UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

FINANCIAL GUARANTY INSURANCE COMPANY, Plaintiff, -against- THE PUTNAM ADVISORY COMPANY, LLC, Defendant.	12 Civ. 7372 (RWS) **ECF Case** **Electronically Filed**

DEFENDANT PUTNAM ADVISORY COMPANY, LLC'S LOCAL RULE 56.1 STATEMENT OF UNDISPUTED MATERIAL FACTS

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Pursuant to Federal Rule of Civil Procedure 56 and Local Civil Rule 56.1 of the United States District Court for the Southern District of New York, Defendant Putnam Advisory Company, LLC ("Putnam") respectfully submits this statement of material facts as to which there is no genuine issue to be tried in support of Defendant's Motion for Summary Judgment.[1]

I. Overview Of The Pyxis ABS CDO 2006-1

1. A collateralized debt obligation ("CDO") is a structured finance investment vehicle backed by a portfolio of debt instruments, such as notes issued by residential mortgage-backed securities ("RMBS") or by other CDOs. (*See* Ex. 2 at ¶ 31; Ex. 3 at ¶ 55.)

2. CDOs issue notes divided into different tranches; generally the more highly-rated, senior tranches are lower risk and offer lower potential returns than the lower-rated tranches, which offer greater potential return. (*See* Ex. 3 at ¶ 55.)

3. The Pyxis ABS CDO 2006-1 ("Pyxis") was a $1.5 billion subprime hybrid CDO principally backed by a portfolio of RMBS and other CDOs backed by RMBS. (*See* Ex. 1 at i; Ex. 2 at ¶¶ 10, 102; Ex. 3 at ¶ 64.)

4. Putnam was the Collateral Manager for Pyxis and was tasked with selecting and monitoring the collateral that backed Pyxis (the "Pyxis Portfolio"). (*See* Ex. 1 at i, 5.)

5. Calyon Corporate and Investment Bank ("Calyon") was the arranging bank for Pyxis. (*See* Ex. 2 at ¶ 22.)

6. Magnetar Capital LLC ("Magnetar") and Deutsche Bank were the equity investors in Pyxis. (*See* Ex. 3 at ¶ 34.)

[1] Citations to "Ex." refer to Exhibits to the Declaration of Thomas A. Arena, submitted herewith.

7. Pyxis issued approximately $1.479 billion notes and approximately $20.6 million in Preference Shares. (*See* Ex. 3 at Ex. III.2.)

8. The Pyxis Notes were segregated by seniority into tranches, with the most senior $900 million of notes called the "Super Senior Tranche." The Pyxis Super Senior Tranche consisted of a CDS[2] under which Calyon sold protection to Pyxis on the underlying assets in the CDO in exchange for premium payments. In return, Calyon was required to make payments to Pyxis if adverse credit events caused principal or interest shortfalls to the Super Senior Tranche (the "<u>Pyxis-Calyon Swap</u>"). (*See* Ex. 1 at 1-9; Ex. 2 at ¶¶ 12, 103, 105; Ex. 3 at ¶¶ 64, 69; Ex. 5 at 2.)

9. In October 2006, Financial Guaranty Insurance Company ("<u>FGIC</u>") entered into a CDS with Calyon, (the "<u>FGIC-Calyon Swap</u>") which mirrored the Pyxis-Calyon Swap. (*See* Ex. 2 at ¶ 13; Ex. 3 at ¶¶ 29, 83.) Under the terms of FGIC-Calyon Swap, FGIC received monthly premium payments and, in exchange, FGIC was required to reimburse Calyon for any payments Calyon made to Pyxis as the protection seller on the Pyxis-Calyon Swap. FGIC was not required to make any protection payments to Calyon under the FGIC-Calyon Swap until September 2016. (*See* Ex. 2 at ¶ 13; Ex. 3 at ¶ 83; Ex. 5 at 1-2.)

10. Pyxis closed on October 3, 2006. (*See* Ex. 1 at i.)

II. <u>FGIC Was A Sophisticated Insurer Of CDOs And Subprime RMBS</u>

11. Tracy Pridgen and Elizabeth Menhenett of FGIC drafted a memorandum to the FGIC Board of Directors regarding "Collateralized Debt Obligations and Credit Default Swaps –

[2] A credit default swap ("<u>CDS</u>") is a contract between two parties: a "credit protection seller" (the long investor) and a "credit protection buyer" (the short investor). The credit protection seller agrees to indemnify the credit protection buyer against losses on a specified "reference asset" against certain adverse credit events. In exchange, the credit protection buyer makes periodic premium payments to the credit protection seller. (*See* Ex. 2 at ¶ 29; Ex. 3 at ¶ 49.)

Notification of Readiness to Insure" (the "Readiness to Insure Memo"), dated June 30, 2004. (*See* Ex. 13.) This memorandum stated that FGIC would review "all reporting made available to the trustee and any additional information that FGIC feels is appropriate on a case-by-case basis." (*See* Ex. 13 at 5.)

12. The Readiness to Insure Memo also stated:

> FGIC will rigorously examine the structural components governing each transaction. Cash flow models will be developed for each transaction and will be used to confirm FGIC's interpretation of the transaction mechanics against that of the dealer and the sponsor. Structural protections such as overcollateralization (O/C) and interest coverage (I/C) tests will be compared against internal and market standards. Rating agency modeling techniques will be replicated to confirm the shadow ratings and to assess the rating agency loss levels against the bands used to establish each rating category in order to more precisely identify credit quality (e.g., distinguish between "weak" 'AAA' and "strong" 'AAA'). Structures will be stress tested to ensure that they can withstand multiples of historical default levels in combination with other cash flow stresses like interest rate and prepayment scenarios.

(*See* Ex. 13 at 5.)

13. The Readiness to Insure Memo stated that FGIC would "monitor all closed transactions on a monthly basis using FGIC's proprietary surveillance database." (*See* Ex. 13 at 7.)

14. An internal FGIC document dated December 1, 2004 stated, among other things, that "[e]ach [structured finance transaction in which FGIC participated] is to be monitored on an ongoing basis to ensure that assets are performing as projected and that the counterparties are in compliance with the relevant covenants, triggers, reps & warranties and other factors." (*See* Ex. 18 at 9.)

15. In the second half of 2006, FGIC insured eight CDOs with a total exposure of $7.694 billion. (*See* Ex. 3 at Ex. VI.1.)

16. As of September 30, 2007, FGIC's MBS portfolio comprised 252 transactions representing an insured exposure amount of $31.3 billion, $7.9 billion of which were subprime RMBS transactions. (*See* Ex. 19 at 8-10.) As of that date, FGIC had also insured 18 ABS CDOs representing an insured exposure amount of $10.9 billion. (*See* Ex. 19 at 20.)

III. Calyon Provided FGIC With All Pyxis Marketing Materials And Target Portfolios

17. On June 21, 2006, Calyon provided FGIC with a preliminary marketing presentation for Pyxis, which included an indicative term sheet and a target portfolio reflecting that the collateral would contain 6% prime RMBS assets. Putnam was not copied on this communication. (*See* Ex. 11 at 13-14.)

18. On July 7, 2006, Calyon provided FGIC with an updated marketing presentation, which included an indicative term sheet and a target portfolio reflecting that the collateral would contain 6% prime RMBS assets. Putnam was not copied on this communication. (*See* Ex. 4 at 13-14.)

19. On July 14, 2006, Calyon provided the final marketing presentation for investors for Pyxis (the "Final Investor Presentation"). The target portfolio in the Final Investor Presentation reflected that the collateral would contain 4% prime RMBS assets. (*See* Ex. 12 at 14.)

20. The Final Investor Presentation contained a disclaimer that Putnam owed no fiduciary duties and all participants in the Pyxis CDO needed to conduct their own independent examination of the deal. (*See* Ex. 12 at 2.)

21. The Final Investor Presentation also contained a "Targeted Collateral Securities Profile" which stated that at least 80% of the Pyxis collateral securities would be midprime or subprime assets, and the amount of prime RMBS would be capped at 20%. There was no

requirement that the portfolio would contain prime RMBS or RMBS from any particular vintage. (*See* Ex. 12 at 13.)

22. The Final Investor Presentation was attached to a two-page email from Bertrand Delaunay of Calyon. In the "Transaction Highlights" section of the email, Calyon noted that "[t]he collateral manager is able to cherry-pick the collateral for this portfolio via the CDS markets, with the ability to focus on seasoned product." (*See* Ex. 12.) Ms. Menhenett of FGIC testified that she understood the term "seasoned" to mean "'05 vintage or prior to '06." (*See* Ex. 31 at 149:19-25.)

23. On July 18, 2006, Calyon provided FGIC with a list of assets acquired for the Pyxis portfolio as of that date (the "<u>July 18 Portfolio</u>"). Putnam was not copied on this communication. The 82 collateral assets listed on the July 18 Portfolio had a notional value in excess of $1 billion, and represented approximately two-thirds of the final $1.5 billion Pyxis portfolio. Of these 82 assets, $75 million consisted of an index that represented 20 subprime RMBS called "ABX" and $176 million consisted of ABX constituent securities. The July 18 Portfolio did not contain any prime RMBS or RMBS issued in the first half of 2005 ("<u>2005H1 RMBS</u>"). (*See* Ex. 15.)

24. On August 7, 2006, FGIC asked Calyon for a list of the yet-to-be-acquired collateral assets for the Pyxis portfolio. (*See* Ex. 55.) In response to that request, on August 8, 2006, Sachin Anand of Calyon sent to FGIC an email attaching a target portfolio in which "the assets highlighted in the peach colour [sic] are the target assets" (the "<u>PCS</u>"). Mr. Anand advised FGIC that "Alex Rekeda has not yet checked over this pool, so please be aware that there might be some changes he may wish to make as the deal ramps up further." Putnam was not included on this email. (*See* Ex. 16; Ex. 17 at 526:20–528:11.) Mr. Anand assembled the target assets in the PCS, without any input from Putnam, from other Calyon deals arranged by Calyon. (*See* Ex. 54.)

25. The PCS contained the same 82 assets listed in the July 18 Portfolio, as well as 16 additional collateral assets acquired after July 18, 2006. The notional value of these 98 assets constituted nearly 75% of the final Pyxis portfolio. None of these 98 assets was prime or 2005H1 RMBS. The PCS also included 52 "target assets," highlighted in peach coloring, for the yet-to-be ramped portion of the Pyxis portfolio. Of these "target assets," 24 were designated as "RMBS Prime" in the column titled "Moody's Asset Type." Four of the "RMBS Prime" assets were not designated by name, but were listed as "Syn RMBS Asset." The remaining 20 assets, although listed as "RMBS Prime," were not prime RMBS, but rather were either Alt-A RMBS or Option Arm RMBS assets, which are different from and riskier than prime RMBS assets. Additionally, of the "target assets" listed in the PCS, 10 assets, representing 4.8% of the collateral pool, were 2005H1 subprime RMBS. (*See* Ex. 16; Ex. 25 at 297:12–298:7.)

26. On September 5, 2006, Putnam emailed Calyon, stating "[w]e have updated the target portfolio based on our aggregation to date, current investment views, and current market conditions." Pyxis also informed Calyon that "[w]e would like this target portfolio ***to be reflected in the termsheet provided to investors prior to pricing***." (*See* Ex. 26 (emphasis added).)

27. On September 8, 2006, Calyon provided Elizabeth Menhenett of FGIC with both the Preliminary Offering Memorandum and a Summary of Key Terms Sheet for Pyxis (the "Term Sheet"). The Term Sheet contained a target portfolio (the "September Target Portfolio"), which showed that only 2% of the Pyxis portfolio would be invested in "RMBS – Prime" assets. The September Target Portfolio did not specify that any assets would be from 2005H1. (*See* Ex. 6 at 6.) Ms. Menhenett acknowledged that she received this communication and the attached documents, but claimed that she did not review them. (*See* Ex. 6; Ex. 24 at 240:14–245:22.)

28. Calyon sent FGIC the final Offering Memorandum for Pyxis on October 3, 2006. Putnam was not included on this communication. (*See* Ex. 1.) The Offering Memorandum provided:

> No representation or warranty, express or implied, is made by... the Collateral Manager or any of their respective affiliates (except (i) in the case of the Collateral Manager, with respect to the information set forth in the section entitled "The Collateral Manager" (other than information set forth under the subheading "General" contained therein)...) as to the accuracy or completeness of the information set forth herein, and nothing contained herein is or shall be relied upon as, a promise or representation as to the past or the future.

(*See*. Ex. 1 at ii-iii.)

29. The Offering Memorandum also included the warning, in capital letters, that "IN MAKING AN INVESTMENT DECISION, INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE CO-ISSUERS AND THE TERMS OF THE OFFERING, INCLUDING THE MERITS AND RISKS INVOLVED." (*See* Ex. 1 at iii (emphasis in original).)

30. As part of its "Summary of Terms," the Offering Memorandum described the "Collateral Manager" and stated that:

> Pursuant to the Collateral Management Agreement and in accordance with the Indenture, the Collateral Manager will manage the selection, acquisition and disposition of the Collateral Debt Securities on behalf of the Issuer (including exercising rights and remedies associated with the Collateral Debt Securities) based on the restrictions set forth in the Indenture (including the Eligibility Criteria described herein) and on the Collateral Manager's research, credit analysis and judgment (in each such case, subject to the standard of care set forth in the Collateral Management Agreement)....

(*See* Ex. 1 at 5.)

IV. FGIC Negotiated Pyxis's Structure With Calyon

31. On August 8, 2006, Calyon emailed FGIC, reporting "per your request, we have talked to the Equity investor and came up with the following potential additions to address your concerns during the investment period." (*See* Ex. 21 at 1.)

32. On August 28, 2006, FGIC emailed Calyon and noted that "I know you have mentioned the equity does not want [an overcollateralization] haircut, but our understanding is this equity investor had done deals where haircut was included…." (*See* Ex. 22 at 2; Ex. 24 at 100:15–101:21.)

33. On August 30, 2006, FGIC emailed Calyon with "slight modifications" to the deal structure. FGIC requested that Calyon "[p]lease see if equity & Putnam agree to this and let's finalize." FGIC further stated "[a]s mentioned before, equity should have no issue as they've agreed to this in an already closed deal." (*See* Ex. 23 at 1.)

V. The FGIC Credit Application For Pyxis

34. A meeting of FGIC's Structured Credit Committee ("SCC") to discuss Pyxis was held on September 6, 2006. At the meeting, FGIC's underwriting team presented its application summarizing FGIC's underwriting team's research and analysis of Pyxis (the "Credit Application"). (*See* Ex. 5.)

35. The Credit Application stated that "FGIC has the opportunity to earn 10 bps at super senior attachment of 40%. This represents strong risk/return compared to previous mezz[anine] ABS opportunities we participated/reviewed," and "[t]his deal allows FGIC to take exposure to the subprime RMBS sector…." (*See* Ex. 5 at 1.)

36. The Credit Application noted that any losses that FGIC incurred on the FGIC-Calyon Swap "is only paid to Calyon after year 10." (*See* Ex. 5 at 2.)

37. The Credit Application identified one of the "mitigants" of risk in Pyxis as:

> Good diversification across originator/issuer/servicer, which provides protection against event risk. Underlying mortgage loan characteristics do not appear to be adversely selected vs. the market. Quality appears to be comparable to the FGIC Subprime book. There are no Option ARM loans in the mortgage pools backing the bonds we reviewed. We are familiar and comfortable with the majority of the originators/issuers/servicers."

(*See* Ex. 5 at 2-3.)

38. The Credit Application noted that "Putnam has held a general preference for Subprime RMBS since 2001." (*See* Ex. 5 at 5.)

39. John Van Tassel of Putnam testified:

> [T]o the extent [Putnam] had latitude, it was [Putnam's] belief at the time that prime assets could actually be riskier than subprime because of the very thin credit enhancement to prime deals. Subprime transactions were enhanced by the worst historical reference points in mind, whereas prime were enhanced with sort of the best performance history in mind. Prime assets could not withstand much disruption whatsoever, whereas subprime structures could handle significant defaults and losses. So as investors if we had latitude, in many cases we would have preferred subprime.

(*See* Ex. 41 at 221:14–222:14.)

40. The Credit Application provided that:

> FGIC's MBS team performed a review of all 82 RMBS bonds in the ramped portfolio and found the quality of issuers/originators and servicers to be representative of the market with no adverse selection. The ramped positions are from 2005 and 2006 vintage.... FGIC assigned lower ratings to 73% of the underlying bonds by balance (72% by count). The rating results are used in the CDO analysis.... The degree of rating adjustment is somewhat expected since FGIC holds a skeptical view of the subprime sector.

(*See* Ex. 5 at 6.)

41. Dana Skelton of FGIC testified that "no adverse selection" meant that the acquired portfolio was not "concentrated" in "what FGIC would perceive as weaker issuers, originators, or servicers than the market average." (*See* Ex. 52 at 134:7-15.) Elizabeth Menhenett testified that

"no adverse selection" meant that the portfolio "wasn't concentrated in…bad originators, issuers, or servicers." (*See* Ex. 24 at 491:22–492:10.)

42. The Credit Application showed that FGIC analyzed Pyxis's projected performance based on FGIC's re-rating of the assets, ran numerous simulations, and determined that the portfolio assets likely would have a default rate of 22.8%. (*See* Ex. 5 at 9.)

43. The Credit Application indicated that FGIC also analyzed the default probabilities and the degree of correlation of the final expected Pyxis portfolio. (*See* Ex. 5 at 10.)

44. Appendix 3 of the Credit Application contained the "General Eligibility Criteria" and "Asset Concentration" for the Pyxis portfolio Appendix 3 does not list any constraints regarding the amount of prime or 2005H1 RMBS. (*See* Ex. 5 at 17.)

45. The Credit Application stated:

> Overall, the portfolio consists of securities coming from top subprime originators, issuers and servicers. The portfolio does not exhibit any adverse selection in this regard. As the table above illustrates, the portfolio consists primarily of subprime assets. ***There are no Option ARM loans in any of the pools and there are no seasoned bonds with all securitizations having closed in 2005 or 2006.***"

(*See* Ex. 5 at 26 (emphasis added).)

46. The Credit Application also noted that "[t]he portfolio is well diversified with respect to originator," there was "a strong mixture" of issuers and "we have a favorable view of the vast majority of the originators and issuers." (*See* Ex. 5 at 27-28.) The Credit Application also stated that "[t]he portfolio shows a very strong mix of servicer names." (*See* Ex. 5 at 28.)

47. The Credit Application additionally stated:

> [T]here will be additional bonds added into the CDO during the ramp up period. In other words, we assumed that they would perform in line with the rest of the pool. For the prime bonds, we selected four prime deals from the FGIC portfolio that were most similar to the deals that will be in the fully ramped up CDO.

(*See* Ex. 5 at 29.)

48. John Dolan, Putnam's industry expert, testified that he "would not have labeled" the "four prime deals" referenced in FGIC's Credit Application "as prime." He "believe[d] at least two of them are Alt-A platforms, and...one of either a second lien or an [O]ption ARM platform." (*See* Ex. 25 at 295:9-15.)

49. While one section of the Credit Application projected that 10% of the final collateral pool would consist of prime assets, the portfolio that was the subject of the credit analysis by FGIC in the Credit Application matches the July 18 Portfolio, not the PCS. (*See* Ex. 2 at ¶¶ 65, 85, 86; Ex. 5 at 23-24, 26.)

50. The Credit Application provided that "[t]he new 'FGIC ratings'... were used by the CDO group in their sensitivity analysis. Approximately 54% of the ratings (by value) migrated downwards. This is somewhat expected since FGIC has held a skeptical view of the credit profile relative to ratings the subprime sector for some time." (*See* Ex. 5 at 30.)

51. In its evaluation of Putnam, the Credit Application stated that "[c]ash bonds are sourced from the current market" and "due to lack of sufficient cash opportunities in the subordinate market, Putnam's strategy is to purchase higher rated securities in the cash market, (A, AA and AAA), while entering into CDS on the subordinate tranches" because "[t]his way ***Putnam is not locked into the new issue market and is able to look at issuance for the past year*** while searching for appropriate opportunities." (*See* Ex. 5 at 35-36 (emphasis added).)

52. On September 6, 2006, FGIC's SCC granted credit approval for FGIC to enter into the FGIC-Calyon Swap. (*See* Ex. 9; Ex. 45.)

VI. <u>FGIC Received Regular Updates Concerning The Final Pyxis Portfolio</u>

53. FGIC requested and was granted access to the website Putnam maintained for Pyxis, which included up-to-date monthly reports disclosing the identity of each collateral asset in Pyxis, as well as detailed information concerning the performance of each such asset. (*See* Ex. 50; Ex. 51, Ex. 56, Ex. 57, Ex. 58, Ex. 59, Ex. 60.)

54. LaSalle Bank, an independent entity unaffiliated with Putnam, prepared monthly reports after the closing of Pyxis (the "<u>Trustee Reports</u>"). The Trustee Reports listed each of the portfolio assets, identified them by asset category, including whether they were prime or subprime RMBS, and confirmed that each collateral asset met all of the eligibility criteria and collateral quality tests for the deal. (*See, e.g.*, Ex. 10 at 11-13, 31-37.)

55. The first monthly Trustee Report for Pyxis, which FGIC received, was dated February 6, 2007. This Trustee Report listed the full-ramped portfolio for Pyxis, which contained 153 securities, including 12 CDOs. Four of the CDOs, constituting 3.6% of the Pyxis fully-ramped portfolio, were Magnetar-sponsored CDOs. This Trustee Report also confirmed that the fully-ramped Pyxis portfolio did not violate any eligibility criteria or collateral quality constraints. (*See* Ex. 10 at 1, 11-13, 31-37.)

VII. <u>FGIC Confirmed On Two Occasions It Had No Objections To The Pyxis Transaction</u>

56. A Closing Memorandum for Pyxis (the "<u>Closing Memorandum</u>"), was sent to the "FGIC Chief Credit Officer – Structured Finance and International (CCO-SF&I)." The Closing Memorandum stated that "[t]here were no material differences between the closed transaction and the transaction approved by the SCC." Elizabeth Menhenett of FGIC signed the Closing Memorandum as the Team Leader on October 30, 2006. (*See* Ex. 45.)

57. On April 27, 2007, William Carson, Katya Sverdlov, Elizabeth Menhenett, and Mathias Pulster of FGIC signed an "Amendment Request Form" by which FGIC consented to Putnam's continued service as Collateral Manager in light of Putnam's acquisition by Great-West Lifeco Inc. The Amendment Request Form recommended that FGIC "approve this request" for multiple reasons, including that "the deal is performing as expected." (*See* Ex. 46; Ex. 24 at 521:12–523:2.)

VIII. <u>FGIC Was Aware Of Magnetar's Trading Strategy And Its Role In Pyxis</u>

58. On September 12, 2006, Eric Hurst of FGIC wrote an email to several FGIC colleagues, stating "[a]s you know, there is one equity provider behind Pyxis, Octans 1 and Octans 2." Mr. Hurst testified that he knew the equity provider of Pyxis was Magnetar and he thought the others on the email would know Magnetar was the equity provider as well because "everybody knew Magnetar was the largest mezzanine CDO issuer out there" and "at that point…you could tell by the names." (*See* Ex. 30; Ex. 29 at 168:8–170:14.)

59. Elizabeth Menhenett of FGIC testified that in or about August 2006 she "reach[ed] out to [her] contact[ ] at Citi," Sohail Khan, to ask "[w]hat are you guys hearing about this name Magnetar?" and was told that there was an article about Magnetar. Ms. Menhenett asked Mr. Khan to send her the article. (*See* Ex. 24 at 104:4-13.) On August 29, 2006, Mr. Khan emailed Ms. Menhenett a *Derivatives Week* article entitled "Ill. Fund Swallows Big Chunk of Synthetic ABS," originally published on August 11, 2006 (the "<u>*Derivatives Week* Article</u>"). The *Derivatives Week* Article stated:

> Magnetar Financial, an Evanston, Ill.-based multi-strategy hedge fund, is dominating the market for asset-backed securities collateralized debt obligations by buying bespoke deals in massive sizes. The fund has enlisted a clutch of Wall Street firms to structure full-capital structure deals in which is buys the equity slice.

> Three CDOs have priced or closed so far, each over USD1 billion and named after an astrological constellation, and a handful of others are in the works. The structures consist primarily of credit-default swaps referencing sub-prime residential mortgage-backed securities.

(*See* Ex. 27; Ex. 47.)

60. The *Derivatives Week* Article also stated that "[m]arket participants speculate the fund is shorting other parts of the capital structure against its long equity positions" and identified Pyxis as a Magnetar-sponsored "Constellation" CDO. (*See* Ex. 27.)

61. Ms. Menhenett testified that she discussed the *Derivatives Week* Article with Lynn Finkel, her manager, but did not inform the SCC about the information contained therein because it was "not relevant" and did not "affect [FGIC's] investment thesis." (*See* Ex. 24 at 117:22–118:2; 181:22–183:24; Ex. 31 at 81:8–83:7; 169:18–172:2.)

62. Ms. Menhenett testified that she never reached out to Calyon with questions about Magnetar's trading strategy. Ms. Menhenett testified that, while she could have contacted Putnam with any questions about Magnetar, she "did not reach out to [Putnam] because the information [she] had learned did not warrant a call to [Putnam]." (*See* Ex. 24 at 107:15-116:11; Ex. 31: 172:5-23.)

63. On September 28, 2006, Ms. Finkel of FGIC forwarded several FGIC colleagues a Merrill Lynch article titled "Long ABS Correlation Trade Ignites Mezz SF CBO Market," published that same day, which discussed, in pertinent part, a "long-short" trading strategy in which hedge funds purchased a CDO's equity and shorted the CDO's higher-rated tranches. In her email, Ms. Finkel wrote "[t]he triggerless deals referenced below are the Magnitar [sic] deals." (*See* Ex. 28 at 1.)

IX. FGIC Insured Other Transactions Which Included Magnetar-Sponsored CDOs After Pyxis Closed

64. After Pyxis closed, FGIC continued to pursue opportunities to insure tranches of other Magnetar-sponsored CDOs, including Octans II CDO ("Octans II") and Auriga CDO 2006-1 Ltd. ("Auriga"). (*See* Ex. 2 at ¶ 100; Ex. 32; Ex. 33; Ex. 34.)

65. After Pyxis closed, FGIC insured tranches of six CDOs that contained Magnetar-sponsored CDOs in their collateral pools – Raffles Place II Funding, Ltd., Singa Funding Ltd., Davis Square Funding VII, Ltd., Gloucester Street ABS CDO, Longshore CDO Funding 2006-2 Ltd., and Grand Avenue CDO III, Ltd. (*See* Ex. 2 at ¶ 99). The Raffles Place II collateral pool included a Pyxis cash bond. (*See* Ex. 36 at 26.)

66. On May 18, 2007, the FGIC Structured Credit Committee met to discuss FGIC's participation in a transaction named "Havenrock II – ABS Conduit" (the "Havenrock II Credit Application"). The Havenrock II Credit Application stated "[t]he reference portfolio consists of $2.5B[illion] of direct collateral spread across 95 investments in 60 ABS CDOs." $577 million of the Initial Reference Portfolio assets, representing 25% of the portfolio, consisted of Magnetar CDOs; $70 million of that figure consisted of Pyxis notes. (*See* Ex. 2 at ¶ 99; Ex. 35 at 1, 23-24.)

X. FGIC Insured Other Transactions Similar To Pyxis After Pyxis Closed

67. One of the CDOs insured by FGIC after Pyxis was Ischus Synthetic ABS CDO 2006-1 ("Ischus"). FGIC insured the super senior tranche of Ischus on December 4, 2006. (*See* Ex. 37.)

68. In its Credit Application for Ischus, FGIC described Ischus in the following way:

> This transaction is ***almost identical*** to the Pyxis transaction, managed by Putnam, approved last August. The Pyxis transaction was driven principally by a reverse equity inquiry and we rely on Putnam to balance the interests of the equity and debt investors. Ischus is driven principally by the Collateral Manager and while there are the same competing

> interests to balance, the initial equity providers (inclusive of Ischus itself) differ in their motivations.

(*See* Ex. 37 at 2 (emphasis added).)

69. After the onset of the Financial Crisis, an internal FGIC document titled "MBS and CDO of ABS Remediation Update" noted that Ischus performed more poorly than Pyxis, observing that Ischus "has had 55% of its collateral downgraded," while Pyxis experienced "downgrades of 52%." (*See* Ex. 38 at 43, 45.)

XI. FGIC's Commutation Of The FGIC-Calyon Swap

70. In 2008 and 2009, FGIC was in severe financial distress as a result of significant losses in its CDO and RMBS books. FGIC used its financial condition to negotiate settlements or termination payments "significantly below what [FGIC's] ultimate loss could have been" under its obligations with respect to all 18 CDOs it had insured. (*See* Ex. 14 at 40:10–41:20; 204:13–205:13; 214:17–216:18.)

71. On July 2, 2009, FGIC and Calyon entered into an agreement to terminate the FGIC-Calyon Swap (the "Termination Agreement"), in which FGIC agreed to pay Calyon $100 million (the "Termination Payment") for release of its obligations to Calyon associated with three CDOs – Gloucester Street ABS CDO ("Gloucester"), Liberty 2005 ("Liberty"), and Pyxis. The Termination Agreement did not state what portion of the Termination Payment was attributable to any of the three CDOs. (*See* Ex. 3 at ¶ 38; Ex. 8.)

72. FGIC had an exposure of $890 million for Gloucester, $372 million for Liberty, and $900 million for Pyxis. (*See* Ex. 3 ¶ 194.)

73. In internal workpapers, FGIC allocated $74,461,394.00 of the Termination Payment to the termination of the FGIC-Calyon Swap for Pyxis. FGIC allocated the remaining

approximately $25.5 million to Gloucester, and $0 of the $100 million Termination Payment to Liberty. (*See* Ex. 8.)

74. FGIC attributed approximately $74.5 million of the $100 million Termination Payment to Pyxis based on after-the-fact loss reserve estimates that required some subjectivity, "some assumptions," and an evolving methodology. (*See* Ex. 40 at 72:24–74:9; Ex. 3 at ¶¶ 185, 193, 195-198.)

75. FGIC's allocation of the Termination Payment to commute its exposure under the FGIC-Calyon Swap for Pyxis was less than amounts FGIC paid to commute its exposure to other CDOs, including Ischus. In fact, FGIC paid less to commute its exposure under the FGIC-Calyon Swap, as a percentage of total exposure, than it did to commute its exposure to almost every other CDO it insured during 2006 and 2007. (*See* Ex. 3 at ¶ 197, FN 291, and Ex. VII.2; Ex. 39; Ex. 48.)

XII. Three Rating Agencies Confirmed Their Ratings After Pyxis Was Fully Ramped.

76. Fiachra O'Driscoll, FGIC's industry expert, opined that, had the rating agencies known Pyxis would not contain 10% prime RMBS, they would have insisted on a 25% "AAA" attachment point. Mr. O'Driscoll testified that, if the initial "AAA" attachment point were 25%, FGIC would have insisted on an attachment point for the Pyxis Super Senior Tranche it insured at 50%, rather than at 40% because FGIC only attached at two times the initial AAA attachment point. (*See* Ex. 53 at 259:5 – 260:7, 272:5-12).

77. Section 7.17 of the Pyxis Indenture required the rating agencies that initially rated Pyxis to confirm those ratings. (*See* Ex. 20 at 171-172.) All three rating agencies confirmed their ratings of the Pyxis portfolio as required under Section 7.17 of the Indenture in February 2007. (*See* Ex. 42; Ex. 43; Ex. 44.)

XIII. Putnam's Collateral Management Fees Incentivized It To Select The Collateral That Would Perform Well

78. Section 1.1 of the Pyxis Indenture provided:

> "Senior Collateral Management Fee" means the fee payable to the Collateral Manager in arrears on each Monthly Distribution Date pursuant to Section 7 of the Collateral Management Agreement, in an amount equal to 0.15% per annum of the Monthly Asset Amount for such Monthly Distribution Date; *provided* that (a) the Senior Collateral Management Fee will be payable on each Monthly Distribution Date only to the extent of funds available for such purpose in accordance with the Priority of Payments ....

(*See* Ex. 20 at 72-73.)

79. Section 1.1 of the Pyxis Indenture also stated:

> "Subordinated Collateral Management Fee" means the fee payable to the Collateral Manager in arrears on each Quarterly Distribution Date pursuant to Section 8 of the Collateral Management Agreement, in an amount (as certified by the Collateral Manager to the Trustee) equal to 0.05% per annum of the Monthly Asset Amount for such Monthly Distribution Date; *provided* that (a) the Subordinated Collateral Management Fee will be payable on each Quarterly Distribution Date only to the extent of funds available for such purpose in accordance with the Priority of Payments....

(*See* Ex. 20 at 78-79.)

80. The Pyxis Indenture provided that Putnam was not entitled to receive either the "Senior Collateral Management Fee" or the "Subordinated Collateral Management Fee" on any assets that had defaulted. (*See* Ex. 2 at ¶ 149.)

XIV. Putnam Acquired Assets For The Pyxis Portfolio Based On Its Own Analysis and Judgment

81. Putnam employed its own analysis and judgment in selecting assets for the Pyxis portfolio. Mr. Bell and Mr. Van Tassel provided extensive deposition testimony describing

Putnam's process for determining which assets it would acquire for Pyxis. (*See* Ex. 41 at 45:9–47:3, 176:10-19, 272:20–273:25; Ex. 17 at 357:6-18.)

82. Even FGIC communicated with a CDO collateral manager regarding the selection of portfolio assets and, on at least one occasion, FGIC conditioned its approval of a transaction on the removal of assets from the collateral pool. (*See* Ex. 49 at 1.)

83. Putnam regularly chose not to acquire assets identified by Magnetar. (*See, e.g.*, Ex. 2 at ¶ 156.)

XV. <u>The Financial Crisis and Its Impact on Pyxis and FGIC's CDOs Book</u>

84. Eric Hurst of FGIC testified that he discussed with Sandy D'Imperio of FGIC in the fall of 2007 the fact that "we were coming up to an Armageddon scenario," in reference to the beginning of the Financial Crisis. Mr. Hurst also stated that "it didn't just have to do with Pyxis…it had to do with the entire market." (*See* Ex. 29 at 192:23–194:23.)

85. Mr. Hurst also testified "in 2007 there was tremendous strain in the CDO market," which "was largely attributed to RMBS and subprime RMBS" and that a large number of RMBS subprime securities were downgraded at that time. (*See* Ex. 29 at 9:18–10:2.)

86. Mr. Hurst also testified that "it wouldn't be surprising if every[ ] [other mezzanine CDOs in the marketplace experienced] severe rating migration." (*See* Ex. 29 at 231:21–232:5.)

87. Dana Skelton of FGIC testified that she recalled that, in 2007 and 2008, a significant number of RMBS subprime securities were downgraded by the rating agencies, and that the downgrades were widespread. (*See* Ex. 52 at 206:9-18.)

88. By October 2010, every CDO tranche FGIC insured from January 2006 to July 2007 had been downgraded from Aaa to below investment grade. (*See* Ex. 2 at Ex. 15.)

89. By March 2012, fourteen of sixteen CDOs similar to Pyxis that were issued in the one-month period before and after the pricing of Pyxis – including eight non-Magnetar CDOs – had defaulted. (*See* Ex. 2 at Ex. 11.) Additionally, nearly every ABS CDO insured by FGIC defaulted or suffered substantial losses. (*See* Ex. 2 at Ex. 15.)

90. Elizabeth Menhenett testified that she could not recall any CDOs insured by FGIC in 2006 and 2007 that were not downgraded. (*See* Ex. 24 at 135:14-23.)

91. Derek Donnelly of FGIC testified that the decline in the mortgage market in 2007 and 2008 "was probably one of the most significant factors" on FGIC's CDO book. (*See* Ex. 14 at 158:2-24.)

XVI. <u>FGIC's Damages Experts' Analysis</u>

92. Plaintiff's damages expert, Dr. Karl Snow, calculated FGIC's damages from Pyxis based on hypothetical losses FGIC would have incurred had it not entered into the Termination Payment. According to Dr. Snow's calculations, FGIC would have lost $782 million due in September 2016 had it not settled its potential exposure for $100 million in July 2009. Dr. Snow then compared those losses to alternative hypothetical portfolios that FGIC argues would have cured for any misrepresentation, such as a portfolio that was similar to the PCS. (*See* Ex. 40 at 66:12–68:12; 72:11-23; 104:18–107:16.) Thus, according to Dr. Snow, his damages are based upon "multiple hypotheticals" that assume the Termination Payment never occurred. (*See* Ex. 40 at 82:4-9; 123:14–124:10.)

93. Dr. Snow also testified that, but for the Termination Payment, FGIC would have lost $710.5 million had Putnam constructed the Pyxis Portfolio to be identical to the PCS. This amount constituted 90% of the hypothetical losses FGIC would have incurred based on Pyxis's

actual portfolio had it not settled with Calyon. (*See* Ex. 40 at 60:8-61:22; 92:11-14; 149:18–150:4.)

94. Dr. Snow testified that, "according to [his] analysis," "if the only misrepresentation was there should have been 10 percent more prime [RMBS] in the portfolio, then [he] calculated zero damages." According to Dr. Snow, the addition of more prime RMBS would have only increased FGIC's exposure under the FGIC-Calyon Swap. (*See* Ex. 40 at 114:19–117:10; 121:4-8.) Prime RMBS performed more poorly than subprime RMBS because, as a general matter, a note issued by a prime RMBS had less subordination, and was supported by fewer assets, than a note issued by a subprime RMBS of the same rating. (*See* Ex. 2 at ¶¶ 180-181).

95. Dr. Snow did not use FGIC's actual losses (*i.e.*, the payment FGIC made to Calyon in July 2009 to settle its exposure) in his calculation of damages except, to the extent his proposed damages exceed the actual losses, he would use actual losses as a "cap" on damages. Dr. Snow testified that he had no basis to do so other than instruction from counsel. (*See* Ex. 40 at 219:13–220:19.)

96. Dr. Snow testified that looking at what FGIC would have had to pay Calyon to settle its exposure on Pyxis absent the alleged harm caused by Putnam would have been a reasonable approach, and was the approach he initially proposed, but it was not something he attempted to calculate because of instructions from FGIC's counsel. (*See* Ex. 40 at 95:25–97:16; 125:15–126:2; 215:19–216:3; 226:3–227:19.)

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