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Securities Arbitrations Involving Mortgage-Backed Securities and Collateralized Mortgage Obligations: Suitable for Unsuitability Claims?

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I. INTRODUCTION AND BACKGROUND

Over the past two years, the world has witnessed the unfolding of the "subprime mortgage crisis". A steep rise in home foreclosures be-ginning in late 2006 caused a ripple effect throughout the economy, resulting in a dearth of liquidity across the lending sector. The largest rise in defaults occurred on so-called "subprime" and other adjustable rate mortgages (ARMs). These types of mortgages were offered initially during a time of rising housing prices, often to unqualified borrow-ers, who thought that they would later have the opportunity to refinance at more favorable terms. As housing prices declined, however, re-financing became more difficult; defaults increased sharply as interest rates reset at higher rates on many of the mortgages. These events contributed to approximately 1.3 million foreclosures in 2007, an increase of approximately 75% from 2006. Foreclosures increased to 2.3 million in 2008, an increase of approximately 80% from 2007. Some experts have estimated that subprime defaults ultimately will reach between $200 billion and $300 billion before the crisis ends.

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