UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE GENWORTH FINANCIAL, INC. SECURITIES LITIGATION	Case No. 14 Civ. 02392 (AKH)
	CLASS ACTION

LEAD PLAINTIFFS' MEMORANDUM OF LAW
IN OPPOSITION TO DEFENDANTS' MOTION TO DISMISS

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Lead Plaintiffs City of Hialeah Employees' Retirement System ("Hialeah Employees") and New Bedford Contributory Retirement System ("New Bedford") (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, the "Defendants") to dismiss Plaintiffs' Second Amended Class Action Complaint (the "Complaint").[1]

I. INTRODUCTION

Leading up to the Class Period (November 3, 2011 through April 17, 2012 inclusive), Genworth's Australian Mortgage Insurance division (the "Australian MI unit" or "Genworth Australia") was one of the Company's most profitable business segments, never reporting an operating loss prior to the April 17, 2012 announcement that ends the Class Period. In contrast, the US Mortgage Insurance business had operated at a loss for years, and recorded a net operating loss of $507 million for 2011. Seeking to capitalize on their Australian asset, Defendants announced, at the beginning of the Class Period, a minority initial public offering (the "IPO") of the Australian MI unit, planned for 2Q '12, "subject to market conditions" (¶45) and characterized by Defendants as "one of our most important initiatives" (¶48).

Throughout the Class Period, Defendants reassured investors that the Australian MI unit was financially stable, and that no market conditions existed that would jeopardize the timing of the IPO, by: (1) addressing the known risks posed by flooding in Queensland in January, 2011, and outlining steps taken to mitigate those risks, including "accelerating" delinquent loans to claim (Br. 9) and "stress testing" the Australian market (¶106); (2) issuing reported loss ratios –

[1] References to "¶__" are to paragraphs in the Complaint, Dkt. #42. References to "Br.__" are to the brief in support of Defendants' motion to dismiss the Complaint, Dkt. #44. Relevant facts are incorporated as discussed herein. Defendants do not challenge loss causation in their motion to dismiss.

the ratio of claims on policies and loss reserves to net premiums earned from the insurance – that remained stable in the 40% range throughout 2011, and even decreased slightly in 4Q '11 (¶50); (3) representing that Australia was "transitioning as expected, *absorbing the loss pressures coming from the early 2011 Queensland flood events* as well as the combined pressures of higher interest rates and living costs, an elevated currency, and lower consumer spending on some small business owners and consumers" (¶49); (4) touting "improving" delinquency rates and the "stable" Australian housing market (¶¶50-51); and (5) reiterating that the IPO was "on track" (¶58).

At the same time, however, Defendants failed to disclose skyrocketing claims during the Class Period, mainly in Queensland and in low-documentation loan portfolios, that amounted to a record $100-125 million in claims by December 2011, exceeding Genworth Australia's reserves. Moreover, as Defendants knew, Genworth's exposure to risky low-documentation loans from 2007-2008 amounted to over $12 billion and was particularly susceptible to a weaker economy. Yet as late as March 29, 2012, Klein stated that he expected the Australian housing market to remain "solid" (¶106), and responded to a direct question on the IPO's timing (*id.*) without disclosing that the Australian MI unit's claims had exceeded its reserves by December 2011, or that current market conditions made the IPO unfeasible. Just weeks later, on April 17, 2012, Genworth announced a delay in the IPO due to "business performance in Australia" (¶109), and the first-ever reported loss by the Australia MI unit. Investors and analysts were shocked at the abrupt reversal from the picture of stability. Genworth's stock price plummeted over 23% in a single day on unusually heavy trading volume following the announcement. ¶110. An April 19, 2012 article in the Australian Financial Review stated that Genworth had "delivered bad news out of the blue and in the process raised serious doubts about [its] past risk

management practices." ¶114. Defendants later disclosed a shocking triple-fold increase in the Australian unit's loss ratio. Reported loss ratios of 45%, 48%, 48%, and 46% for 1Q, 2Q, 3Q, and 4Q '11, respectively (¶50), spiked drastically to *154*% in 1Q '12. ¶116. Defendants further disclosed a massive $82 million charge to shore up reserves, and acknowledged observing both increasing delinquencies and delays in lender processing of those delinquencies in the second half of 2011, mainly in Queensland. ¶¶86-87.

Defendants now argue that their Class Period statements were not literally false, and that they remained ignorant of increasing delinquencies until they noticed an "emergence" of claims in March 2012. At the least, professed ignorance of such a large increase in the Australian MI unit's loss ratio comprises severe recklessness, given Defendants' Class Period statements that "we see Australia as an important business" (¶47) and that the IPO was "one of our most important initiatives" (¶48). The Court should deny Defendants' motion to dismiss for the reasons below.

First, Defendants improperly disregard the Complaint's cogent theory of fraud, namely, that Defendants' statements and omissions collectively conveyed the materially misleading impression that the Australian MI unit was stable, with loss ratios seemingly confirming that the Queensland risks had been mitigated, and that no market conditions warranted a delay in the IPO. Defendants, however, concoct three "subjects" (financial performance/results; loss reserves; and IPO plans) and separate their Class Period statements accordingly. Viewed in isolation, Defendants then claim that their statements were not false. For example, Defendants claim that Klein's March 29, 2012 statement that "[w]e're working very actively to put ourselves in a position to execute [the IPO] in the second quarter [of 2012]" (¶106), is literally true because Plaintiffs fail to allege that Defendants were *not* "working very actively." Defendants disregard

that such a statement can be literally true and still contribute to the materially misleading impression that the Australian MI unit and market were stable and, therefore, that there were no market conditions that would delay the IPO.

Similarly, Defendants assert that they "disclosed" increasing delinquencies throughout the Class Period, and thus that the post-Class Period admission that they saw increasing delinquencies "in the second half of 2011" (¶87) should be disregarded. Yet Defendants cannot account for the seemingly stable loss ratios over the entirety of 2011 – metrics that, by definition, account for current claims and loss reserves (that in turn reflect current delinquencies). Indeed, the reported 4Q '11 loss ratio *decreased* slightly from 3Q '11, and on February 3, 2012, during the 4Q '11 earnings call, Klein stated that the decrease "reflect[ed] a *decline* in new delinquencies [and] [t]he delinquency rate *improved* across *all regions* sequentially." ¶50. The stable to decreasing loss ratios further bolstered the seeming stability of the Australian MI unit, as did Defendants' reassurances that the Queensland risks had been addressed, that they received current information from their lenders under contract (¶102), and that, according to Klein in March 2012, they "stress tested" the Australian market using parameters such as housing prices and unemployment (¶106). Moreover, the post-Class Period admission that Defendants saw an increase in delinquencies "[i]n the second half of 2011" (¶117) was made in the context of explaining a *triple-fold* increase in loss ratio, from 46% in 4Q '11 to *154%* in 1Q '12.

Defendants also implausibly insist that they only were aware of deteriorating Queensland conditions with increasing claims in *March 2012*. Because delinquencies drive claims over a period of time, Defendants necessarily had to know of the magnitude of the claim increase prior to March. Indeed, Confidential Witness ("CW") 1 confirms that a claim increase of $100-125 million in Australia, mainly in Queensland (¶65), was disclosed during an internal presentation

on global MI units at a December 2011 meeting at Company headquarters, and that it also was disclosed at the same meeting that claims had exceeded allotted reserves. Defendants spend multiple pages in their brief attacking CW1, including going so far as to improperly re-write the Complaint's allegations by claiming it "far more likely" that CW1 "misremembered" the date of the meeting (Br. 27), yet Defendants fail to show why the Court should not accept CW1's eyewitness account of the December 2011 meeting. Plaintiffs have described CW1 with sufficient particularity to establish that, as a "Band 3" director, he was a regular participant at "Leadership and Management" ("L&M") meetings such as the December 2011 meeting. ¶62. Accordingly, CW1 is described with enough particularity to support the probability that a person in his position would have participated in the L&M meeting, and thus would have known what was disclosed in that meeting. More is not required. CW2 was similarly in a position to know how Fraizer received the monthly "reporting package" that tracked core metrics including delinquencies, including in Australia, and the length of those delinquencies. ¶70.

Viewed collectively with the magnitude of the fraud ($82 million in reserve charges); the strong core operations inference from Defendants' repeated statements regarding the IPO's importance; and the post-Class Period admissions that Defendants had indeed observed increasing delinquencies and lender processing delays in the second half of 2011, Plaintiffs sufficiently have alleged a strong inference of Defendants' scienter regarding the true deterioration in Queensland during the Class Period, which they ultimately were forced to reveal during the due diligence process for the IPO.

Defendants' motion should be denied.

II. ARGUMENT

A. Applicable Legal Standards On A Motion To Dismiss

To survive a motion to dismiss under Federal Rule of Civil Procedure ("Rule") 12(b)(6), a plaintiff must plead sufficient factual allegations "to state a claim to relief that is plausible on its face." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007). A claim is facially plausible "when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). The Court "must accept as true all well-pleaded factual allegations in the complaint, and 'draw [ ] all inferences in the plaintiff's favor.'" *In re ITT Educ. Servs., Inc. Sec. Litig*., 34 F.Supp.3d 298, 304 (S.D.N.Y. 2014) (quoting *Allaire Corp. v. Okumus*, 433 F.3d 248, 250 (2d Cir. 2006)).

In addition, Rule 9(b) requires that a plaintiff alleging securities fraud under Section 10(b) and Rule 10b-5 "state with particularity the circumstances constituting fraud," *i.e.*, plaintiffs "must do more than say that the statements... were false and misleading; they must demonstrate with specificity why and how that is so." *Rombach v. Chang*, 355 F.3d 164, 174 (2d Cir. 2004). The Private Securities Litigation Reform Act ("PSLRA") further requires that a plaintiff (1) "specify each statement alleged to have been misleading [and] the reason or reasons why the statement is misleading," and (2) "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 551 U.S. 308, 321 (2007). In determining whether a strong inference of scienter has been alleged, a court must: (1) "accept all factual allegations in the complaint as true"; (2) "consider the complaint in its entirety"; and (3) "take into account plausible opposing inferences." *Id*. at 322-23. However, "[t]he inference that the defendant acted with scienter need

not be irrefutable… or even the most plausible of competing inferences," *id*. at 324; it need only be "*at least as likely* as any plausible opposing inference," *id*. at 328.

B. Defendants' Statements Created A Materially Misleading Impression That The Queensland Delinquency Risks Had Been Mitigated, And That No Market Conditions Existed That Would Impede the IPO

"The law is well settled… that [even] literally true statements that create a materially misleading impression – will support claims for securities fraud." *S.E.C. v. Gabelli*, 653 F.3d 49, 57 (2d Cir. 2011), *rev'd on other grounds*, 133 S.Ct. 1216 (2013) (citing Rule 10b–5, 17 C.F.R. § 240.10b–5); *Kleinman v. Elan Corp., plc*, 706 F.3d 145, 153 (2d Cir. 2013) ("[s]tatements of literal truth 'can become, through their context and manner of presentation, devices which mislead investors,' [and] '[e]ven a statement which is literally true, if susceptible to quite another interpretation by the reasonable investor[,] may properly be considered a material misrepresentation'"). Moreover, "[i]n analyzing whether the statements… were false or misleading the court must read [them] as a whole... [because the] central issue... is not whether the particular statements, taken separately, were literally true, but whether defendants' representations, *taken together and in context*, would have misl[ed] a reasonable investor about the nature of the securities."[2] *In re Fannie Mae 2008 Sec. Litig.*, 891 F.Supp.2d 458, 476 (S.D.N.Y. 2012).

Here, however, Defendants self-servingly and improperly categorize their misleading Class Period statements into three separate "subjects," then argue that none of the alleged statements was false. *E.g.*, Br. 15 (separating statements regarding "Genworth Australia's financial performance and results"; "Genworth Australia's loss reserves"; and "Genworth's plan for the IPO"); Br. 33 (statement that IPO was "on track" not false because, *inter alia*, of the

[2] All emphases added and citations omitted unless otherwise indicated.

absence of allegations that "Defendants [had] changed their plans for the IPO" or that Defendants "suspected that the IPO might not happen."). In so doing, Defendants deliberately misconstrue and disregard the Complaint's "coherent… theory of securities fraud," Br. 2, *i.e.*, that Defendants had given investors "no reason to suspect that the Australian MI unit – and the planned Australian IPO – was subject to any sudden destabilization," ¶13, because Defendants had addressed the risks posed to the Australian MI unit by the January 2011 Queensland flooding and repeatedly *reassured* the market that those risks were not only recognized, but mitigated. *Plumbers & Pipefitters Nat'l Pension Fund v. Orthofix Int'l, N.V.*, 2015 WL 981518, *9-10 (S.D.N.Y. 2015) (rejecting argument that "misse[d] the full picture of wrongdoing presented by the plaintiff.").

1. Genworth Australia's Reported Class Period Loss Ratios Gave The Materially Misleading Impression Of Financial Stability

A critical component of Defendants' Class Period reassurances that the Queensland risks had been mitigated was the Australian MI unit's reported loss ratios, which were 45%, 48%, 48%, and 46% in 1Q, 2Q, 3Q 11, and 4Q11 respectively (¶50) – consistent with Defendants' false assertions that "Australia is transitioning as expected, absorbing the loss pressures coming from the early 2011 Queensland flood events as well as the combined pressures of higher interest rates and living costs, an elevated currency, and lower consumer spending on some small business owners and consumers." ¶91. Because those misleading loss ratios represented the ratio of *claims* on policies and *loss reserves* to net premiums earned from the insurance (¶7), Defendants' falsely reported claims and reserves also were an integral part of the misleading impression that Queensland had stabilized and accordingly, that no market conditions warranted delaying the IPO.

Similarly, Defendants' failure to disclose increasing delinquencies in Queensland during the Class Period made the impression that Queensland had stabilized, and thus that the IPO would not be jeopardized, false and misleading. Indeed, it was those increasing delinquencies that led to increased claims in the Australian MI unit for which Genworth Australia's loss reserves were inadequate – the same market conditions that ultimately derailed the IPO. Defendants argue that "Plaintiffs identify no class period statement by Defendants that delinquencies were not increasing in the second half of 2011[;] [o]n the contrary, Defendants repeatedly discussed increasing delinquencies and the resulting impact on earnings." Br. 17. Defendants then cite particular statements purportedly disclosing "increased" delinquencies during the Class Period. Br. 17-18. Defendants wholly disregard that – notwithstanding these isolated "disclosures" of increased delinquencies, only some of which concern the Queensland region – Genworth's reported loss ratios during the same period *remained stable or decreased*, at 45%, 48%, 48%, and 46% in 1Q, 2Q, 3Q, and 4Q '11 respectively. Indeed, on the February 3, 2012 4Q11 earnings call, Klein specifically highlighted that "the loss ratio [for the Australia MI unit] *decreased* 2 points sequentially to 46%, reflecting a decline in new [mortgage loan] delinquencies," and that "[t]he delinquency rate *improved* across *all* regions sequentially." ¶50. As explained *supra*, the loss ratios incorporate claims (driven by delinquencies) and reserves (reflecting current delinquencies). In other words, Defendants' reported loss ratios gave investors the materially misleading impression that the Australian MI unit was stable, and thus that the IPO was proceeding as planned.

Defendants similarly disregard the context in which Jerome Upton ("Upton"), the CFO of Genworth's Global Mortgage Insurance, made his post-Class Period admission that "[i]n the second half of 2011, we did see increasing delinquency levels and we did observe lender

processing delays." Br. 17. Most importantly, Upton disclosed on the same May 2, 2012 earnings call that the Australian MI unit's loss ratio for 1Q '12 was an incredible *154%* – a drastic increase from the reported loss ratio of only 46% in 4Q '11 (and ratios of 45%, 48%, and 48% in 1Q, 2Q, and 3Q '11 respectively). It was in the context of explaining the suddenness and magnitude of this increase that Upton disclosed that the Queensland region had been particularly impacted by slumping housing prices, leading to increased delinquencies, foreclosures, and consequently lender claims. ¶86. Upton further admitted that Defendants had seen increasing delinquency levels as early as "the second half of 2011." ¶87.

Upton's admission thus supports that Defendants' reported Class Period loss ratios had failed to adequately reflect the true increase in delinquency levels. "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." *Freudenberg v. E*Trade Fin. Corp.*, 712 F.Supp.2d 171, 183 (S.D.N.Y. 2010); *see also In re Vivendi Universal, S.A. Sec. Litig.*, 381 F.Supp.2d 158, 181 (S.D.N.Y. 2003) (post-class period articles can be used to establish awareness of falsity of class period statements; the opposite result would reward defendant for successful concealment). Moreover, viewing the Complaint's allegations holistically, *Tellabs,* 551 U.S. at 322, Upton's admission is consistent with, and further bolstered by, CW1's account that an increase in claims in Australia amounting to $100-125 million was disclosed internally as early as December 2011. Thus, the reported loss ratios created the materially misleading impression that Defendants had, as they asserted, managed the risks posed by the January 2011 Queensland flooding and that the region was "absorbing loss pressures" as expected. ¶91.

2. Defendants' Statements Addressing Queensland Risks And The Purported Mitigation Of Those Risks Further Bolstered the Misleading Impression Portrayed By The Loss Ratios

That Defendants deliberately addressed the *same* risks to Australian market conditions that ultimately resulted in Genworth Australia's first-ever recorded loss, and specifically outlined how they were mitigating those risks, further validated the misleading impression of financial stability conveyed by Genworth's reported Class Period loss ratios. For example, the September 26, 2011 presentation asserted "expect[ed] ongoing strong employment" with only "some regional pressure in Queensland," and the "Risk Management" section of the presentation noted that the Company had "modified 'high-risk' areas based on environment" with specific reference to the "Queensland Coastal Area," as well as the "2007/2008 [loan origination] Books – Queensland Region Pressured." ¶6. The presentation also addressed the measures taken to mitigate the Queensland risk, stating that a "7.5MM flood reserve" had been established "in 1Q 11" and projecting a "second half [2011] loss ratio in high 40's/low 50's" based on the identified Queensland risks and their mitigation – numbers that were consistent with the reported Class Period ratios, thus apparently verifying the effectiveness of Defendants' purported risk mitigation. ¶7. As part of "Risk Management – Loss Mitigation," the presentation stated that Genworth would "accelerate action on late stage delinquencies," and that Genworth "monitor[ed] reserve adequacy and key loss metrics quarterly," with a "quarterly actuarial review by [an] independent actuary." ¶7. Defendants reiterated in their February 2, 2012 news release that lenders had "accelerated actions to move… loans through to claim" in 4Q '11. Br. 9 (citing Defendants' Ex. I).

Having reassured investors that "late stage delinquencies" would be accelerated and presumably factored into the monitored "key loss metrics," investors further were misled into believing that any subsequent reported loss ratios accurately would reflect those "accelerated"

delinquencies, and similarly that the ratios would reflect adequate reserves based on current "key loss metrics." And, as noted *supra*, Defendants' Class Period loss ratios remained stable in the 40% range. In addition, as late as March 29, 2012, Klein – while reiterating that "[t]his year we expect the Canadian *and Australian* markets to *remain solid*" – asserted that the Company "specifically stress test[ed]" the Australian market "in terms of home price depreciation… and unemployment," and that the Company "look[s] at the *impact on delinquencies* and on cure rates." ¶¶106-07. Investors accordingly were blindsided when Defendants disclosed a 1Q '12 loss ratio of over *150%*, citing both "*accelerated processing of delinquencies* in our pipeline from 2011 through foreclosure to claim" and "updated estimates for property price declines in certain submarkets, particularly in Queensland." These were the very risk factors Defendants had claimed to mitigate, as demonstrated by the misleading Class Period loss ratios. ¶85. An April 19, 2012 article in the Australian Financial Review underscored the market's reaction, stating that "[Genworth has] delivered bad news *out of the blue* and in the process raised serious doubts about [its] past risk management practices." ¶114.

Defendants ignore the coherent theory that Defendants misled the market into believing the Australian MI unit was stable and could support the IPO as planned. Separating allegations regarding delinquencies from those regarding loss ratios and risk mitigation, Defendants contend that "[t]he complaint does not allege any specific material information about lenders' processing of claims (whether delays or acceleration efforts) that Defendants knew but failed to disclose." Br. 19. This argument misconstrues the allegations that – viewed collectively – demonstrate that Defendants misleadingly reassured the market that the Queensland risks had been mitigated and, through falsely stated loss ratios that purportedly reflected actual delinquencies (on which loss reserves are based), portrayed the Australian MI unit and the Queensland market as stable.

Accordingly, that Genworth "explained in a February 2, 2012, news release… that the company had increased reserves for prior delinquencies where lenders accelerated actions to move these loans through to claim," and that the Form 10-K filed on February 27, 2012 stated the Company had "increased reserves… as lenders accelerated actions to transition delinquencies to claim," Br. 18-19, does not render the impression that the Australian MI unit was stable any less misleading. *Cf. City of Providence v. Aeropostale, Inc*., 2013 WL 1197755, *4-6, 13 (S.D.N.Y. 2013) (statements that "we have taken steps to rectify [our mistakes] and to get this brand back on course" and "we are appropriately attacking the inventory problem," "while technically true, [were] materially misleading" when those steps "would not lead to better results" imminently, as defendants implied.).

Indeed, Defendants disregard that the February 27, 2012 10-K *also* reassured investors that conditions had since stabilized since the Queensland flooding, and gave the impression that the effects from that flooding were in the past, as the rate of new delinquencies "slowed" in 4Q '11:

> In the first quarter of 2011, losses began to increase driven by higher rates, lower retail spending and higher reserves for claims anticipated from the natural disasters during that quarter, *particularly the flooding in Queensland*. During the second and third quarters of 2011, there was an increase in the number of outstanding delinquencies and reserves as the cumulative impact of the factors noted previously exerted pressure on elements of the portfolio. *During the fourth quarter of 2011, total delinquencies decreased* but remained above 2010 levels *and the rate of new delinquencies slowed*. We expect overall 2012 losses to remain near 2011 levels. ¶51.

Similarly, the February 2, 2012 news release stated that "higher severity experience in the New Zealand run-off portfolio [were] partially offset by a *decrease in new delinquencies*, *including reductions in Queensland*." ¶50. These statements were consistent with the decrease in the 4Q11 reported loss ratio of 46%, *i.e.*, they served to foster the misleading impression that Queensland – and the Australian MI unit – was stable.

Plaintiffs have, therefore, demonstrated how Defendants' misleading loss ratios – which purportedly reflected accurate claims and loss reserves – gave rise to the misleading impression that the Australian MI unit was stable, and that no market conditions existed that would jeopardize the IPO. Contrary to Defendants' assertion, Br. 29, Plaintiffs also have identified the "when" and "by how much" Genworth's reserves were insufficient. Specifically, the Complaint alleges that "Defendants should have recorded a significant portion (if not the entirety) of the $*82 million* reserve charge announced at the end of the Class Period *in 3Q 11 and 4Q 11*." ¶82 (explaining that "an increase in claims of $100-125 million by December 2011; the susceptibility of the [$12 billion exposure to] 2007/2008 low-documentation loans to a weak economy; the Australian MI unit's increasing delinquencies in the second half of 2011; and a significant increase in the number and severity of claims as early as November 2011, were all factors available to Defendants that Defendants failed adequately to account for when they established materially understated loss reserves during the Class Period."). Moreover, the Second Circuit does "not require the pleading of detailed evidentiary matter in securities litigation," as Defendants suggest. *In re Scholastic Corp. Sec. Litig*., 252 F.3d 63, 72 (2d Cir. 2001). Accordingly, "a plaintiff need not plead dates, times and places with absolute precision… or precisely quantify the amount by which financial statements were overstated." *In re Flag Telecom Holdings, Ltd. Sec. Litig*., 352 F.Supp.2d 429, 467 (S.D.N.Y. 2005), *abrogated on other grounds,* 574 F.3d 29 (2d Cir. 2009).

Plaintiffs further have met the standard in *Omnicare Inc. v. Laborers District Council Construction Industry Pension Fund*, 135 S.Ct. 1318 (2015), by sufficiently alleging that Defendants omitted material facts regarding the basis for their reserves (*id*. at 1332). It was internally disclosed by December 2011 that claims in Australia had skyrocketed to $100-125

million and had exceeded reserves[3] (¶¶64-65) – material facts that Defendants failed to consider in setting their Class Period reserves. Further, as shown *infra* in § II.E, Defendants were aware of facts contradicting their false statements that reserves adequately were established, given their awareness of the deteriorating economic conditions in Queensland (including claims that had exceeded reserves by December 2011) that eventually forced them to disclose a drastic triple-fold increase in the Australian MI unit's loss ratio at the end of the Class Period. *Omnicare*, 135 S.Ct. at 1326.

3. Defendants' Failure To Disclose Skyrocketing Claims During The Class Period Is Actionable

Defendants' arguments regarding their failure to disclose drastically increasing claims during the Class Period are also unavailing. Br. 19-20. As a threshold matter, Defendants' argument is flawed because it is based on a tautology – Defendants cite to the very claims figures that are alleged to be false and misleading to argue that they were not false and misleading. *Id*. More importantly, Defendants cannot credibly explain how the Australian MI unit's reported Class Period loss ratios remained stable for an entire year following the January, 2011 Queensland flooding, then spiked unaccountably and suddenly at the end of the Class Period. Defendants' reliance on the "March [2012] loss emergence and average claims size" is inconsistent with Klein's own *March 29*, 2012 statement that "[t]his year we expect the Canadian and Australian markets to remain solid," based in part on "stress testing" of the

[3] These specific facts, which contemporaneously establish that Defendants had no reasonable basis for their Class Period reserves, distinguish the Complaint's allegations from the generalized allegations in *City of Omaha, Nebraska Civilian Employees' Retirement System v. CBS Corp.*, 679 F.3d 64, 68 (2d Cir. 2012), Br. 31, which did not involve any CW accounts of insider knowledge and relied only on "allegations regarding the downward trajectory of CBS's overall market capitalization, declining advertising revenues for some CBS reporting units, analysts' expectations regarding the media business environment, and CBS's own anticipation of an economic slowdown." Defendants' other cited cases are inapposite for the same reason. Br. 31-32.

Australian market, including parameters such as home prices and unemployment. ¶106. Notably, Klein did *not* state that any market conditions would derail the IPO, which was postponed on April 17, 2012, only *weeks* after his comments. Indeed, a loss emergence of this magnitude, in the span of *less than one* month, is implausible on its face as it would require large amounts of practically *simultaneous* delinquencies. It is far more plausible that Defendants were forced to acknowledge a previously known spike in claims as underwriters for the IPO planned for the 2Q12 proceeded with their due diligence. ¶¶20-21.

Indeed, CW1 confirms that the spike in claims was internally disclosed as early as December 2011, rendering the Class Period loss ratios – and Defendants' statements bolstering the impression that the Australian MI unit was stable – false and misleading. *See In re Tower Auto. Sec. Litig.*, 483 F.Supp.2d 327, 342 (S.D.N.Y. 2007), *overruled in part by Stoneridge Inv. Partners, LLC v. Scientific–Atl. Inc.,* 552 U.S. 148 (2008) (a statement is false and misleading where it is adequately alleged "that Defendants had access to facts contrary to the alleged statement"). Not surprisingly, Defendants' attempt to discredit CW1 spans more than eight pages of their brief. Notwithstanding Defendants' frenzied protestations, Plaintiffs have pled CW1's account with the requisite particularity, and the Court should accept CW1's account as true.

"Information presented through [c]onfidential [w]itnesses in a complaint is allowed as long as the witnesses 'are described in the complaint with sufficient particularity to support the probability that a person in the position occupied by the source would possess [ ] the information alleged.'" *Cornwell v. Credit Suisse Grp.*, 689 F.Supp.2d 629, 637 (S.D.N.Y. 2010) (quoting *Novak v. Kasaks*, 216 F.3d 300, 314 (2d Cir. 2000)). Here, the Complaint describes CW1's position as a former senior IT Infrastructure Program Manager and North America IT

Infrastructure Leader (MI division) in the Company's Raleigh, North Carolina location from October 1999 to April 2014, and provides his chain of supervisors up to Fraizer. ¶60. *Because* of his position, CW1 was in "Band 3" of the top three MI "bands" or tiers of Raleigh-based employees that participated in the Leadership and Management ("L&M") meetings in Raleigh, where Genworth's Global MI issues were discussed, and MI employees (including CW1) were updated as to how Global MI was trending. ¶62. CW1 explained that "the top three MI 'bands'" or tiers of Raleigh-based employees participated in the L&M meetings," and that the quarterly domestic MI meetings consisted of about 40 – 50 MI employees, including around 10 senior IT employees of the MI division). *Id*. Accordingly, the Complaint describes CW1 "with sufficient particularity to support the probability that a person in the position occupied" by CW1 would have participated in the quarterly L&M meetings, and would have, therefore, possessed the knowledge of a participant in those meetings. *Novak*, 216 F.3d at 314. Thus, the Court should allow these well-pled allegations. *Cornwell*, 689 F.Supp.2d at 637.

CW1's account of the December 2011 meeting is based on direct, first-hand knowledge. CW1 directly observed and witnessed "a Powerpoint presentation in this meeting showing the increase in claims in Australia equaling around $100-125 million" and that the loans affected by the flooding were mostly in Queensland. ¶65. He further witnessed "either Schneider or Upton" fielding the question as to whether the IPO was still planned for the early part of 2012, and recalled that the response was that the Australian MI unit had had a poor quarter due to increased claims, leading to miscalculating of reserves, and that claims were exceeding the allotted reserves. ¶64. CW1's account establishes that Defendants had access to information directly contradicting their statements that the Australian MI unit was stable, and that no market conditions existed to jeopardize the IPO.

Defendants' arguments do not, and cannot, alter that the Complaint sufficiently describes CW1 with sufficient particularity to support the probability that a person in the position occupied by CW1 would possess the knowledge attributed to him, *i.e.*, that a participant in the December 2011 L&M meeting would have seen the same presentation and heard the same response regarding the IPO. That is all that this Circuit requires to accept CW1's account. Nothing in the *Novak* pleading requirement for CWs *requires* another witness's corroboration, such that the account of a well-pled CW should be disregarded. Br. 21 ("none of CW1's assertions about the December L&M meeting are corroborated by… CW2.").[4] Nor does CW1's position as an IT technician disqualify his first-hand observations at a meeting in which CW1 – by virtue of that same position – participated. Plaintiff does not allege that CW1's position provided him "any exposure to Genworth Australia's business operations or results," Br. 23, beyond what he personally witnessed at the L&M meeting. Accordingly, *Steinberg v. Ericsson LM Telephone Co.*, 2008 WL 5170640 (S.D.N.Y. 2008), Br. 23, is inapposite because CW1's account is based on his direct knowledge as a participant in the December 2011 L&M meeting. Nor does CW1's first-person observation of the contents of the slide showing $100-125 million in claims increases, with most of the loans affected being in Queensland, or his witnessing of the response to the question regarding the IPO that "claims were exceeding allotted reserves," depend on an "expertise to understand or interpret Genworth Australia's operations and results." Br. 24. Indeed, it is unclear what expertise would be necessary to further parse the meaning of the

[4] That CW2 chose not to make statements regarding the December 2011 meeting does not in any way undermine CW1's first-hand account – CWs make statements voluntarily and have any number of reasons, including the existence of separation agreements; wariness of preserving their reputation in a certain industry, *etc*. for not disclosing certain kinds of information. Nor does CW2's decision not to disclose information regarding the L&M meeting amount to an "inconsistency" in CW1's account – mere silence cannot be distorted into an "inconsistency." Br. 26-27.

response that "claims exceed[ed] allotted reserves."[5] Defendants disregard that the "knowledge" attributed to CW1 here is what CW1 learned at the December 2011 meeting, which does not require that CW1 "would have had [a] financial background or was privy to the finance department's methodology."[6]

Similarly unavailing is Defendants' unrealistic portrayal of the December 2011 L&M meeting as a "conspiracy running from Genworth's senior management right down to 'director-like employees'… in the company's IT department." Br. 25. It is unclear why Defendants would assume that every participant at the meeting – at least 10 of whom were IT employees that Defendants assert would not be able to understand the information presented – should be whistleblowers that would be willing, *en masse*, to run the risk of losing their jobs over revealing confidential information immediately after having learned it. It hardly is uncommon for executives to present information internally that is at odds with statements made to the public. *E.g., In re Sturm, Ruger & Co., Inc. Sec. Litig.*, 2011 WL 494753, *8 (D. Conn. 2011) (allegations that executives "were privy to confidential information about the company's operations and financial condition, but deliberately withheld adverse facts that would have given a true picture of the company's financial situation" supported where CWs "stated that daily meetings were held at the New Hampshire plant in which the failure to meet production goals was discussed, and company vice presidents, managers and engineers attended those meetings.").

[5] CW1's opinion that "homeowners were more likely to walk away from" secondary homes if trouble occurred, Br. 24 n.7, does not impact his direct observations of what was presented at the December 2011 meeting.

[6] Defendants' argument assumes, without basis, that no MI employee participating at the L&M meetings including the 10 IT employees that participated in the December 2011 meeting (¶62) – could "understand" the MI updates being presented to them unless they had such qualifications.

Even more ludicrous is Defendants' wholesale, self-serving and improper speculation that CW1 must have "misremembered" his account. Br. 27 ("even giving CW1 the benefit of the doubt that the meeting he recalls, in fact, occurred, the far more likely explanation is that CW1 is describing a meeting *in 2012* where he heard about Genworth Australia's materially increased Q1 2012 losses and the impact on the IPO and is *misremembering* when that meeting occurred and what the $100-125 million represented."). Defendants cannot be permitted so brazenly to re-write the Complaint's plain allegations. *In re Philip Servs. Corp. Sec. Litig.*, 383 F.Supp.2d 463, 474 (S.D.N.Y. 2004) (defendant's "characterizations either contradict the plain meaning of the allegations in the Complaint or rely on convoluted inferences favoring" defendant; "[g]ranting plaintiffs the reasonable inferences to which they are entitled at the pleading stage, the allegations are sufficient to establish [defendant's] conscious misbehavior"); *In re Initial Pub. Offering Sec. Litig.*, 241 F.Supp.2d 281, 332-33 (S.D.N.Y. 2003) (rejecting defendants' efforts to "rewrit[e] the [c]omplaints in a way that they believe favors dismissal"; "[d]efendants must take the [c]omplaints as they are written").

Finally, Defendants cite extra-Circuit law on CWs to argue that CW1 should be discounted. Br. 21 (citing *City of Livonia Emps.' Ret. Sys. v. Boeing Co.*, 711 F.3d 754 (7th Cir. 2013)). As explained *supra*, however, the Complaint amply has met the *Novak* standard for pleading CW1's knowledge of the information presented at the December 2011 meeting. Therefore, the Court should accept CW1's well-pled account. *Cf. Aeropostale*, 2013 WL 1197755, *17 ("I decline to accept [d]efendants' invitation to overlook the law in this [C]ircuit regarding confidential sources, as articulated in *Novak*, in favor of the Seventh Circuit's decision… [i]f the confidential employees turn out to have given [p]laintiff's counsel false information, or have axes to grind that renders implausible their testimony about what

Defendants knew and when they knew it, so be it—but that is an issue for trial, not on a motion to dismiss.").

C. Defendants' Statements Regarding The IPO Were Materially Misleading

Improperly viewing the misleading statements made regarding the IPO in isolation, Defendants argue that such statements were not literally false. *E.g.*, Br. 34 ("Plaintiffs also do not allege that Defendants were not actually 'working very actively' or 'working really hard' to execute the IPO in Q2 2012"). Statements like these were made as late as *March 29, 2012*, only weeks before the Company announced that the IPO would be delayed because of market conditions in Australia. Notably, Klein's March 29, 2012 statements were made in response to a direct question on whether the IPO might be delayed, but Klein failed to disclose that any market conditions existed that would derail the IPO, instead further conveying the misleading impression that the Australian MI unit was stable ("[t]his year we expect… the Australian market[] to remain fairly flat," ¶106); and that the IPO would be done from "a position of strength." Viewed collectively with the misleading Class Period loss ratios, Defendants' statements that the Queensland risks had been mitigated, and Klein's February 2012 statements that the IPO remained "on track," these late March 2012 statements further bolstered the misleading impression that the Australian MI unit was stable, and that no market conditions would jeopardize the IPO. Even if the statement that Defendants were "working very actively" were literally true, that does not cure the misleading impressions of stability. *Kleinman*, 706 F.3d at 153 ("[s]tatements of literal truth 'can become, through their context and manner of presentation, devices which mislead investors'"); *Fannie*, 891 F.Supp.2d at 476 ("[i]n analyzing whether the statements… were false or misleading the court must read [them] as a whole... [because the] central issue... is not whether the particular statements, taken separately, were

literally true, but whether defendants' representations, *taken together and in context*, would have misl[ed] a reasonable investor about the nature of the securities.").

Moreover, Defendants themselves stated that the IPO was "subject to market conditions." ¶109. Accordingly, that claims had exceeded reserves by at least December, 2011 (¶64) made their statements regarding the IPO materially misleading, because they failed to disclose that market conditions did, indeed, render it unfeasible for the IPO to occur in the stated timeframe. Defendants' disclosure at the end of the Class Period specifically ties the delay in the IPO to the underperformance in Australia, which forced Defendants to more than triple the loss ratio for the Australian MI unit. *See* ¶109 (delay in IPO "timeframe primarily reflects recent business performance in Australia."). And, as explained *supra*, even if Defendants' statements that the IPO was "on track" could be viewed as mere opinion, Defendants had no basis for that opinion given the information internally disclosed in the December 2011 L&M meeting. Contrary to Defendants' argument that Plaintiffs have not explained "why the IPO was not objectively achievable by Q2 2012, or when Defendants should have known this," the Complaint plainly alleges that by at least "the second half of 2011" delinquency levels had increased, and by December 2011 claims had exceeded reserves, thus making it impossible for the IPO to occur in 2Q12 from "a position of strength." ¶106.

D. The Safe Harbor Does Not Protect Defendants' IPO Statements

"The safe harbor… is dependent on what the defendant knows at the time of the statement; cautionary language is meaningful only when it discloses the known risks of the statement's falsity and *statements are forward-looking only if they are not false when made*." *In re ITT Educ. Servs., Inc. Sec. Litig.*, 34 F.Supp.3d 298, 305 (S.D.N.Y. 2014). Accordingly, "the safe harbor does not cover claims that were 'made or approved by an executive officer with actual knowledge by that officer that the statement was false or misleading.'" *Id.* at 306 (quoting

Slayton v. Am. Exp. Co., 604 F.3d 758, 762 (2d Cir. 2010)); *see also Rombach*, 355 F.3d at 173 ("[c]autionary words about future risk cannot insulate from liability the failure to disclose that the risk has transpired"); *Dolphin & Bradbury, Inc. v. SEC*, 512 F.3d 634, 640 (D.C. Cir. 2008) (highlighting "the critical distinction between disclosing the risk a future event might occur and disclosing actual knowledge the event will occur").

With regard to Fraizer, the Complaint sufficiently alleges that his statements that the IPO was "on track" were made with actual knowledge that existing conditions had already caused a loss in the Australian unit that would delay the IPO. *First*, Fraizer received monthly the operational results from that unit, including risk assessments and detailed delinquency information. ¶70. Further, Upton – who also received the *same* monthly information from Australia as Fraizer (¶¶62, 65) – led the December 2011 L&M meeting where it was disclosed that the Australian unit had had a bad quarter and that the increase in claims for Australia equaled around $100-125 million. Accordingly, Fraizer had actual knowledge of losses in Australia, during the Class Period, that would preclude an on-time IPO, and his "on-track" statements are not subject to safe harbor protection. *In re Vivendi Universal, S.A.*, 2004 WL 876050, *7 (S.D.N.Y. 2004) (declining to apply safe harbor protection to statement that company was "on track" to achieve earnings targets where defendants did not reasonably believe their own statements at the time they were made).

Nor was there any meaningful cautionary language to warrant protecting any of the Defendants' IPO statements, because Defendants knew that the "risks addressed" – namely, that the IPO was subject to "market conditions"; and that "adverse market or other conditions might delay" the IPO, Br. 29-30; and that "rising unemployment rates" and "natural disasters… including floods [could] trigger an economic downturn" – all *already had transpired* at the time

Defendants made their statements. *Strougo v. Barclays PLC*, 2015 WL 1883201, *5 (S.D.N.Y. 2015) ("statements are not protected where defendants had no basis for their optimistic statements and already knew… that certain risks had become reality."). Here, Defendants not only knew by December 2011 that the Australian unit had seen an increase in claims of $100-125 million – a development more than sufficient to delay the IPO – they effectively nullified their cautionary language by misleadingly reassuring the market during the Class Period that (1) Genworth Australia was "absorbing the loss pressures coming from the *early 2011* Queensland flood events" (¶91); (2) home prices were "stable" and unemployment would remain near "current levels" in Australia (¶104); (3) the "delinquency rate" had *improved* across all regions, including Queensland (¶96); and (4) the reported Class Period loss ratios – which purportedly reflected current claims, delinquencies, and reserves – remained stable and even decreased slightly in 4Q11, seemingly validating Defendants' purported mitigation of the Queensland risks (¶50).[7] Because Defendants' cautionary language "warned" of risks that already had transpired, it is not "meaningful" and cannot protect Defendants' misleading IPO statements.[8] Indeed, Klein's "caution" regarding "market conditions… and looking at the impact also in the Australian housing market," Br. 44, came as late as March 29, 2012 – less than three before the IPO was delayed – further stripping the language of any "meaningfulness" and supporting that the risks warned against already had transpired.

[7] Indeed, Defendants cannot convincingly rely on cautionary language regarding "natural disasters," Br. 45, when they specifically addressed the Queensland risks; outlined their mitigation of those risks, and reported misleading Class Period loss ratios that validated the purported mitigation. *See supra* § II.B.

[8] Defendants concede that the IPO statements are material. Br. 43 (invoking only "the 'meaningful cautionary language' prong and, independently, the 'no actual knowledge' prong.").

E. The Complaint Adequately Alleges Defendants' Scienter

Defendants' recitation of the scienter standard, Br. 35-36 (citing *ECA & Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co.*, 553 F.3d 187, 198 (2d Cir. 2009)), critically omits that 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,* 551 U.S. at 322-23, 326 (emphasis in original). Further, 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*. Thus, a "tie . . . goes to the plaintiff." *Sawabeh Info. Servs. Co. v. Brody*, 832 F.Supp.2d 280, 295 (S.D.N.Y. 2011).

Defendants argue that the alleged fraud is "illogical," Br. 36-37. That the Australian MI unit's poor performance and the underwriters' due diligence overtook Defendants' fraud, such that Genworth could not take advantage of the opportunity to unlock capital from its subsidiary, however, is irrelevant to Defendants' scienter. *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 710 (7th Cir. 2008) ("that a gamble – concealing bad news in the hope that it will be overtaken by good news – fails is not inconsistent with its having been a considered, though because of the risk a reckless, gamble. It is like embezzling in the hope that winning at the track will enable the embezzled funds to be replaced before they are discovered to be missing.").

The suggestion that Genworth Australia experienced so-called "unexpected losses" during March 2012 is fatally undermined by Upton's admission that the Australian MI unit had seen "[i]n the second half of 2011…increasing delinquency levels and… lender processing delays." *Compare* Br. 17 *with* ¶87. And the inference of concealed losses earlier in the Class Period is confirmed by CW1's recollection that claims in the Australian MI unit had outstripped reserves, with claims reaching a record $100-125 million. ¶¶64-65. Defendants' competing inference only makes sense if these well-pled facts are ignored. The more compelling inference

– and the only inference that is consistent with the totality of the facts alleged – is that Defendants were aware of the earlier increase in claims (particularly those tied to their large exposure to Queensland loans and to low-documentation loans in the Australian MI unit) but concealed those problems in their bid to promote the IPO and raise the capital that they needed to restore Genworth's operations.[9] *In re Ambac Fin. Grp., Inc. Sec. Litig.*, 693 F.Supp.2d 241, 269 (S.D.N.Y. 2010) (finding after "taking the facts in the light most favorable to the plaintiffs" and "[v]iewing the allegations collectively" that the more compelling inference of scienter was that offered by plaintiffs).

1. Defendants Had Motive To Commit Fraud

Defendants do not dispute that they had the opportunity, but contend that "Plaintiffs do not allege a single motive Defendants had to commit fraud." Br. 38.[10] Defendants disregard their motive to conceal the Australia MI unit's problems to ensure a successful and timely IPO,

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[9] Defendants' cases questioning scienter theories are easily distinguishable. Br. 37 n.12. Unlike those cases, plaintiffs' theory here is perfectly logical – defendants were attempting to spin off a portion of Genworth Australia at the same time that they were seeing "increasing losses" in Queensland and its high risk low-documentation portfolio to, in their own words, "free material capital for redeployment." ¶45. In contrast, *Local No. 38 IBEW Pension Fund v. Am. Express Co.*, 724 F.Supp.2d 447, 462-63 (S.D.N.Y. 2010), rejected an inference of scienter as lacking common sense where defendants made statements in 2007 but "were unaware of a spike in write-offs for recently issues cards until sometime in 2008." Such a temporal disconnect does not exist here. Similarly, *In re PXRE Group, Ltd. Sec. Litig.*, 600 F.Supp.2d 510, 533-34 (S.D.N.Y. 2009), characterized the alleged scheme as seemingly futile where "[d]efendants did not attempt to raise enough capital to offset PXRE's entire losses," electing instead to raise capital incrementally as losses increased. Here, however, Defendants sought to raise, according to one analyst's estimate, as much as $720 million in a single offering. ¶46. And *Fadem v. Ford Motor Co.*, 352 F.Supp.2d 501, 511 (S.D.N.Y. 2005) found the theory that defendants were speculating on "palladium forward contracts" required Ford to act contrary to its "economic self-interest" because it depended on Ford "purchas[ing] more palladium than it knew or thought it would need." Here, it would have been contrary to Genworth's "economic self-interest" for it not to attempt to complete the IPO to fund its U.S. Mortgage business. ¶¶10, 63.

[10] Defendants argue that Plaintiffs do not "explain *why*," essentially asking the Court to focus its scienter analysis solely on motive. Br. 36. Even assuming *arguendo* that Plaintiffs had not established motive, they are not required to do so to state a claim for securities fraud in the Second Circuit. *Novak*, 216 F.3d at 308-09 (plaintiffs can, in the alternative, plead conscious misbehavior). In any event, Defendants' posed questions are unpersuasive. For example, Defendants suggest that they took "meaningful reserve charges consistent with the results disclosed," but the unprecedented increase of $82 million in reserves suggests that "meaningful" was insufficient, especially in light of the up to $125 million in Australian claims extant in December 2011. ¶¶65, 77, 81, 84.

allowing the Company to raise capital for its struggling U.S. MI unit. *See* ¶¶10, 49, 63; *In re Silvercorp Metal, Inc. 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 Am. Bank Note Holographics, Inc. Sec. Litig.*, 93 F.Supp.2d 424, 445 (S.D.N.Y. 2000) (concrete benefit from scheme to complete IPO sufficient to infer scienter); *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). The opportunity to raise as much as $720 million (according to one analyst) that Defendants could redeploy to Genworth's struggling U.S. MI unit, represented a concrete benefit to Defendants. ¶¶10, 46, 63; *see also Novak*, 216 F.3d at 311; *Silvercorp*, 26 F.Supp.3d at 275.[11] Disclosure of the Australian MI unit's true condition would have jeopardized the acquisition of this critical funding.[12]

2. Defendants' Conscious Misbehavior or Recklessness

To allege scienter based on conscious misbehavior or recklessness, "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

[11] *In re Sec. Capital Assurance, Ltd. Sec. Litig.*, 729 F.Supp.2d 569 (S.D.N.Y. 2010), does not support Defendants' argument that insider trading is the only acceptable motive. Br. 38. There, plaintiffs merely made "broad allegations" that defendants had knowledge "because they held management roles." 729 F.Supp.2d at 595. Under those circumstances, not present here, the lack of insider trading compelled a finding against scienter. In any event, courts repeatedly have found that the absence of financial gain or insider trading allegations does not negate scienter. *Tellabs*, 551 U.S. at 325; *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. Am. W. Holding Corp.*, 320 F.3d 920, 944 (9th Cir. 2003); *PR Diamonds, Inc. v. Chandler*, 364 F.3d 671, 691 (6th Cir. 2004).

[12] Accordingly, Defendants' reliance on *Shemian v. Research in Motion Ltd.*, 2013 WL 1285779, *14 (S.D.N.Y. 2013) is misplaced. Br. 47. *Shemian* recognized that the motive to artificially "inflat[e] stock prices in order to acquire another company may, in some circumstances, be sufficient for scienter," but did not so find on its particular facts, because the timing of the acquisitions rendered such a motive implausible. 2013 WL 1285779, *13-14. No such implausibility exists here. Indeed, completing the IPO and injecting new capital into the other parts of Genworth's business can be viewed as a necessary condition to Fraizer's continued position at Genworth, given that Fraizer resigned just two weeks following the disclosure that the IPO would be delayed. ¶¶24, 33.

duty to monitor." *In re Stillwater Capital Partners Inc. Litig.*, 853 F.Supp.2d 441, 453 (S.D.N.Y. 2012); *Novak*, 216 F.3d at 311. 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; *Gould v. Winstar Commc'ns, Inc.*, 692 F.3d 148, 158-59 (2d Cir. 2012) ("[r]ecklessness may be established where a defendant 'failed to review or check information that [it] had a duty to monitor, or ignored obvious signs of fraud.'"). "'[G]reat specificity'" is not required. *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 169 (2d Cir. 2000). Plaintiffs need only plead enough facts to support "'a strong inference of fraudulent intent.'" *Id.*[13]

(a) Scienter Is Inferred From Company Admissions That Problems Had Arisen During The Class Period

Admissions showing that Defendants contemporaneously were aware of facts contradicting their Class Period statements strengthen the inference of scienter. *Scholastic*, 252 F.3d at 73 ("post-class period data may be relevant to determining what a defendant knew or should have known during the class period"); *Hall v. Children's Place Retail Stores, Inc.*, 580 F.Supp.2d 212, 227 (S.D.N.Y. 2008) ("admissions of misrepresentations, coupled with defendants' continuous intimate knowledge of company affairs is enough to adequately infer scienter"); *see also Lormand v. US Unwired, Inc.*, 565 F.3d 288, 254 (5th Cir. 2009) (admissions "are evidence that the defendants actually knew earlier that the course of action would turn out badly"); *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).

Here, Upton admitted during Genworth's May 2, 2012 conference call (on which Klein also participated), that "we did see increasing delinquency levels and we did observe lender

[13] Defendants' main approach to showing that the Complaint fails to allege conscious misbehavior is to baselessly attack the CWs. Br. 39-42. Defendants' approach improperly disregards the Complaint's other allegations. *Tellabs*, 551 U.S. at 326 ("[w]e reiterate, however, that the court's job is not to scrutinize each allegation in isolation but to assess all the allegations holistically.").

processing delays" "in the *second half of 2011*." ¶¶16, 87, 117. Upton further acknowledged that Defendants had to work "[i]n partnership with key lenders" "*[d]uring 2011*" to clear "*backlogs* of delinquencies." ¶116. These admissions, coupled with the (1) IPO's importance and management's focus on the Australian MI business in advance of the IPO; (2) over $12 billion exposure to the low-doc loans issued in 2007 and 2008; and (3) sharp increase of claims mid-Class Period, including in Queensland, leave little doubt that Genworth executives, including Fraizer and Klein, were at minimum reckless in continuing to represent that the Australian MI unit was financially stable and "on track" for its IPO. ¶¶47-48, 58, 64-66, 72, 82, 88.

(b) The "Core Operations" Inference Imputes Knowledge To The Individual Defendants

The Second Circuit has "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 F. 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." *Winstar*, 2006 WL 473885, *7. "[I]f a plaintiff can plead that a defendant made false or misleading statements when contradictory facts of critical importance to the company either were apparent, or should have been apparent, an inference arises that high-level officers and directors had knowledge of those facts by virtue of their positions within the company." *In re Atlas Air Worldwide Holdings, Inc. Sec. Litig.*, 324 F.Supp.2d 474, 489 (S.D.N.Y. 2004). Plaintiffs have done so here, as shown *infra*.

Knowledge that Genworth Australia's claims, particularly in Queensland and on low-documentation loans, were increasing to the point of outstripping available reserves is imputable to Fraizer and Klein because, as they themselves explained, the Australian MI unit was critical to

Genworth's operations, was one of only two business units paying regular dividends, and was the designated unit to supply an influx of needed capital to the holding company. ¶¶5, 37, 43. Historically, Genworth Australia was one of the Company's best performing operating units and, among Genworth's numerous business subsidiaries, it contributed more than a quarter of the total dividends to the holding company. ¶¶2-3, 32, 37, 43. Fraizer further noted that "we see Australia as an important business" and that along with Genworth Canada, the Australian MI unit "act[ed] as a key source of earnings, capital, and returns" that "certainly…benefit[ed] the holding company and the enterprise." ¶47. Klein also recognized that "the Australian and Canadian businesses have been capital generators providing dividends to the holding company." ¶48. The Australian MI unit's "critical importance" to Genworth's operations permits the imputation of knowledge regarding its business deterioration in 2011 to Fraizer and Klein.

Similarly, the IPO's importance – as Defendants repeatedly emphasized – gives rise to the strong inference that Fraizer and Klein knew, or recklessly disregarded, that the IPO could not possibly be "from a position of strength." ¶¶15, 48, 58. Indeed, on March 29, 2012, just weeks before the IPO was postponed, Klein told investors that the IPO was "one of our most important initiatives" and "a very, very important transaction for us." ¶48. Klein failed to disclose, however, any indication of increased delinquencies and claims, notwithstanding the increase in claims throughout "the second half of 2011." ¶¶16, 81-82. The stated importance of the IPO and the due diligence required for it renders Defendants' assertion that Plaintiffs have failed to plead actual knowledge implausible. *See* ¶73.

Defendants' characterization of Fraizer's and Klein's IPO statements as mere opinion – *i.e.*, that they "did not genuinely hold their stated beliefs that the IPO would go forward as planned," or "that they did not want Genworth to complete the IPO 'from a position of strength,'" or "that Mr. Fraizer did not genuinely hold his opinion that Australia was transitioning as he expected" – does not immunize them from liability. Br. 48. Defendants can cite no case law stating that Plaintiffs must plead Defendants did "not genuinely hold their stated beliefs." Indeed, the Supreme Court recently rejected this argument in *Omnicare*, 135 S.Ct. at

1318. *Omnicare* held that "a reasonable investor may, depending on the circumstances, understand an opinion statement to convey facts about how the speaker has formed the opinion – or, otherwise put, about the speaker's basis for holding that view. And if the real facts are otherwise, but not provided, the opinion statement will mislead its audience." *Id*. at 1328. Plaintiffs thus are not required to show that Defendants did not subjectively believe the statement – liability attaches for an opinion statement where there is an omission of material facts concerning Defendants' "inquiry into or knowledge concerning a statement of opinion [] if those facts conflict with what a reasonable investor would take from the statement itself." *Id*. at 1329.

Here, Fraizer's and Klein's "beliefs" about the IPO's completion omitted material facts that made their statements misleading to a reasonable investor. Statements that the IPO was on track and that defendants were "working very actively" to complete the IPO failed to convey that the Australian MI unit had inadequate reserves for the delinquencies Defendants saw increasing *at the same time* they were making these statements. ¶¶87, 116-17. And notably, Defendants' focus on plaintiffs' CW allegations disregards Upton's admission that Defendants saw increasing delinquencies in the second half of 2011. ¶87. This admission, the known $12 billion exposure to low-documentation loans in a weak Australian economy, the $100-125 million increase in claims by December 2011 (primarily in Queensland), and Fraizer's close monitoring of financial data collectively establish that Fraizer and Klein were aware of facts contradicting their false statements regarding the IPO.[14] ¶¶70, 77, 81, 85-88.

[14] *Mechel OAO* and *Malin* are inapposite. Br. 49. *Mechel* rejected CW allegations where the plaintiff attempted to allege that the individual defendants were involved in a conspiracy to violate Russian laws based on a witness "described only as 'an analyst with over ten years' experience in analyzing sources in Latvia." *Bd. of Trustees of the City of Ft. Lauderdale Gen. Emp. Ret. Sys. v. Mechel OAO*, 811 F.Supp.2d 853, 880 (S.D.N.Y. 2011). *Mechel* concluded that this description fell "far short of the particularity needed to substantiate the witness's knowledge." *Malin* similarly involved confidential witness allegations to support defendants' knowledge without presenting "any evidence that that they communicated any of the alleged problems to any of the [i]ndividual [d]efendants or that the [i]ndividual [d]efendants otherwise knew about these issues." *Malin v. XL Capital Ltd.*, 499 F.Supp.2d 117, 141 (D. Conn. 2007). Here, in contrast, Plaintiffs have described both confidential witnesses with sufficient particularity to support the probability that someone in their position would know the information attributed to them.

(c) The Magnitude Of The Reserve Charge Supports A Strong Inference of Scienter

The magnitude of the purported fraud here supports a strong inference of scienter. *Scholastic*, 252 F.3d at 77 ($24 million charge "undermines, at the pleading stage, the argument that the defendants were unaware" of any increase in returns); *Rothman v. Gregor*, 220 F.3d 81, 92 (2d Cir. 2000) (deeming significant the "magnitude" of a defendant's write-off in determining scienter); *Me. State Ret. Sys. v. Countrywide Fin. Corp.*, 2011 WL 4389689, *17 (C.D. Cal. May 5, 2011) ("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 v. E*Trade Fin. Corp.*, 712 F.Supp.2d 171, 199 (S.D.N.Y. 2010) ("magnitude of write-offs alleged to be the subject of the misstatements supports a strong inference of scienter").

Here, the $21 million loss in 1Q '12 and the massive $82 million charge related to claims paid in Australia – resulting in the Australian MI unit recording its first historical loss and the unit's loss ratio skyrocketing from 46% in 4Q '11 to 154% in 1Q '12 – supports scienter. As in *Scholastic*, 252 F.3d at 77, these figures "undermine[] at the pleading stage the argument that defendants were unaware" of the facts giving rise to the figures.

Defendants cannot credibly claim that they were unaware of the underlying problems that caused this massive reserve charge. ¶¶16, 82, 116. The nature of the claims process, where claims made to the Australian MI unit generally followed months after the initial default, necessarily meant that the defaults underlying the massive reserve charge occurred before the "March loss emergence." ¶¶55, 117. Indeed, the December 2011 L&M presentation and Upton's post-Class Period admission demonstrate that the claims driving these numbers existed throughout the Class Period. ¶¶64-65, 85-87, 116. The extraordinary size of the reserve charge, especially for a business that had never had an operating loss and where the "blowout in losses" was "not typical of the LMI sector in Australia over the past five years" (¶¶23, 114), supports an

inference that Defendants were aware of the delinquencies and claims that drove the reserve increase. *Scholastic*, 252 F.3d at 77.

Defendants further fail to address the $12 billion exposure to 2007-2008 low-documentation loans, which drove the large reserve charge and also supports scienter. That Defendants were aware of the risk in these low-documentation loans is reflected in Genworth's decision to stop issuing these types of loans. ¶¶81, 88. Accordingly, any professed ignorance of an exposure of this magnitude, which was particularly susceptible to problems in the weak Australian economy, can only – at a minimum – be reckless indifference. ¶¶82, 88, 100, 107.

(d) Defendants' Access To Genworth Australia's Data Supports A Strong Inference Of Scienter

"[S]ecurities fraud claims typically have sufficed to state a claim based on recklessness when they have specifically alleged defendants' knowledge of facts or access to information contradicting their public statements." *Novak*, 216 F.3d at 308; *In re New Oriental Educ. & Tech. Grp. Sec. Litig.*, 988 F.Supp.2d 406, 425 (S.D.N.Y. 2013). "Under certain circumstances," the Second Circuit has "found allegations of recklessness to be sufficient where plaintiffs alleged facts demonstrating that defendants failed to review or check information that they had a duty to monitor, or ignored obvious signs of fraud." *Novak*, 216 F.3d at 308-09.

In addition to their admissions demonstrating their knowledge, *supra*, and Defendants' repeated claims that the IPO to which they were devoting a lot of time and energy was "one of our most important initiatives" (¶¶45-48), Fraizer and Klein both certified multiple times that Genworth's SEC filings did "not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report." ¶¶90. Fraizer and Klein further received material information regarding the increases in delinquencies and claims at the Australian MI unit. Indeed, Genworth's public filings attest that Defendants regularly monitored information material to a mortgage insurance business, specifically delinquencies, claims, trends and loss reserves. ¶¶55-56. Klein also represented that

Defendants conducted "stress testing across all the platforms," providing them information about the loans' performance in the context of the weaker Australian economy. ¶57. Defendants could not have assessed loss reserves without access to this information, which establishes their scienter. *In re Nortel Networks Corp. Sec. Litig.*, 238 F.Supp.2d 613, 631 (S.D.N.Y. 2003) ("that the [d]efendants either had actual knowledge of or ready access to facts that contradicted their public statements" is indicative of recklessness).

The Complaint also establishes that Defendants discussed the Australian MI unit's performance and the IPO during regular L&M meetings. ¶¶62-65. According to CW1, in a Powerpoint presentation during an early to mid-December 2011 meeting, Genworth's management reported that the Australian MI unit was showing an increase of $100-125 million in claims, particularly in Queensland and in secondary homes. ¶¶60, 64-65. At the same time, and as both CW1 and CW2 confirm, Fraizer and Schneider additionally had contemporaneous information about the Australian MI unit and the Australian market based on their trips to Australia in advance of the IPO. ¶¶61, 67.[15]

CW2, the former Chief Operating Officer for the Australian MI unit from 2010 through 2012, confirmed that throughout 2011, internal reports showed increasing delinquencies in Australia. ¶¶67-68. CW2 also detailed that Genworth Corporate received monthly reports providing current and forecasted defaults, and identifying risk trends. ¶¶69-70. And CW2 noted that Fraizer would "get on," at least quarterly, the monthly international calls led by Upton. ¶72. These calls provided updates on the Company's finances. In particular, CW2 recalled that

[15] *City of Brockton Ret. Sys. v. Avon Prods., Inc.*, 2014 WL 4832321, *20 (S.D.N.Y. 2014) is inapposite. Defs.' Mem. at 39. *Avon* involved the existence of bribes to Chinese government officials to secure a direct-selling license for Avon's operations in China, which by their very nature were clandestine activities. *Id*. The *Avon* court rejected attempts by plaintiff to allege that the Individual Defendants' were involved in those activities or "should have been aware" of them because of their "supervisory positions," including their involvement in meetings. In this case, by contrast, the increasing delinquencies were admittedly pervasive; Upton even admitted that Genworth Australia was openly working with lenders to increase focus on default management as they processed "backlogs of delinquencies." ¶116-17. Defendants' frequent travels to Genworth Australia for the critically important IPO put them in a position to know about the admitted increasing delinquencies in the second half of 2011. ¶117.

Australian default rates were discussed, including "what's driving the conditions in the marketplace." Following these calls, a higher-level executive call was usually held. With all of these sources of information, it is highly implausible that Fraizer and Klein did not have access to information regarding the increasing delinquencies in the second half of 2011 that required a need for additional reserves, the market conditions jeopardizing the IPO, and that this information contradicted their public statements.[16] Viewed "collectively" with the other allegations, the Complaint raises a strong inference of defendants' scienter. *Tellabs*, 551 U.S. at 326.

Defendants argue that *Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc.*, 531 F.3d 190, 196 (2d Cir. 2008) supports dismissal. Br. 39. To the contrary, *Dynex* supports sustaining the Complaint. *Dynex* reversed a district court's decision denying Dynex's motion to dismiss based on corporate scienter. The district court held that the plaintiff had successfully pleaded scienter against Dynex and its Merit subsidiary despite failing to find scienter pleaded as to any specific officer or employee of either company. *Id*. at 192. The Second Circuit held that a plaintiff can, in fact, "raise the required inference [of scienter] with regard to a corporate defendant without doing so with regard to a specific individual defendant" but found that plaintiffs had not done so because they had not "identif[ied] the reports or

[16] *Jones v. Perez*, 550 F. App'x 24, 28 (2d Cir. 2013) is distinguishable. Br. 41. *Perez* rejected scienter allegations where plaintiff's sources, "[a]t most, [] confirm[ed] what was already known to the market, *i.e*., that Kodak's inkjet business was underperforming." *Id.* While plaintiff alleged that "defendants had access to reports showing that consumer inkjet sales were missing internal forecasts," paintiff failed to allege that those forecasts "diverg[ed] from publicly disclosed information." *Id.* Here, in contrast, the market was not aware of Genworth Australia's true financial condition – the reaction of analysts prove as much – and Plaintiffs have alleged a huge divergence from what was publicly represented and what was presented internally ($100-$125 million in claims). ¶¶81, 110-14. *Glaser v. The9, Ltd.*, 772 F.Supp.2d 573, 594 (S.D.N.Y. 2011) is also distinguishable. Br. 41. In *Glaser*, three of the four alleged confidential witnesses worked for a different company and were not alleged to have "had contact with anyone at the The9," while the one confidential witness who did work for The9, was inadequately described. *Id*. The confidential witnesses here are sufficiently described and were in a position to know the information attributed to them. ¶¶60, 67.

statements containing [the] information" that undermined defendants' statements. *Id*. at 196. Here, Plaintiffs *have* identified the "reports or statements" that undermined Defendants' representations about the strength of the Australian MI unit and the viability of the IPO, including the December 2011 PowerPoint presentation that showed an increase in claims in Australia of $100-$125 million. ¶18. Accordingly, *Dynex* supports a finding of corporate scienter here.

F. The Complaint Adequately Alleges Control Person Liability

Rule 8 governs pleading §20(a) control-person liability. *In re 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. Br. 49. Because control is undisputed and plaintiffs have alleged a primary violation, Defendants' motion to dismiss the §20(a) claim must be denied. *See also* ¶¶36-41.

CONCLUSION

Defendants' motion should be denied in its entirety.

Dated: May 26, 2015

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on May 26, 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 May 26, 2015.

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