providing loans with final rankings. First, a loan reviewer, such as Ms. Napolitano, would rank the loan. Next, Quality Control (QC) would review all of the completed loans. Finally, the Lead would review the ranking. If Ms. Napolitano had a question when reviewing a loan, she would ask the Lead or a QC person. Most of the QCs and Leads were also contractors, rather than Clayton employees.

Review of Loan Files. The loan reviewers were expected to review one loan file an hour. Each loan file could be 200-300 pages long. According to Ms. Napolitano, Clayton provided 3 copies of lending guidelines to be shared by 50-100 people. Nothing would happen if a loan reviewer missed but came close to the target of one loan an hour, but if someone missed the target by a lot they would not get staffed again. A typical loan file that Ms. Napolitano would review included the following:

- Fannie Mae form 1003 loan application.
- Fannie Mae form 1008 uniform underwriting and transmittal summary.
- Lender approval.
- All credit documents. Contents would vary depending whether the loan type was full doc, stated income (a.k.a. "liar loan"), no ratio doc, no doc, or lite loan.
- The note and the mortgage.
- Compliance documents.
- Appraisal report.
- Any other relevant document (e.g. a divorce decree).

As a loan reviewer, Ms. Napolitano would point out errors. If she rejected a loan because it had a 3 ranking, the supervisors would often tell QC to "make the loan work." Also, the loan reviewers were instructed never to use the "f- word" (which was fraud) because the loan reviewers were not trained in making a legal determination of whether there was fraud.

According to Ms. Napolitano, Clayton was under pressure from its clients not to rank too many loans in a pool as 3s; otherwise Clayton would not receive repeat business from that client. Loans receiving 3 rankings that were based on compliance issues received less push back, because compliance issues were more clear cut than credit issues. According to Ms. Napolitano, a typical credit issue that might be considered a "qualifying factor," thereby allowing a ranking to be changed from a 3 to a 1 or 2, is the following:

> The lending guidelines allow only 1 late payment that is late 30 days. A rolling 30 day late payment (i.e. borrower is 30 days late on each mortgage payment) counts as 1 late payment. If, however, the borrower has rolling 30 day late payments, then is 60 days late on a payment, then goes back to making rolling payments that are 30 days late, the borrower would have two 30 day late

payments and one 60 day late payment. In this instance, the loan may be accepted even though it does not meet the guidelines because the fact that the borrower has consistently made his/her late payments could be considered a "qualifying factor."

Ms. Napolitano stated that rankings of a 3 were usually overturned by a supervisor.

Also, Ms. Napolitano stated Clayton's clients were under pressure not to review too many loans in the pool from the whole loan sellers because the less sampling the client did, the more likely it was to win the bid for the pool of loans.

According to Ms. Napolitano, under the lending guidelines the following factors were more likely to be subject to manipulation:

a) Income. Income is typically averaged over 2 years. If the borrower provides 2 pay stubs, the second showing a higher income, income might be stated at the higher level, rather than averaging the 2 years.

b) Assets.

   a. Only 70% of a 401(k) account is supposed to count towards a person's assets, but 100% of the value of the 401(k) account might be counted instead.

   b. Large deposits that are not sourced or seasoned are not usually counted when considering a borrower's assets. Also, in the industry, credit reports are usually good for sixty days. Borrowers (sometimes at the suggestion of mortgage brokers) can get a cash advance on their credit cards and deposit that money in their savings account. This way, it looks like the borrower has savings, and an exception could be granted, allowing the source and date of the deposit to be ignored.

c) Appraisal. Appraisal manipulation was a big problem. Brokers would sometimes call borrowers and suggest they re-finance so that they can take equity out of their homes. Appraisals were often inflated as discussed above under "First Franklin – Westchester Branch" above.

d) Trade Lines. A common requirement is that borrowers are current on three trade lines, as shown on their credit report. Trade lines are usually major credit cards, but there is some discretion on what can be considered a trade line. Sometimes a borrower would not have credit cards, because they typically pay in cash. In this instance, some mortgage brokers would get a borrower's payments to utility companies (i.e. heat and water bills for their apartment), cell phone providers, cable providers etc. listed on the person's credit report. The mortgage broker would then get obtain a credit supplement and provide it to the loan underwriter.

e) Seasoning. If a borrower refinances within 12 months of closing, the price to be used for the refinancing must be the lower of the purchase price or the current appraised value (this is called "seasoning"). Rather than take the lower of the two, refinacings done within 1 year of the closing were often done at the higher current appraised value, which allowed borrowers to cash-out the equity they had gained on their homes. Many of these borrowers had 100% financing. Countrywide was notorious for this practice.

f) Income verification (for stated income loans). A self-employed borrower was sometimes called upon to verify his own income. Oftentimes the phone number provided would be a cell number, rather than a business number, and a business card would be submitted, rather than a business license or good standing certificate.

g) SLD (Structured Loan Desk) Exception. Traders can approve certain exceptions, provided they follow certain parameters. This was a way to layer on triple risk. First, the loans did not comply with the guidelines. Second, the traders would not follow the stated parameters necessary for them to grant an exception to the guidelines. Third, the exceptions sought went above and beyond the exceptions allowed under the guidelines. SLD exceptions often involved multiple exceptions for a single loan.

Ms. Napolitano spent quite a bit of time in California, where she worked with 36 CFR 1256.56 - Privacy of Texas as the Lead. According to Ms. Napolitano, Bear Stearns often requested [redacted] for their projects because he would reject very few loans in the pools. Leads received bonuses depending upon how quickly they completed a job. As a result, they would often push the loan reviewers to work long hours, sometimes from 7 a.m. to 11 p.m.

Ms. Napolitano did not get along with 36 CFR 1256.56 - Privacy so asked to be staffed on more East Coast based projects. On the East Coast she mainly worked on projects for Opus Capital Market in New Jersey. According to Ms. Napolitano, all the due diligence firms she worked for through PCI had similar procedures and similar problems.

Clients of the due diligence firms included Bear Stearns, Merrill Lynch, Lehman Brothers and Morgan Stanley. Oftentimes Ms. Napolitano did not know who the client was on any given pool of loans she was reviewing.

Some of the larger document reviews Ms. Napolitano worked on were held at the Ace Center country club in Pennsylvania, where there were 2 rooms with stadium seating full of loan reviewers.

Cash Flow Modeling. According to Ms. Napolitano, the cash flow models used by Clayton were not based on historical data. They did not take defaults into account, and they assumed that borrowers would repay their loans. The five-year forecasts would show some loans being paid off in full, but they did not show delinquencies or foreclosures.

PCI paid Ms. Napolitano an hourly wage 36 CFR 1256.56 - Privacy and a per diem of 36 CFR 1256.56 - Privacy She knew people at PCI who made over $100,000 a year. Ms. Napolitano worked for PCI for about 2 years.

Societe General

After leaving PCI Group, Ms. Napolitano accepted a permanent job at Societe General reviewing requests to repurchase loans and identifying breaches of representations and warranties relating to the loans.

Next Steps

1. In-person interview with Ms. Napolitano.

2. See if Ms. Napolitano's contacts in North Carolina, Florida and Indiana are willing to talk with us.

3. Contact 36 CFR 1256.56 - Privacy the former branch manager at First Franklin's Long Island branch.

4. Contact 36 CFR 1256.56 - Privacy (TX), former lead on Clayton Holdings due diligence matters that worked quite a bit on Bear Stearns projects.

5. Consider contacting Steve Lamanda (former CEO of Clayton) and Neil Spagna (oversaw Clayton's Residential and Consumer Services Group from1997-2006). Currently they both work at Shelving Rock Partners, along with several other former Clayton executives. http://www.shelvingrock.com/index.php

6. Consider contacting Musette T. Vincent, VP and Senior Attorney for National City (parent company for First Franklin), who corresponded with Ms. Napolitano's lawyer regarding Ms. Napolitano's termination from First Franklin.