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The Rise And Fall Of Statistical Sampling In RMBS Cases

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The 2008 mortgage crisis prompted a wave of residential mortgage-backed securities and repurchase litigation as trustees, certificate holders (i.e. investors), monoline insurers, securitizers and other stakeholders pursued claims related to loans securitized in RMBS trusts. One of the hallmarks of large-scale RMBS litigation is the large number of loans in dispute. These cases usually include allegations relating to thousands (or tens of thousands) of loans. In order to reduce the burden and expense of proving such claims on a loan-by-loan basis, plaintiffs typically have sought to prove their allegations through the use of statistical sampling. In other words, rather than allege individual breaches on thousands of loans, plaintiffs will hire a statistics expert to draw a sample, engage a re-underwriting expert to determine the proportion of the sample loans in breach, and then hire yet another expert to extrapolate the results to the overall population. In the early days of RMBS litigation, this strategy was highly successful. However, in recent years, a new trend has emerged. Courts have grown increasingly skeptical about the use of statistical sampling in repurchase cases, especially where language in the applicable loan sale agreements requires a loan-level determination of breach in order to trigger a repurchase obligation. This article discusses the growing trend in courts towards rejecting the use of sampling in such cases and the implications of such trends.

Early Cases in Favor of Statistical Sampling

Judges presiding over the initial wave of RMBS cases reacted favorably to the use of statistical sampling to prove breaches. For example, in MBIA Insurance Corp. v. Countrywide Home Loans Inc., MBIA Insurance sought to use statistical sampling to prove its causes of action for fraud and breach of contract.[1] There, Justice Eileen Bransten approved the use of sampling, finding that statistical sampling was appropriate under the Frye standards of admissibility in a case involving between approximately 8,000 and 48,000 loans because "statistical sampling is a widely used method to present evidence from a large population of data."[2] Judge Bransten also found that a sample of 400 loans per population, which provided a confidence level of approximately 95 percent, was sufficiently reliable.[3]

Similarly, in Assured Guaranty Municipal Corp. v. Flagstar Bank FSB, a monoline insurer, Assured, alleged that defendant bank Flagstar, which served as servicer, depositor and originator of all the loans underlying the trusts at issue, materially breached the representations and warranties made to Assured because it failed to comply with the originators' underwriting guidelines.[4] Assured sought to use statistical sampling to make a binary decision on each loan regarding whether the loan conformed to the representations and warranties made in the transaction documents.[5] Flagstar opposed Assured's attempt to use statistical sampling to prove the bank's liability by arguing that "the fact [that] determination of material breach in any given instance requires consideration of an entire loan file renders the loans ill-suited to proof by statistical sampling."[6] Judge Jed Rakoff rejected Flagstar's argument and concluded that sampling was a "widely accepted method of proof in ... cases relating to RMBS and involving repurchase claims" and that the sample was "reflective of the proportion of the individual members in the entire pool exhibiting any given characteristic."[7] Judge Rakoff further rejected the defendants' objections to sampling as a method of proving damages.[8] In doing so, he emphasized that because Flagstar's 90-day cure period had already expired, Flagstar's right to cure any breach was irrelevant and that Flagstar would receive nothing back on defaulted loans regardless.[9] Judge Rakoff also rejected Flagstar's argument that Assured was required to provide loan-level notice of defects in order to obtain cure or repurchase, finding that Assured's repurchase demand — which purported to inform Flagstar of "pervasive breaches" within particular trusts — was sufficient to trigger Flagstar's repurchase obligation as to all of the materially defective loans within those trusts.[10]

After Flagstar, a number of state and federal courts approved the use of statistical sampling in similar cases.[11] Notably, however, most of these cases involved monoline insurers and fraud claims. In such cases, plaintiffs are not required to prove breaches at the loan level, but rather, they are required to show an aggregate level of deception within the population of loans. Despite this key distinction, plaintiffs sought to extend these early successes to later-filed large scale repurchase cases.[12]

Growing Skepticism of Statistical Sampling in RMBS Repurchase Cases

Despite the acceptance of statistical sampling in Flagstar and subsequent cases, more recent cases have chipped away at the perception that sampling always will be approved in RMBS and repurchase cases. In Retirement Board of the Policemen's Annuity and Benefit Fund of the City of Chicago v. Bank of New York Mellon, the Second Circuit stated: "We acknowledge that district courts have sometimes permitted plaintiffs to use statistical sampling to prove the incidence of defects within individual trusts, see, e.g., Assured Guar. Mun. Corp. v. Flagstar Bank, FSB, 920 F.Supp.2d 475, 486–87 (S.D.N.Y.2013), but Plaintiffs cite no case in which a single sample of loans taken from hundreds of trusts was used to prove a defendant's liability with respect to each of those trusts."[13] The Second Circuit's acknowledgement that there were limits to statistical sampling in RMBS cases did not go unnoticed.

For example, in MASTR Adjustable Rate Mortgages Trust 2006-OA2 v. UBS Real Estate Securities Inc. (MARM), a trustee sought recovery from the sponsor of three RMBS securitizations for the sponsor's breaches of representations and warranties concerning the characteristics of securitized loans that it made in pooling and servicing agreements (PSAs) governing the securitizations.[14] The court analyzed the relevant language of the pooling and servicing agreements, which featured singular nouns and defined terms that referenced characteristics of individual loans.[15] Based on this, the court rejected the use of statistical sampling and required loan-by-loan proof of breach.[16] In doing so, the court focused on the contractual language of the PSAs and emphasized that "the PSAs' cure-or-repurchase remedy is addressed to 'such Mortgage Loan' and the Purchase Price mechanism is loan specific."[17]

Similarly, in the Lehman bankruptcy proceedings before U.S. Bankruptcy Judge Shelley Chapman, RMBS

trustees pursuing loan repurchase claims against the Lehman estate sought to use sampling in place of producing the 209,000 loan files at issue and conducting a loan-by-loan review. There, Judge Chapman explained that prior cases authorizing sampling in RMBS securities law cases and in monoline insurance cases were distinguishable from loan repurchase cases, and expressed "serious concerns" about the viability of sampling as a method of proof in repurchase cases. Accordingly, although Judge Chapman expressly reserved the issue of whether the RMBS trustees could offer statistical sampling in support of their claims at trial, she ordered the trustees to produce the 209,000 loan files and identify each loan they claimed was subject to repurchase and why.[18]

Most recently, in 2017, a number of courts in repurchase cases have rejected the use of statistical sampling. In BlackRock Allocation Target Shares v. Wells Fargo Bank National Association, plaintiff RMBS trusts sued Wells Fargo in its capacity as trustee, alleging that Wells Fargo violated its obligations under the PSAs to cure or repurchase the loans upon discovery or notice of a material breach.[19] Like the court in MARM, the BlackRock court turned to the contractual language of the PSAs.[20] The court found the PSAs were drafted in loan-specific terms and concluded that prior cases were distinguishable because they had no explicit or implicit loan-level requirements.[21] Specifically, the court found that because the cure and repurchase remedies under the PSAs were the sole remedies available to the plaintiffs, and because a loan-level determination of material breach is required in order to trigger a repurchase obligation, the use of statistical sampling was inconsistent with the parties' agreement.[22] Since the holding in BlackRock, numerous courts have turned to the relevant contractual language between the parties to determine whether a repurchase obligation is loan-specific.[23]

Conclusion

As the cases described above illustrate, the use of statistical sampling in RMBS cases will turn on the language in the parties' agreements. In repurchase cases with PSA language requiring repurchase only in the event of material breaches as to specific loans, there is now a substantial body of case law to support the argument that sampling is not a viable form of proof. These holdings may well be extended to other RMBS cases where the applicable agreements contain language requiring loan-level proof in order to trigger any kind of remedy.

Moreover, in approximately mid-2018, the court overseeing the ResCap repurchase litigation is expected to rule on the viability of statistical sampling in the largest active repurchase case. In that case, the court initially allowed the plaintiffs to attempt to prove their claims through the use of statistical sampling, but preserved all of the defendants' objections to be ruled on at a later date. If statistical sampling is ultimately approved in the ResCap matters, it will run contrary to the trend discussed above. Stakeholders should keep a close eye on these developments as they strategize how to defend against claims premised on the use of statistical sampling.

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DISCLOSURE: The authors represented correspondent lenders in the In re: RFC and ResCap Liquidating Trust Litigation case referenced in the article.

information purposes and is not intended to be and should not be taken as legal advice.

[1] MBIA Ins. Corp. v. Countrywide Home Loans Inc., 2010 WL 5186702, at *2 (N.Y. Sup. Ct. Dec. 22, 2010).

[2] Id. at *3-4.

[3] Id. at *6.

[4] Assured Guar. Mun. Corp v. Flagstar Bank FSB, 920 F. Supp. 2d 475, 476-77 (S.D.N.Y. 2013).

[5] Id. at 487.

[6] Id. at 512.

[7] Id.

[8] Id. at 514.

[9] Id.

[10] Id. at 512-513.

[11] See e.g., Federal Hous. Fin. Agency v. JPMorgan Chase & Co., 2012 WL 6000885, at *31 (S.D.N.Y. Dec. 3, 2012) (denying joint motion challenging FHFA's use of statistical sampling); Massachusetts Mut. Life Ins. Co. v. Residential Funding Co. LLC, 989 F. Supp. 2d 165, 175 (D. Mass. 2013) (denying motion to exclude sampling expert testimony); Minute Order on NCUA's Mot. in Limine to Admit Expert Statistical Sampling Test. at 1, National Credit Union Admin. Bd. v. Goldman Sachs & Co., No. 2:11-cv-06521-GW-JEM (C.D. Cal. Feb. 10, 2014), ECF No. 259 (granting motion to admit expert sampling).

[12] See Pls.' Mem. of Law in Supp. of Mot. to Approve Use of Statistical Sampling at 6, In Re: RFC and RESCAP Liquidating Trust Litigation, No. 13-cv-3451, (D. Minn. Feb. 17, 2015), ECF No. 156 (Arguing for approval of statistical sampling in a repurchase case on the grounds that "[t]he overwhelming majority of federal and state courts" have permitted statistical sampling "in cases involving large number of allegedly defective mortgage loans.").

[13] Retirement Bd. of the Policemen's Annuity and Benefit Fund of the City of Chicago v. BNYM, 775 F.3d 154, 162 n.6 (2d Cir. 2014).

[14] MASTR Adjustable Rate Mortgages Trust 2006-OA2 v. UBS Real Estate Securities Inc., 2015 WL 764665, at *1 (S.D.N.Y. Jan. 9, 2015).

[15] Id. at *10-11.

[16] Id. at *11-12.

[17] Id. at *12.

[18] See Hearing Tr. at 70:22-71:13, 93:3-95:4, 350:23-351:7, 354:10-355:17, In re Lehman Brothers

Holding Inc., No. 08-13555 (Bkrtcy. S.D.N.Y. Dec. 10, 2014).

[19] BlackRock Allocation Target Shares v. Wells Fargo Bank Natl. Assn., 2017 WL 953550, at *1-3 (S.D.N.Y. Mar. 10, 2017).

[20] Id. at 8-9.

[21] Id. at 9-10.

[22] Id. at 11.

[23] Findings of Fact and Conclusions of Law at 5, Western and Southern Life Ins. Co, et al. v. The Bank of NY Mellon, Ohio 45202-1217, Case No. A1302490 (Ohio Ct. Com. Pl. Aug. 3, 2017) (Rejecting the use of statistical sampling in an RMBS repurchase case because "[c]ountless provisions in the PSAs rely on and presume a loan by loan analysis not sampling."); Homeward Residential, Inc. v. Sand Canyon Corp., 2017 WL 5256760, at *7 (S.D.N.Y. Nov. 13, 2017) ("Because the Court concludes that the Governing Agreements, as relevant here, call for proof of breach on a loan-by-loan basis, the Court finds that Homeward's proposed sampling will not 'assist the trier of fact to understand the evidence or to determine a fact in issue.') (citations omitted).