

Next Wave of MBS Litigation Focuses on Issuers, Underwriters

Article By:

Litigation and Dispute Resolution

Nobody likes mortgage defaults. Not borrowers, not lenders, not investors, and not the fifty State Attorneys General. Yet defaults and foreclosures continue to mount, and both private litigants and government have taken action. Time and again, government investigations and private lawsuits focus on the role that the expansion of mortgage-backed securities (MBS) played in the financial crisis.

While lenders were the primary target of most suits filed in the immediate wake of the financial crisis, in recent months litigants have increasingly focused on MBS issuers, underwriters and servicers. Typical claims allege securities violations arising out of disclosures relating to the quality and character of loans pooled, and the underwriting criteria used to issue those loans. Given the relatively short timeframe for filing claims under *Sections 11 and 12 of the Securities Act*, issuers of MBS can expect to face an increasing number of state-law tort claims such as negligent misrepresentation and fraudulent omission. In addition, the plaintiffs' bar has become increasingly sophisticated in its ability to amass sufficient numbers of certificateholders to pursue litigation for breach of the pooling and servicing agreements underlying MBS. As recently as last week, plaintiffs' lawyers held a meeting in Manhattan for large MBS investors to encourage them to join a group of potential plaintiffs, with an eye toward pursuing claims against MBS lenders and servicers.

Issuers who sought to credit-enhance or "wrap" their offerings with monoline insurance coverage are also finding that their coverage claims are being denied, typically on a claim that the issuer misrepresented the composition of the pool, the underwriting criteria applied to loans in the pool, or the value of the underlying collateral. Somewhat related are claims for rescission of primary mortgage insurance policies by carriers alleging breach of mortgage insurance underwriting criteria, even where the insurance provider purported to independently investigate underwriting. These disputes are likely to be litigated from both sides, with bond issuers and lenders seeking to enforce coverage under their monoline and primary mortgage insurance policies, while carriers simultaneously sue to avoid it.

On the regulatory front, loan originators, servicers, and MBS issuers are also seeing an increase in government subpoenas, most often from the Federal Housing Finance Agency. These subpoenas seek information about underwriting practices and the quality of loans pooled in Ginnie Mae and Freddie Mac sponsored securitizations, often as a precursor to litigation against sellers of Ginnie Mae

and Freddie Mac bonds for violating the regulatory criteria for issuance of those bonds. Whether these investigations portend claims by Ginnie Mae and Freddie Mac themselves to compel loan repurchase under agency guides remains to be seen.

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National Law Review, Volume , Number 312

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