COMMONWEALTH OF MASSACHUSETTS
OFFICE OF THE SECRETARY OF THE COMMONWEALTH
SECURITIES DIVISION
ONE ASHBURTON PLACE, ROOM 1701
BOSTON, MASSACHUSETTS 02108

IN THE MATTER OF:

PUTNAM ADVISORY CO., LLC (PYXIS ABS CDOs),

Respondent.

Docket No.: 2011-0035

ADMINISTRATIVE COMPLAINT

I. PRELIMINARY STATEMENT

The Enforcement Section ("Enforcement Section") of the Massachusetts Securities Division of the Office of the Secretary of the Commonwealth ("Division") files this administrative complaint ("Complaint") in order to commence an adjudicatory proceeding against Putnam Advisory Co., LLC ("Putnam"), a subsidiary of Putnam Investments, LLC, for violating MASS. GEN. LAWS ch. 110A, the Massachusetts Uniform Securities Act ("Act"), and 950 MASS. CODE REGS. 10.00 *et seq.* ("Regulations"). The Complaint alleges fraud and unethical or dishonest conduct against Putnam for: (1) omissions of a material fact necessary to make statements made not misleading in connection with two collateralized debt obligations structured and marketed to investors; (2) engaging in acts, practices or courses of business which operated as a fraud or deceit upon investors in connection with the offer or sale of securities; (3) engaging in acts, practices or courses of business which operated as a fraud or deceit upon investors while registered as an investment adviser; and (4) engaging in unethical or dishonest conduct or practices as an investment adviser in the securities business.

The Enforcement Section seeks an order: (1) requiring Putnam to permanently cease and desist from further conduct in violation of the Act and its related Regulations; (2) requiring Putnam to disgorge all fees obtained as a result of its conduct, acts or courses of business as described in this Complaint, and to pay prejudgment interest thereon; (3) requiring Putnam to pay a civil administrative fine in such amount and upon such terms and conditions as the Director or Hearing Officer may determine; and (4) the Director or Hearing Officer to take such further action against Putnam as may be deemed just and appropriate for the protection of investors.

II. SUMMARY

The Division initiated its investigation into Putnam based on its role as the Collateral Manager of two $1.5 billion collateralized debt obligations ("CDOs") named Pyxis ABS CDO 2006-1 Ltd. ("Pyxis 2006") and Pyxis ABS CDO 2007-1 Ltd. ("Pyxis 2007"). As the Collateral Manager of the Pyxis CDOs, Putnam served as the advisor of the funds and was responsible for the selection, acquisition, surveillance, and disposition of all collateral assets for the CDOs. Putnam also assumed an active role in marketing the Pyxis CDOs to investors, using pitchbooks, termsheets, and offering memoranda that it helped create to solicit investors.

Undisclosed to investors, however, Putnam allowed a large hedge fund, Magnetar Capital, LLC ("Magnetar"), with economic interests adverse to other Pyxis CDO investors, to be heavily involved in creating and structuring critical aspects of the CDOs. Magnetar sponsored both CDOs as the investor in the lowest quality tranche of the

CDOs, the equity tranche. Through its extensive involvement in the Pyxis CDO discussions, Magnetar recommended certain collateral for inclusion in the two CDOs, and then took short positions on that same collateral by purchasing Credit Default Swaps ("CDS") referencing that collateral or tranches in the Pyxis CDOs.

In 2006, during the height of the subprime mortgage securitization market, Magnetar approached Putnam to ask whether Putnam would be interested in acting as the Collateral Manager of a $1.5 billion hybrid mezzanine CDO consisting of subprime and midprime mortgage securities. The Co-Head of Structured Credit at Magnetar, a former Putnam employee, reached out to his former Putnam supervisor, Putnam's Head of Investments, to propose the creation of the CDO. Magnetar told Putnam that Magnetar and Deutsche Bank wanted to sponsor the CDO by committing to split an $82.5 million investment in the lowest quality tranche of the CDO.

Neither Putnam's Head of Investments nor Putnam's CEO had any reservations about working with the Co-Head of Structured Credit at Magnetar, despite the fact that Putnam had terminated him for cause just three years prior.[1] Putnam's CEO and Executive Committee, which included Putnam's Head of Investments, accepted Magnetar's proposal for Putnam to act as the Collateral Manager to the $1.5 billion CDO, which later became Pyxis 2006. Magnetar also recommended that Crédit Agricole Securities (USA) Inc. ("Calyon") act as the structuring bank for Pyxis 2006.

[1] Putnam terminated the Co-Head of Structured Credit at Magnetar for cause in 2003 for excessive trading of growth mutual funds in his personal brokerage account that had occurred eighteen months before. At the time, many asset management firms were under increased regulatory scrutiny for market timing related to mutual funds. The Massachusetts Securities Division brought an administrative action against Putnam Investment Management, Inc., et al., Docket No. E-2003-061, on October 28, 2003 for fraud in connection with market timing of mutual funds by its employees. A consent order was issued on April 4, 2004 and amended on April 15, 2004 settling the matter.

During their initial discussions, Magnetar informed Putnam that Magnetar intended to engage in a "hedged equity strategy," whereby Magnetar would purchase the equity tranches of CDOs while simultaneously shorting other tranches or assets in the same CDO. Magnetar is the same hedge fund that has been linked to approximately twenty-six separate CDO transactions in which Magnetar engaged in sizeable hedging strategies. Despite knowing that Magnetar presented a custom-tailored CDO proposal and planned to bet against it, Putnam agreed to act as the Collateral Manager of Pyxis 2006 in exchange for lucrative collateral management fees of $5,707,429.65. For its efforts, Magnetar made over $60 million from its equity investment and aggressive short positions tied to Pyxis 2006.

Pyxis 2006 closed on October 3, 2006. Three months before Pyxis 2006 closed, Magnetar began discussing the possibility of working on a second CDO transaction with Putnam. Once again, Magnetar told Putnam that it wanted to sponsor a $1.5 billion hybrid mezzanine CDO tied to subprime and midprime mortgage securities by committing to invest in the equity tranche of the CDO. After approval from Putnam's CEO and Executive Committee, Putnam agreed to act as the Collateral Manager to a second Magnetar-sponsored CDO transaction, which later became Pyxis 2007. Magnetar selected Putnam as the Collateral Manager to Pyxis 2007 and recommended Lehman Brothers Inc. ("Lehman") as the structuring bank to ensure Magnetar's control over Pyxis 2007's development.

Throughout Pyxis 2007's development, Magnetar continued to pursue its "hedged equity strategy" by buying protection on collateral and tranches included or referenced in Pyxis 2007. Despite knowing that Magnetar presented a second custom-tailored CDO proposal and planned to place bets against the CDO's assets, Putnam acted as the Collateral Manager of Pyxis 2007 in exchange for lucrative collateral management fees of $3,107,627.91. For its efforts, Magnetar made approximately $6.5 million from its equity investment and aggressive short positions tied to Pyxis 2007.

As the Collateral Manager of both Pyxis CDOs, Putnam represented to potential and actual investors that Putnam would act as an independent advisor of the CDOs. In the offering memoranda for the Pyxis CDOs, Putnam represented to investors that Putnam "will manage the selection, acquisition, and disposition of the Collateral Debt Securities on behalf of [] [Pyxis 2006 and Pyxis 2007] . . . based on the restrictions set forth in the Indenture . . . and on the Collateral Manager's research, credit analysis and judgment. . . ."

Putnam contributed content to the Pyxis 2006 and Pyxis 2007 pitchbooks that touted its CDO management capability and CDO investment philosophy to investors. The pitchbooks assured investors that "Putnam has made a strategic commitment to offering a 'best in class' CDO management capability. . ." and highlighted that "Putnam's success within CDOs is based on a high degree of expertise in both the design of a conservative and stable CDO structure and the management of the underlying fixed income collateral." The pitchbooks described Putnam's investment philosophy as one in which "Putnam should actively drive the product structure" and that "[a] CDO is a marriage of collateral and structure. Putnam seeks to design and undertake transactions that have a high probability of success[.]"

Despite Putnam's representations to investors, the collateral was not selected by Putnam independently. Internal e-mails sent among Putnam, Magnetar, and the structuring banks reveal that Putnam repeatedly violated the trust of investors when it knew about, but failed to disclose, Magnetar's collateral recommendations and purchases of protection on various collateral included or referenced in Pyxis 2006 and Pyxis 2007. Additionally, Putnam not only knew of Magnetar's "hedged equity strategy," but helped execute it. Putnam assisted Magnetar with its "hedged equity strategy" by entering into trades where Putnam, on behalf of the Pyxis CDOs, would sell protection to Magnetar on collateral included or referenced in the Pyxis CDOs. Putnam's Managing Director and Team Leader of the CDO and Portfolio Credit Team ("Putnam's CDO Team Leader") testified to the Division that Putnam knew of Magnetar's "hedged equity strategy" from the inception of Pyxis 2006 and that Magnetar's hedging strategy continued through Pyxis 2007.

For example, in July of 2006, Putnam's CDO Team Leader exchanged e-mails with the Co-Head of Structured Credit at Magnetar about collateral selection for Pyxis 2006. The Co-Head of Structured Credit at Magnetar told Putnam's CDO Team Leader to let him know whether Putnam planned to buy certain asset-backed securities CDOs for Pyxis 2006, because he planned to "do those synthetically," or buy protection on those assets. Putnam's CDO Team Leader replied, "I knew you planned to use mezz[anine] [asset-backed securities] CDOs as part of your hedge, but I am not sure why you would hedge with the deals that we go long in Pyxis [2006]. . . ." The Co-Head of Structured Credit at Magnetar wrote back, "[v]ery hard to get off sizable CDO CDS trades unless they're done against a deal, and this is a natural delta hedge against our equity. . . ." Putnam's CDO Team Leader replied, **"[g]ot it. So when we find a deal we want to buy, we shouldn't put in an order with the syndicate desk but have Calyon broker a**

synthetic trade between you and [] [Pyxis 2006] at an agreed upon level?" The Co-Head of Structured Credit at Magnetar replied, "**[t]hat would be preferable. . . .**" (Emphasis added).

Another example of Putnam assisting Magnetar with its shorting strategy in Pyxis 2006 occurred in September of 2006. In early September of 2006, a Putnam Portfolio Construction Specialist working on Pyxis 2006 e-mailed the Co-Head of Structured Credit at Magnetar. The Putnam Portfolio Construction Specialist wrote that Putnam had acquired $5 million of a particular CDO to include in Pyxis 2006 and was interested in acquiring another $5 million through a CDS transaction, subject to Calyon's approval. The Putnam Portfolio Construction Specialist further wrote, "I know you mentioned before an interest in buying protection at mid market levels, any interest in doing this one?" The Co-Head of Structured Credit at Magnetar replied that Magnetar would buy protection on the transaction. Calyon approved the transaction such that Putnam, on behalf of Pyxis 2006, sold protection to Magnetar on a specific CDO asset referenced in Pyxis 2006.

When discussions of Pyxis 2007 began, Magnetar informed Putnam that it had acquired over $300 million of collateral for the CDO before Putnam and Lehman had even officially committed to their roles for the CDO. After Putnam agreed to be the Collateral Manager of Pyxis 2007, Putnam again allowed Magnetar to be involved in structuring the transaction, and worked to ensure that Pyxis 2007 was structured similarly to Pyxis 2006. Around the beginning of Pyxis 2007 discussions, Putnam's CDO Team Leader testified that he recalled, "a sense that [Magnetar] wanted to try to standardize the structures they were using going forward, but from a broad perspective, [Pyxis 2007] would be a similar transaction to the [Pyxis] 2006 deal."

Pyxis 2007 closed on March 6, 2007. Even after Pyxis 2007 closed, Magnetar remained involved in recommending assets to complete the collateral selection for Pyxis 2007. In May of 2007, Putnam asked the Co-Head of Structured Credit at Magnetar to review a bid list for CDO assets to include in Pyxis 2007. The Co-Head of Structured Credit at Magnetar told Putnam to add at least one CDO name to the bid list, and Putnam complied. Magnetar also offered to buy protection on certain CDOs on the bid list for assets to be included in Pyxis 2007.

Even though Putnam represented to investors that it sought "to design and undertake transactions that have a high probability of success," not long after the transactions were completed the rating agencies extensively downgraded subprime assets referenced or included in Pyxis 2006 and Pyxis 2007. Pyxis 2006 defaulted just over two years after closing and Pyxis 2007 defaulted just one and a half years after closing. Both defaults resulted in tens of millions of dollars in investor losses.

While investors suffered devastating losses, Putnam and Magnetar both made millions off the Pyxis CDO transactions. Putnam received hefty collateral management fees totaling $8,815,057.56 for the Pyxis 2006 and Pyxis 2007 transactions. Magnetar benefited substantially from the widespread downgrades of the subprime assets in the Pyxis CDOs, and reaped an exorbitant net gain of approximately $67 million on its equity investments and aggressive short positions tied to both Pyxis CDOs.

Based on information obtained during the Division's investigation, there is ample evidence to establish that Putnam failed to disclose to other Pyxis 2006 and Pyxis 2007 investors the material conflict of interest that arose from Magnetar's extensive participation and influence in critical aspects of the development of Pyxis 2006 and Pyxis 2007, as well as Magnetar's strategy to short collateral tied to the Pyxis CDOs.

III. JURISDICTION AND AUTHORITY

1. The Massachusetts Securities Division is a division of the Office of the Secretary of the Commonwealth with jurisdiction over matters relating to securities as provided for by the Act. The Act authorizes the Division to regulate: (1) the offer, sale and purchase of securities; (2) those entities and individuals offering and/or selling securities within the Commonwealth; and (3) those entities and individuals transacting business as broker-dealers, broker-dealer agents, investment advisers, or investment adviser representatives within the Commonwealth.

2. The Division brings this action pursuant to the enforcement authority conferred upon it by Section 407A of the Act and MASS. GEN. LAWS ch. 30A, wherein the Division has the authority to conduct an adjudicatory proceeding to enforce the provisions of the Act and all related rules and regulations promulgated thereunder.

3. This proceeding is brought in accordance with Sections 101, 102, 204, and 407A of the Act and its related Regulations. Specifically, those acts and practices constituting violations of the Act occurred in the Commonwealth of Massachusetts.

4. The Division specifically reserves the right to amend this Complaint and/or bring additional administrative complaints to reflect information developed during the current and ongoing investigation.

IV. RELEVANT TIME PERIOD

5. Except as otherwise expressly stated, the conduct described herein occurred during the approximate period of time between January 1, 2006 and December 31, 2008.

V. RESPONDENT

6. "Putnam" and "Respondent" refer to The Putnam Advisory Company, LLC, a subsidiary of Putnam Investments, LLC, with an Organization Central Registration Depository Number ("CRD Number") of 106631, and a principal place of business at One Post Office Square, Boston, Massachusetts 02109. "Putnam" further includes any of its present or former parents, subsidiaries, directors, officers, partners, employees, agents, representatives, attorneys or other persons acting on behalf of The Putnam Advisory Company, LLC, their respective predecessors or successors or any of the affiliates of the foregoing.

VI. RELATED PARTIES

7. "Magnetar" refers to Magnetar Capital LLC, with a CRD Number of 135513, and a principal place of business at 1603 Orrington Avenue, Suite 990, Evanston, Illinois 60201, and an office located at 500 Park Avenue, New York, New York 10022. "Magnetar" further includes any of its present or former parents, subsidiaries, directors, officers, partners, employees, agents, representatives, attorneys or other persons acting on behalf of Magnetar Capital LLC, their respective predecessors or successors or any of the affiliates of the foregoing.

8. "Deutsche Bank" refers to Deutsche Bank Securities Inc., a division of Deutsche Bank Aktiengesellschaft, with a CRD Number of 2525, and a principal place of business at 60 Wall Street, New York, New York 10005. "Deutsche Bank" further includes any of

its present or former parents, subsidiaries, directors, officers, partners, employees, agents, representatives, attorneys or other persons acting on behalf of Deutsche Bank Securities Inc., their respective predecessors or successors or any of the affiliates of the foregoing.

9. "Calyon" refers to Crédit Agricole Securities (USA) Inc., a subsidiary of Crédit Agricole Corporate and Investment Bank and a registered broker-dealer with a CRD Number of 190, and a principal place of business at 1301 Avenue of the Americas, 15th Floor, New York, New York 10019. "Calyon" further includes any of its present or former parents, subsidiaries, directors, officers, partners, employees, agents, representatives, attorneys or other persons acting on behalf of Crédit Agricole Securities (USA) Inc., their respective predecessors or successors or any of the affiliates of the foregoing.

10. "Lehman" and "Lehman Brothers" refer to Lehman Brothers Inc. and Lehman Brothers International Securities Inc., with CRD Numbers of 7506 and 7406, respectively, and a last known domestic principal place of business at 100 Wall Street, 17th Floor, New York, New York 10005. "Lehman" and "Lehman Brothers" further include any of its present or former parents, subsidiaries, directors, officers, partners, employees, agents, representatives, attorneys or other persons acting on behalf of Lehman Brothers Inc. and Lehman Brothers International Securities Inc., their respective predecessors or successors or any of the affiliates of the foregoing.

11. "Pyxis 2006" refers to Pyxis ABS CDO 2006-1 Ltd., an exempted company with limited liability organized under the laws of the Cayman Islands, and Pyxis ABS CDO 2006-1 LLC, a corporation organized under the laws of Delaware (File No. 4215627),

which together issued approximately $1.5 billion of various classes of notes and shares due 2046.

12. "Pyxis 2007" refers to Pyxis ABS CDO 2007-1 Ltd., an exempted company with limited liability organized under the laws of the Cayman Islands, and Pyxis ABS CDO 2007-1 LLC, a corporation organized under the laws of Delaware (File No. 4294487), which together issued approximately $1.5 billion of various classes of notes and shares due 2047.

VII. FACTS AND ALLEGATIONS

A. *OVERVIEW OF A CDO TRANSACTION*

Description of a CDO

13. A CDO is a structured finance product that functions through the creation of a special purpose entity. A CDO purchases and pools various debt instruments[2] into a single fund in an attempt to reduce investor exposure to any one asset through diversification.

14. Some examples of debt instruments that are pooled and securitized into CDOs include asset-backed securities ("ABS"), residential mortgage-backed securities ("RMBS"), commercial mortgage-backed securities ("CMBS"), other CDOs, automobile loans, credit card debt, and student loan debt.

15. A single pool of debt instruments collateralizes a CDO. In exchange for their investment, investors receive periodic interest payments that are generated from payments from the underlying debt instruments that make up the CDO's collateral pool.

[2] For ease of reference, the term "debt instrument" will be used throughout this Complaint interchangeably with the terms "collateral," "assets," and "collateral assets."

16. The CDO issues notes or shares related to hierarchical tranches of the CDO to investors. Each tranche investment entitles the investor to a different level of priority in the sequence of payments generated by the CDO's collateral pool, and thus each tranche carries a different level of risk and return.

17. Pyxis 2006 is an example of a CDO whose pool of assets consisted of and synthetically[3] referenced subprime and midprime RMBS, CMBS, and CDOs.

18. Pyxis 2007 is an example of a CDO whose pool of assets consisted of and synthetically referenced subprime and midprime RMBS, CMBS, and CDOs.

Structure of a CDO

19. CDOs are sliced into tranches and structured in a hierarchical fashion based on the distinct tranches of notes or shares issued to investors. Interest and principal payments flowing from the CDO are paid out in a "waterfall" structure such that investors in the higher-rated tranches are paid out first, followed by investors in the middle-rated tranches, and finally those invested in the equity tranche.

20. Investors in the top "senior" tranche are the first in line to receive principal and interest payments and, therefore, theoretically assume the least amount of risk, as well as the lowest rate of return. Investing in the senior tranche can also be thought of as investing in the tranche with the highest level of credit protection in the CDO.

21. Investors in the middle "mezzanine" tranches are next in line to receive principal and interest payments and, therefore, theoretically assume more risk than senior investors, which is reflected in the receipt of higher interest payments.

[3] "Synthetic" CDOs are CDOs that consist entirely of Credit Default Swaps ("CDS") or other non-cash assets in order to gain exposure to other portfolios of fixed income assets. A CDS is a type of credit derivative that allows a purchaser of the swap to transfer the loan default risk of a particular "reference" asset to the seller of the swap. In effect, the buyer of a CDS is buying credit protection in the event that the referenced asset performs poorly, whereas the seller of a CDS is guaranteeing the credit worthiness of the product.

22. Investors in the bottom "equity" tranche are last in line to receive payments and, therefore, theoretically assume greater risk than both the senior and mezzanine investors, which is reflected in their receipt of the highest levels of interest payments for their investments. Investing in the equity tranche can also be thought of as investing in the tranche with the lowest levels of credit protection in the CDO.

23. The implication of this organizational structure is that in the event of a default of the CDO ("Event of Default"), the lower-rated tranches are designed to absorb payment defaults before the higher-rated tranches experience any payment defaults.

Composition of a CDO

24. CDOs can be structured in various forms.

25. "Cash" CDOs are CDOs that consist entirely of individual debt instruments and issue notes to investors that are collateralized by those same underlying debt instruments.

26. "Synthetic" CDOs are CDOs that consist entirely of Credit Default Swaps or other non-cash assets to gain exposure to other portfolios of fixed income assets.

27. "Hybrid" CDOs are more sophisticated types of CDOs that blend cash assets and synthetic assets together into one CDO.

28. Pyxis 2006 is an example of a hybrid CDO whose pool of assets consisted of both cash assets and synthetic assets.

29. Pyxis 2007 is an example of a hybrid CDO whose pool of assets consisted of both cash assets and synthetic assets.

Role of a Collateral Manager

30. The role of a CDO Collateral Manager is to act as an independent advisor of the CDO.

31. In this role, the Collateral Manager is responsible for the selection, acquisition, surveillance, and disposition of collateral assets in the CDO.

32. In terms of the selection process, the Collateral Manager must conduct analysis on each asset to determine whether the asset is appropriate and eligible to be recommended for inclusion into the CDO collateral pool. The significance of the Collateral Manager's front-end analysis cannot be overstated since the Collateral Manager is obligated to ensure that each asset selected for inclusion in the collateral pool comports with predefined standards of quality and risk.

33. In terms of the acquisition of collateral assets, the Collateral Manager is also responsible for surveillance of the performance of each asset once it is included in the CDO to ensure that the asset's performance remains within an acceptable range.

34. Moreover, a Collateral Manager often creates or contributes to the sales and marketing materials, such as termsheets, pitchbooks, and offering memoranda, for the CDO and participates in meetings with potential or actual investors of the CDO.

B. *THE PYXIS 2006 CDO TRANSACTION*

Initiation of Pyxis 2006 and Putnam's Role as Collateral Manager

35. In early 2006, the Co-Head of Structured Credit at Magnetar contacted the then-Head of Investments at Putnam ("Putnam's Head of Investments") to have dinner in Boston. During dinner, Magnetar proposed that Putnam act as the Collateral Manager for a CDO in which Magnetar and Deutsche Bank would be the equity tranche investors.

36. Magnetar is a large U.S. hedge fund based in Evanston, Illinois that was founded in 2005.

37. The Co-Head of Structured Credit at Magnetar had been an employee of Putnam from 1992 to 2003. For at least the last five years of his employment with Putnam, the Co-Head of Structured Credit at Magnetar reported to Putnam's Head of Investments.

38. The Co-Head of Structured Credit at Magnetar was terminated for cause from Putnam in 2003 for excessive trading of growth mutual funds in his personal brokerage account that had occurred eighteen months before. At the time, many asset management firms, including Putnam, were under increased regulatory scrutiny for market timing related to mutual funds.

39. Putnam's Head of Investments indicated that he and the Co-Head of Structured Credit at Magnetar were friends while they worked together at Putnam. Putnam's Head of Investments and the Co-Head of Structured Credit at Magnetar remained in touch after the Co-Head of Structured Credit at Magnetar was terminated from his employment at Putnam, getting together at least four times a year for drinks or dinner in Boston or New York City.

40. Following Magnetar's CDO proposal during dinner in early 2006, Putnam's Head of Investments discussed Magnetar's CDO proposal with Putnam's Managing Director and Team Leader of the Mortgage-Backed Securities/Asset-Backed Securities/ Government Group ("Putnam's MBS Team Leader") and Putnam's Managing Director and Team Leader of the CDO and Portfolio Credit Team ("Putnam's CDO Team Leader"). Both Putnam's MBS Team Leader and Putnam's CDO Team Leader agreed that Putnam should pursue the CDO transaction further. This transaction was later formally named Pyxis ABS CDO 2006-1 Ltd. ("Pyxis 2006").

41. Putnam's CDO Team Leader testified that when Magnetar approached Putnam in 2006, Magnetar was "interested in pursuing a series of [CDO] transactions that had a focus on subordinate . . . BBB rated residential bonds." This type of CDO is a mezzanine ABS CDO. Additionally, Putnam's CDO Team Leader testified that "[a]nother distinct feature [of Magnetar's proposed CDO] is that it was a hybrid focus, so both the assets and liabilities were combinations of cash securities and synthetic securities. . . ."

42. Shortly after Magnetar approached Putnam to create Pyxis 2006, Putnam's Head of Investments told Putnam's then-Chief Executive Officer ("Putnam's CEO") about Magnetar's CDO proposal for Putnam to act as the Collateral Manager for Pyxis 2006, in which Magnetar would be the equity tranche investor. Putnam's CEO approved moving forward with the transaction, notwithstanding that Putnam's point of contact at Magnetar had been terminated from Putnam for excessive trading just a few years before.

43. The Putnam Executive Committee also signed off on Putnam becoming the Collateral Manager for the Magnetar-sponsored Pyxis 2006 CDO during a Putnam Executive Committee meeting, which included Putnam's CEO, Chief Financial Officer, Chief Technology Officer, General Counsel, Senior Managing Director of Operations, Senior Managing Director of Distribution, and Head of Investments.

Calyon's Role as Structuring Bank to Pyxis 2006

44. Not only did Magnetar initiate the idea of Pyxis 2006, Magnetar was also heavily involved in the development of Pyxis 2006.

45. On March 29, 2006, Putnam hosted a meeting with the Co-Head of Structured Credit at Magnetar at Putnam's Boston office to discuss Magnetar's proposed CDO in more detail.

46. After Putnam agreed to act as the Collateral Manager of the CDO, Magnetar recommended to Putnam that Calyon serve as the structuring bank for the CDO transaction. At that time, Calyon was the structuring bank of another hybrid mezzanine CDO transaction that Magnetar had initiated called Orion 2006-1 Ltd. ("Orion").

47. Putnam's Head of Investments testified that Calyon's responsibilities as the structuring bank to the CDO were "to oversee the construction of the [I]ndenture, to interact with the rating agencies, to construct the deal and to sell both the debt and equity."

48. On April 10, 2006, the Co-Head of Structured Credit at Magnetar forwarded an e-mail describing the Orion CDO deal to Putnam's CDO Team Leader and members of Calyon's CDO team, including the Head of Structured Credit, Derivatives and CDOs at Calyon ("Calyon's Head of CDOs"). Magnetar's purpose of forwarding the e-mail was to introduce the Putnam and Calyon CDO teams to each other. The Co-Head of Structured Credit at Magnetar wrote: "As we try to get a deal going and will be meeting on May 1, thought I would make [an] official introduction. [Calyon's Head of CDOs], [Putnam's CDO Team Leader] would find it useful to get the detailed [Orion] term sheet and . . . file so that he can begin analyzing the structure. Looking forward to getting together in Boston." Two days later, Calyon sent Putnam the Orion termsheet which described the structure and composition of the Orion CDO transaction.

49. On May 1, 2006, Putnam held a due diligence meeting with members of the Calyon CDO team at Putnam's Boston office to discuss Putnam's CDO capabilities. The Co-Head of Structured Credit at Magnetar also attended the meeting.

50. After the meeting, Putnam's CDO Team Leader sent a follow up e-mail to the Co-Head of Structured Credit at Magnetar, to which the Co-Head of Structured Credit at Magnetar replied, "[l]ets [sic] huddle on next steps, then I'll go back to [Calyon's Head of CDOs] and try to get the ball rolling."

51. Two days later, Calyon's Head of CDOs e-mailed Putnam's CDO Team Leader and attached the Orion engagement letter[4] and warehouse agreement[5] to serve as models for the CDO transaction involving Putnam, copying the Co-Head of Structured Credit at Magnetar and the Managing Director of Deutsche Bank's Special Situations Group on the e-mail.

52. On June 2, 2006, Putnam's CDO Team Leader e-mailed the Co-Head of Structured Credit at Magnetar, Calyon's Head of CDOs, and the Managing Director of Deutsche Bank's Special Situations Group asking which draft documents of the engagement letter and warehouse agreement he should review to officially commence the Pyxis 2006 CDO transaction. According to the e-mail, Putnam had been reviewing one set of draft documents provided by Calyon, but Magnetar had provided a second set of draft documents with their own terms to use instead. Putnam's CDO Team Leader sought clarification about which documents to use, and the Co-Head of Structured Credit at Magnetar replied to all: "I am fine with using the form of the [C]alyon docs as long as

[4] In general, an "engagement letter" for a CDO is a transaction document whereby the structuring bank engages the Collateral Manager to act as the manager of the CDO transaction. The structuring bank's responsibilities usually include working with the Collateral Manager to structure and model the transaction, prepare marketing materials, prepare final transaction documents for the securities offering, underwrite the placement of the securities, and warehouse the collateral for the CDO before the securities offering.

[5] In general, a "warehouse agreement" is a contract that memorializes the rights and responsibilities (*i.e.*, liabilities) of those entities involved in the "warehousing" phase of a CDO transaction. The "warehousing" phase is the phase of a CDO transaction in which typically the structuring bank for the transaction approves the collateral selection and places the collateral into a segregated account or "warehouse" until the CDO is ready to be closed. Prior to a CDO's close, the risk of loss associated with the collateral is borne by the entity "warehousing" the collateral.

we incorporate the differences in terms. Magnetar Partners want the warehouse terms to be very well defined, that's why we went to the trouble of putting together our form of the docs. Let's go thru [sic] the[n] compare and discuss."

53. Soon after, in an e-mail to Putnam's CDO Team Leader, the Managing Director of Deutsche Bank's Special Situations Group wrote that he and the Co-Head of Structured Credit at Magnetar had been discussing Pyxis 2006 and that "there [were] some portfolio and structural issues that we need to agree on and on which we will come back to you and Calyon." The next day, the Managing Director of Deutsche Bank's Special Situations Group provided a list of changes to Putnam's CDO Team Leader which included that Magnetar and Deutsche Bank "[w]ant[ed] a constraint that minimum 90% is sub-prime or mid-prime collateral. . . ."

54. On June 12, 2006, the Co-Head of Structured Credit at Magnetar again met with Putnam about Pyxis 2006. Following the meeting, the Co-Head of Structured Credit at Magnetar e-mailed Putnam with a master list of constellations from which to choose the deal name because Magnetar's founder—an astronomy enthusiast—wanted Magnetar-sponsored CDOs to be named after constellations. Both the Co-Head of Structured Credit at Magnetar and members of Putnam's CDO team agreed upon "Pyxis" as the deal name, which refers to the "Mariner's Compass" constellation.

55. From early on in the Pyxis 2006 transaction, Putnam allowed the equity investors Magnetar and Deutsche Bank to provide their input in the structure and composition of Pyxis 2006, even though the equity investors' interests were in contrast to other Pyxis 2006 investors.

<u>Putnam's Early Knowledge of Magnetar's "Hedging" Strategy</u>

56. From the beginning of the development of Pyxis 2006, Putnam knew that the equity investors' strategy was to bet against many of the same assets that would be included or referenced in Pyxis 2006.

57. Putnam's CDO Team Leader confirmed that Magnetar and Deutsche Bank conveyed their interest in pursuing a "hedged equity strategy" to him in the early stages of creating Pyxis 2006. Putnam's CDO Team Leader testified that his understanding of Magnetar and Deutsche Bank's interest was that "there was an attractive relative value opportunity between equity or junior exposure and mezzanine ABS CDO's and related hedges, so it would be called a hedged equity strategy, so . . . [Magnetar and Deutsche Bank] would have a long equity exposure to equity in the CDO's and then they'd have a series of hedges against those CDO's comprised of a combination of single named [credit] default swaps that were effectively . . . referenced entities in the CDO's and potentially CDO liabilities."

58. Putnam's CDO Team Leader further described his knowledge of Magnetar and Deutsche Bank's interest in a subprime mortgage securities-focused transaction as: "[I]t was a hedged equity strategy, so it was not just, 'I want to be long at equity exposure,' it's 'I want to be long at equity exposure relative to a series of hedges,' so that's what I knew their strategy to be."

59. Putnam's MBS Team Leader also testified that he knew "somewhere at the beginning of [Putnam's] process of doing Pyxis [2006]" about Magnetar's "hedged equity strategy where they were going to purchase equity, and in the case that the equity

performed poorly, they were going to try to have a hedge that would protect them from the downside of that event."

60. Putnam's MBS Team Leader described that, with respect to most of the underlying collateral in Pyxis 2006, "this was a synthetic strategy, so what that meant was there weren't securities that [Putnam was] buying and selling. **It was two sides of a credit default swap, and [the Co-Head of Structured Credit at Magnetar's] hedged strategy, hedged equity strategy, really had both sides, so the deal itself would have one side where [Pyxis 2006 would] be selling protection, and [the Co-Head of Structured Credit at Magnetar's] hedge would be on the other side where he'd be buying protection**." (Emphasis added).

61. Putnam's MBS Team Leader further testified that, "the one thing [the Co-Head of Structured Credit at Magnetar] definitely wanted to do was if we were going to go out, which we had to do, and sell protection, [the Co-Head of Structured Credit at Magnetar] wanted to have . . . access to that because it was the supply he needed."

62. The Division also asked Putnam's MBS Team Leader, "so there were instances that you were aware of in which Magnetar was purchasing protection through the use of an intermediating bank; is that correct?" Putnam's MBS Team Leader answered, "Yes."

63. With respect to the relationship between Magnetar and Deutsche Bank, Putnam's CDO Team Leader testified that his understanding was that "they were partnering together to jointly invest in a series of transactions with that [hedged equity] strategy." Putnam's CDO Team Leader further testified that for Pyxis 2006 Magnetar and Deutsche Bank "definitely were speaking as a unit in terms of their views."

64. On June 5, 2006, Putnam's CDO Team Leader exchanged e-mails with the Managing Director of Deutsche Bank's Special Situations Group, in which Putnam's CDO Team Leader wrote: "Hedged equity should do very well in a general economic based loss environment[] **(which I believe is your investment thesis)**" and the Managing Director of Deutsche Bank's Special Situations Group replied, "**yes, that is the thesis.**" (Emphasis added).

65. Although Putnam's CDO Team Leader testified that he was not aware of the exact implementation of the "hedged equity strategy" at the early stages of the creation of Pyxis 2006, he testified that, "over time I definitely became aware that there were single name hedges, index hedges and CDO liability hedges." Putnam's CDO Team Leader further testified, "I definitely learned more about [Magnetar and Deutsche Bank's] hedging strategy through time and they definitely were using hedges that were at times reference obligations that we were long in a CDO."

66. Additionally, the Division asked Putnam's MBS Team Leader, "do you know what type of protection Magnetar was interested in purchasing, for instance, single name protection, protection that referenced an index or a tranche, for instance?" Putnam's MBS Team Leader answered, in part, "My image is because we were primarily going after single name exposure I know that there were times when [Magnetar was] doing that, and . . . I thought their hedged equity trade was primarily [to] buy the equity on CDOs and hedge with the underlying kind of securities that represent the whole thing. . . ."

Pyxis 2006 Contracts and Putnam's Fees

67. On June 18, 2006, Putnam's CDO Team Leader e-mailed the Co-Head of Structured Credit at Magnetar and the Managing Director of Deutsche Bank's Special

Situations Group and wrote: "Putnam is ready to sign the engagement letter tomorrow, start buying assets, and market in Germany/London later in the week. Are you ready to sign the equity purchase letter? I am not completely comfortable signing with Calyon without having your commitment on the equity in place."

68. On June 21, 2006, Putnam and Calyon signed an engagement letter ("Pyxis 2006 Engagement Letter") that confirmed Putnam's role as the Collateral Manager to Pyxis 2006, which was to be a $1.5 billion mezzanine CDO tied to the U.S. housing market.

69. The Pyxis 2006 Engagement Letter provided that Putnam would manage the assets within the CDO and would earn a senior collateral management fee of fifteen basis points and a subordinated collateral management fee of five basis points.

70. In a sworn statement submitted to the Division, Putnam confirmed that it received approximately $5,707,429.65 in collateral management fees for Pyxis 2006.

71. The Pyxis 2006 Engagement Letter also provided that Calyon's role as the structuring bank would be to "render financial advisory and investment banking services" for the $1.5 billion CDO comprised of "synthetic asset-backed securities, cash asset-backed securities and collateralized debt obligations."

72. On June 21, 2006, Putnam and Calyon entered into a warehouse agreement ("Pyxis 2006 Warehouse Agreement") that provided that Putnam, in its role as the Collateral Manager to the CDO, would identify to Calyon the collateral it wished to recommend to include in the CDO. The agreement provided that Calyon would warehouse up to $1.5 billion of the selected collateral before the collateral would be transferred to the CDO, and notes and shares issued to investors.

73. However, neither the Pyxis 2006 Engagement Letter nor the Pyxis 2006 Warehouse Agreement mentioned Magnetar's: (1) initiation of discussions with Putnam about Pyxis 2006's creation; (2) solicitation of Putnam to act as the Collateral Manager for Pyxis 2006; (3) recommendation of Calyon to act as the structuring bank to Pyxis 2006; or (4) commitment to purchase half of the equity tranche of Pyxis 2006 prior to Pyxis 2006's inception.

Structure and Composition of Pyxis 2006

74. Magnetar dictated what the target portfolio would be for Pyxis 2006 by proposing that the CDO be structured as a hybrid mezzanine CDO, whose pool of assets consisted entirely of lower-rated cash and synthetic assets tied primarily to the subprime mortgage securitization market.

75. The targeted portfolio for Pyxis 2006 called for 46% of the collateral assets to be RMBS subprime; 41% of the collateral assets to be RMBS midprime; 10% of the collateral assets to be ABS CDOs; 2% of the collateral to be RMBS prime; and 1% of the collateral to be Commercial Real Estate CDOs. Pyxis 2006 was further structured such that 85% of the assets would be Credit Default Swaps of RMBS/CMBS/ABS securities and 15% of the assets would be cash RMBS/CMBS/ABS securities.

76. Additionally, the target portfolio for Pyxis 2006 was for the CDO to contain 71% of collateral assets that were rated Baa3 by Moody's rating agency.

77. Pyxis 2006 was divided into several tranches, including a "Super Senior" class with the highest rating agency rating, several subordinate classes with lower rating agency ratings, and a "Preferred Shares" class which was the non-rated equity tranche.

78. Magnetar and Deutsche Bank committed to splitting the $82.5 million equity tranche of Pyxis 2006.

Putnam Markets Pyxis 2006 to Investors

79. Putnam participated in soliciting debt investors[6] for Pyxis 2006. As part of its marketing efforts of Pyxis 2006 to potential debt investors, Putnam contributed important information and representations in a Pyxis 2006 Pitchbook and Termsheet.

80. During July of 2006, Putnam and Calyon worked to finalize the Pyxis 2006 Pitchbook that would be used in marketing Pyxis 2006 to potential investors. A final version of the Pyxis 2006 Pitchbook was circulated from Calyon by e-mail on July 14, 2006.

81. The Pyxis 2006 Pitchbook contained background information on Putnam and its "[d]eep, [e]xperienced" management team who would be involved in Pyxis 2006. Putnam was described as having "[s]easoned leaders committed to investment excellence and high fiduciary standards" and being "[c]onsistent, [d]ependent], [and] [s]uperior."

82. The Pyxis 2006 Pitchbook provided that Putnam's "goal is to generate excellent long term investment results based on a core investment philosophy that seeks to exploit all available alpha sources as part of a systematic **valuation**, **risk management**, and **portfolio construction** framework[.]" (Emphasis in original).

83. Additionally, the Pyxis 2006 Pitchbook highlighted Putnam's extensive due diligence and surveillance processes for analyzing and monitoring asset-backed securities and mortgage-backed securities. With respect to CDOs, the Pyxis 2006 Pitchbook provided that "Putnam has made a strategic commitment to offering a 'best in class' CDO

[6] In this Complaint, the term "debt investor" refers to an entity that invests in the top and middle tranches of a CDO, while the "equity investor" refers to an entity that invests in the lowest tranche of a CDO.

management capability. . ." and that "Putnam's success within CDOs is based on a high degree of expertise in both the design of a conservative and stable CDO structure and the management of the underlying fixed income collateral."

84. The Pyxis 2006 Pitchbook also set forth Putnam's investment philosophy with respect to CDOs, which included that "**Putnam should actively drive the product structure**" and that "[a] CDO is a marriage of collateral and structure. **Putnam seeks to design and undertake transactions that have a high probability of success[.]**" (Emphasis added).

85. In addition to the Pyxis 2006 Pitchbook, Putnam contributed content to the Pyxis 2006 Termsheet, which was a more abbreviated summary of the Pyxis 2006 deal terms.

86. The Pyxis 2006 Termsheet provided the target portfolio ratings and target asset type to be included in Pyxis 2006, which were largely dictated by Magnetar's desire to create a mezzanine CDO containing cash and synthetic assets tied to the subprime mortgage securitization market.

87. The Pyxis 2006 Termsheet further provided that Putnam would be the Collateral Manager to Pyxis 2006 and touted, among other things, that "Putnam has developed a multi-asset class CDO capability and currently manages approximately $3.5 billion in CDO assets across 7 funds."

88. However, undisclosed to investors in either the Pyxis 2006 Pitchbook or Pyxis 2006 Termsheet, was that Putnam allowed Magnetar, a hedge fund with economic interests adverse to the other Pyxis 2006 investors, to initiate and develop critical aspects of Pyxis 2006's development, such as selecting the Collateral Manager and structuring

bank, dictating the target portfolio of Pyxis 2006, and shorting the same assets included in Pyxis 2006.

89. Before marketing Pyxis 2006 to potential debt investors, Putnam allowed equity investors Magnetar and Deutsche Bank to provide input in the structure and asset composition of Pyxis 2006. For example, in late June of 2006, the Putnam CDO Team Leader e-mailed the Co-Head of Structured Credit at Magnetar and the Managing Director of Deutsche Bank's Special Situations Group in preparation of a pre-marketing trip to Europe. Putnam's CDO Team Leader wrote: "I want to get your incremental profile constraints (minimum subprime) into the marketing book today. Have you sent these to Calyon? We need these constraints before we see the debt investors on Thursday. [Calyon's Head of CDOs] will be calling."

90. A few days later, Putnam and Calyon conducted an investor presentation in Germany for Pyxis 2006.

91. On August 1, 2006 and August 3, 2006, Putnam hosted a series of investor presentations with Calyon for Pyxis 2006 at its Boston office to discuss Putnam's CDO platform, investment strategy, credit selection, approval, and surveillance processes.

92. In at least one investor meeting, Putnam caused a potential debt investor to question Putnam's relationship with the equity investors. For example, after an August 3, 2006 investor meeting, Putnam's CDO Team Leader e-mailed the Calyon CDO team about an issue related to a potential debt investor:

> [Debt investor] was pretty focused on an AB coverage test[7] for the life of the deal, but I emphasized that this would be a material change to both the junior debt and equity

[7] In CDO transactions, another form of protection to note holders may come in the form of coverage tests. Coverage tests set forth certain performance-related triggers that can alter priority of payments in the waterfall depending on how the underlying assets are performing.

> investors that have spent time on this deal to date as it effectively reduces their recovery value in a high stress environment. . . . I know this is significant to [the Managing Director of Deutsche Bank's Special Situations Group] & [the Co-Head of Structured Credit at Magnetar]. . . . Without clearing this issue we will not have a deal with this investor group and, at a minimum, will have a significant delay in closing. Please let me know when we can discuss your strategy around this.

Calyon's Head of CDOs replied to Putnam's CDO Team Leader:

> The problem is that I have an e-mail from our sales covering [debt investor], who said that [debt investor] called him to ask the questions about the relationship between the equity investors and the manager. . . . I can say that **any time a manager is trying to negotiate a structure, while mentioning the equity investor, it immediately raises a red flag**. . . . we should try to offer [debt investor] some other rationale rather than interest of the junior investors. As you probably understand, at this point [debt investor] is the only party that can prevent this deal from happening on time, so we have to be extra careful.

(Emphasis added).

93. Even after the potential debt investor questioned the relationship between Putnam and the equity investors, Putnam failed to disclose to the potential debt investor the background on the relationship between Putnam and Magnetar, that Magnetar had proposed the mezzanine structure of Pyxis 2006, recommended Calyon as the structuring bank, and planned to implement a "hedging" strategy to short collateral included or referenced in Pyxis 2006.

94. Throughout August of 2006, Putnam continued to participate with Calyon on due diligence calls with potential investors for Pyxis 2006.

95. However, Putnam did not disclose to potential debt investors the background on the relationship between Putnam and Magnetar and that Putnam knew about Magnetar's "hedging strategy" related to Pyxis 2006.

Magnetar's Extensive Involvement in Pyxis 2006

96. Putnam allowed Magnetar to be extensively involved in the Pyxis 2006 transaction, allowing Magnetar to, among other things, participate in the collateral selection and acquisition phases of Pyxis 2006.

97. Putnam's CDO Team Leader testified that during the collateral selection phase of Pyxis 2006, "Magnetar put forward model portfolios that they liked. They put forward example portfolios from other deals. They put forward examples of assets they bought at other deals, so Magnetar actively put forward their investment views."

98. In late June of 2006, Putnam's Head of Investments had dinner in New York City with the Co-Head of Structured Credit at Magnetar. The following day, the Co-Head of Structured Credit at Magnetar e-mailed Putnam's Head of Investments to thank him for dinner and comment on Putnam's first asset purchases for the Pyxis 2006 warehouse. He wrote, "[l]ooks like the fellahs [sic] came out of the gate strong today. I'm very excited!" Putnam's Head of Investments replied, "[w]as bang[]ing on them to get it on. Good start. [Putnam's CDO Team Leader] talking about a big chunk of [ABX Index][8] to lock. In

[8] The ABX Index was created by a private financial information services company called Markit. The ABX Index provides a financial benchmark that measures the overall value of mortgages made to borrowers with subprime or weak credit. The ABX Index uses selected CDS contracts to create an index measuring the overall value of the RMBS CDS market. The ABX Index is made up of twenty (20) bonds that are comprised of groups of subprime mortgages. There are multiple series of the ABX Index and by using these indices, financial institutions are able to determine if the market for these securities is improving or worsening.

w[]ider spreads[9]." The Co-Head of Structured Credit at Magnetar wrote back, "[y]es, like 250 now, very nice. Even better if Calyon intermediates[10] into deal at those spreads in form of regular single name on underlying [collateral]."

99. Putnam's MBS Team Leader testified, "the wider that spread is the more that the equity investor is happy. . . ."

100. Additionally, the Division asked Putnam's MBS Team Leader: "So it was your understanding . . . that Magnetar could achieve the spread that it wanted through its investment in [the] equity tranche through an investment in non-agency residential mortgage-backed securities?" Putnam's MBS Team Leader answered, "[t]hat's what I thought, yeah."

101. Around the same time that Putnam began the process of acquiring collateral for Pyxis 2006, the Co-Head of Structured Credit at Magnetar e-mailed Putnam's CDO Team Leader to check in on Putnam's warehouse purchases and asked if Putnam would send him a trade log each night of what collateral had been purchased and placed into the warehouse, which Putnam subsequently agreed to do.

102. The Co-Head of Structured Credit at Magnetar would e-mail Putnam with feedback after receiving the lists of collateral that Putnam had purchased for Pyxis 2006.

[9] In general, the term "spread" in the CDO context refers to the difference between the interest cash flow from underlying assets and the interest paid to CDO liabilities (including transaction fees). In the absence of defaults, excess spread flows through the CDO to the equity investor. Thus, in general, a wider spreading portfolio that does not experience defaults results in a higher return to the equity investor.

[10] For a CDO that contains synthetic assets, the structuring bank sometimes uses its trading desk to act as an intermediary for trades between the CDO and other market participants in exchange for a small intermediation fee for each trade. For example, the structuring bank can facilitate a trade whereby the CDO sells protection to a counterparty who wants to buy protection on collateral contained or referenced within the CDO. For Pyxis 2006, Calyon agreed to intermediate trades for the CDO for an intermediation fee per trade.

For example, in early July of 2006, the Co-Head of Structured Credit at Magnetar e-mailed Putnam's CDO Team Leader: "List results look very good."

103. Shortly after the July 4, 2006 holiday, the Co-Head of Structured Credit at Magnetar exchanged e-mails with Putnam's CDO Team Leader wherein he suggested that Putnam enter into credit default swaps related to the ABX Index on behalf of Pyxis 2006. Further, the Co-Head of Structured Credit at Magnetar outlined Magnetar's investment strategy related to Pyxis 2006 to Putnam's CDO Team Leader. The e-mail exchange included the following dialogue:

> Co-Head of Structured Credit at Magnetar: What's post-holiday plan of action? On the [ABX] index, I think we should get someone else to intermediate the names if Calyon won't do it.
>
> Putnam's CDO Team Leader: . . . I haven't discussed the ABX [Index] with Calyon in the last week or so. I will check in on where they stand on them and on the potential to increase the fraction of the deal that is synthetic. . . .
>
> Co-Head of Structured Credit at Magnetar: Excellent. Let me know on the [asset-backed securities] cdo's, I will try to do those synthetically as I may have mentioned. . . .
>
> Putnam's CDO Team Leader: I knew you planned to use mezz[anine] [asset-backed securities] CDOs as part of your hedge, but I am not sure why you would hedge with the deals that we go long in Pyxis. . . . We, of course, would pick different deals as the best short candidates (in terms of being a hedge against sub-prime issues). Is your goal to hedge the specific [asset-backed securities] deals we go long in Pyxis or to hedge the sub-prime risk in the deal?
>
> Co-Head of Structured Credit at Magnetar: Would love your list of best short candidates. It's really a comb[ination] of delta hedging and supply-demand. Very hard to get off sizable CDO CDS trades unless they're done against a deal, and this is a natural delta hedge against our equity . . . That being said, I would definitely sniff around and try to buy protection on the bonds you don't like.

> Putnam's CDO Team Leader: Got it. So when we find a deal we want to buy, we shouldn't put in an order with the syndicate desk but have Calyon broker a synthetic trade between you and [] [Pyxis 2006] at an agreed upon level?
>
> Co-Head of Structured Credit at Magnetar: That would be preferable, but biggest thing is you can look at any deal late [20]05 up to now, don't have to stick to new deals.

104. On July 27, 2006, the Co-Head of Structured Credit at Magnetar had another meeting with Putnam about Pyxis 2006, in part to discuss Magnetar's experience with purchasing CDS on collateral within the Orion CDO so that the same types of trades could be executed in Pyxis 2006.

105. On August 8, 2006, a member of Calyon's CDO team e-mailed Putnam asking Putnam to purchase more CDO assets within the next few days because several investors were holding out on placing orders in Pyxis 2006 because there were too few CDO assets in the warehouse. The Co-Head of Structured Credit at Magnetar and the Managing Director of Deutsche Bank's Special Situations Group were copied on the e-mail. Putnam's CDO Team Leader replied to all about Putnam's progress and named four CDOs that Putnam had acquired so far for Pyxis 2006. The Co-Head of Structured Credit at Magnetar replied to Putnam's CDO Team Leader and the other e-mail recipients:

> We are going to source the CDO exposure synthetically. We will buy CDO CDS on names of your choosing at mid-market, or bid list +3 [basis points], whatever you prefer. Any recent mezz[anine] [asset-backed securities] deal is fine. I can send you a list of what's in our other deals if it's helpful. Typical names that we see in other deals a lot, plus our other deals that have been priced:
>
> Orion
> Cetus
>
> Vertical 06-1 and 06-2

Tourmaline
Cambr 5 and 6
Gemst 5 and 6
Dukef 9 and 10

Many others of similar ilk, but these in particular we see a lot.

Two of the CDOs on the Co-Head of Structured Credit at Magnetar's list, Orion and Cetus, were also Magnetar-sponsored mezzanine ABS CDOs, on which Magnetar wanted to buy protection.

106. Two days later, the Co-Head of Structured Credit at Magnetar e-mailed two members of Putnam's CDO team and wrote: "I need to buy protection on abx1 ffml[11] and sasc[12] and abx2 arsi[13]. If u [sic] have any ability to add these to [the] portfolio [it] would really help me out." One of Putnam's employees wrote back: "We have $8.0 [million] of SASC from ABX1 and $12.0 [million] of ARSI from ABX2 in the warehouse, both in CDS form. We put the FFML from ABX1 on one of our bid lists and the high bid was 176 with a 170 cover. Well short of the 190 bogey. If we can live with the spread give up, we can easily add the FFML."

107. The following day, on August 11, 2006, a Putnam employee circulated by e-mail an article about Magnetar's involvement in the CDO market to Putnam's CDO Team Leader and Putnam's MBS Team Leader titled "Ill. Fund Swallows Big Chunk of Synthetic ABS." The article stated, "[m]arket participants speculate the fund is shorting other parts of the capital structure against its long equity positions."

108. The Co-Head of Structured Credit at Magnetar e-mailed Putnam's CDO Team Leader in mid-August of 2006 discussing particular assets to be included in Pyxis 2006

[11] The term "abx1 ffml" references a specific asset within one of the ABX Index series.
[12] The term "sasc" references a specific asset within one of the ABX Index series.
[13] The term "abx2 arsi" references a specific asset within one of the ABX Index series.

and also to be included in a potential second CDO transaction with Lehman Brothers (which later became Pyxis 2007). He wrote:

> For Pyxis [2006] not sure how much Baa2 you still need, but if we start Pyxis [2007] with Lehman soon sourcing Baa2 will definitely be important. . . . I can use the [ABX] index to source the underlying [assets] at much better spreads. What I need from you guys is a complete list, of the 40 names in ABX [Index] 1 and 2, how many can you approve to go into the deal? In Pyxis [2006], that will of course be net of any [ABX] index names to which you already have exposure and subject to how much more Baa2 you still need. For Pyxis [2007], we can do the full Monty.

109. Approximately a week later, the Co-Head of Structured Credit at Magnetar followed up with Putnam by sending a spreadsheet listing the ABX Index assets and asked Putnam to fill out the spreadsheet for him "with acceptable exposures to each of the 40 [ABX] index names." Putnam asked whether the spreadsheet was for Magnetar to obtain collateral for the proposed Pyxis 2007 deal and the Co-Head of Structured Credit at Magnetar replied, "[y]es, although if u [sic] still need any of the names for [P]yxis [2006], I might be able to source."

110. Two days later, on August 23, 2006, Putnam e-mailed the Co-Head of Structured Credit at Magnetar a color-coded spreadsheet listing assets within two series of the ABX Index that highlighted which assets Putnam was interested in including in Pyxis 2006. Putnam asked the Co-Head of Structured Credit at Magnetar where Putnam could obtain particular assets for the Pyxis 2006 warehouse. The Co-Head of Structured Credit at Magnetar replied by listing twelve assets and estimated bids for the assets that he could "fill in" for Pyxis 2006. Putnam's CDO Team Leader forwarded the list to a Putnam Mortgage Specialist responsible for asset acquisition and wrote, "we can/should do the ones 100+ that you like[.]"

111. The Putnam Mortgage Specialist followed up by e-mailing the Co-Head of Structured Credit at Magnetar and indicated that Putnam was interested in certain assets at particular levels. The Putnam Mortgage Specialist requested further information from the Co-Head of Structured Credit at Magnetar, who replied with a list of four assets that Magnetar could obtain for Putnam. The Co-Head of Structured Credit at Magnetar asked if Putnam wanted to execute a trade for the first three assets on his list for Pyxis 2006, and Putnam agreed to trade on behalf of Pyxis 2006, whereby Pyxis 2006 would sell protection to Magnetar.

112. The following day, Putnam e-mailed Calyon for approval to execute CDS trades on the same three assets the Co-Head of Structured Credit at Magnetar had recommended for Pyxis 2006. Calyon approved two of the trades but pushed back on approving the third trade due to the asset's low spread relative to its lower rating. Putnam's CDO Team Leader replied, "[g]iven that we appear to be on track to price soon we should be focused on getting the deal fully invested. **It is counter to the interests of the equity investors in this deal to cherry pick what we find at this stage of the process.** I request that you reconsider on this asset." (Emphasis added). A member of Putnam's CDO team forwarded the e-mail to the Co-Head of Structured Credit at Magnetar who wrote to Calyon and Putnam: "Please approve this one, then we can review structure w[ith] [P]utnam." Calyon replied, "Ok[.]"

113. On August 29, 2006, Putnam's CDO Team Leader e-mailed one of Putnam's CDO team members and wrote: "Just reminding myself on this point – [the Co-Head of Structured Credit at Magnetar/the Managing Director of Deutsche Bank's Special Situations Group] – both want . . . to buy protection on CDOs exposed to subprime

assets. They claim they will provide risk at mid-market levels or better. We need to connect with them soon to understand their needs/interest relative to the CDS on CDO vs. [Asset-Backed Securities] tranche [Credit Linked Note] structures."

114. Later that day, the Co-Head of Structured Credit at Magnetar forwarded to Putnam a bid list for four First Franklin Mortgage Loan bonds from an asset-backed securities trader at Lehman Brothers with the subject: "You guys like this name?" Two hours later, one of the members of Putnam's CDO team submitted a request to Calyon to purchase two of the bonds provided in the list for Pyxis 2006.

115. On September 5, 2006, Putnam e-mailed Calyon seeking approval to acquire four CDOs to include in Pyxis 2006, including two CDOs named Jackson 2006-1 and Buchanan 2006-1, which Calyon approved. Putnam forwarded the list of the four CDOs to the Co-Head of Structured Credit at Magnetar, who wrote back, "I would prefer we do these synthetically and we buy the protection. I have been trying to buy protection on Jackson and Buchanan."

116. A few days later, a Putnam Portfolio Construction Specialist working on Pyxis 2006 e-mailed the Co-Head of Structured Credit at Magnetar stating that Putnam had acquired $5 million of a particular CDO and was interested in acquiring another $5 million through a CDS transaction, subject to Calyon's approval. The Putnam Portfolio Construction Specialist further wrote, "I know you mentioned before an interest in buying protection at mid market levels, any interest in doing this one?" The Co-Head of Structured Credit at Magnetar replied that he would buy protection on the transaction. Calyon approved the transaction such that Putnam, on behalf of Pyxis 2006, sold protection to Magnetar on a specific CDO asset referenced in Pyxis 2006.

117. In mid-September of 2006, a Putnam Portfolio Construction Specialist working on Pyxis 2006 e-mailed the Co-Head of Structured Credit at Magnetar and wrote, "[a]m I correct in recalling that you are interested in purchasing protection on the BBB's[14] off Gemstone VI[15]? . . . And would you be interested in any of the prior Gemstone deals?" The Co-Head of Structured Credit at Magnetar replied, "[y]es, I've traded [Gemstone] 3, 4, and 5. Would prefer to do [Gemstone] 6 at this time, kind of full on the others. I can do your full size. . . ." Putnam submitted a request for approval to Calyon for Pyxis 2006 to sell protection on the Gemstone VI CDO to Magnetar, which Calyon approved.

118. These examples demonstrate that Putnam allowed Magnetar to control the collateral selection and acquisition processes for Pyxis 2006. These examples further demonstrate that Putnam knew about and helped execute Magnetar's strategy to purchase protection on assets referenced in Pyxis 2006, thus allowing Magnetar to benefit at the expense of other investors when the assets referenced or included in Pyxis 2006 defaulted. Putnam, however, failed to disclose this material conflict of interest to the other Pyxis 2006 investors.

Putnam's Representations in the Pyxis 2006 Offering Memorandum

119. The Pyxis 2006 Offering Memorandum[16] was finalized on October 2, 2006 and distributed to investors.

120. The Pyxis 2006 Offering Memorandum stated that, as the Collateral Manager, Putnam "will manage the selection, acquisition, and disposition of the Collateral Debt Securities on behalf of [] [Pyxis 2006] . . . based on the restrictions set forth in the

[14] The term "BBB's" refers to a credit rating that certain assets receive. In this example, the rating corresponds to the rating of a particular tranche of the Gemstone VI CDO.
[15] "Gemstone VI" refers to a CDO.
[16] An offering memorandum is a legal document for a transaction that sets forth the details about the securities being offered, the risks involved, as well as the parties involved in the transaction.

Indenture . . . and on the Collateral Manager's research, credit analysis and judgment. . . "

121. The Pyxis 2006 Offering Memorandum further provided that "[d]ay-to-day portfolio management of the Collateral will be the joint responsibility of the CDO & Portfolio Credit Team, which provides centralized expertise and support for all Putnam managed CDOs, and the members of Putnam's Mortgage-Backed Securities/Asset-Backed Securities/Government Team. The CDO management team will have the benefit of the expertise and analysis of other members of Putnam's Core Fixed Income team as well as Global Credit Research (Putnam's credit analysts) and Fixed Income Quantitative Research." The Pyxis 2006 Offering Memorandum also included biographies of the Putnam employees working on the Pyxis 2006 transaction outlining their experience and expertise in particular areas of CDO construction.

122. However, the portions of the Pyxis 2006 Offering Memorandum that Putnam prepared for investors failed to disclose Magnetar's: (1) initiation of discussions with Putnam about Pyxis 2006's creation; (2) recommendation of Calyon as the structuring bank for Pyxis 2006; (3) commitment to purchase half of the equity tranche of Pyxis 2006 prior to Pyxis 2006's creation; (4) recommendation of certain assets for inclusion in Pyxis 2006 during discussions with Putnam and Calyon; and (5) intent and actual shorting of certain assets selected for inclusion or referenced in Pyxis 2006.

123. On October 3, 2006, the final transaction documents were signed and Pyxis 2006 closed.[17] Pyxis 2006 subsequently issued notes and shares to investors representing their investments in the CDO.

[17] Approximately five months after Pyxis 2006 closed, Magnetar hired the Managing Director of Deutsche Bank's Special Situations Group and another member of Deutsche Bank's Special Situations Group.

124. Even though the notes that Pyxis 2006 issued to investors were not scheduled to mature until 2046, the rating agencies extensively downgraded the subprime assets in Pyxis 2006 not long after the transaction was completed. Pyxis 2006 defaulted just over two years after it closed and was forced into liquidation, resulting in tens of millions of dollars in investor losses.

125. Magnetar made millions of dollars related to its equity investment and aggressive short positions tied to Pyxis 2006.

C. *THE PYXIS 2007 CDO TRANSACTION*

Initiation of Pyxis 2007 and Putnam's Role as Collateral Manager

126. Approximately three months before Pyxis 2006 closed, Magnetar approached Putnam with a second CDO proposal.

127. Putnam's CDO Team Leader testified that, "at some point Magnetar and Deutsche Bank parted ways in the sense that they were co-investing in a series of transactions. . . . at some point Magnetar went forward with a strategy and Deutsche Bank was not joining them to continue with the strategy, so a series of deals had been done in the market and Magnetar was looking to increase the number of deals, and at some point there was a communication that either came to us from Magnetar or from Lehman . . . where there was a suggestion or a proposal for us to consider a follow-on transaction."

128. On August 8, 2006, Putnam's CDO Team Leader e-mailed Putnam's Head of Investments and Putnam's MBS Team Leader, writing:

> Magnetar and Lehman [Brothers] have agreed to terms such that Magnetar is going to sponsor an ABS CDO with Lehman as structuring and placement agent. Both Magnetar and Lehman are interested in Putnam acting as the collateral manager (according to [the Co-Head of Structured Credit at Magnetar]). . . . I will probably have a

> call with [the Co-Head of Structured Credit at Magnetar] about it later this week. . . .

129. Putnam's Head of Investments testified that after Magnetar approached Putnam's CDO Team Leader about creating a second Magnetar-sponsored CDO, he told Putnam's CEO about the idea of Putnam becoming the Collateral Manager for another CDO in which Magnetar would be the equity investor. Putnam's CEO approved moving forward with the transaction.

130. The Putnam Executive Committee also signed off on Putnam becoming the Collateral Manager for a second Magnetar-sponsored CDO during a Putnam Executive Committee meeting, which included Putnam's CEO, Chief Financial Officer, Chief Technology Officer, General Counsel, Senior Managing Director of Operations, Senior Managing Director of Distribution, and Head of Investments.

131. As was the case in Pyxis 2006, Magnetar initiated the development process for Pyxis 2007 and maintained substantial influence and control over the process from inception to completion.

132. Magnetar told Putnam that it wanted the second CDO transaction to be another hybrid mezzanine ABS CDO, which later became Pyxis 2007.

133. Putnam's CDO Team Leader testified: "I do know that over time, Magnetar was looking across their whole portfolio, their hedged equity strategy, was trying to optimize . . their execution and what they were trying to accomplish, and I also recall they had a view that they wanted things to be kind of similar, that they were having a bit of a challenge of having every deal [] slightly different in terms of their issues of kind of managing their portfolio, so I do recall a sense that they wanted to try to standardize the

structures they were using going forward, but from a broad perspective, [Pyxis 2007] would be a similar transaction to the [Pyxis] 2006 deal."

134. In addition, Putnam's CDO Team Leader testified that he had no reason to believe that Magnetar's "hedging" strategy did not continue into Pyxis 2007.

135. Putnam's MBS Team Leader also testified that he did not remember Magnetar's "hedging" strategy changing for Pyxis 2007.

Lehman's Role as Structuring Bank to Pyxis 2007

136. Magnetar recommended to Putnam that Lehman act as the structuring bank for Pyxis 2007.

137. Before any initial Pyxis 2007 transaction documents were executed, Magnetar acquired $300 million of collateral for the deal in a Lehman warehouse, and notified Putnam that it was doing so.

138. For example, in mid-August of 2006, the Co-Head of Structured Credit at Magnetar e-mailed members of Putnam's CDO team and asked them to fill out an attached spreadsheet with "acceptable exposure to each of the 40 [ABX] index names." When Putnam's CDO Team Leader asked the Co-Head of Structured Credit at Magnetar whether the spreadsheet would be used to obtain assets for the proposed second CDO with Lehman, the Co-Head of Structured Credit at Magnetar replied: "I have strong armed Lehman into taking down [the] trade this week even though deal not officially signed up."

139. In mid-September of 2006, Putnam's CDO Team Leader e-mailed the Co-Head of Structured Credit at Magnetar, stating that he had spoken to the Managing Director of Trading at Lehman. He wrote:

> [Lehman is] ready to open the warehouse when you are comfortable with the spreads available in the marketplace. Do you want to go through a model portfolio exercise before starting to aggregate [collateral] or are there some thresholds that you have in mind for Baa2 and Baa3 synthetics that can be used to start aggregation [of collateral] now and work on the model portfolio in parallel?

The Co-Head of Structured Credit at Magnetar replied:

> Yes, lets [sic] go thru [sic] model portfolio. I have already accumulated most of the ABX [Index] 06-1 Baa3 and [ABX Index] 06-2 Baa2 we would need for the deal, so we should plan on confirming the names for that piece and structuring the rest of the portfolio.

140. On September 13, 2006, the Co-Head of Structured Credit at Magnetar e-mailed Putnam's CDO Team Leader and attached a spreadsheet. The Co-Head of Structured Credit at Magnetar wrote: "Have accumulated around $300 [million] each of [ABX Index] 06-1 BBB- and [ABX Index] 06-2 BBB. Sitting on [Lehman] books for your warehouse. . . . Need to buy protection on names as indicated to fill in." Putnam's CDO Team Leader forwarded the spreadsheet to several members of Putnam's CDO team.

141. Two days later, Putnam's CDO Team Leader e-mailed Putnam's Head of Investments with an update on the proposed CDO with Lehman, writing that Putnam had received a draft engagement letter from Lehman and that "[the Co-Head of Structured Credit at Magnetar] has already pre-warehoused about 20% of the assets (which we can take if we like them)." Putnam's CDO Team Leader added that he hoped to execute the "first [s]ubprime list for the Lehman deal for early [the] next week."

142. The Co-Head of Structured Credit at Magnetar dictated what fees Putnam was to earn for its role as Collateral Manager to Pyxis 2007. On September 13, 2006, Putnam's CDO Team Leader wrote to the Co-Head of Structured Credit at Magnetar that he was

assuming that they were going to use the same fee structure for Pyxis 2007 as they did for Pyxis 2006, which was a senior collateral management fee of fifteen basis points with a subordinated collateral management fee of five basis points. The Co-Head of Structured Credit at Magnetar replied, "[w]ith the arb[itrage] tighter, we've had to go to 10/5 for our best managers such as yourself. . . . Still good $ I hope, and we'll certainly be good for pyxis 3 behind this. Apprec[iate] your understanding on this point."

143. Putnam allowed Magnetar to dictate certain deal terms for the Pyxis 2007 transaction. With respect to Pyxis 2007, Putnam's CDO Team Leader testified that, "[Magnetar] influenced what the guidelines would be in the ultimate deal, so in terms of what were expected eligibility requirements, what were concentration constraints as well as through Lehman what was approvable for the warehouse . . . they definitely had that same type of participation in the process."

144. For example, in mid-October of 2006, Putnam provided Lehman with feedback on a draft engagement letter and a draft warehouse agreement, including comments about the collateral management fees that Putnam had previously discussed with Magnetar. With respect to edits to the transaction documents, Putnam's CDO Team Leader wrote that, "[m]ost of our business comments on the engagement letter and warehouse agreement will relate to conforming it to the terms (with a few adjustments based on conversations with [the Co-Head of Structured Credit at Magnetar]) of our recent transaction with Calyon as arranger and Magnetar as lead equity investor."

145. In late October of 2006, the Co-Head of Structured Credit at Magnetar e-mailed members of Putnam and Lehman's CDO teams. The Co-Head of Structured Credit at Magnetar wrote, "**I have no higher priority than the standardization of deal terms**"

and attached two examples of CDOs that he liked, along with a list of structural features that he would like to incorporate into Pyxis 2007. (Emphasis added). He further wrote, "[b]etween our three firms we should be able to create a structure for this deal that will be the standard for 2007."

Pyxis 2007 Contracts and Putnam's Fees

146. On November 7, 2006, Putnam and Lehman signed an engagement letter ("Pyxis 2007 Engagement Letter") that confirmed Putnam's role as the Collateral Manager to Pyxis 2007, which, like Pyxis 2006, was also contemplated to be a $1.5 billion mezzanine CDO tied to the subprime mortgage securitization market.

147. The Pyxis 2007 Engagement Letter provided that Putnam would select and manage the assets within the CDO and would earn a senior collateral management fee of ten basis points and a subordinated collateral management fee of five basis points.[18]

148. In a sworn statement submitted to the Division, Putnam confirmed that it received approximately $3,107,627.91 in collateral management fees for Pyxis 2007.

149. The Pyxis 2007 Engagement Letter also provided that Lehman and Putnam would: (1) establish a special purpose entity for acquiring a portfolio of "mezzanine mortgage-backed securities, other asset-backed securities and/or synthetic securities" to be selected and managed by Putnam; (2) offer classes of notes secured by the collateral; and (3) offer "preference shares," also known as the equity tranche, for the $1.5 billion CDO.

150. On November 7, 2006, Putnam and Lehman entered into a warehouse agreement ("Pyxis 2007 Warehouse Agreement") that provided that Lehman would finance the acquisition and warehousing of the collateral selected and managed by Putnam. The

[18] Putnam's subordinated collateral management fee was later raised to seven basis points.

agreement provided that Lehman would warehouse up to $1.5 billion of the selected collateral for the CDO, and that approximately $90 million of that collateral would make up the equity tranche.

151. However, neither the Pyxis 2007 Engagement Letter nor the Pyxis 2007 Warehouse Agreement disclosed Magnetar's: (1) initiation of discussions with Putnam about Pyxis 2007's creation; (2) enlisting of Putnam to act as the Collateral Manager for Pyxis 2007; (3) recommendation of Lehman to act as the structuring bank to Pyxis 2007; (4) commitment to purchase the entire equity tranche of Pyxis 2007 prior to Pyxis 2007's inception; and (5) pre-warehousing of collateral with Lehman before the formal commencement of the Pyxis 2007 transaction.

Structure and Composition of Pyxis 2007

152. Like Pyxis 2006, Pyxis 2007 is another example of a hybrid mezzanine CDO, whose pool of assets consisted entirely of lower-rated cash and synthetic assets tied primarily to the subprime mortgage securitization market.

153. The targeted portfolio of Pyxis 2007 called for 49.3% of the collateral assets to be RMBS subprime; 40.7% of the collateral assets to be RMBS midprime; 5.0% of the collateral assets to be ABS CDOs; and 5.0% of the collateral to be CMBS Conduit.

154. Additionally, the target portfolio of Pyxis 2007 was for the CDO to contain 49.7% of collateral assets that were rated Baa3 by Moody's rating agency; 24.7% of Baa2 rated assets; 19.1% of Baa1 rated assets; 3.0% of A2 rated assets; 2.2% of Ba2 rated assets; and 1.3% of Ba1 rated assets.

155. Pyxis 2007 was divided into several tranches, including a senior "Class A-1" group with the highest rating agency rating, several subordinate classes with lower rating agency ratings, and a "Preference Shares" class that was the non-rated equity tranche.

156. Magnetar invested $50 million in the equity and subordinated debt tranches of Pyxis 2007.

<u>Putnam Markets Pyxis 2007 to Investors</u>

157. Putnam solicited debt investors for Pyxis 2007. As part of its marketing efforts of Pyxis 2007 to potential debt investors, Putnam contributed important information and representations in a Pyxis 2007 Pitchbook and Termsheet.

158. In late 2006 and early 2007, Putnam and Lehman worked to finalize the Pyxis 2007 Pitchbook that would be used in marketing Pyxis 2007 to potential investors.

159. Putnam's CDO Team Leader testified that "[i]f we're meeting with an investor and it's part of marketing the deal, the pitch book would be the document that would be the basis for that meeting."

160. The Pyxis 2007 Pitchbook contained background information on Putnam and its "[d]eep, [e]xperienced" management team who would be involved in Pyxis 2007. Putnam was described as having "[s]easoned leaders committed to investment excellence and high fiduciary standards" and being "[c]onsistent, [d]ependent], [and] [s]uperior."

161. The Pyxis 2007 Pitchbook provided that Putnam's "goal is to generate excellent long-term investment results based on a core investment philosophy that seeks to exploit all available alpha sources as part of a systematic **valuation**, **risk management**, and **portfolio construction** framework[.]" (Emphasis in original).

162. Additionally, the Pyxis 2007 Pitchbook highlighted Putnam's extensive due diligence and surveillance processes for analyzing and monitoring asset-backed securities and mortgage-backed securities. With respect to CDOs, the Pyxis 2007 Pitchbook provided that "Putnam has made a strategic commitment to offering a 'best in class' CDO management capability. . ." and that "Putnam's success within CDOs is based on a high degree of expertise in both the design of a conservative and stable CDO structure and the management of the underlying fixed income collateral."

163. The Pyxis 2007 Pitchbook also set forth Putnam's investment philosophy with respect to CDOs, which included that "**Putnam should actively drive the product structure**" and that "[a] CDO transaction is a marriage of collateral and structure. **Putnam seeks to design and undertake transactions that have a high probability of success**[.]" (Emphasis added).

164. In addition to the Pyxis 2007 Pitchbook, Putnam contributed content to the Pyxis 2007 Termsheet, which was a more abbreviated summary of the Pyxis 2007 deal terms.

165. The Pyxis 2007 Termsheet provided the target portfolio ratings and target asset type to be included in Pyxis 2007, which were largely dictated by Magnetar's desire to create a mezzanine CDO containing cash and synthetic assets tied to the U.S housing market.

166. The Pyxis 2007 Termsheet also provided that Putnam would be the Collateral Manager to Pyxis 2007 and touted, among other things, that "Putnam has a multi-class CDO capability and currently manages CDOs with Liabilities and Preferred Share balances of approximately $4.9 billion across 8 funds. . . ." Like the Pyxis 2007 Pitchbook, the Pyxis 2007 Termsheet also provided that "Putnam has made a strategic

commitment to offering 'best in class' CDO management capability and has developed significant presence in the CDO market. . . ." The Pyxis 2007 Termsheet further provided that "Putnam's success within CDOs is based on a high degree of expertise in both the design of a conservative and stable CDO structure and the management of the underlying fixed income collateral[.]"

167. In December of 2006 and continuing into early 2007, Putnam and Lehman conducted meetings with investors to market Pyxis 2007 by discussing Putnam's CDO and MBS teams, market views, investment strategy and process, and the Pyxis 2007 portfolio.

168. However, undisclosed to investors in the Pyxis 2007 Pitchbook, Pyxis 2007 Termsheet, and during investor meetings was that Putnam allowed Magnetar, a hedge fund with economic interests adverse to the other Pyxis 2007 investors, to drive and control critical aspects of Pyxis 2007's development, such as selecting the Collateral Manager and structuring bank, pre-warehousing assets, dictating the target portfolio of Pyxis 2007, and recommending collateral to Putnam to reference or include in Pyxis 2007 that Magnetar planned to short.

Magnetar's Extensive Involvement in Pyxis 2007

169. Putnam allowed Magnetar to be extensively involved in the Pyxis 2007 transaction, allowing Magnetar to, among other things, participate in the collateral selection and acquisition phases of Pyxis 2007.

170. For example, in October of 2006, before any engagement letters or warehouse agreements for Pyxis 2007 had been signed, a Putnam Mortgage Specialist working on the proposed second CDO e-mailed the Co-Head of Structured Credit at Magnetar. He

told him that Putnam was putting together a list of assets in the ABX Index 1 series and ABX Index 2 series that it was going to seek bids on in the market. The Putnam Mortgage Specialist wrote: "We had a conversation about this a month or so ago and I'm a bit unclear if there [is] any thing [sic] special we need to do or you'd like to be involved in given we have legacy ABX [Index] exposure in the warehouse?" The Co-Head of Structured Credit at Magnetar wrote back, "[w]ell, should check with [Lehman]. When the warehouse first opened, we put a decent sized chunk of [ABX] index in their [sic] to get the ball rolling in case spreads tightened in. Happily, things [are] a lot wider, but the [ABX] index might be enough to make you full on those names." The next day, the Co-Head of Structured Credit at Magnetar wrote back, "[j]ust spoke to [Lehman], seems we have enough [ABX] index exposure, we'll have too much of those deals if you add more."

171. On November 6, 2006, the day before the Pyxis 2007 Engagement Letter and Pyxis 2007 Warehouse Agreement were executed, a member of Putnam's CDO team e-mailed the Co-Head of Structured Credit at Magnetar stating that Putnam was looking to include the Lacerta CDO, which was a Magnetar-sponsored CDO, in either Pyxis 2006 or Pyxis 2007. The member of Putnam's CDO team wrote that he "[c]ould do some in CDS format" and asked whether the Co-Head of Structured Credit at Magnetar had a "particular axe . . . for the BBBs or As?" The Co-Head of Structured Credit at Magnetar replied, "[g]reat, I could do either, whatever you prefer."

172. On November 29, 2006, the Co-Head of Structured Credit at Magnetar e-mailed Putnam's CDO Team Leader and another member of Putnam's CDO team stating that a member of Lehman's CDO team wanted to discuss the Pyxis 2007 CDO bucket. The Co-

Head of Structured Credit at Magnetar also wrote that he would send the Putnam CDO team "a list of deals on which [the Co-Head of Structured Credit at Magnetar] would buy cds." Later that day, the Co-Head of Structured Credit at Magnetar e-mailed a spreadsheet titled "CDO List" to a member of Putnam's CDO team. This list of CDOs that Magnetar wanted to short included four tranches of Pyxis 2006, along with other CDO names.

173. In late January of 2007, Putnam's CDO Team Leader provided Putnam's Head of Investments with an update on the status of Pyxis 2007's offering memorandum ("Pyxis 2007 Offering Memorandum"). He wrote that Magnetar had given Lehman some new requests on the document which delayed the timing of the Pyxis 2007 Offering Memorandum.

174. During February of 2007, it became increasingly challenging for Lehman and Putnam to find debt investors to place orders for the mezzanine tranches of Pyxis 2007 because subprime assets started experiencing significant downgrades. Ultimately, orders for all Pyxis 2007 tranches were placed, with Lehman investing approximately $90 million in the mezzanine tranches of Pyxis 2007.

175. On February 28, 2007, Putnam's MBS Team Leader e-mailed the Co-Head of Structured Credit at Magnetar seeking confirmation on Putnam's fee formula to include in the Pyxis 2007 Offering Memorandum. The Co-Head of Structured Credit at Magnetar replied with a fee formula to which Putnam's MBS Team Leader wrote back, "cool. [S]hould we include the remaining trades to fully ramp[19] the portfolio?" The Co-

[19] The "ramp-up phase" or "ramping phase" of a CDO transaction is the phase in which a Collateral Manager selects assets for the CDO's initial collateral portfolio prior to the issuance of the CDO's notes to investors and completes their acquisition. During this phase, the CDO's structuring bank finances the asset purchases and bears the risk of loss on those assets.

Head of Structured Credit at Magnetar responded, "[y]es, ideally we should have the portfolio fully ramped or estimate balance. We should discuss CDO bucket, [I] sent [member of Putnam's CDO team] a bespoke portfolio[20] to follow up on that plan. . . . In any case, will need some real bonds so we should come up with names together."

176. On March 2, 2007, Putnam's MBS Team Leader e-mailed the Co-Head of Structured Credit at Magnetar to determine which of two different subordinate collateral management fees would be described in the Pyxis 2007 Offering Memorandum. The Co-Head of Structured Credit at Magnetar replied that he was "fine with 7" basis points for the subordinate collateral management fee to which Putnam's MBS Team Leader replied, "we'll do the 7, want to make sure you and [M]agnetar are happy."

Putnam's Representations in the Pyxis 2007 Offering Memorandum

177. The Pyxis 2007 Offering Memorandum was finalized on March 5, 2007 and distributed to investors.

178. The Pyxis 2007 Offering Memorandum stated that, as the Collateral Manager, Putnam "will manage the selection, acquisition, and disposition of the Collateral Debt Securities on behalf of [] [Pyxis 2007] . . . based on the restrictions set forth in the Indenture . . . and on the Collateral Manager's research, credit analysis and judgment. . .

[20] A "bespoke" CDO is a custom-tailored CDO created for one or more investors based on their specific requests. Once a bespoke CDO is created, the requesting investor group typically invests in a single tranche of the bespoke CDO, while the remaining tranches are held by the CDO structuring bank or sold in the marketplace to other investors. During the Pyxis 2006 and Pyxis 2007 transactions, Putnam, Magnetar, and, initially, Deutsche Bank, attempted to put together a bespoke CDO whereby Putnam, Magnetar, and Deutsche Bank would select collateral to include within the bespoke CDO, then Putnam would recommend to Calyon that the bespoke CDO be included in the Pyxis 2006 or Pyxis 2007 warehouse, and Magnetar and/or Deutsche Bank would be the counterparty to protection sold by Pyxis 2006 referencing the bespoke CDO. Throughout late 2006 and early 2007, Putnam and Magnetar worked to complete the bespoke CDO transaction to include in the Pyxis CDOs; however, Putnam and Magnetar did not end up completing the bespoke CDO in time to include in either of the deals.

179. The Pyxis 2007 Offering Memorandum further provided that "[d]ay-to-day portfolio management of the Collateral will be the joint responsibility of the CDO & Portfolio Credit Team, which provides centralized expertise and support for all Putnam managed CDOs, and the members of Putnam's Mortgage-Backed Securities/Asset-Backed Securities/Government Team. The CDO management team will have the benefit of the expertise and analysis of other members of Putnam's Core Fixed Income team as well as Global Credit Research (Putnam's credit analysts) and Fixed Income Quantitative Research." The Pyxis 2007 Offering Memorandum also included biographies of the Putnam employees working on the Pyxis 2007 transaction outlining their experience and expertise in particular areas.

180. However, the portions of the Pyxis 2007 Offering Memorandum that Putnam prepared for investors failed to disclose Magnetar's: (1) initiation of discussions with Putnam about Pyxis 2007's creation; (2) recommendation of Lehman as the structuring bank for Pyxis 2007; (3) commitment to purchase the equity tranche of Pyxis 2007 prior to Pyxis 2007's creation; (4) extensive involvement in the collateral selection and acquisition phases, including pre-warehousing collateral for Pyxis 2007 with Lehman; and (5) intent and actual shorting of collateral tied to Pyxis 2007.

181. On March 6, 2007, the final transaction documents were signed and Pyxis 2007 closed. Pyxis 2007 subsequently issued notes and shares to investors representing their investments in the CDO.

Post-Closing of Pyxis 2007

182. Just days after the Pyxis 2007 Offering Memorandum was finalized and Pyxis 2007 closed, a member of Putnam's MBS team e-mailed a member of Putnam's CDO

team the title of a Bloomberg news article that read, "Magnetar Hedge Fund Gains on Bets Against Subprime Home Loa[ns]."

183. Upon information and belief, Putnam made no attempts to change the Pyxis 2007 offering materials to disclose Magnetar's involvement in Pyxis 2007 and Magnetar's "hedging" strategy related to CDOs.

184. Even after Pyxis 2007 closed, Magnetar continued to recommend collateral to be included in Pyxis 2007 during the final ramp-up phase of collateral acquisition, and also recommended trading strategies for collateral in both Pyxis 2006 and Pyxis 2007 that Putnam managed. For example, on May 3, 2007, the Co-Head of Structured Credit at Magnetar e-mailed members of Putnam's CDO and MBS teams, and wrote:

> We'd like to have a conf[erence] call to discuss trading opportunities in the Pyxis deals. In particular, we still have $90 [million] left to ramp on Pyxis [2007], all in the CDO bucket. This could be done at extremely attractive spreads and we would like to have the ramp completed as soon as possible. Lets [sic] agree on a list of deals that we will either source or you can go out and [issue a Bid Wanted in Competition] in the market. Also, think it's an interesting time to talk about trading opportunities in the resi[dential] securities. . . .

185. Within half an hour of Magnetar's e-mail, a member of Putnam's CDO team e-mailed the Co-Head of Structured Credit at Magnetar and stated, "[a]fter some activity this week and last week, we are considerably more ramped than the last update you have seen." The Putnam CDO team member attached a current portfolio list of acquired collateral to his e-mail. The Co-Head of Structured Credit at Magnetar was not pleased with Putnam's trading update and replied:

> We would have really preferred to have discussed strategy with you before you did so much trading. We have been patiently waiting to discuss the CDO strategy as you

> revamped your resi[dential] analysis. . . . We have also spent a lot of effort working on bespokes to fill that bucket. It is disappointing that so much of the ramp was executed without us having a chance to discuss some key issues.
>
> The portfolio spread on this deal is quite low relative to the extraordinarily high levels at which Lehman executed the liabilities. Therefore, I would have hoped that you would use the remaining ramp to get the portfolio spread as high as possible within the flexibility given by the 500 WARF[21] target and 10% CDO bucket. Consequently, there are several things I don't understand about the recent trades. . .
>
> Why are the CDO's being done at the AA level? You could source Baa2 CDO exposure synthetically at a spread in excess of 1000 for a 360 WARF. Also, you should always check on our bid, we would have executed all of those trades with you at better levels.
>
> Given the very small amount of ramp left with which to soften the blow of these recent trades, I request that for the balance of the ramp you increase the exposure to Baa2 CDO's with par CDS. . . .
>
> Lets [sic] please discuss before any additional trading is done as the composition of the deal has significantly shifted from that to which we agreed[,] at the same time [] the liability execution was much poorer than expected.

186. Putnam's CDO Team Leader wrote back to the Co-Head of Structured Credit at Magnetar:

> It seems like we have gotten our 'wires crossed'. [sic] We did not realize that you were waiting on us to discuss CDO strategy. I am sorry for the confusion. We will circle up on this internally this morning and then we would be happy to have a call with you. . . . For background, our portfolio was over 80% ramped when things really started to get crazy in February. . . . [w]e became concerned about

[21] The term "WARF" stands for "Weighted Average Rating Factor" and refers to a concept introduced by the rating agencies whereby a number is assigned to each rating, and that number represents the expected default rate over a 10-year period. With respect to CDOs, WARF is used to provide one number to help describe the average credit quality of the portfolio. For example, Moody's rating agency assigned a rating factor of 1 to the highest-rated "Aaa" rated securities, while it assigned a rating factor of 4,770 to low-rated "Caa1" rated securities.

> meeting all of the necessary tests on the ramp-up completion date, with the biggest risk coming from a large round of asset downgrades. . . . This led to a more conservative approach with the recent trades. . . . [W]e are underdelivering a bit relative to Pyxis [2006]. We will look at this carefully as we think about what constraints we have for the balance of the ramp-up. Not Checking Your Bid [--] This was an oversight. . . . We should have focused on more direct communication post-closing.

The Co-Head of Structured Credit at Magnetar replied, "[t]hanks, just try to keep us in the loop. . . ." Putnam's CDO Team Leader forwarded the e-mail exchange to Putnam's Head of Investments and wrote, "crisis averted. . . ."

187. Several days after Magnetar's request to keep Magnetar "in the loop," a member of Putnam's CDO team e-mailed the Co-Head of Structured Credit at Magnetar with a bid list that Putnam intended to submit to the marketplace for collateral to include in Pyxis 2007. The member of Putnam's CDO team asked whether the Co-Head of Structured Credit at Magnetar had any thoughts or comments on the bid list, to which the Co-Head of Structured Credit at Magnetar replied, "[w]e'll call you now."

188. Less than an hour later, the Co-Head of Structured Credit at Magnetar e-mailed members of Putnam's CDO team about the bid list and wrote, "[g]ood talking to you. Let us know what bids you get back on Orion 1, Scorp[ius] and C[o]rona. If they're not great, we'll buy the protection." Magnetar was the equity sponsor of these three CDOs to be added to Pyxis 2007, and on which Magnetar wanted to buy protection.

189. The following day, on May 10, 2007, the Co-Head of Structured Credit at Magnetar wrote to the Putnam CDO team members that he would check in later that day to see how the bids went. He further wrote, "[d]id u [sic] add c[o]rona to the list?" Putnam's CDO Team Leader replied, "Its [sic] on the list now[.]"

190. On May 11, 2007, Putnam's CDO Team Leader and the Co-Head of Structured Credit at Magnetar exchanged several e-mails about the bid list responses. Putnam's CDO Team Leader thanked the Co-Head of Structured Credit at Magnetar for his help and confirmed that Putnam executed a trade for Corona. With that trade, the collateral selection for Pyxis 2007 was completed.

191. Even though the notes that Pyxis 2007 issued to investors were not scheduled to mature until 2047, Pyxis 2007 defaulted just one and a half years after it closed and was forced into liquidation, resulting in tens of millions of dollars in investor losses.

192. Magnetar made millions of dollars related to its equity investment and aggressive short positions tied to Pyxis 2007.

D. *AFTERMATH OF PYXIS 2006 AND PYXIS 2007*

Putnam Communications with Magnetar Following Pyxis 2006 and Pyxis 2007

193. On July 13, 2007, the former Managing Director of Deutsche Bank's Special Situations Group, who had become a Magnetar employee following the close of Pyxis 2006, e-mailed Putnam's CDO Team Leader to schedule dinner or drinks later in the month with the Co-Head of Structured Credit at Magnetar and himself. Putnam's CDO Team Leader wrote back, "[s]ure. **Going to bring your money bags?** If you have the liquidity, I assume you are reducing hedges at these levels. . . ." (Emphasis added). The former Managing Director of Deutsche Bank's Special Situations Group replied on behalf of Magnetar, "[w]e're doing ok. Actually, the bummer is being forced to close trades that ramped early this year and are only now coming to closing for one reason or another. . . . That takes away some of the fun." The former Managing Director of Deutsche Bank's Special Situations Group wrote further, "[w]e've generally been pretty

disciplined in taking off hedges over the last few months, but good news was that we did a decent job differentiating the hedges that were less useful to us (not correlated or better quality portfolios) and taking those off, so that the average quality of the shorts is not better for us (which is really worse).".

194. Putnam's CDO Team Leader forwarded this e-mail chain to Putnam's MBS Team Leader and a member of Putnam's CDO team. The member of Putnam's CDO team replied only to the Putnam personnel and added his own commentary below the e-mail sent by the former Managing Director of Deutsche Bank's Special Situations Group. He interpreted that the former Managing Director of Deutsche Bank's Special Situations Group really meant that Magnetar was "bummed to close in a market where CDO spreads are crazy" and that Magnetar was "happy they took off less efficient shorts [] and the remaining hedges are better correlated with their longs."

195. In early August of 2007, Putnam's MBS Team Leader e-mailed the Co-Head of Structured Credit at Màgnetar and wrote, "are you enjoying this market?" The Co-Head of Structured Credit at Magnetar replied, **"[n]ot sure enjoy is the right world, watching [w]orld end always very stressful, but at least making truckloads of loot like u [sic] read about."** (Emphasis added). The Co-Head of Structured Credit at Magnetar and Putnam's MBS Team Leader then agreed on a date to get together for dinner in the following month.

196. In November of 2007, a representative of the senior most investor in Pyxis 2006 e-mailed Putnam's CDO Team Leader and requested a meeting between the investor's representatives and all Putnam personnel involved in the Pyxis 2006 transaction to go over the transaction in detail. **The investor representative wrote that one of the topics**

that he wanted to discuss with Putnam was, "how Putnam became involved in the transaction. Specifically, I believe you[r] equity investor has a rather unique approach to investing in ABS CDOs. I would like to know what you know about them and what your level of communication is with them." Putnam's CDO Team Leader replied, "[t]here is probably very little we can discuss under [that topic]." (Emphasis added).

<u>Events of Default for Pyxis 2006 and Pyxis 2007</u>

197. Even though Putnam represented to Pyxis 2006 investors that it sought to "design and undertake transactions that have a high probability of success," the rating agencies extensively downgraded subprime assets included or referenced by Pyxis 2006 not long after the transaction was completed. Pyxis 2006 defaulted just over two years after it closed and was forced into liquidation, resulting in tens of millions of dollars in investor losses.

198. Even though Putnam represented to Pyxis 2007 investors that it sought to "design and undertake transactions that have a high probability of success," Pyxis 2007 defaulted just one and a half years after it closed and was forced into liquidation, resulting in tens of millions of dollars in investor losses.

<u>Putnam's Total Fees Received on Pyxis 2006 and Pyxis 2007</u>

199. In a sworn statement submitted to the Division, Putnam confirmed that it received approximately $5,707,429.65 in collateral management fees for Pyxis 2006.

200. In a sworn statement submitted to the Division, Putnam confirmed that it received approximately $3,107,627.91 in collateral management fees for Pyxis 2007.

201. In total, Putnam benefited by making approximately $8,815,057.56 in collateral management fees from the Pyxis CDOs.

Magnetar's Shorts on Pyxis 2006

202. Magnetar made tens of millions of dollars by shorting the Pyxis 2006 and Pyxis 2007 CDO tranches and collateral within the Pyxis CDOs.

203. Magnetar made a total long investment in Pyxis 2006 of $38,512,403 in the equity tranche and a subordinated tranche.

204. Magnetar received principal and interest payments of $4,635,836 on these investments until approximately May of 2008 when Pyxis 2006 stopped making payments to investors.

205. Magnetar purchased $89 million worth of CDS protection on the Pyxis 2006 Class C tranche and $3.5 million of CDS protection on the Pyxis 2006 Class D tranche. Magnetar received $79 million on the Pyxis 2006 Class C tranche and $3.2 million on the Pyxis 2006 Class D tranche when credit events occurred.

206. Magnetar purchased $9.9 million worth of CDS protection on the Gemstone VII CDO that was an asset included in Pyxis 2006. Magnetar received $9.7 million on this short position when credit events occurred.

207. Magnetar purchased $5 million worth of CDS protection on the Arca CDO that was an asset included in Pyxis 2006. Magnetar received $5 million on this short position when credit events occurred.

Magnetar's Shorts on Pyxis 2007

208. Magnetar made a total long investment in Pyxis 2007 of $50 million in the equity and subordinated debt tranches.

209. Magnetar received principal and interest payments of $7,779,348 on these investments until approximately January of 2008 when Pyxis 2007 stopped making payments to investors.

210. Magnetar purchased $10 million worth of CDS protection on the Pyxis 2007 Class C tranche, $45 million of CDS protection on the Pyxis 2007 Class B tranche, and $10 million of CDS protection on the Pyxis 2007 Class A2 tranche. Magnetar received $10 million, $30 million, and $10 million, respectively, on these Pyxis 2007 short positions when credit events occurred.

211. Factoring in Magnetar's short positions, equity investments, and interest payments made and received, in total Magnetar reaped a net gain of approximately $67 million on its equity investments and aggressive short positions tied to Pyxis 2006 and Pyxis 2007.

VIII. CONCLUSION

212. Based on information obtained during the Division's investigation, there is ample evidence to establish that Putnam knew that Magnetar proposed and was extensively involved in the structure and composition of two custom-tailored CDOs, Pyxis 2006 and Pyxis 2007, in which Magnetar committed to invest in the equity tranches.

213. Further, Putnam knew of Magnetar's shorting strategy tied to Pyxis 2006 and Pyxis 2007.

214. Putnam knew or should have known that Magnetar's extensive involvement and shorting strategy created a material conflict of interest with other Pyxis 2006 and Pyxis 2007 investors.

215. As the Collateral Manager of the Pyxis CDOs, Putnam had a duty to inform investors of material information regarding Pyxis 2006 and Pyxis 2007.

216. Because Putnam failed to disclose Magnetar's extensive involvement and "hedged equity strategy" in the Pyxis CDOs, the other Pyxis 2006 and Pyxis 2007 investors were not able to make informed decisions with respect to their investments and, as a result, lost tens of millions of dollars.

IX. VIOLATIONS OF THE MASSACHUSETTS UNIFORM SECURITIES ACT

A. Count 1: Violation of Section 101(2)

217. Section 101(2) of the Act provides, in pertinent part:

> It is unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly . . . (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading . . . .

MASS. GEN. LAWS ch. 110A, § 101(2).

218. The Division herein restates and re-alleges the facts and allegations set forth in paragraphs 1 through 216 above.

219. The conduct of Respondent, as described above, constitutes a violation of MASS. GEN. LAWS ch. 110A, § 101(2).

B. Count 2: Violation of Section 101(3)

220. Section 101(3) of the Act provides, in pertinent part:

> It is unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly . . . (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

MASS. GEN. LAWS ch. 110A, § 101(3).

221. The Division herein restates and re-alleges the facts and allegations set forth in paragraphs 1 through 216 above.

222. The conduct of Respondent, as described above, constitutes a violation of MASS. GEN. LAWS ch. 110A, § 101(3).

C. <u>Count 3: Violation of Section 102(2)</u>

223. Section 102(2) of the Act provides, in pertinent part:

> It is unlawful for any person who receives, directly or indirectly, any consideration from another person primarily for advising the other person as to the value of securities or their purchase or sale, whether through the issuance of analyses or reports or otherwise . . . (2) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon the other person.

MASS. GEN. LAWS ch. 110A, § 102(2).

224. The Division herein restates and re-alleges the facts and allegations set forth in paragraphs 1 through 216 above.

225. The conduct of Respondent, as described above, constitutes a violation of MASS. GEN. LAWS ch. 110A, § 102(2).

D. <u>Count 4: Violation of Section 204(a)(2)(G)</u>

226. Section 204 of the Act provides, in pertinent part:

> (a) The secretary may by order impose an administrative fine or censure or deny, suspend, or revoke any registration or take any other appropriate action if he finds (1) that the order is in the public interest and (2) that the applicant or registrant or, in the case of a broker-dealer or investment adviser, any partner, officer, or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser:— (G) has engaged in any unethical or dishonest conduct or practices in the securities, commodities or insurance business. . . .

MASS. GEN. LAWS ch. 110A, § 204(a)(2)(G).

227. The Regulations at 950 MASS. CODE REGS. 12.205(9)(c) provide:

> The following practices are a non-exhaustive list of practices by an adviser which shall be deemed "dishonest or unethical conduct or

> practices in the securities business" for purposes of M.G.L. c, 110, § 204(a)(2)(G):
>
> 8. Misrepresenting to any advisory client, or prospective advisory client, the qualifications of the adviser, its representatives or any employees, or misrepresenting the nature of the advisory services being offered or fees to be charged for such services, or omitting to state a material fact necessary to make the statements made regarding qualifications, services or fees, in light of the circumstances under which they are made, not misleading.

228. The Division herein restates and re-alleges the facts and allegations set forth in paragraphs 1 through 216 above.

229. The conduct of Respondent, as described above, constitutes a violation of MASS. GEN. LAWS ch. 110A, § 204(a)(2)(G).

X. STATUTORY BASIS FOR SECURITIES DIVISION'S ACTION

Section 407A of the Act, entitled Violations; Cease and Desist Orders; Costs, provides in pertinent part:

> (a) If the secretary determines, after notice and opportunity for hearing, that any person has engaged in or is about to engage in any act or practice constituting a violation of any provision of this chapter or any rule or order issued thereunder, he may order such person to cease and desist from such unlawful act or practice and may take such affirmative action, including the imposition of an administrative fine, the issuance of an order for an accounting, disgorgement or rescission or any other such relief as in his judgment may be necessary to carry out the purposes of [the Act].

MASS. GEN. LAWS ch. 110A, § 407A(a).

XI. PUBLIC INTEREST

For any and all of the reasons set forth above, it is in the public interest and will protect Massachusetts investors to enter an Order: (1) requiring Respondent to permanently cease and desist from further conduct in violation of the Act and its related

Regulations of the Commonwealth; (2) requiring Respondent to disgorge all fees obtained as a result of its conduct, acts or courses of business as described in this Complaint, and to pay prejudgment interest thereon; (3) requiring Respondent to pay a civil administrative fine in such amount and upon such terms and conditions as the Director or Hearing Officer may determine; and (4) Director or Hearing Officer to take such further action against Respondent as may be deemed just and appropriate for the protection of investors.

XII. RELIEF REQUESTED

WHEREFORE, the Enforcement Section of the Division requests that the Director or Hearing Officer take the following actions:

A. Find as fact all the allegations set forth in paragraphs 1 through 216, inclusive of the Complaint;

B. Find that all sanctions and remedies detailed herein are in the public interest and necessary for the protection of Massachusetts investors;

C. Enter a permanent Order against Respondent ordering it to cease and desist from further violations of the Act and its related Regulations;

D. Order Respondent to disgorge all fees obtained as a result of its conduct, acts or courses of business as described in this Complaint;

E. Impose a civil administrative fine on Respondent in such amount and upon such terms and conditions as the Director or Hearing Officer may determine; and

F. Take such further action against Respondent as may be deemed just and appropriate for the protection of Massachusetts investors.

MASSACHUSETTS SECURITIES DIVISION
ENFORCEMENT SECTION
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Dated: October 17, 2012