UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re GENWORTH FINANCIAL, INC. SECURITIES LITIGATION	:	Master File No. 1:14-cv-02392-AKH
	:	CLASS ACTION
This Document Relates To: ALL ACTIONS.	:	LEAD PLAINTIFFS' MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' MOTION TO DISMISS THE AMENDED COMPLAINT

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page

CASES

Page

Page

Page

Page

Page

Page

STATUTES, RULES AND REGULATIONS

Page

SECONDARY AUTHORITIES

Lead Plaintiffs City of Hialeah Employees' Retirement System and New Bedford Contributory Retirement System (collectively, "plaintiffs") respectfully submit this opposition to the motion of defendants Michael D. Fraizer ("Fraizer") and Martin P. Klein ("Klein") (the "Individual Defendants"), and defendant Genworth Financial, Inc. ("Genworth" or the "Company") (collectively, "defendants") to dismiss plaintiffs' Amended Complaint for Violation of the Federal Securities Laws (Dkt. No. 26) (the "Complaint").[1]

I. INTRODUCTION

The Complaint pleads a classic case of securities fraud. Defendants misrepresented the strength of Genworth Australia's business in advance of a minority share IPO (the "IPO") necessary to pull $800 million in capital out of that business to disburse to other Genworth segments, particularly its floundering U.S. Mortgage segment. In the months before the IPO, while defendants represented that the transaction was "on track" and would occur "from a position of strength," they concealed a massive exposure to low-documentation (or "low-doc") loans approved using "projected" and manipulated sources of income. Only after the Class Period (November 3, 2011-April 17, 2012) did defendants admit that these low-documentation loans were defaulting at an "***increasing***" rate ***before the Class Period***, as factors in the Australian economy – and particularly in Queensland, where Genworth Australia concentrated its business – put greater pressure on these borrowers. In repeatedly representing to the market that Genworth Australia's strength would allow the IPO to go forward for "capital redeployment," defendants hid from the market the necessity of taking additional reserves for its exposure to these deteriorating loans. When the truth came out that

[1] Unless otherwise noted, all paragraph references ("¶_" and "¶¶__") are to the Complaint. Emphasis is added and citations and footnotes are omitted throughout unless otherwise indicated. "Defs.' Mem." refers to the Memorandum of Law in Support of Defendants' Motion to Dismiss the Amended Complaint (Dkt. No. 30).

Genworth had to take an unprecedented $82 million charge due to "small business and self-employed borrowers" – the very borrowers that defendants targeted for low-documentation lending – and delay indefinitely the IPO, the market was stunned and analysts were "surprised" as the stock dropped 24% in heavy trading.

Defendants' motion is notable for what it ignores. It overlooks allegations that defendants touted Genworth Australia's business strength – devoting a single paragraph to arguing why those statements should be dismissed – and ignores the IPO as a motive for these false statements. The motion rarely mentions Genworth Australia's exposure to low-doc loans provided especially to small business and self-employed borrowers, and, importantly, the way these loans were underwritten using "prospective" sources of income, "fudged figures," and tricks to get approved. This particular oversight is telling since this very category of borrower caused the $82 million increase in reserves, the unheard of losses at Genworth Australia, and suspended the IPO.

While overlooking these allegations, defendants ask this Court to believe that "Genworth experienced unexpected losses that caused the postponement of the IPO and a strengthening of reserves" in "March 2012." Defs.' Mem. at 40. In essence, they ask the Court to accept a "we didn't know" argument. But in pleading ignorance, just prior to the Class Period's end, they have again disregarded nearly every fact eviscerating that excuse, including defendants' own post-Class Period admission to seeing "***increasing delinquency levels***" "***[i]n the second half of 2011***." By defendants' own admission, these "later-stage delinquencies from prior years" were particularly marked among "certain groups of small business owners and self-employed borrowers," some having been delinquent for ***up to 21 months before the Class Period***. As a result, they had to work "[i]n partnership with key lenders" to clear "***backlogs*** of delinquencies."

That defendants remained ignorant until March 2012 makes little sense when combining

these admissions with the fact – again ignored by defendants – that Genworth Australia faced an $8 billion exposure to low-doc loans, which had previously driven Genworth Australia's growth in 2007 and 2008. But in "late 2008," recognizing the unacceptable risk these loans carried, and with the portent of the U.S. financial crisis and devastation from similar toxic mortgages written in the United States, defendants ***discontinued offering insurance on those loans***. Instead, borrowers had to show 12 months of Business Activity Statements as proof of income – a stark contrast from the "projected" and manipulated sources of income that Genworth Australia used earlier.

Defendants also omit any reference to the allegations that the losses reported at the end of the Class Period were, as an Australian analyst described it, "a blowout . . . not typical of the LMI sector in Australia over the last five years" and completely disregard analyst commentary expressing surprise and even stating that "***what was surprising*** was the stated reason for the postponement." This particular omission, again, is startling given that this commentary amounts to objective evidence that the purported "disclosures" on which defendants focus, in fact, did not reveal the truth about the risk facing Genworth Australia. And Genworth Australia's losses cannot, as defendants try, be explained by the Queensland flooding that had occurred earlier in the year since, as an Australian analyst reported, the fallout from that had "occurred ***long ago***" and had already been "well and truly dealt with by its major competitor."

Defendants' wholesale disregard of most allegations demonstrates their force. They directly undermine defendants' statements about the strength of Genworth's business and made highly improbable the IPO that defendants repeatedly told investors was "on track" to take place in 2Q 2012. Any interpretation that defendants were unaware of the problems with these loans and the need to increase reserves by $82 million until the very last week of the quarter is simply not credible. Defendants have no answer for the core of plaintiffs' case. Their motion must be denied.

II. STATEMENT OF RELEVANT FACTS

A. Background

Genworth is a holding company that brands itself as a leading provider of insurance products and other related financial services. ¶¶1, 14, 16. At issue in this case is Genworth's lenders mortgage insurance ("LMI"), a financial product that allows borrowers to purchase homes with low down payments while protecting lenders against the risk of default. ¶¶1, 15. Genworth offered LMI to lenders through its Mortgage Insurance division, which operated through the U.S. Mortgage Insurance segment and the International Mortgage Insurance segment. ¶14. The International Mortgage Insurance segment, for its part, operated primarily through subsidiaries offering LMI on mortgages in Australia ("Genworth Australia") and Canada ("Genworth Canada"). ¶¶1, 14.

Following its 2004 IPO, Genworth became a leading provider of LMI on the very same high-risk mortgages that drove the 2008 global economic slowdown. ¶¶16, 18. Genworth reported strong financial results between 2004 and 2007, attributed largely to its U.S. Mortgage Insurance division that had offered insurance on high-risk loans, including low-doc loans. ¶¶16, 18, 21. And Genworth paid the price. When the U.S. economy collapsed in 2008, and in the years following, Genworth suffered devastating losses from policies insuring toxic U.S. mortgages. ¶¶18, 21, 23. Genworth's stock price collapsed as a result, falling to $0.90 per share in November 2008, and remained stagnant in the years leading up to the Class Period. ¶¶18, 20.

Defendants saw the U.S. Mortgage Insurance segment as driving Genworth's turnaround – and even analysts described the segment as "[t]he key driver of future earnings growth for [Genworth]" and its turnaround as "imperative" for restoring the securities' valuation – but the segment needed massive capital infusions and creative stop-gap measures just to write new business and to satisfy its regulators. ¶¶20, 22-28. These measures were temporary and set to soon expire.

¶¶26, 27. So, in 2011, defendants turned their attention to Genworth Australia. ¶¶30-31, 33. Genworth Australia had reportedly produced strong results throughout the financial crisis, and in 2011 was one of the only subsidiaries paying dividends to Genworth. ¶¶28, 30, 33. It was a prime candidate for defendants to tap, especially with a book value of $2 billion. ¶¶28, 33. Defendants could sell a piece of it, retain control, and secure a much-needed capital infusion. ¶¶28, 32, 33.

B. Defendants Announced 3Q 2011 Financial Results and a Planned Minority Interest IPO of Genworth Australia

The Class Period starts on November 3, 2011, when defendants announced Genworth's financial results for 3Q 2011, including net income of $29 million and $0.06 diluted EPS. ¶36. To address Genworth's stagnant stock price, defendants told investors that they planned to pull $800 million in capital out of Genworth Australia through a minority interest IPO "in the second quarter of 2012," and use the proceeds for strategic purposes, including to "free material capital for redeployment." *Id.* The International Mortgage Insurance segment, which included Genworth Australia, was "solid" and "strong" with Genworth Australia posting a "loss ratio" (the ratio of losses and loss reserves[2] to net earned premiums) of 48%, which was "flat sequentially." ¶¶14, 37, 65, 66. Defendants also stated that the Australian economy was not significantly affecting Genworth Australia. ¶67. Rather, it was "transitioning as expected" and "absorbing the loss pressures" from economic conditions and the January 2011 Queensland flood. *Id.*

The market credited defendants' upbeat version of events. Genworth's share price rose 16.7% on the news. Analysts noted "Solid Overall 3Q Results" with "Delinqs [sic] Low" in Australia, the "core upside in Australia," and that the business, having been "relatively resilient,"

[2] Loss reserves are liabilities established for claims against Genworth in the event that a borrower defaults on their loan. They represent the total estimated ultimate cost of claims at a point in time that Genworth anticipates it will pay in the future. ¶2 n.1.

"sustained strong returns throughout the downturn." ¶¶38, 70.

But defendants concealed an important fact – Genworth Australia was sitting on an ***$8 billion exposure*** to high-risk low-doc mortgages that, as defendants later admitted, began defaulting at an increasing rate "***in the second half of 2011***." ¶¶42-43. In 2007 and 2008, Genworth Australia promoted the use of (and wrote insurance on) these low-doc loans, suggesting to lenders that they tap into "a previously overlooked category of borrower" – the self-employed – while its LMI policies offset the "greater risk associated with offering loans to this group." ¶¶4, 40, 42. Nearly 16% of the mortgage insurance Genworth Australia wrote in 2007, and 23% in 2008, was for low-doc loans, helping to make Genworth "the leading provider of mortgage insurance in Australia." ¶42.

But, as defendants knew long before the Class Period, these low-doc loans were toxic. They permitted "low-doc borrower[s] [to] self-certif[y] their income" and required ***only*** "that the ***stated income*** [was] sufficient to meet the proposed mortgage commitments." ¶¶40, 41. Testimony before the Australian parliament reveals that all of the major Australian banks that issued Genworth's LMI policies encouraged brokers to systematically manipulate low-doc loans ***at the same time*** that Genworth Australia promoted their use. ¶¶44, 115-116. According to that testimony, lenders used "'[f]udged figures'" and tricks "to get loans across the line, such as calling rising house prices [and capital growth] 'income.'" *Id.* Low-doc lending was thus a "free-for-all," where, according to a broker's testimony, in her eight years of finance brokering, she had only ever met one person who was self-employed, even for one day. ¶¶44, 115.

In 2008, seeing the fall-out from toxic U.S. mortgages, Genworth Australia took decisive action to curtail its own exposure to toxic mortgages. But only after the Class Period were the corrective measures disclosed – and those measures demonstrated that defendants understood the risk these loans posed: going forward, borrowers proved income through 12 months of Business

Activity Statements, while Genworth Australia resorted to ***external*** reinsurance rather than ***affiliated*** reinsurance beginning in 2009 to provide distance from the exposure for the rest of Genworth. ¶¶45, 46. The result was "higher quality Book Years written ***post 2009***." ¶45. The damage, however, was already done – but the pre-2009 exposure remained undisclosed.

When the Australian economy weakened in 2011, the performance of Genworth's "small business and self-employed" portfolio reveals that Genworth Australia had insured in 2007 and 2008 the very type of low-doc loans that brokers and banks had manipulated. Indeed, defendants attributed Genworth's losses at the Class Period's end to "small business and self-employed" borrowers in Australia from the 2007 and 2008 vintage years. ¶¶45, 102-103. And the losses were more marked in Queensland, Australia's so-called "Gold Coast," a region facing greater economic upset and where Genworth Australia had concentrated its business. ¶¶34-35. And unbeknownst to investors, these loans were defaulting at an increasing rate since the "second half of 2011," with a "significant" increase in the amount of paid claims. ¶¶53, 103. The defaults were so significant that defendants were ultimately forced to admit to working "[i]n partnership with key lenders" "during 2011" to clear "***backlogs*** of delinquencies." ¶43.

The high-risk quality of the low-doc loan exposure, increasing defaults, and the sharp increase in paid claims required defendants to take a significant portion, if not all, of the $82 million reserve charge in 3Q 2011. There was no material difference in risk (or in value of the underlying properties) that existed in 1Q 2012 that did not exist in 3Q 2011. ¶¶7, 54, 59. Defendants' claims about Genworth Australia's business and its reported financial results, including its reported loss ratio, loss reserves, net income and earnings per share, were false and misleading.

C. Defendants Announced 4Q and Fiscal Year 2011 Financial Results: Genworth Australia Remains a Strong Generator of Capital with Improving Delinquencies While the IPO Remains on Track

On February 2, 2012, the Company reported 4Q 2011 net income of $107 million, or $0.22 diluted EPS, and emphasized the strength of Genworth Australia's business, stating that "[i]nternational platform capital generation remained ***strong***" and that "Canada and Australia . . . maintain[ed] strong capital positions." ¶¶47, 78. While defendants acknowledged that Genworth had added reserves in Australia "for prior delinquencies where lenders accelerated actions to move these loans through to claim," they did not disclose the worsening state of the low-doc loan exposure. ¶47. Instead, they emphasized ***improving*** conditions at Genworth Australia. Its 46% loss ratio was "down two points from the prior quarter as a result of the ***decrease*** in new delinquencies" while its "***delinquency rate improved across all regions sequentially***." ¶¶48, 78. They further explained that the "higher severity experience [was] in the New Zealand run-off portfolio" and again reiterated that it was "partially offset by ***a decrease in new delinquencies, including reductions in Queensland***." ¶47. Defendants reported in Genworth's Form 10-K on February 27, 2012, that Genworth Australia's loss ratio for the 2011 year was 47%, adding that reported loss reserves "represent our best estimates of the liabilities at the time based on known facts" and were "satisfactory to cover the losses that have occurred." ¶¶86, 87.

Riding on the news of Genworth Australia's strength and improving delinquencies, defendants confirmed that they were "on track right now with the Australia IPO" and had "not encountered any regulatory or market conditions that would change th[e] timing" of the IPO. ¶¶48, 49, 80, 82. And again, the market believed defendants' upbeat version of events. Analysts noted that "GNW appears cheap and the IPO of the Australian mortgage insurance unit and other restructuring actions are potential catalysts" with "the loss ratio in Australia improv[ing] from 3Q11

as housing trends seem to be recovering." ¶83. Analysts' take-away was a "Weak but Stable" company with Genworth Australia reporting "solid" results ahead of the planned IPO. *Id.*

But defendants' statements about Genworth Australia's business, its reported loss ratios and loss reserves, and the resulting net income and earnings per share for Genworth were false. The increasing delinquencies "in the second half of 2011" had increased "significantly" since September and required defendants to take a massive charge to Genworth's loss reserves. ¶52. The number of paid claims on these loans had nearly doubled from 156 in November 2011 to 253 in January 2012, and the average paid claim jumped from $53,000 in December 2011 to $64,000 in January 2012. ¶¶52-53. The average paid claim for small business and self-employed borrowers in Queensland were even worse, reaching $107,000, compared to $65,000 for the entire portfolio and $68,000 for the small business segment as a whole. ¶53. This extraordinary amount was actually ***higher*** than the $104,000 figure for the business as a whole that ultimately drove defendants' decision to take the reserve charge in 1Q 2012. *Id.* Having failed to take the charge in 3Q 2011, defendants were required by Generally Accepted Accounting Principles ("GAAP") to take a significant portion, if not all, of the $82 million reserve charge in 4Q 2011. Again, there was no material difference in risk (or in value of the underlying properties) in 1Q 2012 that did not exist in 4Q 2011. ¶¶54, 74.

D. Defendants Claim that the Australian Market "Remains Solid" and the IPO Is "One of Our Most Important Initiatives"

With Genworth Australia experiencing undisclosed increasing claims from high-risk low-doc loans, defendants presented at a JP Morgan Insurance Conference on March 29, 2012. Defendants stated that they expected the "Canadian and Australian markets to remain solid," described Genworth Australia as a "capital generator" for Genworth, and even stated that they had "pursued growth in these markets in a disciplined way with sound underwriting guidelines." ¶¶50, 92. In fact, they signaled to investors that for their International Mortgage Insurance business, the segment

expected to be a drain on results was Europe – not Australia. ¶95. While defendants also noted that lenders accelerated actions to move delinquent loans through to claim, they emphasized that higher severities were in the runoff of Genworth Australia's New Zealand book, with no mention of issues in Australia or in Queensland. ¶51.

Defendants also hyped the IPO, stating that it was "on track," claiming that "we're pursuing a transaction from a position of strength," and reiterating, "I would say this IPO for a number of reasons is a very, very important transaction for us." ¶¶51, 93, 94. Defendants emphasized that the "IPO is one of our most important initiatives" and stated that they were "devoting a lot of time and energy to the related preparatory work" and "working very actively to put ourselves in a position to execute this in the second quarter, as we've said." *Id.*

Defendants' message convinced the market. Less than two weeks later, analyst BTIG initiated coverage with a "Buy" rating, emphasizing "adequate reserves" and "improving trends, as its loss ratio declined to 46.0% during 4Q11 from 48.6% in the prior quarter thanks to a decline in delinquencies." ¶97. The IPO, for BTIG, was a "catalyst" for "affirming the unit's value." *Id.* Likewise, analyst Sandler O'Neill maintained its "Buy" rating and stated that "[w]e are not anticipating a reserve charge for GNW [Genworth] this quarter." ¶98. It also noted the market's anticipation of the IPO, stating that "[p]robably the most prescient question facing Genworth today is how the company will unlock the value of the company" and that "[i]nvestors will be looking in particular for an update regarding the planned minority IPO of the Australian mortgage insurance operations." *Id.* The market was clearly unaware of deteriorating exposure at Genworth Australia.

Defendants' statements were blatantly false and misleading. By the time of the JP Morgan conference, Genworth's paid claims had climbed to 306 in March 2012 (96% higher than the claims rate in November 2011, which was already an increase above what defendants witnessed "in the

second half of 2011"), and the average paid claim for the whole division had reached $104,000, ***nearly the same amount that defendants had witnessed in Queensland in the fourth quarter***. ¶¶52-53. Thus, the very conditions that defendants blamed when taking the $82 million reserve charge existed as of the JP Morgan conference. They had no reasonable basis for the statements that they made during that conference. ¶¶51, 80, 82, 92-93.

E. Defendants Disclose the Truth: Genworth Expects Losses Because of Low-Documentation Loans and Postpones the IPO Indefinitely

Then, on April 17, 2012, ***just 19 days*** after the JP Morgan conference, Genworth shocked the market by announcing that the IPO would be delayed because of "business performance" at Genworth Australia. ¶56. Defendants pointed to expected losses due to accelerated claims from "certain groups of small business owners and self-employed borrowers." *Id.* Genworth's stock collapsed in response, falling 23.8% in a single day of heavy trading.

Defendants' disclosures caught analysts off-guard. An analyst from the *Australian Financial Review* reported that "something has gone horribly wrong at Genworth" because of "a blowout in losses that is not typical of the LMI sector in Australia over the past five years." ¶¶6, 57. Analysts in the United States were also surprised. ¶100. BTIG reported that "what was surprising was the stated reason for the postponement," JP Morgan noted that the "loss severity was worse than expected, raising questions about reserve adequacy," and Morgan Stanley emphasized that defendants "had been downplaying" concerns about the Australian housing market. *Id.*

Two weeks later, Genworth announced that Fraizer resigned and that Genworth Australia would report a $21 million loss for 1Q 2012 (the first reported loss in years), with an $82 million charge to its loss reserves largely due to LMI policies to "small business owners and self-employed borrowers ***which were more concentrated in the 2007 and 2008 vintages***." ¶¶7, 58. The total increase to loss reserves in 1Q 2012 for Genworth Australia was $138 million, a staggering 214%

increase from the $44 million in 4Q 2011 and a 176% increase from the $50 million in 3Q 2011. ¶7.

III. ARGUMENT

A. The Standard Governing Motions Pursuant to Fed. R. Civ. P. 12(b)(6)

When ruling on a motion to dismiss, the court must construe the complaint liberally, "'accepting all factual allegations in the complaint as true, and drawing all reasonable inferences in the plaintiff's favor.'" *Holmes v. Grubman*, 568 F.3d 329, 335 (2d Cir. 2009). The complaint's "[f]actual allegations must be enough to raise a right to relief above the speculative level, on the assumption that all the allegations in the complaint are true (even if doubtful in fact)." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007). "Asking for plausible grounds does not impose a probability requirement at the pleading stage; it simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence" of fraud. *Id.* at 556. Thus, "a well-pleaded complaint may proceed even if it strikes a savvy judge that actual proof of those facts is improbable, and 'that a recovery is very remote and unlikely.'" *Id.*[3]

B. Defendants' Statements Were False and Misleading

The Private Securities Litigation Reform Act of 1995 ("PSLRA") requires plaintiffs to "specify each statement alleged to have been misleading [and] the reason or reasons why the statement is misleading." 15 U.S.C. §78u-4(b)(1). To satisfy particularity requirements, the Complaint must """(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements

[3] To plead a §10(b) violation, a plaintiff must allege: (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation. *See Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341-42 (2005). Defendants do not dispute that the Complaint adequately alleges elements (3)-(6). Defendants move to dismiss only on the grounds that the Complaint fails to adequately allege an actionable misrepresentation or omission and scienter.

were fraudulent."'" *Novak v. Kasaks*, 216 F.3d 300, 306 (2d Cir. 2000). "Some statements, although literally accurate, can become, through their context and manner of presentation, devices which mislead investors. For that reason, the disclosure required by the securities laws is measured not by literal truth, but by the ability of the material to accurately inform rather than mislead prospective buyers." *McMahan & Co. v. Wherehouse Entm't*, 900 F.2d 576, 579 (2d Cir. 1990); *Operating Local 649 Annuity Trust Fund v. Smith Barney Fund Mgmt. LLC*, 595 F.3d 86, 92 (2d Cir. 2010) (citing same). "The touchstone of the inquiry is not whether isolated statements within a document were true, but whether defendants' representations or omissions, considered together and in context, would affect the total mix of information and thereby mislead a reasonable investor regarding the nature of the securities offered." *Halperin v. eBanker USA.com, Inc.*, 295 F.3d 352, 357 (2d Cir. 2002).[4]

1. Defendants' Statements About Genworth Australia's Business Conditions Were False and Misleading

Plaintiffs have properly specified the material false statements regarding Genworth Australia's business and its contribution to Genworth's financial standing, identifying the statements, the speakers, when the statements were made, and detailing why the statements were false. *See Novak*, 216 F.3d at 306. Specifically, on at least three different occasions on November 3, 2011, February 2, 2012 and February 3, 2012, defendants emphasized to the market the strength of Genworth Australia, stating that "International capital generation remained strong" (¶¶36, 65, 78,

[4] An omitted fact is "material" for purposes of §10(b) if there is a "substantial likelihood" that its disclosure "'"would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."'" *Matrixx Initiatives, Inc. v. Siracusano*, __U.S.__, 131 S. Ct. 1309, 1318 (2011). "'[A] complaint may not properly be dismissed'" on materiality grounds "'unless [the alleged misrepresented or omitted facts] are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance.'" *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 162 (2d Cir. 2000).

82); that Canada and Australia paid total dividends to the holding company . . . and continued to maintain strong capital positions" (¶78); and the "International Mortgage Insurance achieved its dividend goals and remains a strong generator of capital" (¶80). Buttressing this image of strength, defendant Klein indicated to investors on February 3, 2012 and March 29, 2012 that defendants expected "the Canadian and Australian markets to remain solid" with "Stable Origination Markets." ¶¶82, 92. And when Klein disclosed particulars regarding international dividends on March 29, 2012, he also represented that "[w]e pursued growth in these markets in a disciplined way with sound underwriting guidelines." ¶92. The message was clear: Genworth Australia was a strong, solid contributing subsidiary practicing disciplined growth.[5]

But, as the Complaint alleges, these statements were false and misleading. *Novak*, 216 F.3d at 315 (statements that inventory was "in good shape" or "under control" are actionable); *In re GE Sec. Litig.*, 857 F. Supp. 2d 367, 386 (S.D.N.Y. 2012) (description of a loan portfolio as "fantastic," "great," "robust," "strong" and "really high quality" was misleading). Rather than a "strong" business based on its capital generation, Genworth Australia was experiencing significant deterioration in the low-doc segment of its LMI portfolio. ¶¶52, 71, 84, 95. Those low-doc loans could not withstand the pressures from rising unemployment and falling home prices in Australia, and in particular, Queensland, because of the way the loans were underwritten using "prospective"

[5] As courts and the U.S. Securities and Exchange Commission ("SEC") have found, "material misrepresentations include those 'concern[ing] a segment or other portion of the registrant's business that has been identified as playing a significant role in the registrant's operations or profitability.'" *Freudenberg v. E*Trade Fin. Corp.*, 712 F. Supp. 2d 171, 181 (S.D.N.Y. 2010) (quoting SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45150, 45152 (1999)); *see also Litwin v. Blackstone Grp., L.P.*, 634 F.3d 706, 720 (2d Cir. 2011) ("Even where a misstatement or omission may be quantitatively small compared to a registrant's firm-wide financial results, its significance to a particularly important segment of a registrant's business tends to show its materiality."). Indeed, defendants do not dispute Genworth Australia's importance. Nor could they. Genworth Australia was one of the two primary businesses that paid dividends to Genworth. ¶¶14, 31, 50. Statements regarding Genworth Australia's financial health, then, were particularly material to investors.

sources of income and "fudged figures." ¶¶34-35, 39-45, 52. Rather than grow in a "disciplined way," Genworth Australia had encouraged lenders to issue low-doc loans "to tap into a previously overlooked category of borrower" – namely, "self-employed workers and contractors" – despite the "greater risk." ¶40. Defendants' statements about "strong" capital generation, a "solid" Australian market, and growth based on "disciplined" and "sound" underwriting guidelines were simply false and misleading. ¶¶39, 43, 52-53, 71, 84.

Even more deceptively, defendants falsely represented Genworth Australia's delinquency status. Once defendants chose to speak about delinquencies, they had a duty to speak truthfully. *Caioloa v. Citibank, N.A.*, 295 F.3d 312, 331 (2d Cir. 2002) ("upon choosing to speak, one must speak truthfully about material issues"); *Freudenberg*, 712 F. Supp. 2d at 179 (officers "'obligated to speak truthfully and to make such additional disclosures as are necessary to avoid rendering the statements made misleading'"). But instead, on November 4, 2011, Fraizer stated that "Australia is transitioning as expected, absorbing the loss pressures coming from the early 2011 Queensland flood events" as well as other economic pressures in Australia. ¶67. Defendants also stated on February 2, 2012 that the increased reserves for prior delinquencies and increased severity in loan claims in New Zealand was "partially offset by a decrease in new delinquencies, including reductions in Queensland." ¶78. The next day, Fraizer added that "[t]he delinquency rate improved across all regions sequentially." ¶80.

But this rosy picture was inaccurate. Defendants had not disclosed to investors – and would not until after the Class Period – that "[i]n the second half of 2011, we did see ***increasing delinquency levels*** and we did observe lender processing delays," which caused "***backlogs of delinquencies***." ¶¶43, 52-54, 103. It was not until after the Class Period that investors learned what had driven the increased delinquencies – "natural catastrophes and regional economic slowdowns" in

Queensland and "small-business self-employed borrowers which were more concentrated in the 2007 and 2008 vintages" – forcing Genworth to take an unprecedented $82 million charge. ¶¶102-104. Defendants' statements about delinquencies were, at the very least, misleading, if not actually false, because of the build-up of delinquencies, particularly in that region, from low-doc loans that were manifesting their susceptibility to economic pressures. ¶¶52, 84.

Defendants hardly contest plaintiffs' allegations regarding Genworth Australia's business, addressing them in a single, offhand paragraph. Defs.' Mem. at 25. But neither of their under-developed arguments provide grounds for dismissal: defendants' statements are neither opinions nor puffery, but statements of Genworth Australia's then-present condition.[6] Defendants' statements that Genworth Australia's business was strong – when it was not (because of the exposure to deteriorating low-doc loans), and that delinquencies were improving – when they were not (low-doc delinquencies were increasing), are actionable because they contradict existing facts. *Ark. Teacher Ret. Sys. v. Bankrate, Inc.*, 18 F. Supp. 3d 482, 485 (S.D.N.Y. 2014) ("while a term like 'high quality' might be mere puffery or insufficiently specific to support liability in some contexts, it is clearly a material misrepresentation when applied to assets that are entirely worthless").[7]

---

[6] The federal securities laws "recognize no distinct 'puffing' exception. To say that a statement is mere 'puffing' is, in essence, to say that it is immaterial." *Hoxworth v. Blinder, Robinson & Co.*, 903 F.2d 186, 200 (3d Cir. 1990); *see also Abbey v. 3F Therapeutics, Inc.*, No. 06 CV 409 (KMW), 2009 U.S. Dist. LEXIS 111917, at *26 (S.D.N.Y. Dec. 2, 2009) (to constitute puffery, statements must be "'obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance'"). Questions of materiality involve assessments that "are peculiarly ones for the trier of fact." *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449-450 (1976).

[7] *See also In re MF Global Holdings Sec. Litig.*, 982 F. Supp. 2d 277, 305 (S.D.N.Y. 2013) (no puffery where statements are "'misrepresentations of existing facts' made even though the speaker 'knew that the contrary was true'") (quoting *Novak*, 216 F.3d at 315); *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 572 (S.D.N.Y. 2011) ("the mere fact that a statement uses conclusory, indefinite, and unverifiable terms, rather than expressing a reason in dollars and cents, does not compel a conclusion that it is immaterial as a matter of law"; collecting similar propositions); *see also* §III.B.2., *infra*.

Defendants' meager arguments are of no avail; plaintiffs have alleged falsity as to defendants' statements about Genworth Australia's financial performance.[8]

2. Defendants' Statements About Genworth Australia's Loss Reserves and Loss Ratios Were False and Misleading

In *Fait*, the Second Circuit addressed liability for statements "based upon a belief or opinion" and held that under §11, liability lies "where the statement was both objectively false and disbelieved by the defendant at the time it was expressed." *Fait v. Regions Fin. Corp.*, 655 F.3d 105, 110 (2d Cir. 2011). A year later, the Second Circuit extended *Fait*'s holding to claims brought under §10(b). *City of Omaha v. CBS Corp.*, 679 F.3d 64, 68 (2d Cir. 2012). Although *Fait* held that judgments about goodwill and loss reserves qualify as statements of opinion, it did not erect an insurmountable hurdle. Indeed, GAAP requires accounting estimates to have a reasonable basis, prohibiting management from simply picking a number of its choice. Accounting Standards Codification 450. *See* ¶¶54, 72. The court in *CBS*, in fact, recognized from *Fait* that a plaintiff ***can*** plead an actionable misstatement of opinion or belief by "'***plausibly*** alleg[ing] that defendants did not believe the statements regarding goodwill [or loss reserves] at the time they made them.'" *CBS*, 679 F.3d at 67; *City of Westland Police & Fire Ret. Sys. v. MetLife, Inc.*, 928 F. Supp. 2d 705, 717 (S.D.N.Y. 2013) (falsity alleged where defendant "either did not believe the accuracy of its

---

[8] Defendants merely cite to cases in which contradicting facts were too tangential and inadequately pleaded for the courts to find anything but puffery for the alleged misrepresentations. Defs.' Mem. at 25 n.11. *See ECA & Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co.*, 553 F.3d 187, 205-06 (2d Cir. 2009) (statements about "highly disciplined" risk management and integrity were too general to find actionable as a deception about JP Morgan's involvement in the Enron and WorldCom scandals); *Johnson v. Sequans Commc'ns S.A.*, No. 11 Civ. 6341 (PAC), 2013 U.S. Dist. LEXIS 8115, at *4, *42 (S.D.N.Y. Jan. 17, 2013) (defendants' business position statements inactionable where success depended on demand from another company, whose own success depended on demand from a third company); *Gissen v. Endres*, 739 F. Supp. 2d 488, 511-12 (S.D.N.Y. 2010) (statement regarding a "strong balance sheet" was merely "summarizing [the Company's] undisputed SEC disclosures").

statements or actually knew that ***there was no reasonable basis*** for its estimates").

a. The Complaint Alleges Objective Falsity

Here, the Complaint clearly alleges that Genworth's loss reserves and corresponding loss ratios were false and misleading. Genworth reported loss reserves of $247 and $272 million for 3Q and 4Q 2011 (including loss ratios of 48% and 46%, respectively). ¶¶66, 69, 79. These reserves were understated, as alleged, by up to $82 million in each quarter precisely because the conditions that drove the ultimate $82 million reserve charge ***existed before the Class Period***. Indeed, defendants admitted that claims from small business and self-employed borrowers in the 2007 and 2008 vintage years – the very years when Genworth Australia was promoting low-doc loans for these borrowers – drove the need to increase reserves. ***And these same loans were, in fact, in default in 3Q 2011 and 4Q 2011***. The presentation by Genworth's CFO and COO of its Global Mortgage Insurance division, Jerome Upton ("Upton"), even disclosed that some of these loans had been in default for ***up to 21 months*** before defendants took the reserve charge. ¶59; Dkt. No. 31-22 at 10. These loans' status ***before the Class Period*** provides a basis to infer that defendants' reserves were understated. *In re SLM Corp. Sec. Litig.*, 740 F. Supp. 2d 542, 555-56 (S.D.N.Y. 2010) ("'[s]tatements regarding loss reserves are not projections [if] they are directed to "the then-present state of the Company's financial condition"'"); *In re Omnicon Grp., Inc. Sec. Litig.*, No. 02 Civ. 4483 (RCC), 2005 U.S. Dist. LEXIS 5272, at *19-*27 (S.D.N.Y. Mar. 30, 2005) (***existing decline*** in market value of e-services investments "provide[s] a basis to infer that Defendants' accounting for the e-services investments was incorrect or inflated"); *Winslow v. BancorpSouth, Inc.*, No. 3:10-00463, 2011 U.S. Dist. LEXIS 45559, at *48-*49 (M.D. Tenn. Apr. 26, 2011) (increase in loss reserves resulting from existing conditions can be a basis for a §10(b) claim).

Genworth's exposure to these loans during the Class Period was significant. Loans approved

using "[f]udged figures" and "tricks" such as listing "rising house prices" and "capital growth" as an income source were very likely to move through to claim. ¶44. As happened in the United States, when the economy soured in Australia and drained any "prospective" sources of income, these low-doc loans began defaulting in admittedly increasing numbers, resulting in "***backlogs*** of delinquencies." Defendants had no reasonable basis to believe that these borrowers would suddenly become current on their loans, especially those in default for up to 21 months. Such allegations demonstrate that a significant portion, if not all, of the $82 million reserve charge was required in 3Q 2011 and 4Q 2011. There was no material difference in risk (or in the value of the underlying properties) between 1Q 2012, 3Q 2011 and 4Q 2011. ¶¶54, 59, 74, 90. *In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 342-43 (S.D.N.Y. 2004) ("failure to write down the value of network capacity" actionable where defendants knew of existing "'capacity glut as well as competition from impending new technologies that were displacing its business'").[9]

Defendants cite *Vodafone* and *Wachovia* to argue that the Court should dismiss the Complaint because it fails to identify "the date when additional reserves should have been added, what specific event or information required it, how Defendants knew it, and why it was fraud, not a difference in judgment." Defs.' Mem. at 19-20. These cases actually support plaintiffs. In both, the courts dismissed accounting claims where plaintiffs made generalized allegations that "certain

[9] Defendants' brief offers little response to the Complaint's allegations that Genworth Australia's exposure to low-doc loans underwritten using manipulated sources of income required substantially higher loss reserves. Instead, it harps that plaintiffs' claims are "unsubstantiated." Defs.' Mem. at 17, 24. Defendants are mistaken. The Complaint alleges the existence of the delinquencies before the Class Period, the nature of the low-doc loans underlying those delinquencies, defendants' experience with low-doc loans in the United States during the financial crisis, and defendants' policy change to no longer insuring low-doc loans. Together, these allegations support the conclusion that a significant portion, if not all, of the $82 million reserve strengthening taken in 1Q 2012 should have been taken during the Class Period (*i.e.*, 3Q 2011 and 4Q 2011). The specifics defendants arbitrarily demand are not required. *Global Crossing*, 322 F. Supp. 2d at 343 (requiring plaintiffs "to plead at the level of specificity demanded by [defendants] would be absurd").

business risks" (*Vodafone*) and "'deteriorating real estate market[s]'" (*Wachovia*) required impairment charges and increased loss reserves. *City of Sterling Heights Police & Fire Ret. Sys. v. Vodafone Grp. Pub. Ltd. Co.*, 655 F. Supp. 2d 262, 271 (S.D.N.Y. 2009); *In re Wachovia Equity Sec. Litig.*, 753 F. Supp. 2d 326, 361-62 (S.D.N.Y. 2011). But unlike *Vodafone* and *Wachovia*, ***existing defaults*** in a segment of Genworth Australia's portfolio that was highly likely to present for claim (because of the way they were underwritten using manipulated sources of income) provides the contemporaneous facts that these cases were missing. And, as the Complaint alleges, added reserves were necessary in 3Q 2011 and 4Q 2011 because there was no material difference in risk or in the value of the underlying properties that existed in 1Q 2012 that did not exist in those prior quarters.[10]

Defendants' contention that plaintiffs have not alleged that "Genworth Australia's delinquencies or losses were, in fact, higher than the percentages" disclosed and that its overall delinquency rate decreased slightly in 4Q 2011 and 1Q 2012, while its reserves steadily increased, is misleading. Defs.' Mem. at 18, 20. Loss reserves represent estimated future claims, and delinquency rates are one key metric companies must consider when establishing loss reserves. Under GAAP, waiting until a claim submits before booking a loss reserve is too late. A company must set a reserve when it determines that it is ***probable*** that a liability has been incurred and the amount can be estimated. ¶72. The small increases in the overall reserve balance during the Class Period was minor compared to the Company's substantial exposure to these then-***deteriorating*** low-doc loans. Given the manner in which the loans were underwritten and defendants' experience with them in the United States, the reported delinquencies were misleading at best. These loans were

[10] These allegations, which defendants ignore, defeat defendants' contention that plaintiffs do not plead that their disclosures "failed to account for the risk associated with this category of loans." Defs.' Mem. at 22. The conditions that drove defendants' $82 million reserve increase ***existed in 3Q 2011 and 4Q 2011***, resulting in the Company understating its loss reserves and overstating its net income and EPS. ¶39.

highly likely or "probable" to be submitted for claim, requiring increased loss reserves during the Class Period. *SEC v. Goldstone*, 952 F. Supp. 2d 1060, 1241-42 (D.N.M. 2013) (defendant's knowledge of nonpublic facts about the fraud supported both objective and subjective falsity).[11]

Defendants argue that the number and severity of claims did not increase until 1Q 2012, and not "'starting in the second half of 2011.'" Defs.' Mem. at 23. Defendants are mistaken. In fact, they ignore that this allegation came directly from an admission by Upton. ¶¶5, 59, 103. *Freudenberg*, 712 F. Supp. 2d at 183. They also ignore that Upton's presentation pertained to the delinquencies seen "in the 2007, 2008 vintages and with small business owners and self-employed borrowers," who defendants targeted for low-documentation policies. Dkt. No. 31-23 at 4. These allegations directly undercut defendants' baseless assertion that plaintiffs do not allege that Genworth's disclosures regarding Genworth Australia's delinquencies in 3Q 2011 and 4Q 2011 "were wrong." *Compare* Defs.' Mem. at 22 *with* ¶¶39, 52, 59, 71, 74, 76. The dramatic increase in reserves attributed specifically to ***this category of borrower***, which were in default before the Class Period, demonstrates that defendants failed to account for the risk that existed with these loans, particularly in the slowing Australian economy. ¶¶66, 79. *Me. State Ret. Sys. v. Countrywide Fin. Corp.*, No. 2:10-CV-0302 MRP (MANx), 2011 U.S. Dist. LEXIS 125203, at *58-*59 (C.D. Cal. May 5, 2011) (failure to disclose systematic disregard of underwriting guidelines inferred from high

[11] *Pfizer* and *GeoPharma* do not support defendants' argument that their disclosures about delinquencies "'weaken[] any inference that defendants intended to defraud the market'" because the disclosures do not add to the total mix of information to investors about the increasing number and severity of claims for low-doc loans. Defs.' Mem. at 21; *In re Pfizer, Inc. Sec. Litig.*, 538 F. Supp. 2d 621, 631, 637 (S.D.N.Y. 2008) (evidence conflicting defendants' statements found in public scientific articles); *In re GeoPharma Sec. Litig.*, 399 F. Supp. 2d 432, 452-53 (S.D.N.Y. 2005) (no duty to update market that there were competitors for a drug treatment where competitors' own statements were public). Moreover, defendants here had disclosed data on delinquencies and losses at Genworth Australia for years. It defies logic that the mere existence of those disclosures would weaken any inference of scienter during the Class Period.

default and delinquency rates and a widespread downgrade of the certificates).[12]

b. The Complaint Alleges Subjective Falsity

The Complaint also plausibly alleges that defendants did not believe that Genworth's loss reserves had a reasonable basis when issued. As they admitted, they knew that delinquencies in Genworth Australia's low-doc loan portfolio were increasing "in the second half of 2011."[13] As discussed in §III.D.2.a., defendants knew that Genworth Australia had encouraged low-doc lending, recognizing the "greater risk associated with offering loans to this group," and knew that by "late 2008," the risk of relying on "stated" (*i.e.*, manipulated) incomes was so unacceptable that Genworth Australia ceased writing these policies and distanced itself from this segment, resulting in admittedly "higher quality Book Years written post 2009." ¶¶40, 45. Implementing a policy requiring 12 months of "business activity statements" meant that defendants Fraizer and Klein knew that the

[12] Defendants take issue with plaintiffs' allegation that the average paid claim had jumped considerably beginning as early as November 2011, arguing that plaintiffs are "fabricat[ing] trends to bolster a fraud theory." Defs.' Mem. at 21-22. But this argument overlooks Upton's own characterization that the increases in claims paid was "significant" and not "trend[ing] . . . downward" as defendants now argue. ¶¶1-3, 52-53; Defs.' Mem. at 22. And the numbers do support plaintiffs' allegation. The average paid claim did jump considerably in November 2011, increasing from $60,000 in September to $77,000 in November 2011, ***a jump of 28%***. After dipping to $53,000 in December 2011, it jumped again to $64,000, $60,000, and $104,000 in 1Q 2012. ¶53. Under no reasonable reading can these numbers qualify as a "downward trend." Importantly, and what defendants completely overlook, is that the average paid claim for low-doc borrowers in Queensland, ***the location primarily responsible for the added reserves***, was $107,000 in 4Q 2011. *Id.* This amount was ***higher than*** the $104,000 amount in 1Q 2012 that defendants admitted drove their decision to finally increase reserves by $82 million.

[13] Defendants disregard that these allegations are fundamentally different than those alleged in *Fait* and *CBS*. Defs.' Mem. at 17-19. Unlike here, neither plaintiff alleged that the assets at issue were actually impaired and relied instead solely on a decline in general "market conditions" to alleged that the estimate was misstated. *Fait*, 655 F.3d at 112-13; *CBS*, 679 F.3d at 69. Defendants' other cases challenging the entirety of defendants' loan portfolio fare no better since plaintiffs here identify a specific segment of the portfolio that was actually impaired. *See Okla. Firefighters Pension & Ret. Sys. v. Student Loan Corp.*, 951 F. Supp. 2d 479, 496 (S.D.N.Y. 2013); *In re CIT Grp., Inc.*, 349 F. Supp. 2d 685, 689 (S.D.N.Y. 2004).

"stated income" loans were likely to default and be submitted for claim when the economy slowed, ***just as they had done in the United States just a few years earlier***. The Complaint plausibly alleges that defendants did not believe that Genworth's reserves had a reasonable basis.[14]

Defendants contend that "[p]laintiffs plead no details . . . that come close to alleging subjective falsity" and that plaintiffs instead "rely on conclusory statements about housing trends premised on information that was public during the class period." Defs.' Mem. at 23. These assertions are clearly untrue. And "information from internal reports or firsthand employee accounts" (*id.*), on which defendants focus, is unnecessary where, as here, defendants have admitted that they saw "increasing" delinquencies "in the second half of 2011," that there were "backlogs" of delinquencies in 2011, and that those delinquencies occurred in an especially high-risk category of borrower who, as defendants knew from the changes that Genworth Australia made in "late 2008" and 2009, were highly likely to default and present for claim. ¶¶43, 59. *Global Crossing*, 322 F. Supp. 2d at 343 (level of specificity demanded by defendants "absurd").

3. Defendants' Statements Regarding Genworth Australia's Minority IPO Were False and Misleading

Plaintiffs have also properly specified defendants' material false and misleading statements about the IPO. In particular, defendants repeatedly told investors that they "plan[ned] to pursue a minority [IPO] . . . in the second quarter of 2012," that the IPO was "on track" to take place in 2Q 2012, that they were "very focused" and "working really hard" to complete the IPO, and that they

---

[14] These facts distinguish this case from defendants' inapplicable authority dismissing reserve claims based on hindsight or a lack of clairvoyance. Defs.' Mem. at 18-19; *In re Fannie Mae 2008 Sec. Litig.*, 525 F. App'x 16, 19 (2d Cir. 2013) (inference of fraud too "attenuated" "[g]iven the market turmoil"); *Wachovia*, 753 F. Supp. 2d at 361 ("generalized allegations fail to specify what caused the Defendants to know that the loan loss reserves were insufficient"); *NECA-IBEW Pension Trust Fund v. Bank of Am. Corp.*, No. 10 Civ. 440 (LAK)(HBP), 2012 U.S. Dist. LEXIS 112573, at *40-*41 (S.D.N.Y. Feb. 9, 2012) (no actionable misrepresentation for inadequate loss reserves in connection CDO and loan portfolios in wake of extreme dislocation in the financial markets).

"ha[d] not encountered any regulatory or market conditions that would change that timing." ¶¶65, 67, 69, 78, 80-82, 88, 93-94. These statements were material to investors. *Freudenberg*, 712 F. Supp. 2d at 181 ("Material facts include . . . 'facts which affect the probable future of the company and those which may affect the desire of investors to buy, sell, or hold the company's securities.'").

These statements were false and misleading because, unbeknownst to investors, Genworth Australia's exposure to low-doc loans written in 2007 and 2008, for which Genworth Australia had failed to provide adequate reserves, was increasing and likely to derail the IPO. ¶¶77, 84, 96. Without full disclosure of the low-doc loan exposure, investors could not accurately evaluate defendants' capacity to complete the IPO and use its proceeds for "capital redeployment." *See Litwin*, 634 F.3d at 718-19 ("the key information that plaintiffs assert should have been disclosed is whether, and to what extent, the particular known trend, event, or uncertainty might have been reasonably expected to materially affect" the company's investments, and since "this potential future ***impact*** was certainly not public knowledge . . . [it] cannot be considered part of the 'total mix' of information already available to investors") (emphasis in original).[15]

Defendants cite to *Faulkner v. Verizon Commc'ns, Inc.*, 156 F. Supp. 2d 384, 395 (S.D.N.Y. 2001), and *Elliott Assocs. L.P v. Covance, Inc.*, No. 00 Civ. 4115 (SAS), 2000 U.S. Dist. LEXIS 17099, at *27 (S.D.N.Y. Nov. 28, 2000), to suggest that statements that a merger was "'on track'" were "'mere predictions or . . . opinions.'" Defs.' Mem. at 27. But where, as here, "'"plaintiffs . . . supply some factual basis for the allegation"'" that defendants would not go forward with the

[15] Defendants argue that statements that the IPO was "on track" were "opinions" dismissible under *Fait*. Defs.' Mem. at 27. But this type of attempt to cast every statement as mere "opinion" upon which no claim can rest makes a mockery of the federal securities laws. "'In passing the 1934 Act, Congress did not intend to allow corporations or their officers to insulate themselves by simply attaching throat-clearing language to their public utterances.'" *Gov't of Guam Ret. Fund v. Invacare Corp.*, No. 1:13CV1165, 2014 U.S. Dist. LEXIS 170352, at *10 (N.D. Ohio Dec. 9, 2014).

merger, the statements are actionable. *Faulkner*, 156 F. Supp. 2d at 396; *see also Elliott Assocs.*, 2000 U.S. Dist. LEXIS 17099, at *23-*24 (a "faulty premise" unsupported by facts fails to allege falsity of statement that merger was "on track"). Defendants' argument also disregards the Supreme Court's opinion in *Basic Inc. v. Levinson*, 485 U.S. 224, 240 (1988), where statements regarding a merger were found to be materially misleading. The Court concluded that statements and omissions regarding "merger negotiations, [with] the ever-present possibility that the contemplated transaction will not be effectuated," may be material. *Id.* at 232, 239 ("Whether merger discussions in any particular case are material therefore depends on the facts. Generally, in order to assess the probability that the event will occur, a ***factfinder will need to look to indicia of interest in the transaction at the highest corporate levels***."). Plaintiffs here have supplied a factual basis for finding that defendants knew the IPO was not "on track." Genworth Australia's LMI portfolio was deteriorating and likely to derail the IPO. Their statements about the IPO are actionable.[16]

Defendants' argument that their statements about the IPO were "opinions" also overlooks the fact that defendants' statements communicated facts about the ***then-present*** status of the IPO. *In re Secure Computing Corp.*, 184 F. Supp. 2d 980, 986 (N.D. Cal. 2001) (statement that company was "on track" to report projected earnings concerned the company's "then-current financial state"); *In re Aetna Inc. Sec. Litig.*, 34 F. Supp. 2d 935, 946 (E.D. Pa. 1999) (statement that company was "'on track to meet all the objectives'" referred to "presently known facts" and thus was actionable). Rather, defendants knew – because they claimed to be "very focused on th[e] transaction" – that the planned IPO could not possibly be "on track." ¶67. Indeed, just 19 days before defendants publicly

[16] Defendants cite to *Jones v. Perez*, 550 F. App'x 24, 26 (2d Cir. 2013), in support of their erroneous contention that plaintiffs "fail" to "'challenge the accuracy of any of [defendants'] financial disclosures.'" Defs.' Mem. at 27-28. Since plaintiffs ***do*** challenge the accuracy of defendants' disclosures, *Jones* is irrelevant. *See* §III.B.2.a., *supra*.

scuttled the IPO, Klein assured the market that "we're working really hard" and "devoting a lot of time and energy to the related preparatory work." ¶93. But as defendants knew," they were not "pursuing a transaction from a position of strength," particularly in light of Genworth Australia's deteriorating exposure to low-doc loans. *Id.*

Defendants contend that "Plaintiffs do not allege even once that Defendants did not actually plan to do an IPO or, for that matter, that Defendants were not 'devoting a lot of time.'" Defs.' Mem. at 26. Defendants' apparent misconception of the allegations is not a reason to dismiss plaintiffs' claims. Plaintiffs have clearly alleged that statements that the IPO was "on track" were false and misleading in light of the exposures to low-doc loans at Genworth Australia, which defendants knew could – and ultimately did – derail the entire transaction. What was false and/or misleading was Genworth Australia's ability to complete the IPO, not, as defendants contend, what defendants' "plan" was. The fact defendants were "devoting a lot of time" to the transaction misled investors about the potential for the transaction's completion. They are not allegations suggesting that defendants were not spending a lot of time on the IPO. To the contrary, the time spent refutes defendants' arguments that they did not know about Genworth Australia's deteriorating condition until the end of the Class Period. *See* §III.D.2.b., *infra*.

Finally, defendants suggest that plaintiffs have misconstrued defendants' statements as "assurances" that the IPO would take place in 2Q 2012, contending "Genworth disclosed the exact opposite." Defs.' Mem. at 25. But it is defendants that have misconstrued the allegations – defendants' assurances related to the present fact about Genworth Australia being in a position to do an IPO, which their statements communicated.[17] ¶¶69, 78, 80-82, 88, 94. Boilerplate warnings that

[17] Defendants' argument that they informed the market that the IPO might not go forward ignores their repeated representations that it was. In fact, this "disclosure" argument is comparable to a "truth-on-the-market" defense where "a defendant attempts to refute the argument that its

the IPO would take place "subject to market conditions" do not counteract defendants' message to the market, or warn the market of the specific risks facing the IPO.[18]

C. Defendants Are Not Entitled to Safe Harbor Protection

1. The Alleged Misstatements Were Not Forward Looking

Defendants cannot escape liability by seeking safe harbor protection. Defs.' Mem. at 28. The PSLRA only protects forward-looking statements "accompanied by meaningful cautionary statements." 15 U.S.C. §78u-5(c)(1)(A)(i). The "safe harbor applies only to forward-looking statements and does not protect representations of current or historical fact." *In re Ambac Fin. Grp., Inc.*, 693 F. Supp. 2d 241, 272 n.36 (S.D.N.Y. 2010); *In re Nortel Networks Corp. Sec. Litig.*, 238 F. Supp. 2d 613, 629 (S.D.N.Y. 2003) (safe harbor does not apply to aspect of statement encompassing a representation of present fact); *Iowa Pub. Emps.' Ret. Sys. v. MF Global, Ltd.*, 620 F.3d 137, 144 (2d Cir. 2010) ("forward-looking elements and the non-forward-looking are severable").

Defendants repeated throughout the Class Period their plans for a minority IPO of Genworth Australia. Defendants' statements misled investors about Genworth Australia's then-present capacity to undertake the IPO and the then-present status of the IPO. After revealing at the beginning of the Class Period their plans for the IPO to take place in 2Q 2012, defendants thereafter

---

misrepresentations affected stock price, because the truth already was known." *In re Bank of Am. Corp. Sec., Derivative, & ERISA Litig.*, 757 F. Supp. 2d 260, 301-02 (S.D.N.Y. 2010). But there – and here – such an argument only works when the "disclosure" is "communicated "'with a degree of intensity and credibility sufficient to counter-balance effectively any misleading information created by" the alleged misstatements'" and rarely provides an appropriate basis for dismissing a §10(b) claim. *Id.*

[18] *See In re Am. Int'l Grp., Inc.*, 741 F. Supp. 2d 511, 531 (S.D.N.Y 2010) ("generic risk disclosures are inadequate to shield defendants from liability for failing to disclose known specific risks"); *see also* §III.C.2., *infra*; *Lormand v. US Unwired, Inc.*, 565 F.3d 228, 246-47 (5th Cir. 2009) (cautionary language was not meaningful where the warning was "very vague and general" and failed to "disclose the specific risks and their magnitude"); *Winslow*, 2011 U.S. Dist. LEXIS 45559, at *50 ("vanilla assertions about possibilities" may be insufficient for a reasonable investor to make an informed decision).

reiterated that the IPO was "targeted for the second quarter of 2012" (¶67), and they "still anticipate[d] second-quarter 2012 execution " (¶80). Indeed, defendants repeated that the IPO was "on track" (¶82) and "moving down the track right in accordance with our plans." ¶81. They even claimed that "[w]e have not encountered any regulatory or market conditions that would change that timing." ¶80. As late as March 29, 2012, just days before pulling the IPO, they claimed that "[w]e're devoting a lot of time and energy" (¶93) to the IPO, and were working "really hard" and "very actively" to "put ourselves in a position to do the transaction in the second quarter." ¶94. These statements do not qualify for safe harbor protection – they were representations of current fact designed to convince investors about Genworth Australia's capacity to complete the IPO in 2Q 2012. *In re Fairway Grp. Holding Corp. Sec. Litig.*, No. 14 Civ. 0950 (LAK) (AJP), 2015 U.S. Dist. LEXIS 5999, at *24 (S.D.N.Y. Jan. 20, 2015) (insofar as statements about a company's capacity to expand communicates present facts about the company's business, they are not protected by the PSLRA or the bespeaks caution doctrine).

2. Defendants Did Not Publish Meaningful Cautionary Language

The safe harbor only protects forward-looking statements when they are accompanied by cautionary statements that are "meaningful." 15 U.S.C. §78u-5(c)(1)(A)(i). And to be meaningful, the cautionary statement must discredit the alleged misrepresentations to such an extent that "the risk of real deception drops to nil." *Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1097 (1991). Courts have recognized that exactly what constitutes "meaningful cautionary statements" is "difficult if not impossible" to decipher, particularly "at the pleading stage, before plaintiffs have access to discovery." *Asher v. Baxter Int'l Inc.*, 377 F.3d 727, 729, 734 (7th Cir. 2004). But they have also held that a defendant cannot avoid its duty to disclose material facts by hiding behind vague and generalized "warnings." *See Am. Int'l Grp.*, 741 F. Supp. 2d at 531-32; *In re Prudential Sec. Ltd.*

P'ships Litig., 930 F. Supp. 68, 72 (S.D.N.Y. 1996) (the securities laws do not protect "someone who warns his hiking companion to walk slowly because there might be a ditch ahead when he knows with near certainty that the Grand Canyon lies one foot away").

Defendants' "disclosures" – cobbled together with extensive use of the ellipsis sign – were not meaningful. Defs.' Mem. at 29. They are nothing more than the boilerplate disclosures of hypothetical and unspecified risks that courts routinely reject. *Am. Int'l Grp.*, 741 F. Supp. 2d at 531-32. In fact, they do nothing more than warn of conditional risks that "may," "could" or "would" affect Genworth's operations when, in reality, those risks had already actually occurred in the form of increasing defaults. Defendants' disclosure about "economic conditions" provides a perfect example. Defs.' Mem. at 29. That disclosure warned investors that "[a]s in the United States, deterioration in economic conditions internationally ***may*** increase the ***likelihood*** that borrowers in a given country will not have sufficient income to pay their mortgages, and can also adversely affect home values, which ***increases our risk*** of loss." Dkt. No. 31-1 at 67. But Australia's deteriorating economic conditions ***already had*** adversely affected home values and low-doc borrowers ***already were*** unable to pay their mortgages. These "disclosures" also say nothing about the added risk from low-doc borrowers whose loans were underwritten and insured in 2007 and 2008 using manipulated sources of income. Defendants' actions in late 2008 and 2009 demonstrate that these loans presented (***and were then presenting***) a far greater risk to Genworth Australia than the other segments of the portfolio and were a significant risk to the IPO.

The same problem exists with defendants' qualifier that "'adverse market or other conditions ***might*** delay or impede the planned IPO'" or the other "'number of factors that impact timing.'" Defs.' Mem. at 30. These disclosures did not warn investors that defendants were sitting on a massive exposure to low-doc loans and that those loans were performing in a way that jeopardized

the IPO. At the same time, defendants' recurring statements that the IPO was "on track" and that they were "working very actively" for it to occur in 2Q 2012 nullified anything meaningful in these qualified cautions. ¶¶67, 81-82, 93-94. Defendants' disclosures certainly did not "discredit the alleged misrepresentations to such an extent that "the risk of real deception drops to nil." *Va. Bankshares*, 501 U.S. at 1097.[19]

Finally, should the Court find Genworth's purportedly cautionary language to be meaningful, the PSLRA's safe harbor would still fail to insulate defendants from liability because they had actual knowledge that their statements about the IPO were false and misleading. *See* §III.D.2.a., *infra*.[20]

D. The Complaint Adequately Alleges Defendants' Scienter

A plaintiff may plead scienter "by alleging facts (1) showing that the defendants had both motive and opportunity to commit the fraud or (2) constituting strong circumstantial evidence of

---

[19] Defendants' authority does not transform their boilerplate cautions into meaningful ones. Defs.' Mem. at 30. In fact, the Second Circuit in *Slayton*, which defendants cite heavily, found that disclosures strikingly similar to those here were ***not meaningful***, "'verg[ed] on the mere boilerplate,'" and did not warn of the risk that materialized. *Slayton v. Am. Express Co.*, 604 F.3d 758, 772 (2d Cir. 2010). And *WebMD* is inapposite because, unlike here, where the $8 billion low-doc loan exposure remained undisclosed, the existence of a patent cliff was public knowledge, alleviating the need for meaningful cautionary language. *In re WebMD Health Corp. Sec. Litig.*, No. 11 Civ. 5382 (JFK), 2013 U.S. Dist. LEXIS 1512, at *25 (S.D.N.Y. Jan. 2, 2013).

[20] Defendants rely on *Slayton,* 604 F.3d 758, to argue that the safe harbor applies to statements about the IPO "because Plaintiffs fail to plead that these statements were 'made with actual knowledge that [they] w[ere] false or misleading.'" Defs.' Mem. at 30-31. But again, *Slayton* supports plaintiffs, holding that this actual knowledge standard is satisfied when "the defendants (1) did not genuinely believe the [forward-looking] statement, (2) actually knew that they had no reasonable basis for making the statement, or (3) were aware of undisclosed facts tending to seriously undermine the accuracy of the statement." 604 F.3d at 775. Defendants' knowledge of "backlogs of delinquencies" in a segment of the portfolio that defendants knew was underwritten without regard for the borrowers' ability to repay seriously undermined the accuracy of defendants' statements about the timing of the IPO. *See* §III.D.2.a., *infra*. And while *Slayton* found the inference of scienter less compelling than the non-fraudulent inference, it did so in large part because "[t]he plaintiffs have not pleaded any facts supporting a motive to deceive." 604 F.3d at 776. The same is not true here. *See* §III.D.1., *infra*.

conscious misbehavior or recklessness." *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 99 (2d Cir. 2007). A court must consider whether "***all*** of the facts alleged, taken collectively [and "holistically"], give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322-23, 326 (2007) (emphasis in original). The inference "need not be irrefutable, *i.e.*, of the 'smoking-gun' genre, or even the 'most plausible of competing inferences.'" *Id.* at 324. It need only be "cogent and ***at least as*** compelling as any opposing inference one could draw from the facts alleged." *Id.* A "'tie . . . goes to the plaintiff.'" *Sawabeh Info. Servs. Co. v. Brody*, 832 F. Supp. 2d 280, 295 (S.D.N.Y. 2011).

1. Defendants Had the Motive to Commit Fraud

Defendants contend that "Plaintiffs do not allege a single motive Defendants had to commit fraud." Defs.' Mem. at 31. The need to raise capital through a public offering, however, provides a recognized motive. *In re Silvercorp Metals. Sec. Litig.*, 26 F. Supp. 3d 266, 276 (S.D.N.Y. 2014) (motive to raise capital through a stock offering "may have been strong enough to survive dismissal ***on its own***"); *Van Dongen v. CNinsure Inc.*, 951 F. Supp. 2d 457, 474 (S.D.N.Y. 2013) ("secondary offering can provide a motive for fraud"); *In re MicroStrategy Inc. Sec. Litig.*, 115 F. Supp. 2d 620, 648 (E.D. Va. 2000) (need to raise capital through public offerings probative of scienter). Indeed, "[t]hese more particularized sorts of motive allegations," such as the need "to preserve the Company's ability to borrow pursuant to its credit facility," "warrant closer scrutiny" and "are more probative of scienter." *See PR Diamonds, Inc. v. Chandler*, 364 F.3d 671, 690 (6th Cir. 2004).

Here, defendants misrepresented the strength of Genworth Australia's business to raise needed capital through a minority interest IPO. Defendants had dumped massive amounts of capital into Genworth's U.S. Mortgage Insurance business after its collapse and, as "***[t]he key driver of***

future earnings growth" for Genworth, defendants needed that business to recover profitability to restore the Company's value. Indeed, defendants faced significant pressure to turn the business around, as Frazier's post-Class Period "resignation" suggests. ¶102. The IPO, "one of [defendants'] most important initiatives," would thus give them an added source of capital for the U.S. Mortgage Insurance business if the temporary stop gap measures expired before the business returned to profitability. Had defendants disclosed the true state of Genworth Australia, they would have jeopardized a crucial source of funding.

The Complaint's motive allegations are "temporally connected with the allegedly fraudulent [statements]" and thus should be "strong enough to survive dismissal on [their] own." *Silvercorp*, 26 F. Supp. 3d at 276. Defendants planned to sell 40% ($800 million) of Genworth Australia while misrepresenting the strength of its business and concealing its deteriorating low-doc exposure. ¶112. The IPO's timing matched its objective since defendants scheduled the IPO for "the second quarter of 2012," just before July 31, 2012 – the date when the waivers on which the U.S. Mortgage Insurance business was relying to operate would begin to expire. *Id.*

Defendants ignore these motive allegations and merely put forward an oft-rejected "failure to allege insider trading" argument. Defs.' Mem. at 31-32. But insider trading is not the only way to allege motive – "[s]cienter can be established even if the officers who made the misleading statements did not sell stock during the class period." *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. Am. W. Holding Corp.*, 320 F.3d 920, 944 (9th Cir. 2003); *PR Diamonds*, 364 F.3d at 691 (same); *Tellabs*, 551 U.S. at 325 (absence of personal financial gain not dispositive of scienter). The court in *Silvercorp* rejected the same contention under similar circumstances, finding that allegations of recklessness and misconduct that "strongly buttress[ed] the [offering] motive alleged" sufficed where defendants did not sell stock and even "acquired company stock during this

period." 26 F. Supp. 3d at 275. Plaintiffs' motive allegations, in addition to the allegations regarding defendants' knowledge (*see infra*), raise a strong inference of scienter.[21]

2. Defendants Acted with Conscious Disregard or Recklessness

To allege scienter, "'plaintiffs may either specifically allege defendants' knowledge of facts or access to information contradicting defendants' public statements, or allege that defendants failed to check information they had a duty to monitor.'" *In re Stillwater Capital Partners Inc. Litig.*, 853 F. Supp. 2d 441, 453 (S.D.N.Y. 2012). Evidence that "defendants were aware of information that contradicted their statements . . . 'alone [is] enough to'" plead scienter. *Van Dongen*, 951 F. Supp. 2d at 473. "'[G]reat specificity'" is not required. *Ganino*, 228 F.3d at 169. Plaintiffs need only plead enough facts to support "'a strong inference of fraudulent intent.'" *Id.*

a. Defendants Had Actual Knowledge of Genworth Australia's Exposure to Manipulated Low-Doc Loans

Here, the Complaint establishes that both Fraizer and Klein knew (1) that Genworth Australia had a massive ***$8 billion*** exposure to high-risk low-documentation loans; and (2) that those loans were defaulting at an increasing rate at the same time (and even before) defendants touted Genworth Australia's performance while promoting the IPO. As Upton admitted during Genworth's May 2, 2012 conference call (Klein also participated), "***we*** did see increasing delinquency levels and ***we*** did observe lender processing delays" "***in the second half of 2011***." ¶¶43, 103. Upton even explained that defendants had to work "[i]n partnership with key lenders" "***[d]uring 2011***" to clear "***backlogs*** of delinquencies." ¶43. In fact, the admittedly "significant" increase in actual claims paid – claims that ***drove defendants' decision to increase reserves by $82 million*** – necessarily meant that those

[21] *In re Sec. Capital Assurance, Ltd. Sec. Litig.*, 729 F. Supp. 2d 569 (S.D.N.Y. 2010), does not support defendants' argument. Defs.' Mem. at 32. Plaintiffs there merely made "broad allegations" that defendants had knowledge "because they held management roles" and under those circumstances, the lack of insider trading compelled a finding of no scienter. 729 F. Supp. 2d at 595.

loans had defaulted ***before*** the Class Period and required reserves. Accordingly, their own admissions demonstrate that defendants were contemporaneously aware of facts contradicting their statements about the strength of Genworth Australia's business and the IPO. *In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 73 (2d Cir. 2001) ("post-class period data may be relevant to determining what a defendant knew or should have known during the class period"); *Aldridge v. A.T. Cross Corp.*, 284 F.3d 72, 79-80 (1st Cir. 2002) ("extremely reasonable" to infer from later statements made by company officials that the company had offered price protection guarantees to induce customers to carry their product).

These facts also raise a strong inference of scienter for Genworth. While "the pleaded facts must create a strong inference that someone whose intent could be imputed to the corporation acted with the requisite scienter," corporate scienter can be alleged under the PSLRA without any specific individual's scienter. *Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital, Inc.*, 531 F.3d 190, 195-96 (2d Cir. 2008) ("we do not believe [Congress] ha[s] imposed the rule urged by defendants, that in no case can corporate scienter be pleaded in the absence of successfully pleading scienter as to an expressly named officer").[22]

Genworth Australia's 2014 IPO – whose Prospectus provided a previously unavailable and in-depth historical look into Genworth Australia's business – reveals that Fraizer and Klein had long been aware of the exposure facing Genworth Australia. As the Prospectus disclosed, low-doc loans in Australia played a large role in Genworth's early success, making it "the leading provider of

[22] *See also Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 710 (7th Cir. 2008) ("*Tellabs II*") ("[I]t is possible to draw a strong inference of corporate scienter without being able to name the individuals who concocted and disseminated the fraud."). Here, executives, including the Individual Defendants, who were sufficiently knowledgeable about Genworth Australia's low-doc loan exposure and incapacity to carry out the IPO, approved and made statements touting Genworth Australia's strength and reiterating the IPO was "moving down the track right in accordance with our plans." ¶81.

mortgage insurance in Australia based upon flow new insurance written" in 2007. ¶42. These loans represented nearly ***16%*** of the insurance that Genworth Australia wrote in 2007 and ***23%*** in 2008, for a combined total of ***$8 billion covering high-risk low-doc loans***. *Id.* The significant contribution to financial results from these policies, followed by the sudden cessation of their issuance in "late 2008," establishes that defendants Fraizer and Klein were on notice that the loans carried extreme risk for Genworth Australia. ¶¶115-117. *See SEC v. Stanard*, No. 06 Civ. 7736 (GEL), 2009 U.S. Dist. LEXIS 6068, at *78-*79 (S.D.N.Y. Jan. 27, 2009) ("a defendant cannot plead ignorance of the facts where there are warning signs or information that should have put him on notice of either misrepresented or undisclosed material facts").[23]

The changes that defendants made in "late 2008" also evidence defendants' scienter. Through its "Business Select" program requiring 12 months of business activity statements, Genworth Australia conspicuously turned away from the low-doc loan segment that was so prevalent with manipulated and falsified income statements. ¶45. Additional changes included the claimed use of ***external*** reinsurance instead of ***affiliated*** reinsurance, differential pricing, and enhancements to the "monitoring of Lender Customer underwriting performance." ¶¶45-46. These changes, which were part of a concerted effort to distance Genworth Australia from its low-doc portfolio, bolster a strong inference of scienter. *In re Citigroup Inc. Sec. Litig.*, 753 F. Supp. 2d 206, 238 (S.D.N.Y. 2010) ("Citigroup was taking significant steps internally to address increasing risk in its CDO

[23] Defendants argue that the purported absence of internal information means "'plaintiffs' interpretation is nothing more than an assumption.'" Defs.' Mem. at 35 (quoting *City of Monroe Emps.' Ret. Sys. v. Hartford Fin. Servs. Grp.*, No. 10 Civ. 2835 (NRB), 2011 U.S. Dist. LEXIS 106046, at *69 (S.D.N.Y. Sept. 19, 2011)). This argument, however, ignores the 2014 Prospectus and Upton's May 2, 2012 presentation, both of which provided insight into Genworth's internal operations. *See Freudenberg*, 712 F. Supp. 2d at 183 ("'The Second Circuit has explicitly recognized that plaintiffs may rel[y] on post-class period [statements] to confirm what a defendant should have known during the class period.'"); *Novak*, 216 F.3d at 313 (post-Class Period facts may be used to demonstrate falsity and scienter); *Scholastic*, 252 F.3d at 72 (same).

portfolio but . . . was continuing to mislead investors about the significant risk those assets posed. This incongruity . . . establishes a strong inference of scienter.").

Australia's economic conditions also contribute to a find of scienter. In 2011, Fraizer and Klein observed the same conditions in Australia that had happened in the United States during the financial crisis. A slowing economy and falling housing prices meant that low-doc loans with manipulated income sources – including characterizing "possible rental of properties" and "rising housing prices" as income – drove increasing delinquencies for Genworth Australia. ¶¶44, 115-116. The result was "a blowout in losses" "not typical of the LMI sector in Australia over the past five years." ¶¶6, 57. That this occurred in the particular sector that abused low-doc loans – "small business owners and self-employed borrowers" – and forced defendants to take an $82 million reserve charge contributes to a strong inference of defendants' scienter. *Countrywide*, 2011 U.S. Dist. LEXIS 125203, at *58-*59 ("high default and delinquency rates and a widespread downgrade of the Certificates from investment grade to junk bond levels . . . fairly give rise to an inference that Countrywide had systematically disregarded its underwriting guidelines and that such information was withheld from the offering documents"); *Freudenberg*, 712 F. Supp. 2d at 199 ("magnitude of write-offs alleged to be the subject of the misstatements supports a strong inference of scienter") (collecting cases).

b. Defendants' Access to Genworth Australia's Data Raises a Strong Inference of Scienter

Defendants' claim that they were unaware of the serious problems facing Genworth Australia is not credible. Defs.' Mem. at 34, 37-38. As an initial matter, defendants had a duty to monitor the Company's internal controls pursuant to §§302 and 906 of the Sarbanes-Oxley Act of 2002. ¶85. *See Novak*, 216 F.3d at 311. "[T]he personal participation of [the Individual Defendants] in designing and evaluating the internal controls is relevant to the inquiry." *Dobina v. Weatherford*

Int'l, 909 F. Supp. 2d 228, 246 (S.D.N.Y. 2012). And where, like here, "a statement is made repeatedly regarding an issue of specific personal interest to the officers, the allegations will more readily give rise to the requisite strong inference of scienter." *Id.*

Even beyond the admissions demonstrating their knowledge, *supra* at §III.D.2.a., and defendants' repeated claims that the Genworth Australia IPO to which they were "devoting a lot of time and energy" was "one of our most important initiatives" (¶¶93-94), Fraizer and Klein both certified multiple times that they received "material information" from Genworth's subsidiaries, which includes Genworth Australia. ¶¶68, 85. The public filings for both Genworth and Genworth Australia stated that defendants regularly monitored information material to a mortgage insurance business, specifically delinquencies, claims, trends and loss reserves. Indeed, Genworth Australia's 2011 Annual Financial Report (the "AFR") disclosed that Genworth Australia monitored on a monthly basis "key economic and business performance measures and highlights," including "***adverse trends*** through use of performance triggers against plan." ¶109. It also monitored on a quarterly basis "[p]ortfolio exposure against certain triggers, including geographical dispersion, lender concentration, and LVR ["loan-to-value ratio] bands. *Id.* And the AFR states that Genworth Australia's "monthly operating and risk reviews" included "detailed commentary on the Australian housing market and economy, a review of the portfolio profile and an analysis of portfolio trends," as well as "an outline of key risk issues." ¶110.

There is little doubt Genworth Australia reported this material information to Fraizer and Klein. The AFR states, in particular, that Genworth was engaged in Genworth Australia's reporting process, explaining that Genworth Australia's "global risk reporting methodology" was "developed by its ultimate parent company" and that its "trigger levels" for "portfolio exposure" were "established in consultation with the ultimate parent company." ¶109. At the same time,

Genworth's 2011 Form 10-K acknowledges that this information was critical to setting Genworth's own loss reserves, reviewing "quarterly the loss reserves for adequacy" and considering the "***age and progression of delinquency to claim***." ¶110. Defendants could not have assessed loss reserves without access to this information. It establishes scienter. *In re Nortel Networks Corp. Sec. Litig.*, 238 F. Supp. 2d 613, 631 (S.D.N.Y. 2003) ("that the Defendants either had actual knowledge of or ready access to facts that contradicted their public statements" is indicative of recklessness).

Besides information alleged from these public filings, the Complaint establishes that Fraizer and Klein did, ***in fact***, receive information about Genworth Australia's delinquencies and claims. ¶107. This information included a risk report assembled by the "Risk Team" that presented delinquencies and forecasted trends, hardship exemptions in Australia, the delinquency walk of loans, and specifics about when loans were delinquent and how they were being cured. ¶107. Figures from Genworth's proprietary system for reporting specifics about loans and default rates were included in the monthly reports compiled for Fraizer. ¶108. With access to this information, Fraizer and Klein were, at minimum, reckless in failing to "familiarize[] themselves with the facts relevant to [Genworth's] accounting practices to ensure that the SEC filings they signed were truthful and accurate." *In re Pall Corp.*, No. 07-CV-3359 (JS)(ARL), 2009 U.S. Dist. LEXIS 88240, at *22 (E.D.N.Y. Sept. 21, 2009).

The Complaint also describes quarterly Leadership and Management ("L&M") meetings that could only have occurred if, as defendants certified, they received information on Genworth Australia's delinquencies and claims. The Complaint details when these meetings occurred, their location, the executives who presented, and the topics specific to Genworth Australia that were discussed. ¶111. In particular, the Complaint describes an L&M meeting held in early to mid-December 2011 at which Genworth executives acknowledged a miscalculation of reserves. Viewed

collectively, plaintiffs' allegations raise a strong inference of defendants' scienter.

c. Plaintiffs' Allegations Comply with the PSLRA Particularity Requirement

Defendants contend that plaintiffs "plead no source for any of their information and belief allegations" and thus the scienter allegations should be rejected "[o]n this basis alone." Defs.' Mem. at 33. Defendants' arguments are baseless. The Second Circuit has long held, expressly, that plaintiffs are ***not*** required to allege their sources for every allegation. *Novak*, 216 F.3d at 313-14. "Imposing a general requirement of disclosure of confidential sources serves no legitimate pleading purpose while it could deter informants from providing critical information to investigators in meritorious cases or invite retaliation against them." *Id.* Second Circuit precedent is clear – the PSLRA compels revelation of confidential sources only "under certain circumstances." *Id.* at 313. And where, like here, "plaintiffs rely on confidential personal sources ***but also on other facts***, they need not name their sources as long as the ***latter facts*** provide an adequate basis for believing that the defendants' statements were false." *Id.* at 314.

Judge Rakoff's opinion in *Silvercorp* is instructive. 26 F. Supp. 3d at 272. There, plaintiffs alleged that Silvercorp misrepresented important metrics at its flagship mine in China and based their allegations primarily on a report – *i.e.*, documentary evidence – that Silvercorp filed with the Chinese authorities. *Id.* at 270-71. The complaint also contained allegations from an unnamed source, which defendants argued was insufficiently identified. *Id.* at 272. Judge Rakoff held that the allegations from the unnamed source "add force" "even if defendants are correct that the allegations from the confidential witness, standing alone, would be insufficient to adequately plead falsity." *Id.*

Like *Silvercorp*, plaintiffs here rely extensively on documentary evidence, which provides an adequate basis for defendants' knowledge that their statements were false. In addition to defendants' post-Class Period admission to "significant" delinquency increases in the "second half of 2011,"

plaintiffs base their allegations on lookback information from Genworth Australia's 2014 Prospectus, and on the representations that defendants made during conference calls and in SEC filings and other public filings and documents. *Freudenberg*, 712 F. Supp. 2d at 183 ("'The Second Circuit has explicitly recognized that plaintiffs may rel[y] on post-class period [statements] to confirm what a defendant should have known during the class period.'"). These documentary sources show that defendants' claims about Genworth Australia's business, the IPO, and Genworth's reported financial results were, at minimum, recklessly false and misleading. *See* §III.B., *supra*. Plaintiffs thus satisfy the *Novak* standard. *Novak*, 216 F.3d at 314 ("a complaint can meet the new pleading requirement imposed by paragraph (b)(1) by providing documentary evidence ***and/or*** a sufficient general description of the personal sources of the plaintiffs' beliefs").

At most, the cases defendants cite purportedly requiring plaintiffs to allege a source for every allegation hold only that a plaintiff must allege specifics relating to confidential witnesses where those witnesses are the principal source of plaintiffs' claims that defendants committed fraud. Defs.' Mem. at 33-34; *In re IAC/InterActiveCorp Sec. Litig.*, 478 F. Supp. 2d 574, 589 (S.D.N.Y. 2007) (dismissal based on unidentified former employees where "plaintiffs have disavowed accessing or relying on the contracts, which are not publicly available, in bringing this Complaint"); *Janbay v. Canadian Solar, Inc.*, No. 10 Civ. 4430 (RWS), 2012 U.S. Dist. LEXIS 47125, at *14 (S.D.N.Y. Mar. 30, 2012) (sources required where they were principal source of claims); *Footbridge Ltd. Trust v. Countrywide Home Loans, Inc.*, No. 09 Civ. 4050 (PKC), 2010 U.S. Dist. LEXIS 102134, at *25-*27 (S.D.N.Y. Sept. 8, 2010) (same). These cases are consistent with *Novak*'s holding that plaintiffs are required to allege particulars about sources where they do not base their allegations on

documentary evidence.[24]

Defendants' authority actually supports plaintiffs. In *IAC*, for example, the court acknowledged that

> [t]he Second Circuit has stated that the PSLRA does not require a plaintiff to reveal confidential sources at the pleading stage, so long as the complaint describes the documentary ***or*** personal sources on which it relies with ***enough detail*** for a court to determine whether the plaintiff has "an adequate basis for believing that defendants' statements were false."

IAC, 478 F. Supp. 2d at 592 (quoting *Novak*, 216 F.3d at 314). Detail is exactly what plaintiffs provide here. Plaintiffs' allegations regarding Genworth's U.S. L&M meetings corroborate their other scienter allegations gleaned from documentary sources. And plaintiffs provide detail regarding those meetings, including their names, when they occurred, their locations, who presented during the meetings, and the topics discussed. ¶111. These facts, combined with documentary evidence confirming the regular transfer of information from Genworth Australia to defendants, as well as defendants' own statements regarding their "focus[] on this [the Genworth Australia IPO] transaction" (¶67), show that plaintiffs have "'an adequate basis for believing that defendants' statements were false.'" *IAC*, 478 F. Supp. 2d at 592.

Defendants claim that the L&M meetings "add[] remarkably little to Plaintiffs' other allegations" but fail to address most of the Complaint's other corroborating allegations (Defs.' Mem. at 36-37), including Genworth Australia's exposure to low-doc loans that were underwritten using manipulated sources of income, the contributions that those loans made to Genworth's bottom line in

[24] Defendants offer a long string cite of cases that stand only for the unremarkable proposition that when plaintiffs rely on confidential witnesses as their primary source of relevant information, the source allegations must support the probability that the witness reliably possessed the information. *See* Defs.' Mem. at 33-34. These cases are inapposite in situations where, like here, plaintiffs' principal fraud allegations are based on documentary sources that disclosed facts in existence and undisclosed during the Class Period.

2007 and 2008, the sudden cessation of those loans in "late 2008," the policy changes implemented when insuring those loans in 2008 and 2009, Upton's admissions of increasing delinquencies in those loans in the second half of 2011, and that those loans were largely responsible for the $82 million reserve charge and Genworth Australia's first reported loss in years.[25]

3. The "Core Operations" Inference Imputes Knowledge

The Second Circuit has "very recently endorsed the idea behind the core operations doctrine as enhancing, if not independently supporting, an inference of scienter." *City of Pontiac Gen. Emps. Ret. Sys. v. Lockheed Martin Corp.*, 875 F. Supp. 2d 359, 371 (S.D.N.Y. 2012) (citing *New Orleans Emps. Ret. Sys. v. Celestica, Inc.*, 455 Fed. App'x 10, 14 n.3 (2d Cir. 2011)); *City of Austin Police Ret. Sys. v. Kinross Gold Corp.*, 957 F. Supp. 2d 277, 296 (S.D.N.Y. 2013) (the core operations doctrine "can 'provide supplemental support for allegations of scienter'"). Thus, "'knowledge of . . . falsity . . . can be imputed to key officers who should have known of facts relating to the core operations of their company." *In re Winstar Commc'ns*, No. 01 CV 3014 (GBD), 2006 U.S. Dist. LEXIS 7618, at *22 (S.D.N.Y. Feb. 27, 2006).

Here, knowledge about Genworth Australia's increasing defaults is imputable to both Fraizer and Klein. As defendants themselves explained to investors, Genworth Australia was one of two main businesses that were critical to Genworth's receipt of dividends immediately before the Class

[25] Defendants' heavy reliance on *Janbay*, 2012 U.S. Dist. LEXIS 47125, is to no avail since there, plaintiffs relied solely on witnesses and an unconfirmed third-party complaint for their allegations – unlike here, where plaintiffs have relied on defendants' own statements. With the complaint "unconfirmed," plaintiffs were left with confidential witnesses, triggering *Novak*'s requirement for a sufficient description of the plaintiffs' personal sources. Furthermore, *Janbay* does not hold that plaintiffs must identify their sources regardless of the existence of documentary evidence. Defendants' other cases are similarly inapposite, standing for the unremarkable proposition that when plaintiffs rely on confidential witnesses as the primary source of their allegations (which is not the case here), those allegations must support the probability that the witness reliably possessed the information alleged. *See* Defs.' Mem. at 37.

Period. ¶114 ("International is what is paying dividends to the holding company."). Defendant Fraizer even told investors that "we see Australia as an important business" and explained that Australia and Canada "act as a key source of earnings, capital, and returns," that "certainly . . . benefit the holding company and the enterprise." *Id.*

The distribution of dividends was something defendants, admittedly, were looking at "quite intently, quite actively" along with the need for more capital to offset the losses suffered by Genworth's U.S. Mortgage Insurance operations. ¶114. In fact, Genworth's need for capital was so acute that defendants repeatedly stated that the IPO was "one of our most important initiatives" and "a very, very important transaction for us." ¶¶6, 51. The critical importance of Genworth Australia to Genworth's operations and to fulfilling its need for capital meant that defendants were well aware of its financial health. *See In re Atlas Air Worldwide Holdings, Inc. Sec. Litig.*, 324 F. Supp. 2d 474, 491 (S.D.N.Y. 2004) (top executive "had a duty to familiarize himself with the facts relevant to the core operations of the company and the financial reporting of those operations"); *In re Complete Mgmt. Sec. Litig.*, 153 F. Supp. 2d 314, 325 (S.D.N.Y. 2001) ("reasonable assumptions in favor of the plaintiff includes assuming that principal managers of a corporation are aware of matters central to that business's operation").

4. Genworth's Reserve Charge Establishes Scienter

Large accounting charges contribute to a strong inference of scienter. *Scholastic*, 252 F.3d at 73, 77 ("finding that the magnitude of defendant's post-class period write-off, together with the allegations of poor sales, constituted sufficient pleadings as to recklessness"). This holding is unsurprising, since facts underlying large accounting charges rarely come out of nowhere. Indeed, as *Scholastic* recognized, "the combined total of $24 million in special charges . . . ***undermines, at the pleading stage, the argument that defendants were unaware*** of the sharp increase in

Goosebumps returns until shortly before" the disclosure. *Id.*; *see also In re Bear Stearns Cos., Inc. Sec., Derivative, & ERISA Litig.*, 763 F. Supp. 2d 423, 517 (S.D.N.Y. 2011) (magnitude "'provides some additional circumstantial evidence of scienter'").

Like the *Scholastic* defendants, defendants here took a massive ***$82 million*** reserve charge ($138 million in total (for a 214% increase)) and posted a ***$21 million loss*** in 1Q 2012, yet claim that they were unaware of the underlying delinquencies and claims until the last week of 1Q 2012. Defs.' Mem. at 40. But Upton's presentation revealed that the cause of the massive reserve charge was high-risk low-doc loans that had been defaulting at an increasing rate throughout 2011. The very nature of the claims process, where claims made to Genworth Australia followed months after the initial default, necessarily meant that ***the defaults that drove the massive reserve charge occurred before the Class Period***. The extraordinary size of the reserve charge, especially for a business that had not posted a loss for years and where the "blowout in losses" was "not typical of the LMI sector in Australia over the past five years" (¶¶6, 57), "undermines, at the pleading stage, the argument that defendants were unaware" of the delinquencies and claims that drove the reserve increase. *Scholastic*, 252 F.3d at 77. This is especially true where, as here, defendants were "working very actively" (¶94) on the IPO for that business, and traveled to Australia in advance of the IPO. *Freudenberg*, 712 F. Supp. 2d at 199-200 n.10 ("low reserves followed by a drastic increase in reserves is 'suggestive' of scienter").[26]

[26] Defendants wrongly suggest that the Complaint only makes conclusory assertions of scienter. Defs.' Mem. at 38; *City of Brockton Ret. Sys. v. Avon Prods.*, No. 11 Civ. 4665 (PGG), 2014 U.S. Dist. LEXIS 137387, at *59 (S.D.N.Y. Sept. 29, 2014) ("generalized allegations founded solely on an individuals' corporate position" are insufficient); *In re Aegon N.V. Sec. Litig.*, No. 03 Civ. 0603 (RWS), 2004 U.S. Dist. LEXIS 11466, at *47-*48 (S.D.N.Y. June 28, 2004) (no reports or data establishing inadequate reserves). To the contrary, the Complaint enumerates numerous ways that defendants knew about the reserve shortfall before disclosing it to the market. *See* §III.B.2.a., *supra*. Defendants' cases regarding GAAP violations are unhelpful. Defs.' Mem. at 39 n.19. Unlike here,

5. Defendants' Purported Non-Culpable Inference Is Far Less Compelling

The inference of scienter raised here is "cogent and at least as compelling as any opposing inference one could draw from the facts alleged." *Tellabs*, 551 U.S. at 324. Defendants' competing inference is that "Genworth experienced unexpected losses that caused the postponement of the IPO and a strengthening of reserves." Defs.' Mem. at 40. But as Upton's presentation demonstrates, this "inference" is simply not true. To the contrary, he admitted that they knew that defaults were increasing in a specific, problematic category of loans in a location where defendants had significant exposure, as discussed in §III.D.2.a., *supra*. Defendants' competing "inference" makes sense only if they ignore most of the facts alleged. Defs.' Mem. at 39-40.

The more compelling inference – and the only inference that squares with the facts alleged – is that defendants were aware of the serious problems with low-doc loans facing Genworth Australia but concealed those problems in their bid to promote the IPO and raise the capital that they needed to restore Genworth's operations. Fraizer's subsequent resignation and analyst commentary show that defendants were under serious pressure to raise capital.[27]

E. The Complaint Adequately Alleges Control Person Liability

Federal Rule of Civil Procedure 8 governs pleading §20(a) control-person liability. *In re*

---

where the low-doc loans were impaired by 3Q 2011, defendants only cite to cases in which the quality of the impaired asset had properly been disclosed, and thus there was no fraud alleged.

[27] To counter the inference of scienter, defendants cite for its truth a presentation from September 26, 2011, which was not referenced or incorporated in the Complaint. Defs.' Mem. at 40. It therefore cannot be considered on defendants' motion, especially for its truth. *In re MBIA, Inc. Sec. Litig.*, 700 F. Supp. 2d 566, 576 (S.D.N.Y. 2010). *See* Motion to Strike and Motion to Convert Defendants' Motion to Dismiss the Amended Complaint into a Motion for Summary Judgment and to Open Discovery, filed herewith. In any event, defendants have not cited to any corresponding public transcripts of what was told to investors during the presentation or to analyst commentary about the presentation, suggesting, at very least, that whatever disclosure was contained in that presentation had minimal penetration in the market. The presentation also does not help defendants since it did not disclose Genworth Australia's deteriorating low-doc loan exposure.

Tronox, Inc. Sec. Litig., 769 F. Supp. 2d 202, 208 (S.D.N.Y. 2011). Defendants do not dispute that each defendant satisfies the standard for control, arguing only that the claim should be dismissed for failing to plead a primary violation. Defs.' Mem. at 40. Because control is undisputed and plaintiffs have alleged a primary violation, defendants' motion to dismiss the §20(a) claim must be denied.

IV. CONCLUSION

Defendants' motion should be denied in its entirety. Should the Court be inclined to grant any part of defendants' motion, plaintiffs respectfully request leave to amend. Leave to amend a complaint should be freely given "when justice so requires." Fed. R. Civ. P. 15(a).

DATED: February 2, 2015

Respectfully submitted,

ROBBINS GELLER RUDMAN
& DOWD LLP
DOUGLAS R. BRITTON
ASHLEY M. PRICE

s/ DOUGLAS R. BRITTON

655 West Broadway, Suite 1900
San Diego, CA 92101-8498
Telephone: 619/231-1058
619/231-7423 (fax)
dougb@rgrdlaw.com
aprice@rgrdlaw.com

ROBBINS GELLER RUDMAN
& DOWD LLP
SAMUEL H. RUDMAN
58 South Service Road, Suite 200
Melville, NY 11747
Telephone: 631/367-7100
631/367-1173 (fax)
srudman@rgrdlaw.com

LABATON SUCHAROW LLP
JONATHAN GARDNER
PAUL J. SCARLATO
ANGELINA NGUYEN
140 Broadway, 34th Floor
New York, NY 10005
Telephone: 212/907-0700
212/818-0477 (fax)
jgardner@labaton.com
pscarlato@labaton.com
anguyen@labaton.com

Lead Counsel for Plaintiffs

CYPEN & CYPEN
STEPHEN H. CYPEN
777 Arthur Godfrey Road, Suite 320
Miami Beach, FL 33140
Telephone 305/532-3200
305/535-0050 (fax)

Additional Counsel for Plaintiff

CERTIFICATE OF SERVICE

I hereby certify that on February 2, 2015, I authorized the electronic filing of the foregoing with the Clerk of the Court using the CM/ECF system which will send notification of such filing to the e-mail addresses denoted on the attached Electronic Mail Notice List, and I hereby certify that I caused to be mailed the foregoing document or paper via the United States Postal Service to the non-CM/ECF participants indicated on the attached Manual Notice List.

I certify under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on February 2, 2015.

s/ DOUGLAS R. BRITTON
DOUGLAS R. BRITTON

ROBBINS GELLER RUDMAN
& DOWD LLP
655 West Broadway, Suite 1900
San Diego, CA 92101-8498
Telephone: 619/231-1058
619/231-7423 (fax)

E-mail: dougb@rgrdlaw.com

Mailing Information for a Case 1:14-cv-02392-AKH

Electronic Mail Notice List

The following are those who are currently on the list to receive e-mail notices for this case.

- **Mario Alba , Jr**
  malba@rgrdlaw.com,e_file_ny@rgrdlaw.com,e_file_sd@rgrdlaw.com,drosenfeld@rgrdlaw.com
- **Jeffrey R. Alexander**
  jalexander@bftalaw.com
- **Douglas R. Britton**
  dougb@rgrdlaw.com,kathyj@rgrdlaw.com
- **Greg A. Danilow**
  greg.danilow@weil.com,MCO.ECF@weil.com,robert.ruff@weil.com,Lauren.Engelmyer@weil.com,Larkin.Kittel@weil.com
- **Jonathan Gardner**
  jgardner@labaton.com,lmehringer@labaton.com,fmalonzo@labaton.com,acarpio@labaton.com,electroniccasefiling@labaton.com
- **Caroline Jane Hickey**
  caroline.hickeyzalka@weil.com,mco.ecf@weil.com,Layne.Behrens@weil.com
- **Angelina Nguyen**
  anguyen@labaton.com,electroniccasefiling@labaton.com
- **William Stephen Norton**
  bnorton@motleyrice.com,mkimpson@motleyrice.com,kweil@motleyrice.com
- **Ashley M. Price**
  APrice@rgrdlaw.com,susanw@rgrdlaw.com
- **David Avi Rosenfeld**
  drosenfeld@rgrdlaw.com,e_file_ny@rgrdlaw.com,e_file_sd@rgrdlaw.com
- **Samuel Howard Rudman**
  srudman@rgrdlaw.com,e_file_ny@rgrdlaw.com,mblasy@rgrdlaw.com,e_file_sd@rgrdlaw.com

Manual Notice List

The following is the list of attorneys who are **not** on the list to receive e-mail notices for this case (who therefore require manual noticing). You may wish to use your mouse to select and copy this list into your word processing program in order to create notices or labels for these recipients.

- (No manual recipients)