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Pigs have sprouted wings! Republic Bank & Trust Company plaintiff, v. Bear Stearns & Company, Inc. etal. Defendant - Appellees US Court of Appeals, 6th Circuit 10-5510.

By L. Burke Files, CDDP, President, Financial Examinations & Evaluations, Inc (01/07/2012)

Well the day has finally happened. A judge has held a bank responsible for it’s own choices and lack of due diligence. The first few sentences of the appellate opinion say it all.

“Republic Bank & Trust Company bought more than fifty million dollars worth of residential-mortgage-backed securities from Bear Stearns. It did not read the relevant offering documents before investing.”

Bear Stearns sold Republic Bank 50 million dollars of mortgage back securities, specifically Bear Stearns ALT-A Trust 2005-10, Bear Stearns ARM Trust 2006-2, Bear Stearns ARM Trust 2006-4, and the IndyMac INDX Mortgage Loan Trust 2006-AR11. All had a rating of AA or AAA at the time. Well, we know what happened - (scary words like mortgage back securities and Bear Stearns all in the same investment) - the investments went bad.

Republic Bank claimed fraud by mis-representation as well as fraud by omission in that these purchases were reasonable safe investments. Heck, they were rated AA and AAA what else was a salesman to say at the time. I am also certain the salesman had no idea what was behind these securities - I mean why should he - they were rated AA and AAA. In the litigation that followed the recognition of the losses Republic made claims that Bear Stearns failed to follow their underwriting standards and that the lenders failed to follow their underwriting standards and thus the representations that Republic relied upon were pillars built on sand.

Well it seems Republic did not read the disclosure documents and the supplements closely. The offering documents expressly warned prospective investors about each of the alleged non-disclosures raised by Republic in the complaint. First, the documents explained that some of the loans in the trust were non-conforming loans, meaning that they were “ineligible for purchase by Fannie Mae or Freddie Mac due either to credit characteristics of the related mortgagor or documentation standards in connection with the underwriting of the related mortgage loan.” “These credit characteristics include mortgagors whose creditworthiness and repayment ability do not satisfy such Fannie Mae or Freddie Mac underwriting guidelines.” In light of these disclosures (which Republic did not read), Republic cannot maintain a fraud-by-omission claim. Had it read the disclosures, Republic would have known that the trusts contained loans issued to borrowers with questionable credit histories, despite the AA or AAA ratings.

Had Republic read these documents Republic would have been imparted the full disclosure of the risks of the underlying mortgages, a red faced moment for sure by Republics investment team. Had Republic not read these documents, as they claim Republic was negligent - not Bear Stearns. There is just no good reading of the admissions of Republic’s as it swings between claiming they were either a “willing fool” or a “slovenly fool”.

None the less Republic claimed to have failed to read the offering circulars fully before investing tens of millions of dollars in risky securities!

This opinion set a right and just tone in the process of holding investors, especially sophisticated investors such as Republic Bank & Trust, responsible for their choices. The risks appear to have been fully disclosed. It appears to me, and my not so humble opinion, that Republic relied upon the ratings and never looked any further, not even to read the prospectus in its totality. I am also sure that in the purchase process the buyers had to sign an agreement stating something to the fact ‘We have read the prospectus / offering circular, in its entirety and we understand the risks and are able to bear the losses.’ Thus, again according to Republic’s own testimony and industry norms, not only did Republic not read the documents they signed a subscription agreements saying that they did.

I have often ranted that investors need to be held responsible for their own choices,

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especially when the information was in front of them, in writing, and fully disclosed. Republic was rightly held responsible for Republic's due diligence failures as well Republic should be.
This decision is a *nose in the tent* on holding investors responsible for losses on an informed investment and not always being the victim of the underwriter. I was told, many years ago, by an excellent securities litigator that "*the day investors are held responsible for their bad choices pigs will fly.*"
Pigs still do not fly, but I think they have sprouted some wings.
The full text is available at:
[Republic-Bank-Trust-Co.-v.-Bear-Stearns](#)

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