UNITED STATES DISTRICT COURT

MIDDLE DISTRICT OF NORTH CAROLINA

WINSTON-SALEM DIVISION

No. 1:09-cv-00071

JAMES L. PHILLIPS, Individually and on Behalf of All Others Similarly Situated,	)	CLASS ACTION
Plaintiff,	)	
vs.	)	
TRIAD GUARANTY INC., et al.,	)	
Defendants.	)	

SECOND AMENDED CLASS ACTION COMPLAINT

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Lead Plaintiff Western Pennsylvania Electrical Employees Pension Fund ("Lead Plaintiff"), individually and on behalf of a proposed class (the "Class") of all purchasers of the publicly traded securities of Triad Guaranty, Incorporated ("Triad" or the "Company") (NASDAQ: TGIC) between October 26, 2006 and April 1, 2008 (the "Class Period"), by and through its undersigned counsel, alleges the following against Triad, Mark K. Tonnesen ("Tonnesen"), and Kenneth W. Jones ("Jones") (collectively, "Defendants"), seeking remedies under the Securities Exchange Act of 1934 (the "Exchange Act"). The claims asserted herein arise under and pursuant to Sections 10(b) and 20(a) of the Exchange Act, 15 U.S.C. §§78j(b) and 78t(a), and Rule 10b-5 promulgated thereunder, 17 C.F.R. §240.10b-5, and are made upon personal knowledge as to those allegations concerning Lead Plaintiff and, as to all other matters, upon the investigation of counsel, which included, without limitation: (a) review and analysis of public filings made by Triad with the Securities and Exchange Commission ("SEC"); (b) review and analysis of press releases and other publications disseminated by certain of the Defendants; (c) review of news articles and shareholder communications; (d) review of other publicly available information concerning Triad and the other Defendants; and (e) interviews with factual sources, including individuals formerly employed by Triad.

I. SUMMARY OF THE ACTION

1. This is a federal securities class action on behalf of all purchasers of the publicly traded securities of Triad during the Class Period, against Triad and certain of its officers and directors for violations of the Exchange Act.

2. Triad, headquartered in Winston-Salem, North Carolina, provided private mortgage insurance coverage throughout the United States to residential mortgage lenders and investors as a credit-enhancement vehicle.

3. During the Class Period, Defendants issued materially false and misleading statements regarding the Company's business and financial results. Specifically, Triad under-priced certain of its insurance products known as Modified Pool insurance by knowingly or recklessly under-appreciating the risk involved in the transactions. Triad did so by manipulating its pricing models for Modified Pool insurance, which allowed the Company to under-bid its competitors, increase market share, and artificially boost revenues. Yet, at the same time, Defendants repeatedly assured Triad investors that the Company's underwriting standards were sound and appropriate, that its risk levels were among the best in the industry, that it reserved properly for losses, and that it was properly capitalized for the risk it incurred. Moreover, Defendants continuously told investors, despite increasing loss reserves and deteriorating market conditions, that the Company was on solid footing with positive long-term prospects. As a result of Defendants' false statements, Triad stock traded at artificially inflated prices during the Class Period.

4. In reality, because it was manipulating its pricing models so it could under-price Modified Pool insurance, the premiums charged were not commensurate with the associated risk. As a result, Triad was placing itself in a dangerous position should the mortgage market decline. To be sure, state insurance regulations governing Triad required that the Company place greater than 50% of its earned premiums in a reserve fund so that it

could pay claims in the event of an economic downturn. However, because Triad was undercharging premiums, which had the positive short-term effects of increasing market share and overall revenues, the Company was substantially under-reserving for losses on its policies. In addition, and as explained herein, by under-appreciating risk Triad was understating its risk-to-capital ratio, an important metric used by investors to evaluate the financial soundness of a mortgage insurance company.

5. Defendants Tonnesen and Jones were part of the Company's Risk Management Committee that oversaw pricing and risk assessment on Triad's insurance policies. As a result, from 2006 onward, the Individual Defendants had access to and oversaw the pricing and risk evaluations on Modified Pool insurance policies. In addition, numerous Company employees raised concerns regarding the risk associated with Triad's manipulation of its pricing models and its inadequate reserves. Moreover, the Individual Defendants were specifically told in March 2007 that the Company was undervaluing risk and under-pricing premiums. In response, Triad hired an outside consulting firm that, in June 2007, confirmed the Company was manipulating its pricing models to artificially undercut the competition on price. Despite this knowledge, Defendants repeatedly assured the market that its risk levels were among the best in the industry, and that it was properly capitalized. In addition, Defendants never informed the market that it was manipulating its own pricing models for short-term gain.

6. By August 2007, and as the mortgage and housing markets deteriorated, Defendants could no longer pretend to be adequately capitalized for the risk they undertook.

As a result, and in contrast to its public statements about its financial, liquidity, and capital positions, on August 27, 2007, Triad reported on Form 8-K with the SEC that it had drawn the entire $80 million principal amount of an unsecured revolving credit facility which it entered into just two months earlier. The market's reaction was sharply negative. After closing at a price of $25 per share on August 27, 2007, the stock slid $6 per share, or 24%, in one day to close at $19 per share on August 28, 2007 on trading volume over six times the previous day's volume. As the market absorbed the Company's announcement and analyst concerns, the stock slid another $2.80 per share to close at $16.20 per share on August 29, 2007. In just two days, the price of Triad securities plummeted by 35%.

7. Then, on August 31, 2007, Defendants sought to reassure the market about the Company's future prospects and liquidity. In a press release, Defendants falsely told the market that the drawing down of the entire $80 million credit facility was "not in response to any liquidity issues" and that the Company had a "very liquid portfolio." Moreover, Defendant Tonnesen told investors that Triad had "solid balance sheet fundamentals" and that the Company enjoyed "strong credit quality" in its insured portfolio.

8. Defendants' false and misleading reassurances had the desired effect of artificially propping up the price of Triad stock. On September 4, 2007, the next trading day after the August 31, 2007 announcement, Triad shares closed at $17.56 per share, up 11.1% from a close of $15.80 per share on August 30, 3007.

9. Through the end of 2007 and early 2008, the housing and mortgage markets continued to deteriorate. While Defendants continued to make false and misleading

statements about Triad's capital position and financial future, eventually Defendants could not hide the severe problems caused by their manipulation of pricing models that resulted in the under-pricing of insurance premiums and under-appreciation of risk.

10. Finally, and in contrast to the Company's glowing statements about the risk levels associated with the insurance it had written, long-term prospects, and capital position, on April 1, 2008, Triad filed its annual report for fiscal year 2007 on Form 10-K with the SEC. The 2007 10-K disclosed, for the first time, the dire financial condition facing the Company. To that end, the Company announced that it had been unsuccessful in obtaining any new capital commitments and that it was facing a run-off, which would mean the Company could no longer write any new policies.

11. Upon these revelations and analyst commentary, the market punished Triad stock. Shares of Triad, which closed at $5.25 per share prior to the filing of the 2007 10-K on April 1, 2008, plummeted to $2.15 per share on April 4, 2008 as the market absorbed the news, a staggering loss of 59% on extremely high trading volume.

II. JURISDICTION AND VENUE

12. The claims asserted herein arise under and pursuant to Sections 10(b) and 20(a) of the Exchange Act, 15 U.S.C. §§78j(b) and 78t(a), and Rule 10b-5 promulgated thereunder by the SEC, 17 C.F.R. §240.10b-5. This Court has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. §1331, and Section 27 of the Exchange Act, 15 U.S.C. §78aa.

13. Venue is proper in this district pursuant to Section 27 of the Exchange Act (15 U.S.C. §78aa) and 28 U.S.C. §1391(b). Many of the acts charged herein, including the

preparation and dissemination of materially false and misleading information, occurred in substantial part in this District. Additionally, the Company maintains its principal executive office in this District.

14. In connection with the acts, conducts and other wrongs alleged in this complaint, Defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including, but not limited to, the United States mail, interstate telephone communications and the facilities of a national securities market.

III. THE PARTIES

A. Plaintiff

15. Western Pennsylvania Electrical Employees Pension Fund was appointed by the Court on April 16, 2009 to serve as Lead Plaintiff in this securities fraud action. Lead Plaintiff purchased Triad stock during the Class Period and was damaged thereby.

B. Defendants

16. Triad is a holding company which, through its wholly-owned subsidiary, Triad Guaranty Insurance Corporation, provides private mortgage insurance coverage in the United States to residential mortgage lenders and investors as a credit-enhancement vehicle. Triad and its subsidiaries, including Triad Guaranty Insurance Corporation, are collectively referred to herein as "Triad" or the "Company." Specifically, mortgage insurance is issued in home purchase and refinance transactions involving conventional residential first mortgage loans to borrowers with equity of less than 20%. If the homeowner defaults on the mortgage, mortgage insurance reduces, and in some instances eliminates, any loss to the

insured lender. Mortgage insurance also facilitates the sale of low down payment mortgage loans in the secondary mortgage market, with the largest percentage to the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"). Investors and lenders also purchase mortgage insurance to obtain additional default protection or capital relief on loans with equity of greater than 20%. Under risk-based capital regulations applicable to most financial institutions, mortgage insurance reduces the capital requirement for such lenders on residential mortgage loans retained in the lender's portfolio. During the Class Period, Triad was licensed to do business in all fifty U.S. states and the District of Columbia. Triad is a Delaware corporation with its principal place of business at 101 South Stratford Road, Winston-Salem, North Carolina.

17. Defendant Tonnesen was, at relevant times, President and Chief Executive Officer ("CEO") of the Company. He retired from his executive positions in August 2008.

18. Defendant Jones was, at all relevant times, Senior Vice President and Chief Financial Officer ("CFO") of Triad. In October 2008, he assumed the role of President and CEO of the Company.

19. Defendants Tonnesen and Jones are collectively referred to herein as the "Individual Defendants."

20. During the Class Period, the Individual Defendants, as senior executive officers and/or directors of Triad, were privy to confidential and proprietary information concerning Triad, its operations, finances, financial condition and present and future business prospects, including information about underwriting standards, pricing models, the

Company's capital position, and reserves. The Individual Defendants also had access to material adverse non-public information concerning Triad, as discussed in detail below. Because of their positions with Triad, the Individual Defendants had access to non-public information about Triad's business, finances, products, markets and present and future business prospects via access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management and/or board of directors meetings and committees thereof and via reports and other information provided to them in connection therewith. Because of their possession of such information, the Individual Defendants knew or recklessly disregarded that the adverse facts specified herein had not been disclosed to, and were being concealed from, the investing public.

21. The Individual Defendants are liable as direct participants in the wrongs complained of herein. In addition, the Individual Defendants, by reason of their status as senior executive officers and/or directors, were "controlling persons" within the meaning of §20(a) of the Exchange Act and had the power and influence to cause the Company to engage in the unlawful conduct complained of herein. Because of their positions of control, the Individual Defendants were able to and did, directly or indirectly, control the conduct of Triad's business.

22. The Individual Defendants, because of their positions with the Company, controlled and/or possessed the authority to control the contents of its reports, press releases and presentations to securities analysts and through them, to the investing public. The Individual Defendants were provided with copies of the Company's reports and press

releases alleged herein to be misleading, prior to or shortly after their issuance and had the ability and opportunity to prevent their issuance or cause them to be corrected. Thus, the Individual Defendants had the opportunity to commit the fraudulent acts alleged herein.

23. As senior executive officers and/or directors and as controlling persons of a publicly traded company whose common stock was, and is, registered with the SEC pursuant to the Exchange Act, and was, and is, traded on NASDAQ and governed by the federal securities laws, the Individual Defendants had a duty to disseminate promptly accurate and truthful information with respect to Triad's financial condition and performance, growth, operations, financial statements, business, products, markets, management, earnings and present and future business prospects, to correct any previously issued statements that had become materially misleading or untrue, so that the market price of Triad's securities would be based upon truthful and accurate information. The Individual Defendants' misrepresentations and omissions during the Class Period violated these specific requirements and obligations.

24. The Individual Defendants are liable as participants in a fraudulent scheme and course of conduct that operated as a fraud or deceit on purchasers of Triad's publicly traded securities by disseminating materially false and misleading statements and/or concealing material adverse facts. The scheme: (i) deceived the investing public regarding Triad's business, operations and management and the intrinsic value of Triad's securities; and (ii) caused Lead Plaintiff and members of the Class to purchase Triad's publicly-traded securities at artificially-inflated prices.

IV. SUBSTANTIVE ALLEGATIONS[1]

A. Background of the Company

25. Triad was formed in 1987 as a wholly-owned subsidiary of Primerica Corporation and began writing private mortgage insurance in 1988. Triad provides private mortgage insurance coverage in the United States to residential mortgage lenders and investors as a credit-enhancement vehicle. *See* Form 10-K filed with the SEC on March 16, 2007, for the period ending December 31, 2006. According to the Company, mortgage insurance is issued in many home purchase and refinance transactions involving conventional residential first mortgage loans to borrowers with equity of less than 20%. *Id.* Mortgage insurance reduces, and in some instances eliminates, any loss to the insured lender if the homeowner defaults on the mortgage. *Id.* In addition, mortgage insurance facilitates the sale of low down payment mortgage loans in the secondary mortgage market. *Id.*

26. Triad marketed its insurance products through a dedicated sales force of approximately 45 professionals, including sales management, and an exclusive commissioned general agency serving a specific geographic market. This group reported directly to Defendant Tonnesen – the Company's CEO. During the Class Period, Triad sold mortgage insurance through two distribution channels: flow and structured bulk.

27. The first, called the flow channel, consisted of "primary insurance," or loans originated by lenders and submitted to the Company on a loan-by-loan basis. Primary

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[1] All witnesses are referred to in the masculine to protect their identities.

insurance provides mortgage default protection to lenders ***on individual loans*** and covers a percentage of unpaid loan principal, delinquent interest, and certain expenses associated with the default and subsequent foreclosure.

28. Triad's second distribution channel was known as the structured bulk channel. Structured bulk transactions, such as so-called Modified Pool insurance, involve underwriting and insuring a ***group of loans*** with individual coverage for each loan. Structured bulk transactions are typically initiated by underwriters of mortgage-backed securities, mortgage lenders, and mortgage investors such as Fannie Mae and Freddie Mac, who seek additional default protection (typically secondary coverage or on loans for which the individual borrower has greater than 20% equity), capital relief, and credit enhancement on groups of loans that are sold in the secondary market.

B. Triad Was Motivated to Increase Market Share Through the Growth of Its Bulk Business

29. In 2003, Modified Pool insurance policies accounted for only 15% of the total insurance written by Triad. The Company at that time held only 4.4% of the market share in the structured bulk channel. As the former Assistant Vice President and Regional Underwriting Manager[2] explained, Triad "was a small fish trying to play in the big pond."[3]

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[2] The former Assistant Vice President and Regional Underwriting Manager in Triad's Horsham, PA office was employed with the Company from 2003 through 2008. In this capacity, he oversaw three underwriters and provided underwriting in the Company's "flow" channel.

As a result, the Company "wanted to jump in and grow the business through the bulk business." Indeed, according to a former Triad Consultant,[4] the mortgage industry was clearly moving toward bulk deals. In order to survive, there was a clear incentive to win bids on pool insurance. To this end, the former Assistant Vice President of Data Warehousing[5] explained that the Company's executive management made the decision to leap into the realm of structured pool insurance. To facilitate this goal, Ken Foster ("Foster") was hired by Triad for his expertise in this area. He was brought in to grow that segment of the Company's business and was eventually named Executive Vice President, Structured Transactions and Business Development. According to the former Vice President of Risk Analytics,[6] Foster was in charge of pricing for bulk or pool transactions.

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3 During the Class Period, the private mortgage insurance industry consisted of seven major mortgage insurance companies: Triad, Mortgage Guaranty Insurance Corporation, Radian Guaranty Inc., PMI Mortgage Insurance Co., United Guaranty Corporation, Genworth Financial, Inc., and Republic Mortgage Insurance Company.

4 The former Triad Consultant worked for Triad on and off from 1997 through 2007. In this capacity, he was responsible for developing the Company's Bid Management Software, which the Company used to bid on Modified Pool insurance.

5 The former Assistant Vice President of Data Warehousing worked at Triad in a variety of positions from 1998 until 2008, with the witness's last position being Assistant Vice President of Data Warehousing. In that role, he was responsible for providing data for financial and risk management reporting. Initially, the former Assistant Vice President of Data Warehousing provided this data directly to Foster. Later, he provided this information to Senior Vice President of Risk Management Steve Haferman ("Haferman").

6 The former Vice President of Risk Analytics worked for Triad from November 2006 until August 2007. At the beginning of this former employee's tenure at the Company, the witness reported to Foster. Then, in early 2007, the former Vice President of Risk Analytics began reporting to Haferman.

30. As more fully detailed below, in order to grow Triad's structured bulk business and thereby increase overall revenues, Triad had an incentive to offer its Modified Pool insurance at lower prices than its competitors. Indeed, according to the former Vice President of Risk Analytics, with respect to the Modified Pool insurance market, "the lowest price wins on this sort of business." As a result, "it makes sense if you are trying to grow your business that you have a reason to undercut on price." To achieve the low prices he needed to undercut the competition, Foster freely manipulated the Company's pricing models.

31. Ultimately, Triad was successful in increasing the Company's revenues and market share from 4.9% market share in 2003 to a 9.1% share in 2006. In particular, the Company's market share in its structured bulk channel more than tripled from 4.4% to 14.5% between 2003 and 2006. While the Company achieved short-term benefits through these practices, Triad had significantly undervalued the risk associated with the mortgages it insured, which would cause disastrous long-term results for the Company.

C. Triad Manipulated its Pricing Models to Undercut Competitors

1. The Company Utilized Proprietary Computer Modeling to Bid on Modified Pool Insurance

32. Triad sold its Modified Pool insurance via a bid process. As the former Triad Consultant explained, mortgage originators would provide Triad and other mortgage insurance companies with a "forward bid," which was essentially a pool of fabricated loans that were representative of the actual pool of mortgages to be insured. Triad and its

competitors would analyze the "forward bid" and submit a price for insurance to the mortgage originators.

33. Triad utilized two different sophisticated computer programs during the bid process. The first was its Loan Performance software, which analyzed the risk inherent in the pool of loans using a Monte Carlo simulator.[7] Once this risk was determined, the Company's proprietary Bid Management Software set the price for insuring the loans.

34. Any given "forward bid" arrived on an excel spreadsheet, and the Company would input the data from the spreadsheet into its Loan Performance software. According to the former Triad Consultant, this software would analyze the pool of fabricated loans to "project the probable loss" on that pool based on historical performance of loans. In other words, the Loan Performance model was used to predict the "probability of default and the severity index" for the pool of loans in question. The former Vice President of Risk Analytics confirmed that the Loan Performance software used a Monte Carlo simulator that would value the loans in the pool and make predictions about the loans' performance such as expected prepayments[8] and defaults. Using this simulator, the Loan Performance model

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[7] A Monte Carlo simulation is a commonly used problem-solving technique that approximates the probability of certain outcomes by running multiple trial runs using random variables. As explained below, here, Triad used a Monte Carlo simulation to approximate probable losses on loan pools.

[8] A "prepayment" occurs when the insured mortgage is paid off ahead of schedule, typically due to the homeowner selling or refinancing the property before the expiration of the mortgage. As the majority of Triad's premiums for Modified Pool insurance were

provided predictions for "the losses and premiums" Triad could expect from the mortgages in the pool.

35. Bid prices for insuring the loan pools were then determined using another piece of software: the Bid Management System ("BMS"). BMS was an oracle-based system built specifically for Triad by the former Triad Consultant. It "captured" the probability of loss results from the Monte Carlo simulator and determined the price at which Triad could insure the pool. The former Vice President of Risk Analytics further explained that the BMS model essentially predicted a return on capital ("ROC") for Triad for each pool of mortgages. It did so by aggregating the losses projected by the Monte Carlo simulator and then calculating and generating an expected income statement over time for the Company.

2. Manipulations to the Models Allowed Triad to Achieve Lower Bid Prices at the Expense of Increased Risk

36. However, as described more fully below, Triad's pricing models were easily subject to manipulation. The former Vice President of Risk Analytics recalled generally that the internal controls related to model adjustments "were reckless." Indeed, according to the former Vice President of Risk Analytics, unlike for primary insurance, the Company was not required to file pricing information with any state regulator for mortgage insurance on a pool of loans, which enabled the Company to make adjustments to the pricing model for the bulk business channel. Foster took advantage of this by playing with adjustments to the

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remitted monthly, any prepayments of mortgages had the effect of cutting short Triad's expected income stream.

Company's pricing models in a manner that allowed the Company to offer lower prices while making deals look more lucrative.

37. For example, with the switch of a few "dials" adjusting various assumptions, the models could be tweaked with a certain price point in mind. Thus, the proverbial tail would be wagging the dog. The former Vice President of Risk Analytics explained how Foster "changed the dials for delinquencies and pay-offs" to get where he wanted to be. To this end, the models' dials would be set so that the Company appeared to get a 12% return on capital on its Modified Pool insurance, regardless of the actual risk associated with the pools.

38. Moreover, according to the former Vice President of Risk Analytics, Foster had set the Value-at-Risk for most deals at 99.8%. Foster would "just over-ride the results out of the model." The former Vice President of Risk Analytics explained that setting the Value-at-Risk for most deals at 99.8% resulted in the Company "being severely under capitalized." Indeed, the Company only held capital at two times the mean, which was not correct. The Company should have used the difference between the mean and the 99.8%, or the tail of the transaction. In other words, by the manner in which the pricing of the Modified Pool was set, the Company was able to gain a large share of the Modified Pool insurance. However, once the risk was actually realized, the Company was under-capitalized.

a. Triad's Pricing Models Did Not Account for Inflation and Other Market Conditions

39. Further problematic for the Company was the failure of its financial cash flow model to account for discounting, which violated a basic rule of finance. That is, on

mortgage insurance, the insurance provider (*i.e.*, Triad) receives premiums the entire time the insurance is in force. However, the dollar a company receives in year one of the policy is worth more than the dollar received in year seven, due to inflation. The Company's pricing and risk models did not take into account the time value of money.

40. The former Vice President of Risk Analytics also recalled that the underlying simulation to Triad's pricing model did not have enough variability with regard to home pricing in changing market conditions. Foster would set the home pricing assumed in the Monte Carlo simulator on a "zero path," "meaning that the simulator did not take any home price increase or decrease into account."

41. Moreover, according to the former Vice President of Risk Analytics, the Company's model had been set to show interest rates increasing at a time when rates were actually going down. The impact of having rates increasing in the model was to have the loans on the books for a longer period of time because people would not refinance their homes in a time of rising interest rates.

b. Prepayment Assumptions Were Manipulated

42. As one example of Foster's manipulation of Triad's pricing models, the former Vice President of Risk Analytics stated that Triad "always changed prepayment assumptions." Indeed, during the course of the witness's employment with Triad, Foster decided to change the prepayment assumption in the pricing model so that the collateral pays slower. The former Vice President of Risk Analytics explained that "if you adjust the collateral pre-paying slower, for example from two years to four years, you increase the

income from the transaction." This was because the majority of premiums for Triad's Modified Pool insurance were remitted monthly. While Foster made this change to the prepayment assumption, he refused to make the requisite change to the default assumption. As the former Vice President of Risk Analytics explained, "regardless of the economic conditions, there has to be a corollary increase in default assumptions if you change the pre-payment assumption." The former Vice President of Risk Analytics explained that "you can't say the loans will be on the books for two more years and assume there will not be any more defaults." That is, the Company's pricing model assumed customers would pay insurance premiums for a longer period of time, but that those customers would not default on their mortgages with any more frequency. Because the default assumptions were not increased commensurate with the increased prepayment assumption, the Company was able to underestimate the risk associated with its Modified Pool portfolio for the purpose of offering bulk insurance at a lower price.

43. The former Vice President of Risk Analytics further explained that, by changing prepayment assumptions to extend the payment period, the Company was presuming a longer income stream for a particular deal, which resulted in artificially lower pricing of premiums. However, Triad's extension of the payment period during times of decreasing interest rates was ***not proper*** because refinancing becomes more common when interest rates are falling. Since refinancing results in prepayment of the mortgage, Triad's income stream is cut short for those mortgages that are prepaid.

c. Risky Alt-A Loans Were Priced as if They Were Prime

44. The former Vice President of Risk Analytics provided another example of the lengths Triad went to gain market share in the Modified Pool insurance channel. Triad did considerable business with a subsidiary of Lehman Brothers called Aurora Loan Services ("Aurora"). Aurora specialized in interest-only and no-documentation mortgages that are riskier for lenders than prime loans. One step up from subprime, these "Alt-A" loans were a big part of Lehman's mortgage portfolio and accounted for a large portion of the brokerage firm's losses. Alt-A loans, also called alternative documentation loans, are loans that hold borrowers with good credit to different approval standards than traditional loans. Those applying for an Alt-A loan need not provide income verification or documentation of assets. Instead, the approval for an Alt-A loan is based primarily on an individual's credit score. Alt-A loans are typically subject to manual underwriting, and the interest rates are typically higher than traditionally documented loans. This amount is usually less than one percentage point higher than a conventionally documented, or "prime," loan. Aurora was the nation's largest servicer of Alt-A loans and was once the top originator of these mortgages.

45. Despite the fact that Aurora wrote "mostly Alt-A stuff," Triad "priced the stuff as non-Alt-A for all of the pools of loans." That is, Triad "priced it as if the loans were prime." By pricing the loans as prime, as opposed to Alt-A, Triad "ensure[d] they get the revenue" from the Aurora Modified Pool business because the Company was able to under-price its competitors by purposefully undervaluing the risk involved in the loans. Indeed, the former Vice President of Risk Analytics personally "ran the models" using the Aurora

mortgage historical default rates against the default rates actually employed by Triad to price the pools. The result of the comparison the former Vice President of Risk Analytics ran "showed the impact of doing it one way versus the other." The models the former Vice President of Risk Analytics ran "showed that the Lehman Aurora defaults were higher" than Triad had priced for, meaning the Company had undervalued the risk attendant to Aurora pools.

3. Manipulations Earned Triad Steady Business with Fannie Mae

46. Perhaps the most significant example of Triad's manipulation of its pricing models occurred in its business with Fannie Mae. Insurance on loan pools was often structured such that the insurer (*i.e.*, Triad) would pay 20% of every loss, up to a certain percentage of the entire pool (typically 1%). But for deals with Fannie Mae, there was a deductible cap of 0.8% or 1%, meaning Fannie Mae would actually maintain responsibility for the first 0.8%-1% of losses on the pool. Fannie Mae also absorbed any losses above 3%, so it only sought insurance from Triad for potential losses above 0.8% or 1% but below 3% of the entire pool. Fannie Mae was accordingly a favored customer at Triad in light of the built-in deductible. The former Vice President of Risk Analytics estimated that Fannie Mae accounted for roughly ***80%*** of Triad's Modified Pool insurance business.

47. Since Fannie Mae would absorb all losses up to the first 0.8% or 1%, and anything above 3%, Triad took unreasonable comfort in writing policies for Fannie Mae. According to the former Vice President of Risk Analytics, Defendants simply assumed that losses would be low and "we won't have to pay anything" in light of Fannie Mae's

assumption of the 0.8%-1% deductible cap. The Company changed the "dial settings" on its pricing models to assume that losses would never exceed the 0.8%-1% deductible, meaning Triad would never be responsible for any losses in the pool. Triad even provided Fannie Mae a "huge discount due to the deductible." But this discount was simply unjustifiable because it was premised on an assumption that made no business sense. As the former Vice President of Risk Analytics explained, "it was like they thought there would never be any losses. But why would Fannie pay for the insurance and not get anything?"

4. The Company Lacked Internal Controls Over its Pricing Models

48. In sum, the various manipulations of Triad's pricing models demonstrate that the Company had no internal controls over its pricing models. Indeed, when the former Vice President of Risk Analytics joined Triad in November 2006, he spent the majority of his time simply "trying to understand how the models worked." He noted that Triad's financial modeling was "not very well documented." That is, the Company – and Foster in particular – would make adjustments to the Company's pricing model "with no justification or no documentation." Indeed, the former Vice President of Risk Analytics stated that "[s]ome of the adjustments just didn't even make sense. There would be transactions that were essentially the exact same, and they made an adjustment to the model for one of the transactions, but not the other." Moreover, the former insider explained that some of the adjustments Foster made to the model were deal-specific, but some of the adjustments were "for all deals going forward." To be sure, the former Vice President of Risk Analytics stated that Foster "always seemed to push the envelope on any deal." The former Senior Vice

President of Audit[9] referred to Foster as the Wizard of Oz for his ability to "make up numbers." Moreover, as the former Assistant Vice President of Data Warehousing explained, Foster "would manipulate the model to justify the numbers to what they expected." The former Assistant Vice President of Data Warehousing learned through conversations with co-workers that Foster "would not keep the parameters in the risk model Loan Performance consistent from month to month. If they wanted to change it, they did."

49. As a result of the lack of documentation regarding adjustments made to the model, the former Vice President of Risk Analytics had no idea why model adjustments had even been made. As the former Vice President of Risk Analytics explained, the Company "had no control on making adjustments" to the risk and pricing models. "If you adjust willy-nilly, then why even run the model." Moreover, the former Vice President of Risk Analytics explained that when Foster overrode the results of the Monte Carlo simulator, he was "not really getting the right stress environment." In fact, as a result of all the adjustments made by Foster, the Company "was not really even using the Monte Carlo simulator."

D. The Company Was Successful In Achieving Market Share but Was Left Undercapitalized with Significantly Heightened Risk

50. By manipulating the pricing models on Modified Pool and other structured bulk transactions, Triad was able to outbid its competitors and write more business. As

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[9] The former Senior Vice President of Audit was one of the original founders of Triad along with Darryl Thompson and Jack Williams. Throughout the witness's employment with the Company, he had risk management, audit, and underwriting responsibilities. While the former Senior Vice President of Audit left Triad in December 2004, as a Senior Vice President, he remained in contact with his former colleagues, as detailed herein.

demonstrated in the tables below,[10] the Company grew its Modified Pool business a whopping ***313%*** from 2003 through 2006, increasing its written Modified Pool insurance from $3 billion to over $12.6 billion. Over this same period, Triad's primary insurance written in the flow channel actually ***declined*** such that it accounted for less business than Modified Pool beginning in 2005.

($ in millions)	**2003**	**2004**	**2005**	**2006**
Primary Insurance Written	$17,428	$10,709	$10,488	$12,088
Modified Pool Insurance Written	$3,067	$6,463	$10,681	$12,672
Total Insurance Written	$20,495	$17,172	$21,169	$24,760

	% Change 2004 vs. 2003	**% Change 2005 vs. 2004**	**% Change 2006 vs. 2005**
Primary Insurance Written	(38.6)%	(2.1)%	15.3%
Modified Pool Insurance Written	110.7%	65.3%	18.6%

51. The above tables show a fundamental shift in Triad's revenue streams with Foster at the helm of the Company's Modified Pool business. And with good reason, because, according to the former Vice President of Risk Analysis and Forecasting,[11] writing Modified Pool insurance was "100% profit" for Triad prior to 2007. "They were making

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[10] Data for insurance written, revenues, and market share in the tables herein comes from the Company's Forms 10-K filed with the SEC.

[11] The former Vice President of Risk Analysis and Forecasting was employed with the Company from November 2006 through December 2007.

money hand over fist." The Company's revenues grew steadily as a result, nearly doubling in just four years:

	2003	**2004**	**2005**	**2006**
Total Revenues	$139,867,000	$161,266,000	$192,046,000	$239,144,000

52. Moreover, during this same period, Triad significantly increased its market share in the structured bulk channel, which was largely comprised of Modified Pool insurance. As demonstrated below, the Company more than tripled its market share in the structured bulk channel from 2003 to 2006, with its total market share also nearly doubling during the same period.

	2003	**2004**	**2005**	**2006**
Structured Bulk Channel	4.4%	11.3%	11.5%	14.5%
Total	4.9%	6.0%	7.5%	9.1%

53. Although Triad had successfully gained revenues and market share at the expense of its competitors through the manipulation of its pricing models, unbeknownst to the market, the Company was left severely undercapitalized for the mounting risk it had created. Indeed, in lowering its pricing, the Company failed to collect premiums sufficient to cover the significant risk that resulted from the improper manipulation of the pricing models. Ultimately, this came to a head when the economy declined, and they were forced to pay out all of their capital to cover mounting claims.

1. Defendants Underreported Their Risk-to-Capital Ratios

54. As Triad is an Illinois-domiciled insurance company, the Illinois insurance laws regulate, among other things, certain transactions in the Company's common stock and

certain of Triad's business transactions. In particular, Triad is required by Illinois insurance laws to provide for a contingency reserve in an amount equal to ***at least 50%*** of earned premiums in its statutory financial statements. The contingency reserve, designed to provide a cushion against the effect of adverse economic cycles, has the effect of reducing statutory surplus and restricting dividends and other distributions by Triad. Such reserves must be maintained for a period of 10 years except in circumstances where prescribed levels of losses exceed regulatory thresholds. By undercutting pricing such that the premiums charged did not reflect the actual risk in a given pool of mortgages, Triad caused the Company to have insufficient contingency reserves.

55. In addition to requiring Triad to provide for a contingency reserve in an amount equal to at least 50% of earned premiums, a number of states generally limit the amount of insurance risk that may be written by a private mortgage insurer to 25 times the insurer's total policyholders' surplus. This restriction is commonly known as the risk-to-capital requirement. The risk-to-capital ratio is calculated using net risk in force as the numerator and statutory capital as the denominator.

56. Not only did setting pricing artificially low have the effect of creating insufficient contingency reserves, but it also caused the Company to materially misstate its risk-to-capital ratio. That is, the Company underestimated the risk of its portfolio, thus artificially reducing the numerator of the risk-to-capital ratio. At the same time, the Company's capital position was not commensurate with the risk undertaken. The end result was that Triad was far less well-positioned, and undertook significantly more risk, than it

disclosed to the investing public. Indeed, although Triad's risk-to-capital ratio was 12.5-to-1 at December 31, 2006, by the end of the Class Period, the ratio ballooned to 20.5-to-1 and, shortly following the end of the Class Period, reached 42.7-to-1. As set forth in more detail below, even though Triad's risk-to-capital ratio rose dramatically throughout the Class Period, it remained understated as the Company was undercapitalized for the risk it took on.

2. The Company's Loss Reserves Were Inadequate

57. At the same time Triad's portfolio became significantly more risky due to Foster's manipulation of the pricing models, the Company also reduced its loss reserves. According to former Senior Vice President of Audit, in 2003, at Foster's direction, the Company changed the way it reserved for claims on insurance it provided such that it would reserve substantially less for each claim. The former Senior Vice President of Audit explained that the impact of the change in reserving methodology was evident based on the witness's review of internal Company reports entitled "Monthly Claim Payments and Pipeline Detail Reports." The former Senior Vice President of Audit stated that the impact of the change on reserves was to allow the Company to "smooth earnings" and "manipulate earnings" on a quarter-by-quarter basis. As the witness explained, Triad's "master insurance policy" generally required the Company to pay a claim 60 days after the lender "takes title back." Triad had a practice of delaying the pay-out period in order to delay making the payments. To explain the long-term impact of the inadequate reserves, the former Senior Vice President of Audit used an analogy to a speed boat. A boat can make big waves by its wake, and it is not a problem for the boat until the boat slows down or stops. At that point,

the waves catch up. The former Senior Vice President of Audit explained that Triad was able to cover up its inadequate reserves through growth. "As long as they kept growing, the inadequate reserves were never going to be an issue," the witness stated.

58. In addition to under-reserving for each claim, the former Senior Vice President of Audit also recalled that the Company manipulated its reported reserves by delaying running lender tapes at quarter ends. The lender tapes provided status updates on the loans insured by Triad. "After a given date, the Company did not run the delinquency tapes" in order to avoid having to report reserves for delinquencies, and instead would push them to the following quarter. This was corroborated by the former Vice President of Risk Analytics, who explained that the Company had been "pushing the payment of claims out to the future, which made the short term benefits to the transaction look better." Indeed, the former Vice President of Risk Analytics explained that Dominion Bond Rating Service ("DBRS") set out the timing of the payment of claims, known as the DBRS timing curve, and that the Company had been overriding the timing of the DBRS model.

E. The Individual Defendants Knew Triad Was Under-Pricing Risk

1. The Individual Defendants Were Members of the Company's Risk Management and Weekly Operations Committees

59. According to former Company employees, Triad had a Risk Management Committee comprised of senior executives, including Defendants Tonnesen and Jones, Executive Vice President of Sales and Operations Ken Lard, Senior Vice Presidents Ron Kessinger and Steve Haferman, as well as Foster. The former Senior Vice

President/Director of Underwriting[12] explained that the Company's Risk Committee was responsible for setting the underwriting guidelines. In addition, according to the former Vice President of Product and Strategic Development,[13] the Risk Management Committee met "at least on a monthly basis" to review loss and claim rates. Moreover, the former Vice President of Product and Strategic Development explained that as members of the Risk Management Committee, Tonnesen and Jones were provided written reporting and verbal updates on loss rates by FICO score, region and mortgage originator and that they "were very well aware" of the Company's loss rates and claims. The Risk Management Committee was also tasked with overseeing pricing and risk modeling on Triad's structured bulk transactions.

60. In addition to the Risk Management Committee meetings, the former Vice President of Product and Strategic Development stated that Defendants Tonnesen and Jones participated in Weekly Operations Committee Meetings. These meetings were held on a weekly basis to provide a general operational overview of the entire company.

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[12] The former Senior Vice President/Director of Underwriting worked for Triad from 1993 until January 2007 and reported to Senior Vice President of Operations Shirley Gaddy who, in turn, reported directly to Defendant Tonnesen.

[13] The former Vice President of Product and Strategic Development worked for Triad from approximately August 2006 until August 2007. In this capacity, he reported directly to Foster.

2. Numerous Employees Raised Red Flags Regarding the Risk Associated with the Manipulations of the Pricing Models

61. Numerous Company employees recognized the mounting risks associated with the Company's manipulated pricing models and raised red flags. As the former Vice President of Risk Analytics stated with regard to the pricing of the Modified Pool insurance, "We were winning so many deals, it should have raised red flags."

62. But, despite the existence and purported oversight responsibilities of the Risk Management Committee, Triad continued undervaluing and under-pricing risk. The Company did so despite explicit warnings from top employees about its systemic undervaluing of risk. To be sure, according to the former Assistant Vice President of Data Warehousing, the structured or bulk transactions "seemed a lot riskier than what we normally did." The former Assistant Vice President of Data Warehousing recalled that for structured or bulk transactions, "Foster rated the deal based on the overall characteristics of the book as opposed to the individual loans." As the former Assistant Vice President of Data Warehousing described, the former Senior Vice President of Audit "was raising red flags over the process of assessing risk." Indeed, this confidential witness stated that even before Tonnesen came in, the former Senior Vice President of Audit was crying that: "There is too much risk."

63. Likewise, the former Senior Vice President of Audit raised serious concerns about Foster and the Company's inadequate reserves in an October 2004 meeting with Darryl Thompson, the Company's then-CEO, and General Counsel Earl Wall. Thereafter,

in an email dated January 3, 2005, the former Senior Vice President of Audit again raised his concerns about the reserves with a member of the Company's Board of Directors, David Whitehurst ("Whitehurst"). The former Senior Vice President of Audit also informed Whitehurst that the company was under-reporting loss ratios on some of its bulk transactions. Finally, the former Senior Vice President of Audit discussed the Company's inadequate reserves in a conference call in early 2006 attended by representatives from Company auditor Ernst & Young ("E&Y") and Whitehurst. As the former Senior Vice President of Audit explained, the E&Y auditor had serious concerns about the reserves issue, but that the E&Y managing partner on the audit and Whitehurst "were really badgering" the E&Y auditor to sign off on the year-end 2005 numbers.

64. Then, in December 2007, Triad's Chairman of the Board Will Ratliff ("Ratliff") called former Senior Vice President of Audit to confirm that the witness "was absolutely right" about the Company's inadequate reserves. According to former Senior Vice President of Audit, Ratliff was impressed enough with the former Senior Vice President of Audit's observations about the inadequate reserving that Ratliff retained him as a consultant for another business.

65. The serious concerns raised by Triad employees were unanswered. Yet, despite these clear and well-documented warnings, Defendants trumpeted Foster's so-called successes to the market. On January 25, 2007, during a conference call with analysts, Defendant Tonnesen stated: "Ken Foster, who was promoted during the year to Executive

Vice President, not only provides a foundation in terms of risk management, but is doing an excellent job in creating prudent growth for us in the modified pool business."

66. Additionally, by early 2007, the former Vice President of Risk Analytics personally began to raise significant concerns about the prices and bidding on bulk transactions, and undocumented adjustments to the pricing and risk models. Yet, despite these repeated warnings about the Company's under-pricing and inaccurate risk modeling from a variety of sources, Triad continued writing these insurance policies and telling the market that its business and risk portfolio were sound.

3. The Individual Defendants Are Specifically Informed that the Company Had Underpriced Its Risk

67. After raising these and other concerns about the Company's risk and pricing models in early 2007 to no avail, the former Vice President of Risk Analytics and former Vice President for Risk Analysis and Forecasting were "so frustrated" with adjustments made to the pricing/risk model "without documentation or justification," but which served to underestimate risk, that they felt compelled to prepare a formal evaluation of the Company's modeling. The results of this evaluation showed systematic undervaluing of risk, which resulted in pricing insurance policies below market value. The former Vice President of Risk Analytics and former Vice President for Risk Analysis and Forecasting presented their findings to the Company's Credit Committee on March 28, 2007. A copy of the written portion of the presentation is attached hereto as **Exhibit A**. Attendees at the meeting included Defendants Tonnesen and Jones, as well as Haferman and Foster.

68. As the former Vice President of Risk Analytics explained, the Company had "targeted" a 12-15% rate of return on the Modified Pool insurance. After this witness and the former Vice President for Risk Analysis and Forecasting reviewed the model, however, it was determined that "most of the deals were in the single digits." That is, the risk was significantly understated, resulting in the charging of lower-than-necessary premiums given the actual risk associated with the underlying loans.

69. To prepare the evaluation, the former Vice President of Risk Analytics and former Vice President for Risk Analysis and Forecasting "reviewed four quarters of deals," or 18 specific Modified Pool insurance deal evaluations. Haferman, Triad's Senior Vice President of Risk Management, picked two specific deals for the former Vice President of Risk Analytics and former Vice President for Risk Analysis and Forecasting to compare their methodology versus the model in-place. As a result of the "back-casting" performed on prior deals, the former Vice President of Risk Analytics determined that the model assumptions used to price the Modified Pool insurance were, in fact, wrong.

70. The former Vice President of Risk Analytics and former Vice President for Risk Analysis and Forecasting presented their findings regarding the various ***incorrect*** model assumptions that had been used by the Company to price the Modified Pool Insurance, as detailed above in Section IV.C. Their presentation explained that there was an ***immediate need*** for a process for evaluating deals and submitting bids on them. *See* Exhibit A at 12. This process should be bid-specific and include written explanations of: (1) choice of model settings and ROC by Risk Management; (2) capital by Finance; and (3) bid price by Products.

Id. Moreover, in the presentation, they recommended that there be disclosure and review of the sharing of responsibilities by Products, Risk Management, and Finance of all model overrides and that there be formal approval delegations and signoff. *Id.*

71. Moreover, the presentation made the following additional near term recommendations:

- Remove existing dials from Risk model, but create new dials for Option ARMs and Prime prepayment models.
- Create recommendations for model segment to be applied to deals and rate sheets. The ROC will increase for deals that have the prime model applied, and will decrease for flow rate plans that have Alt-A model applied.
- Create regular and granular backcast reporting to inform deal team of changes in performance, and need for changes in model, segment choice, pricing, and portfolio mix.
- Determine what changes to BMS could easily include Risk Model output that is currently being overwritten.

See Exhibit A at 12. It also suggested several intermediate and long term recommendations. *See* Exhibit A at 13.

72. According to the former Vice President of Risk Analytics, all of the changes suggested by the presentation were necessary to ensure that the Company properly evaluated risk, had proper oversight mechanisms in place, and priced its insurance policies commensurate with the actual risk incurred. Although Defendants knew or should have known of the manipulations that had been made to pricing models by Foster and the significant risks associated with the Company's Modified Pool Insurance portfolio during the

Class Period, following this presentation, it was clear they had actual knowledge of these significant issues impacting the Company.

4. An Outside Consulting Firm Validates the Findings of the March 2007 Presentation

73. After the presentation to Defendants Tonnesen and Jones as well as the other members of the Credit Risk Committee, the Company retained consulting firm Integrated Financial Engineering, Inc. ("IFE") to evaluate the former Vice President of Risk Analytics's and former Vice President for Risk Analysis and Forecasting's model review. IFE is a diversified analytical, consulting, and technology provider that designs, implements, and maintains analytical and financial managements systems.[14] The IFE consultants serving Triad included IFE President Tyler Yang and consultants Henry Cassidy and Dave Andrukonis.[15]

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14 *See* IFE Group, http://www.ifegroup.com/ (last visited March 30, 2012).

15 Yang has a Master's degree and a Ph.D. in finance in addition to 20 years of experience in mortgage analytics and portfolio credit risk management. *See id.* Previously, Yang served as a Senior Research Economist for Fannie Mae and as Senior Director of Credit Portfolio Engineering for Freddie Mac. *See id.* Cassidy also holds a Ph.D., previously served as a Senior Vice President of Freddie Mac, and has over 30 years of experience in financial and economics modeling and portfolio risk management, with specialties in financial portfolio management and loan underwriting processes and scoring. *See id.* Andrukonis holds an M.B.A. and is a widely respected senior mortgage executive with 25 years of experience. *See id.* He previously served as Senior Vice President of Capital Development, Chief Enterprise Risk Officer, and Chief Credit Officer for Freddie Mac. *See id.*

74. As the former Vice President of Risk Analytics described, IFE "validated everything we did, including our methodologies." Yang subsequently wrote a memo for Triad which instructed the Company on how it should "allocate capital." IFE then presented its findings to the Company's Board of Directors in June 2007. In such a way, IFE confirmed the manipulation of Triad's pricing models that resulted in under-pricing and hiding Triad's true risk.

5. As a Result of the Verified Presentation, Defendants Stop Writing Modified Pool Insurance

75. Following the IFE evaluation, the Company had no choice but to place restrictions on Foster. According to the former Vice President of Risk Analytics, the first restriction was that Foster would no longer be able to make any adjustments to the Company's risk and pricing models, but instead all adjustments had to be done by Risk Management. Next, the Company precluded Foster from bidding "live" on any more Modified Pool insurance transactions, without Haferman first reviewing the transaction. While ultimately in the Company's 2007 Form 10-K, Triad disclosed that it had "not written any Modified Pool insurance since the second quarter of 2007," it never disclosed to the market its true reasons for ceasing this practice. This change in practice caused a drastic decline in the Modified Pool insurance written by the Company from 2006 to 2008, as detailed in the table below:

($ in millions)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Primary Insurance Written	$17,428	$10,709	$10,488	$12,088	$19,584	$3,529

Modified Pool Insurance Written	$3,067	$6,463	$10,681	$12,672	$3,331	---
Total Insurance Written	$20,495	$17,172	$21,169	$24,760	$22,915	$3,529

F. Despite Defendants' Knowledge of Serious Problems, They Continued to Reassure Investors About Triad's Risk and Capital Reserves

76. Defendants knew or recklessly disregarded that Triad was manipulating its pricing models so that it could make more competitive bids for Modified Pool insurance, and that this manipulation had the effect of understating risk and leaving the Company insufficiently reserved for an economic downturn. Despite this, during the Class Period, Defendants continuously touted the Company's risk portfolio, capital position, and future prospects, and expressed confidence in both Foster and Triad's Modified Pool business:

- Our focus will be on continuing to manage concentrations of credit risk in our book with an emphasis on quality, and to that end we're encouraged by the industry emphasis on tightening credit standards. *See* ¶110.

- Our production will reflect, as you would anticipate, a continued focus on loan quality. *See* ¶123.

- You'll recall that as we entered into the significant increase that we had in pay-option ARMs what we said was that we have carefully reviewed the underwriting methodologies of our partners. And based upon those methodologies as well as their focus on high quality loans, we felt comfortable that we were taking the right risks. *See* ¶123.

- Ken Foster, who was promoted during the year to Executive Vice President, not only provides a foundation in terms of risk management,

> but is doing an excellent job in creating prudent growth for us in the modified pool business. *See* ¶96.

77. However, by August 2007, and as the mortgage and housing markets deteriorated, Defendants could no longer pretend to be adequately capitalized for the risk they undertook. As a result, Triad was forced to draw down the entire $80 million principal amount of its unsecured revolving credit facility. While the market punished Triad stock in the short-term upon this revelation as the price of Triad securities plummeted by 35% in just two days, the Company continued falsely assuring the investing public that Triad had "solid balance sheet fundamentals" and that the Company enjoyed "strong credit quality" in its insured portfolio.

78. Through the end of 2007 and early 2008, the housing and mortgage markets continued to deteriorate and the risk associated with Defendants' manipulation of the Company's pricing models further materialized. Finally, and in contrast to the Company's glowing statements about the risk levels associated with the insurance it had written, long-term prospects, and capital position, on April 1, 2008, Triad filed its annual report for fiscal year 2007 on Form 10-K with the SEC. Therein, the Company admitted for the first time that it was facing a dire financial predicament because it had been unsuccessful in obtaining any new capital commitments, and that it was facing a "run-off."

79. The market punished Triad stock. Shares of Triad, which closed at $5.25 per share prior to the filing of the 2007 10-K on April 1, 2008, plummeted to $2.15 per share on April 4, 2008 as the market absorbed the news, a staggering loss of ***59%*** on extremely high trading volume.

V. DEFENDANTS' FALSE AND MISLEADING CLASS PERIOD STATEMENTS

80. The Class Period begins on October 26, 2006. On that date, Triad issued a press release entitled "Triad Guaranty Inc. Reports Earnings of $19.4 Million for the Third Quarter." The release stated in part:

> Triad Guaranty Inc. today reported net income for the quarter ended September 30, 2006 of $19.4 million compared with $15.3 million for the same quarter a year ago, an increase of 27%. Diluted earnings per share were $1.30 for the third quarter of 2006 compared with $1.03 for the third quarter of 2005, an increase of 26%. Realized investment losses, net of taxes, did not impact earnings in the third quarter of 2006, compared with a reduction of $0.01 per share in the same quarter of 2005.
>
> Net income for the nine months ended September 30, 2006 was $57.6 million compared with $44.3 million for the same period in 2005. Diluted earnings per share were $3.86 for the first nine months of 2006 compared to $2.99 for the same period last year. Realized investment gains, net of taxes, contributed $0.07 per share for the first nine months of 2006 and did not impact earnings per share for the nine months ended September 30, 2005.
>
> Mark K. Tonnesen, President and Chief Executive Officer, said, "***Our growth in insurance in force, coming from solid sales results in both the Primary and Modified Pool channels coupled with continuing persistency improvements, led to another quarter of strong revenue and earnings growth.*** Earned premiums increased 23% over both the quarter and year-to-date periods when compared with the prior year. Our incurred loss ratio for the quarter at 35.7% was in line with our expectations and included a $5.2 million increase in reserves from the preceding quarter."
>
> Mr. Tonnesen continued, ***"Our operating income, which excludes realized investment gains and losses, set a record this quarter. We view this as a very satisfactory result. Credit quality has remained a key area of focus; and our performance in this regard is very encouraging.*** Expenses were higher in the quarter and much of the increase was due to our planned investment in building for a strong future. Complementing the earnings growth is the fact that reserves and stockholders' equity at September 30, 2006 were up 18% and 12%, respectively, from the beginning of the year."

*   *   *

> Mr. Tonnesen concluded by saying, "Navigating the waters of the mortgage industry is a critically important and challenging task. ***The Triad team has demonstrated deftness this quarter through balancing growth, credit quality, prudent investment and attention to balance sheet fundamentals.***"

81. The Company also reported a risk-to-capital ratio of 12.0:1 as of September 30, 2006.

82. Also on October 26, 2006, the Company hosted a conference call with various securities analysts. Defendants Tonnesen and Jones participated in this call. During the call, Jones stated:

> Our portfolio has continued to involve [sic] in conjunction with the type of products that comprise the regional origination marketplace, and to that extent we have enhanced the disclosure in the statistical supplement included with the earnings release for both our Primary and Modified Pool portfolios. As evidenced from the disclosures, we have had an upward trend in the Alt-A and ARM segments in both Primary and Modified Pool, which has contributed to higher earned premium rates in the last several quarters.
>
> *   *   *
>
> Finally, during the fourth quarter we will be making a change that'll increase the number of reported defaults as shown in our statistical supplement. The change relates to the timing of processing of data that comes in from our lenders near quarter end. Previously information that came in late in the quarter was considered in our incurred but not reported reserve, but the default counts were not reflected in our default statistics. So the information was considered in establishing the incurred but not reported reserve. We do not anticipate a significant change in the total reserves.

83. In addition, Defendant Tonnesen told investors:

> **Mark Tonnesen – Triad Guaranty Inc. – President and CEO**
>
> *   *   *

The improvements in risk factors such as credit score distribution are reflective of our attentions. Finally, it is important to note that we do recognize the inherent risk due to the long-term historical performance data associated or the lack thereof, associated with the product across all market conditions, which increases the volatility of the results in our models. ***We believe we are being appropriately compensated for this risk, and given the growth of our capital base we are in a position where we can accept the higher level of volatility on a portion of our capital for a higher overall return.***

*   *   *

84. During the question and answer session that followed their opening remarks, Defendants touted Triad's credit quality and future prospects while minimizing the increasing defaults the Company was experiencing:

Steve Belmont – Friedman, Billings Ramsey – Analyst

Good quarter. Could you just explain the jump in the reserve, not necessarily a bad thing, but you saw quarter over quarter the provision actually increase by about double from what it was in the second quarter. It is -- meanwhile your credit was actually pretty good, credit trends in a modest [inaudible] delinquencies. Could you give us some insight on the reserve change?

Ken Jones – Triad Guaranty Inc. – SVP and CFO

Sure, yes, I mean our reserving practices are primarily a function of the default inventory. And as the default inventory increase for both the seasoning of book and the seasonality associated with the third quarter, that is generally a default increase towards the last half of the year relative to the first half of the year. We increased our reserves accordingly.

Steve Belmont – Friedman, Billings Ramsey – Analyst

Okay.

Ken Jones – Triad Guaranty Inc. – SVP and CFO

So there was some modest amount of changes in the overall expectations for severity and frequency, but they're almost irrelevant to the total reserve

inventory. It's almost exclusively a function of the default counts, which were right in line with our expectations.

Steve Belmont – Friedman, Billings Ramsey – Analyst

Okay, so almost entirely due to seasonality and to seasoning of the portfolio.

Ken Jones – Triad Guaranty Inc. – SVP and CFO

Absolutely correct.

* * *

Ken Jones – Triad Guaranty Inc. – SVP and CFO

And we wanted to make sure – now each quarter we are committed to being the most transparent company in the industry.

* * *

Mike Grasher – Piper Jaffray – Analyst

Hi, just a couple of follow ups. Ken, you mentioned the reserves -- you expect them to increase, and I guess increase relative to this quarter's change in reserves or the absolute level or exactly what?

Ken Jones – Triad Guaranty Inc. – SVP and CFO

I think probably both. This quarter we had about $5.2 million increase in reserves looking out based on where we think we'll see us in the seasoning and seasonal impact of the falls. We think the reserves will be likely in that range or a little bit higher in the fourth quarter, reserve increase.

* * *

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

* * *

The news that we're becoming familiar with, that isn't particularly good news on the housing front. We feel fortunate that it seems that the worst of the market are markets that my predecessors at Triad Guaranty had chosen not to participate in, primarily the second lien business as well as the sub prime business. And that -- I expect that might have some pretty rough waters. We're not in any way sanguine about this market. ***We're studying our data***

> ***very, very regularly. We expect some choppy waters ahead. Hopefully, they skirt around Triad Guaranty in the future that the way they have thus far,*** but this is going to be a market with some issues going forward, that's our opinion. ***On the other hand, it's a very – there's a lot of wind at our back, and when we talk about things like persistency, the interest rate environment, the economy continues to be -- to be strong, so we're also encouraged by the guidance that's come out regarding products and exotics, that's guidance that we think is good for the industry and show -- so, I think it's a mix.*** I'm not -- I don't think I'm helping you very much, Ed, in terms of getting some clarity. It's just a market that you got to pay close attention to and dive into in pretty good detail in order to understand what's going on.

85. Bolstered by Triad's positive statements about credit quality, analysts sang the Company's praises. In giving Triad a rating of "Outperform" and a valuation range of $56 to $60 per share, Wachovia Capital Markets LLC wrote on October 26, 2006:

> We rate TGIC shares Outperform. Relative to industry peers, TGIC has been able to deliver strong growth in insurance-in-force and earned premiums. ***In addition, we believe that TGIC has the highest quality portfolio and the strongest operating leverage in the mortgage insurance space.***

86. As a result of Defendants' announcement and comments and analyst affirmation, Triad's stock remained at an artificially inflated price of $52.75 – up from a closing price of $51.47 the day before – at the close of trading on October 26, 2006.

87. On November 9, 2006, Triad filed its quarterly report for the third quarter of fiscal year 2006 on Form 10-Q with the SEC, the period ended September 30, 2006. The 2006 third quarter 10-Q reaffirmed the financial results and statements announced in the press release above in ¶80. In addition, it contained the following false statements:

- "We believe there will continue to be opportunities throughout the remainder of 2006 in the structured bulk transaction market that meet our loan quality and pricing objectives."

- "Our Modified Pool insurance in force at September 30, 2006 grew significantly during the past year primarily due to our strong production in the structured bulk channel."

- "Our objective is controlled, profitable growth in both Primary and Modified Pool business while adhering to our risk management strategies."

88. Moreover, Defendants Tonnesen and Jones signed Sarbanes-Oxley ("SOX") certifications which stated in pertinent part:

> 1. I have reviewed this Quarterly Report on Form 10-Q of Triad Guaranty Inc.;
>
> 2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
>
> 3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
>
> 4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
>
>   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

89. Further, Defendants attested to the effectiveness of Triad's disclosure controls and procedures:

> We carried out an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of our disclosure controls and procedures pursuant to Securities Exchange Act of 1934 (Act) Rule 13a-15. Based on that evaluation, our management, including our CEO and CFO, concluded, as of the end of the period covered by this report, that our disclosure controls and procedures were effective.

90. The market reacted positively, closing at an artificially inflated price of $53.28 per share on November 9, 2006.

91. For the reasons stated above in the Substantive Allegations section, and as detailed herein, the statements contained in ¶¶80-84 and 87-89, which touted, among other things, the Company's loan portfolio, credit quality, and pricing objectives, were materially false and misleading when made or omitted material facts to make such statements not false or misleading because:

(a) Triad had far greater exposure to losses as a result of its practice of under-pricing Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(b) Triad had far greater exposure to losses as a result of its practice of under-estimating risk on its Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(c) The Company lacked effective internal controls to detect manipulation in the pricing and risk assessment processes (*see, e.g.*, ¶¶48-49);

(d) Triad was not "adhering to [its] risk management strategies" (*see, e.g.*, ¶¶36-58);

(e) As a result of its under-pricing and manipulation of risk assessment models, Triad was inadequately funding its contingency reserve (*see, e.g.*, ¶¶54-56);

(f) Triad was not "being appropriately compensated" for the risk it undertook (*see, e.g.*, ¶¶36-58);

(g) Triad's credit quality was not "very encouraging" (*see, e.g.*, ¶¶53-58);

(h) Triad was significantly understating its risk-to-capital ratio because it was undervaluing the risk associated with its insurance policies and not reserving capital commensurate with its actual risk (*see, e.g.*, ¶¶54-56);

(i) The effort to reassure investors about Triad's contingency reserves, credit quality, and risk-to-capital ratio was part of a scheme to inflate the stock price; and

(j) The Company's Form 10-Q was materially false and misleading because it failed to disclose (in violation of Item 303 of regulation S-K) these materially adverse conditions to the market.

92. As a result of the foregoing, Defendants' positive statements about the Company, its earnings, financial condition, guidance and prospects were lacking in a reasonable basis at all times and materially false and misleading. Moreover, any risk warnings that may have been provided by Defendants in their Class Period statements were not meaningful, were themselves false and misleading, and do not shield Defendants from liability on the basis that such statements were "forward-looking" in that when such statements were made, as detailed above in the Substantive Allegations section, Defendants had actual knowledge of the falsity of the statements being made, recklessly disregarded

contrary information demonstrating the falsity of such statements and/or Defendants omitted material facts that would have made such statements not false.

93. On January 25, 2007, Triad issued a press release entitled "Triad Guaranty Inc. Reports Earnings of $8.1 Million for the Fourth Quarter and Adds $24.2 Million to Reserves." The release stated in part:

> Triad Guaranty Inc. (NASDAQ: TGIC) today reported net income for the quarter ended December 31, 2006 of $8.1 million compared with $12.6 million for the same quarter a year ago, a decrease of 35%. Diluted earnings per share were $0.54 for the fourth quarter of 2006 compared with $0.85 for the fourth quarter of 2005, a decline of 36%. Realized investment losses, net of taxes, did not impact earnings in the fourth quarter of 2006, compared with realized investment gains of $0.01 per share in the same quarter of 2005.
>
> * * *
>
> Mark K. Tonnesen, President and Chief Executive Officer, said, "Despite many positive developments in the fourth quarter, our earnings are disappointing. While the increase in defaults and the number of paid claims was virtually on target, our average cost per paid claim increased significantly. The fundamental cause of the higher loss per claim was the impact of the slowing housing market on our claims mitigation efforts. A larger percentage of our claims paid in the fourth quarter were full option settlements, causing the average severity on both Primary and Modified Pool business to increase from the levels observed over the last five quarters. In response to this change, which emerged in the fourth quarter, we felt it was both prudent and necessary to adjust the severity factors utilized in our reserving methodology, which increased our reserves and, in turn, our incurred losses. The increase in the severity factors was the major driver of the $24.2 million increase in reserves during the quarter, although a portion of the increase was attributable to changes in our frequency factors and the natural growth and seasoning of our portfolio."
>
> Mr. Tonnesen continued, "***Our fundamentals remain strong.*** Strong production and improved persistency throughout 2006 led to a 28% increase in insurance in force from the end of 2005, with earned premiums increasing 29% for the fourth quarter, and 25% for the full year, compared to the prior year periods. We also established a number of important new customer

> relationships. Portfolio performance remained solid with reserved default counts increasing only 5% during 2006 while insurance in force grew at 28%. Our expense ratio for the fourth quarter of 2006 dropped to 22.8% compared to 26.4% during the same quarter last year, primarily the result of the increase in written premiums during the period."

***   *   ***

94. The Company also reported a risk-to-capital ratio of 12.5:1 as of December 31, 2006.

95. In the same press release, Triad included an exhibit entitled "Review of Fourth Quarter Reserve Increase." This exhibit provided, in pertinent part:

> ***There are many positive and encouraging trends to be found in the fourth quarter numbers*** – 29% premium growth from excellent production and strong persistency, solid portfolio performance, and an improving expense ratio. However, the reserve increase may overshadow our quarterly performance, since the size of the increase was not anticipated. We hope this summary will provide Triad's perspective on the reserve increase and explain what occurred during the quarter that led us to make the increase.

*   *   *

> In regards to the change in default inventory, we are fortunate to have avoided some of the most problematic areas of the lending business, such as sub prime and second liens. ***We believe the quality of our portfolio remains strong***, evidenced by the fact that our year-end reserved defaults are up just 5% from December 31, 2005, even with our recent growth over the past few years. A review of the portfolio's credit quality, in terms of FICO scores and delinquency rates, demonstrates that ***the portfolio credit quality has remained steady. The net message is that default counts showed a moderate increase for the quarter and reflect the consistent quality of our portfolio.*** The normal changes in the default inventory added $5.8 million to reserves this quarter.

96. Also on January 25, 2007, the Company hosted a conference call with various securities analysts. Defendants Tonnesen and Jones participated in this call. During the call, the Individual Defendants stated:

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

There are many positive and encouraging trends to be found in our fourth-quarter numbers; 29% premium growth from excellent production and strong persistency, solid portfolio performance, and an improving expense ratio. However at this point I know our reserve increase is overshadowing our quarterly performance and rightfully so since this increase was not anticipated.

What I hope to accomplish with my remarks is to share Triad's perspective on the reserve increase and explain what occurred during the quarter that lead us to make that increase.

Exhibit 2B included with the earnings release illustrates that the reserve change this quarter is a function of three separate components. A portion of the increase, roughly $5.8 million, is associated with the normal change in the default inventory in terms of count and mix. Another portion, roughly $4.9 million has to do with the changing expectations and model refinements on frequency. And finally the largest portion of the increase, $12.6 million, is a function of the new trends in severity, which became apparent only this quarter.

Regarding the default increase, we are fortunate to have avoided some of the most problematic areas in the lending business such as subprime and second liens. ***We believe the quality of our portfolio remains strong.*** Our year-end reserve defaults are up just 5% from last year even with the recent growth over the past few years.

A review of the portfolio's credit quality in terms of FICO scores and delinquency rates demonstrates that ***the portfolio credit quality has remained steady. The net message is that default counts showed a moderate increase and reflect the kind of portfolio quality that you have come to expect from Triad.*** The normal changes in the default inventory added $5.8 million to the reserve this quarter.

*   *   *

I would now like to turn the presentation back over to Ken ***who will update you on what was otherwise a very good quarter.***

*   *   *

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

Thanks Ken. At the end of 2006, insurance in force stood at $56.8 billion, an increase of 28% from the end of 2005 and earned premiums were up 25% for the year. While I was expecting to report far better financial results for 2006, I am pleased with the position of Triad at the beginning of 2007.

During 2006, we made significant investments in the product and risk management areas to align our organization with the continuing shift towards the need for expertise around nontraditional mortgages and the ability to support capital market transactions. These investments produced dividends in terms of continued growth in our modified pool line and our ability to support our key lender partners in providing insurance for nontraditional products such as Alt-A and pay option ARMs.

We understand that there are new and unique risks to nontraditional mortgages that make their future performance more difficult to predict, but we believe the potential returns demonstrated is reasonable to accept these risks.

As we have expanded our capabilities to insure new types of products, we have not lost sight of Triad's foundational strategy to maintain the highest quality portfolio in the industry. To that end, we exited 2006 with a higher credit quality portfolio in terms of FICO scores than we had at the beginning of the year. The year 2006 was also when we set the stage for diversifying our company through international expansion into Canada. I will have more on Canada later in my remarks.

* * *

When we add up the pluses and minuses, we expect total earned premium growth to slow somewhat in 2007 as the growth of our in force is expected to moderate. We expect the total number of loans in default in both our primary and modified pool businesses to trend upward due to continued seasoning and growth of our in force. We also believe that overall severity will continue to trend upward as the newer policy books with higher average loan amounts develop and claims mitigation strategies remain less successful until the current housing market improves.

We expect that the growth in our domestic operating expenses in 2007 will moderate when compared to 2006 as we have completed most of the organizational changes in staff additions. As a result, we anticipate our domestic expense ratio to stay at or to slightly improve from 2006 levels. Thus as we view the prospects for 2007, we are cautiously optimistic.

* * *

Geoffrey Dunn – Keefe, Bruyette & Woods – Analyst

Ken, the number of claims guidance that you just gave is helpful heading into the new year. I was wondering if you're able to expand your '07 credit guidance, give us a feel for where you think all of your detail boils down with respect to paids or incurred outlook for the year?

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

Jeff, as we mentioned -- this is Mark -- as we mentioned in the call, we expect flat or down paid claims for the first quarter and we expect as the defaults mature to claims, severity would be in the $31,000 range. If you take a look at what has been happening to our defaults, there has been moderate increases and ***our overall loan quality has been relatively stable through the year. I think that that gives you a good perspective on our thoughts for the future.***

One of the things that will have an impact of course on things such as claims rate will be the denominator growth. We see some moderation in our growth, but we have been very successful so far.

In the fourth quarter of this year, we had our highest ever flow market share at 7.7%. We hadn't been above 6% for most of the year. ***So we are having good success in the marketplace. Our credit quality remains stable and our short-term outlook is positive.***

*　　*　　*

Geoffrey Dunn – Keefe, Bruyette & Woods – Analyst

Okay, great. A question with respect to your modified pool business, I think we've seen a lot of the other MIs pull back from that business but a couple seem to be ramping up, whether it is bulk or modified pool. Are you seeing much more competition in the modified pool area in recent quarters than you have seen in past years?

*　　*　　*

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

So, we are very happy with the performance of our modified pool business and see continued success in the future.

*　　*　　*

Mike Grasher – Piper Jaffray – Analyst

Okay. Then how fluid or transparent is that in terms of monitoring that cure rate? It sounds like if nothing else you're paying a great deal more attention to all these factors. How frequently will you look to sort of change them as the market dictates?

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

Mike, one of the things that is true about our business is that we've been undergoing a lot of growth and that has really been terrific for our shareholders. One of the side benefits of that is that it increases the amount of data that is available for us to analyze. So as the full counts go up based upon volume, we are able to refine all of our calculations.

We have had growth with new customers. We have had growth in some of our new businesses and the data that has been provided has given us the ability to explore better and better estimation processes. We think we are pretty well through that but we will always as you say be looking to improve the estimations on the cure rates, whether that means increasing them or decreasing them.

* * *

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

Jim, I think that Darryl was an amazing leader for Triad Guaranty and set the stage not only for the success that we have had, but also the philosophical underpinnings of Triad Guaranty. We've talked with you and everyone in the market about the fact that we have a heritage of focusing on customers, product innovation, and risk management that is better than the industry. That was gifted to us by Darryl Thompson.

I think that this management has had and supported completely by the Board a philosophy that that should not only underpin the decisions that we make but also the way in which we view the balance sheet. And that is part of what you are seeing with this team.

* * *

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

Ken Foster, who was promoted during the year to Executive Vice President, not only provides a foundation in terms of risk management, but is doing an

> ***excellent job in creating prudent growth for us in the modified pool business.***

97. Despite the lower-than-consensus earnings, analysts took notice of Triad's positive statements about credit quality and the Company's outlook. In continuing to give Triad a rating of "Outperform," Wachovia increased the valuation range to $59 to $61 per share. To that end, Wachovia wrote on January 25, 2007:

> We rate TGIC shares Outperform. Relative to industry peers. TGIC has been able to deliver strong growth in insurance-in-force and earned premiums. ***In addition, we believe that TGIC has the highest quality portfolio and the strongest operating leverage in the mortgage insurance space.***

98. Also on January 25, 2007, Fitch Ratings affirmed the long-term issuer and senior debt ratings of Triad at "A+."

99. As a result of Defendants' announcement of lower-than-expected earnings, Triad's stock fell from a close of $58.45 per share on January 24, 2007 to $50.78 on January 25, 2007 on an unusually high volume of 827,500 shares. This 13.1% one-day drop in the price of Triad securities was tempered by the Company's positive comments and analyst affirmation.

100. For the reasons stated above in the Substantive Allegations section, and as detailed herein, the statements contained in ¶¶93-96, which touted, among other things, the Company's capital levels and needs, the relatively low risk associated with its insurance policies, and the Company's credit quality, were materially false and misleading when made or omitted material facts to make such statements not false or misleading because:

(a) Triad had far greater exposure to losses as a result of its practice of under-pricing Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(b) Triad had far greater exposure to losses as a result of its practice of under-estimating risk on its Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(c) Ken Foster was not doing an "excellent job in creating prudent growth" in the Modified Pool business (*see, e.g.*, ¶¶36-58);

(d) The Company lacked effective internal controls to detect manipulation in the pricing and risk assessment processes (*see, e.g.*, ¶¶48-49);

(e) The Company's credit quality was not stable (*see, e.g.*, ¶¶53-58);

(f) The quality of the Company's portfolio and fundamentals were not "strong" (*see, e.g.*, ¶¶36-58);

(g) As a result of its under-pricing and manipulation of risk assessment models, Triad was inadequately funding its contingency reserve (*see, e.g.*, ¶¶54-56);

(h) Triad was significantly understating its risk-to-capital ratio because it was undervaluing the risk associated with its insurance policies and not reserving capital commensurate with its actual risk (*see, e.g.*, ¶¶54-56); and

(i) The effort to reassure investors about Triad's contingency reserves, credit quality, and risk-to-capital ratio was part of a scheme to inflate the stock price.

101. As a result of the foregoing, Defendants' positive statements about the Company, its earnings, financial condition, guidance and prospects were lacking in a reasonable basis at all times and materially false and misleading. Moreover, any risk warnings that may have been provided by Defendants in their Class Period statements were not meaningful, were themselves false and misleading, and do not shield Defendants from liability on the basis that such statements were "forward-looking" in that when such statements were made, as detailed above in the Substantive Allegations section, Defendants had actual knowledge of the falsity of the statements being made, recklessly disregarded contrary information demonstrating the falsity of such statements and/or Defendants omitted material facts that would have made such statements not false.

102. On March 7, 2007, Triad filed its annual report for the fiscal year 2006 on Form 10-K with the SEC, the period ended December 31, 2006. The 2006 10-K reaffirmed the financial results and statements announced in the press release above in ¶93. In addition, it contained the following false statements:

- "Through the structured bulk channel, we participate in bids for structured bulk transactions that meet our loan quality and pricing criteria."
- "We consider effective risk management to be critical to our long-term financial stability. Market analysis, product analysis, prudent underwriting, the use of automated risk evaluation models, sophisticated risk modeling, auditing, and knowledge of our customers are all important elements of our risk management process."
- "We evaluate risk based on historical performance of risk factors and utilize automated underwriting systems in the risk selection process to assist the underwriter with decision-making."

- "We believe the higher premium rates charged on high LTV loans adequately reflect the additional risk."

- "As discussed earlier, we have expanded the risk characteristics that we pursue in both the Primary and Modified Pool marketplaces based, in part, on the change in the overall mortgage origination market. That change has been overseen by our Credit Risk Committee, which is composed of certain members of senior management. The Credit Risk Committee must approve all new product offerings and changes in types of risk that we are willing to assume. This includes approval of the expansion of credit characteristics and review of the overall underwriting guidelines utilized. We employ a comprehensive quality assurance audit plan to determine whether underwriting decisions being made are consistent with the policies, procedures, and expectations for quality set forth by management. All areas of business activity that involve an underwriting decision are examined, with emphasis on new products, new procedures, contract underwritten loans, delegated loans, new employees, new master policyholders, and new branches of an existing master policyholder."

- "We believe there will continue to be opportunities in 2007 in the structured bulk transaction market that meet our loan quality and pricing objectives."

- "Our Modified Pool insurance in force grew significantly in 2006 and in 2005 due to our strong production in the structured bulk channel as well as an improving persistency rate."

103. Moreover, Defendants Tonnesen and Jones signed SOX certifications consistent with that set forth in ¶88 above.

104. Further, Defendants certified that Triad's disclosure controls and procedures and internal controls over financial reporting were effective:

> As of December 31, 2006, an evaluation was performed under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based upon that evaluation, management has concluded that disclosure controls and procedures as of December 31, 2006 were effective in ensuring that material

> information required to be disclosed in this Form 10-K was recorded, processed, summarized, and reported on a timely basis.
>
> *   *   *
>
> Management assessed the effectiveness of Triad Guaranty Inc.'s internal control over financial reporting as of December 31, 2006. Management based this assessment on criteria for effective internal control over financial reporting described in "Internal Control — Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based upon this assessment, management determined that, as of December 31, 2006, Triad Guaranty Inc. maintained effective internal control over financial reporting.

105. As a result of the false statements contained in the Company's 2006 10-K, shares of Triad securities continued to trade at artificially inflated levels as the stock closed at a price of $43.93 per share on March 7, 2007.

106. For the reasons stated above in the Substantive Allegations section, and as detailed herein, the statements contained in ¶102-104, which touted, among other things, the Company's risk assessment methodologies, the relatively low risk associated with its insurance policies, the Company's underwriting standards, and the Company's pricing objectives, were materially false and misleading when made or omitted material facts to make such statements not false or misleading because:

(a) Triad had far greater exposure to losses as a result of its practice of under-pricing Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(b) Triad had far greater exposure to losses as a result of its practice of under-estimating risk on its Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(c) The Company's "bids for structured bulk transactions" did not meet Triad's "loan quality and pricing criteria" (*see, e.g.*, ¶¶36-58);

(d) The Company lacked effective internal controls to detect manipulation in the pricing and risk assessment processes (*see, e.g.*, ¶¶48-49);

(e) The Company failed to disclose the true risks associated with its ability to continue to write new business (*see, e.g.*, ¶¶67-75);

(f) As a result of its under-pricing and manipulation of risk assessment models, Triad was inadequately funding its contingency reserve (*see, e.g.*, ¶¶54-56);

(g) Triad was significantly understating its risk-to-capital ratio because it was undervaluing the risk associated with its insurance policies and not reserving capital commensurate with its actual risk (*see, e.g.*, ¶¶54-56);

(h) The effort to reassure investors about Triad's contingency reserves, credit quality, and risk-to-capital ratio was part of a scheme to inflate the stock price; and

(i) The Company's Form 10-K was materially false and misleading because it failed to disclose (in violation of Item 303 of regulation S-K) these materially adverse conditions to the market.

107. As a result of the foregoing, Defendants' positive statements about the Company, its earnings, financial condition, guidance and prospects were lacking in a

reasonable basis at all times and materially false and misleading. Moreover, any risk warnings that may have been provided by Defendants in their Class Period statements were not meaningful, were themselves false and misleading, and do not shield Defendants from liability on the basis that such statements were "forward-looking" in that when such statements were made, as detailed above in the Substantive Allegations section, Defendants had actual knowledge of the falsity of the statements being made, recklessly disregarded contrary information demonstrating the falsity of such statements and/or Defendants omitted material facts that would have made such statements not false.

108. On April 26, 2007, Triad issued a press release entitled "Triad Guaranty Inc. Reports Earnings of $17.3 Million for the First Quarter." The release stated in part:

> Triad Guaranty Inc. (Nasdaq: TGIC) today reported net income for the quarter ended March 31, 2007 of $17.3 million compared with $18.6 million for the same quarter a year ago, a decrease of 7%. Diluted earnings per share were $1.16 for the first quarter of 2007 compared with $1.25 for the first quarter of 2006, a decrease of 7%. Realized investment gains, net of taxes, increased diluted earnings per share by $0.03 in the first quarter of 2007 and $0.04 the first quarter of 2006.
>
> Mark K. Tonnesen, President and Chief Executive Officer, said, "The highlight for the quarter was our continued success in new production which contributed to the 34% top line growth in earned premiums. Strong Primary production during the quarter coupled with improved persistency enabled our total insurance in force to grow 28% compared to a year ago. ***Changes in the market place -- including tax deductibility for mortgage insurance, problems evidenced in sub prime, widening credit spreads, a flat yield curve, and a concurrent movement toward more traditional underwriting and products -- have favored our business. We view this as an opportunity for Triad.***"
>
> Mr. Tonnesen continued, "That said, it remains difficult navigating through these unsettled times in the housing and mortgage markets. Most challenging in the short term is weakness in the housing market. Home prices are generally flat to declining and housing inventories are growing steadily, placing

> continued pressure on the amount of paid claims and our ability to effectively mitigate potential losses. The result for the first quarter was continued building of reserves and a quarterly loss ratio of 50.9%. Our strategy to limit our exposure to the sub prime market has proven wise. However, ***we have changed our portfolio profile over time to include more Alt A product and recently more potential negative amortization mortgages. These products continue to perform as expected but require our ongoing diligent review as they season further.***"

***   *   ***

109. The Company also reported a risk-to-capital ratio of 13.8:1 as of March 31, 2007.

110. Also on April 26, 2007, the Company hosted a conference call with various securities analysts. Defendants Tonnesen and Jones participated in this call. During the call, the Individual Defendants touted the future prospects of the Company and, in response to an analyst question, praised Triad's investments and loss mitigation efforts:

> **Kenneth Jones – Triad Guaranty Inc. – SVP and CFO**
>
> *   *   *
>
> ***Production in both the flow and bulk channels continued very strong during the quarter and that, along with increased persistency, generated strong growth in insurance in force and revenue.*** Primary and modified pool insurance in-force increased 27% and 28% respectively over the past year. Also, as we note in the statistical supplement, we have about $1.9 billion of structured transaction volume with first quarter effect date that is not reflected in our statistical data since we've not received the final loan level detail.
>
> The growth in insurance in-force, coupled with a decrease in our seed rate and an increase in average basis points, produced a 34% increase in earned premiums compared to the first quarter of 2006. Looking at the production we continue to see strong growth in the Alt-A segments and in mortgages with the potential for negative amortization, primarily pay option ARMs. Pay option ARMs now comprise 14% of our primary risk in-force, and 12% of our modified pool risk in-force.

*   *   *

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

The trends we ended last year continue in 2007. ***We're very pleased with our production and the growth of our insurance in-force that we saw during the quarter.*** Flow production of $4.4 billion is our strongest result since the refi market of 2003 and we continue to execute well in all segments on the Bolt channel.

*   *   *

Looking forward, while we expect to see greater opportunity in the market we're going to be selective in the business we pursue. This will likely translate into a slow down in the growth of the pay option ARMs and reduced emphasis on ILTV primary bulk. ***Our focus will be on continuing to manage concentrations of credit risk in our book with an emphasis on quality, and to that end we're encouraged by the industry emphasis on tightening credit standards.***

As many of you may have noticed, as we definitely have, our stock price has declined since year end. While nothing we say is likely to change investors' perspectives on the current mortgage credit environment, we are confident in the future of our business. The recent problems of the mortgage industry are increasing the demand for mortgage insurance and creating improved underwriting standards and underwriting discipline.

Investments in personnel and process that we've made over the past 18 months put us in an excellent position to take advantage of these opportunities.

*   *   *

While there are challenges ahead for us, ***I believe we are well prepared for them. Rarely does one encounter headwinds and tailwinds at the same time, yet that is precisely where we find ourselves. For us, and for those of you that can look beyond the immediate present, there is clearly a bright future.***

*   *   *

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

Michael, in terms of the new customers; ***we're really doing a great job in terms of adding new customers.*** We ended up where we felt we were at full complement on our sales force in the middle of last year. That included opening up new territories in the Midwest, as well as in the North and the Northeast, and adding significantly to our national account staff. They've done a great job. We have a significant number of new customers that are coming on stream, as well as the field AEs doing a great job of bringing business.

* * *

Kenneth Jones – Triad Guaranty Inc. – SVP and CFO

Okay, I think I'll let Steve have first shot at that. We'll try to get our information available here. Obviously, just in general terms, the modified pool business is growing faster than our primary business is, so we would expect, as that business seasons, to be adding more defaults, and therefore, having a higher increase in reserves; in terms of a percentage basis.

* * *

Kenneth Jones – Triad Guaranty Inc. – SVP and CFO

Sure. Our current debt-to-capital ratio is in the 5% to 6% range, and we feel like we've got some room to put on some debt, to move towards the 15% to 20% range. I think our ratings agencies would be comfortable with that, but it's certainly something that we're having discussions with them about. So short-term, we're looking at putting on a committed credit facility in the $75 million to $100 million range to give us some additional flexibility to continue to pursue the business opportunities that we see in the market now.

111. Analysts again took notice of Triad's positive statements about credit quality and the Company's outlook. In fact, after the conference call, Bear, Stearns & Co. raised its 2007 earnings estimate for Triad from $5.55 to $5.61 per share. In so doing, Bear Stearns noted that: "In Triad's conference call today, the company provided some positive commentary surrounding the traction of its primary business" and that "[m]anagement also stated … they are very optimistic about the business . . . ."

112. Wachovia continued to give Triad a rating of "Outperform," with a valuation range of $59 to $61 per share. To that end, Wachovia wrote on April 26, 2007:

> We rate TGIC shares Outperform. Relative to industry peers. TGIC has been able to deliver strong growth in insurance-in-force and earned premiums. ***In addition, we believe that TGIC has the highest quality portfolio and the strongest operating leverage in the mortgage insurance space.***

113. The market reacted positively to Defendants' statements about earnings and future prospects. To be sure, Triad's stock increased over $2 per share from its close of $43.71 per share on April 25, 2007 to close at $45.87 per share on April 26, 2007 on more the double the prior day's trading volume.

114. For the reasons stated above in the Substantive Allegations section, and as detailed herein, the statements contained in ¶¶108-110, which touted, among other things, the Company's growth in Modified Pool insurance, credit quality, and future prospects were materially false and misleading when made or omitted material facts to make such statements not false or misleading because:

(a) Triad had far greater exposure to losses as a result of its practice of under-pricing Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(b) Triad had far greater exposure to losses as a result of its practice of under-estimating risk on its Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(c) Triad was not "manag[ing] concentrations of credit risk . . . with an emphasis on quality" (*see, e.g.*, ¶¶36-58);

(d) Triad had no reasonable basis to tell investors that "there is clearly a bright future";

(e) The Company lacked effective internal controls to detect manipulation in the pricing and risk assessment processes (*see*, *e.g.*, ¶¶48-49);

(f) As a result of its under-pricing and manipulation of risk assessment models, Triad was inadequately funding its contingency reserve (*see*, *e.g.*, ¶¶54-56);

(g) Triad was significantly understating its risk-to-capital ratio because it was undervaluing the risk associated with its insurance policies and not reserving capital commensurate with its actual risk (*see*, *e.g.*, ¶¶54-56); and

(h) The effort to reassure investors about Triad's contingency reserves, credit quality, and risk-to-capital ratio was part of a scheme to inflate the stock price.

115. As a result of the foregoing, Defendants' positive statements about the Company, its earnings, financial condition, guidance and prospects were lacking in a reasonable basis at all times and materially false and misleading. Moreover, any risk warnings that may have been provided by Defendants in their Class Period statements were not meaningful, were themselves false and misleading, and do not shield Defendants from liability on the basis that such statements were "forward-looking" in that when such statements were made, as detailed above in the Substantive Allegations section, Defendants had actual knowledge of the falsity of the statements being made, recklessly disregarded contrary information demonstrating the falsity of such statements and/or Defendants omitted material facts that would have made such statements not false.

116. On May 9, 2007, Triad filed its quarterly report for the first quarter of fiscal year 2007 on Form 10-Q with the SEC, the period ended March 31, 2007. The 2007 first quarter 10-Q reaffirmed the financial results and statements announced in the press release above in ¶108. In addition, it contained the following false statements:

- "...the number of Modified Pool defaults subject to deductibles and those without deductibles increased at March 31, 2007 from March 31, 2006."
- "Our objective is controlled, profitable growth in both Primary and Modified Pool business while adhering to our risk management strategies."

117. Moreover, Defendants Tonnesen and Jones signed SOX certifications consistent with that set forth in ¶88 above. Defendants also attested to the same effectiveness of disclosure controls and procedures as set forth in ¶89 above.

118. As a result of the false statements contained in the Company's 2007 first quarter 10-Q, shares of Triad securities continued to trade at artificially inflated levels as the stock closed at a price of $46 per share on May 9, 2007, up $1.06 from a close of $44.94 per share on May 8, 2007.

119. For the reasons stated above in the Substantive Allegations section, and as detailed herein, the statements contained in ¶116-117, which touted, among other things, the success of the Company's Modified Pool portfolio and risk management strategies, were materially false and misleading when made or omitted material facts to make such statements not false or misleading because:

(a) Triad had far greater exposure to losses as a result of its practice of under-pricing Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58;

(b) Triad had far greater exposure to losses as a result of its practice of under-estimating risk on its Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(c) Triad was not "adhering to [its] risk management strategies" (*see, e.g.*, ¶¶36-58);

(d) The Company lacked effective internal controls to detect manipulation in the pricing and risk assessment processes (*see, e.g.*, ¶¶48-49);

(e) The Company failed to disclose the true risks associated with its ability to continue to write new Modified Pool business (*see, e.g.*, ¶¶67-75);

(f) As a result of its under-pricing and manipulation of risk assessment models, Triad was inadequately funding its contingency reserve (*see, e.g.*, ¶¶54-56);

(g) The effort to reassure investors about Triad's contingency reserves, credit quality, and risk-to-capital ratio was part of a scheme to inflate the stock price; and

(h) The Company's Form 10-Q was materially false and misleading because it failed to disclose (in violation of Item 303 of regulation S-K) these materially adverse conditions to the market.

120. As a result of the foregoing, Defendants' positive statements about the Company, its earnings, financial condition, guidance and prospects were lacking in a

reasonable basis at all times and materially false and misleading. Moreover, any risk warnings that may have been provided by Defendants in their Class Period statements were not meaningful, were themselves false and misleading, and do not shield Defendants from liability on the basis that such statements were "forward-looking" in that when such statements were made, as detailed above in the Substantive Allegations section, Defendants had actual knowledge of the falsity of the statements being made, recklessly disregarded contrary information demonstrating the falsity of such statements and/or Defendants omitted material facts that would have made such statements not false.

121. On July 25, 2007, Triad issued a press release entitled "Triad Guaranty Inc. Reports Earnings of $15.3 Million for the Second Quarter." The release stated in part:

> Triad Guaranty Inc. (Nasdaq: TGIC) today reported net income for the quarter ended June 30, 2007 of $15.3 million compared with $19.6 million for the same quarter a year ago, a decline of 22%. Diluted earnings per share were $1.02 for the second quarter of 2007 compared with $1.31 for the second quarter of 2006, a decrease of 22%. Realized investment gains, net of taxes, increased diluted earnings per share by $0.05 in the second quarter of 2007 compared to $0.03 per share in the same quarter of 2006.
>
> * * *
>
> Mr. Tonnesen continued, "Our top line growth in both new insurance written and premiums is reflective of the market changes that have improved the competitive position of mortgage insurance. ***Nonetheless, the remainder of 2007 will be pursued cautiously with the focus on loan quality. We will focus our marketing efforts on increasing the number of lender partners with which we do business.*** Our efforts in Canada continue to be going well, although, we do not anticipate a meaningful amount of revenue from Canada until 2008."
>
> Total insurance in force reached $66.4 billion at June 30, 2007 compared with $50.8 billion a year ago. Insurance in force included Primary of $42.7 billion and Modified Pool of $23.7 billion at June 30, 2007, compared with $30.8

billion and $20.0 billion, respectively, a year earlier. New insurance written during the second quarter of 2007 totaled $8.2 billion compared with $5.9 billion written in the second quarter of 2006. Primary new insurance written for the second quarter of 2007 was $6.8 billion compared to $2.9 billion in the second quarter of 2006. New insurance written from Modified Pool transactions totaled $1.4 billion in the second quarter of 2007 compared with $3.0 billion for the same period of 2006. The underlying volume of bulk transactions comprising both Primary and Modified Pool business may fluctuate significantly from quarter to quarter.

*   *   *

122. The Company also reported a risk-to-capital ratio of 16.0:1 as of June 30, 2007.

123. Also on July 25, 2007, the Company hosted a conference call with various securities analysts. Defendants Tonnesen and Jones participated in this call. During the call, the Individual Defendants touted the future prospects of the Company and the quality of Triad's customer base and credit, and expressed confidence in the Company's capital position:

Kenneth Jones – Triad Guaranty Inc. – SVP and CFO

The June 30th risk-to-capital ratio at Triad Guaranty Insurance companies stood at 16 to 1, an increase of 12.5 to 1 from year-end 2006. Our in-force growth produced a 28% increase and risk during the first half of the year, which is impacting our risk-to-capital ratio. ***While we are pleased with the growth of the in-force, we are monitoring the impact of the growth on our capital position.***

*   *   *

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

Thanks, Ken. The second quarter represented a transition in some respects both in the industry and for Triad. Industry production continues to benefit from the market changes over the past year relative to an improved competitive position versus [piggybacks] as well as opportunities created by the sub-prime market disruption.

However, much of this production increase is coming in the form of high LTV lending including a substantial portion greater than 95% LTV loans. We are keeping a watchful eye on the products that we are being asked to ensure in both the flow and structured Bolt channels.

We're committed to supporting our customers and their lending efforts but want to make sure the underwriting is sound, the pricing of the product is appropriate for the risks we are assuming, and that we do not end up with layered risk on high LTV loans.

As we indicated in the call last quarter, ***we've become more selective in the business we pursue and the impact of these changes has begun to appear in our production.*** An example is the pay-option ARM production in the primary line, which declined about 35% for the quarter.

We also significantly reduced our live bids in the structured [bulk] market as we had concerns about the quality of the product and our ability to adequately price the risk in the current environment. Our reported new insurance written for the second quarter in the structured [bulk] market did not reflect the full impact of the changes due to the carry over of transactions and commitments from the prior quarter.

*   *   *

Our production will reflect, as you would anticipate, a continued focus on loan quality.

*   *   *

The rapid development of claims from the more recent vintages versus historical norms if caused by higher levels of misrepresentation of fraud may result in somewhat higher recession levels, a possibility that is not reflected in our reserve methodology. Quite clearly, our paid claim count and dollar volume will increase in the coming quarters and we're looking to augment our already strong mitigation process.

*   *   *

With the uncertainty in the market, our stock price is trading below book value, which we believe is attributable at least in part to the overall negative perception concerning the housing and mortgage industries in the market.

However, consistent with what our strategy has been through the years, ***we continue to manage Triad for the long term and believe that our shareholders will be well served by continuing to invest our capital in the business.***

*   *   *

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

We're comfortable with our capital position today. We've raised $80 million in the line, which is approximately 15% of our capital and when fully applied would take the risk-to-capital ratio down by about 2. As we look forward, as I mentioned the growth in the first half, we don't see that happening in the second half. And that will mitigate the rises that we've seen in the risk-to-capital ratio. All that said, we do think that this is a strong - it will become a strong market here and we do have the opportunities in Canada.

Steve Stelmach – FBR Capital Markets – Analyst

Right.

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

So, presently, we are comfortable. We've got plans to maintain ourselves in a comfortable range.

*   *   *

Geoff Dunn – KBW – Analyst

Thanks. Mark, obviously there's been a lot of speculation around your name. And although all the MIs are hard hit you've been particularly beat up. And there is a fair correlation between you and one of your larger customer stock prices. Can you talk a little bit of more about your option ARM portfolio?

*   *   *

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

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You'll recall that as we entered into the significant increase that we had in pay-option ARMs what we said was that we have carefully reviewed the underwriting methodologies of our partners. And based upon those methodologies as well as their focus on high quality loans, ***we felt comfortable that we were taking the right risks.***

We were willing to trade-off product design for higher quality underwriting, and we believe that strategy will ultimately prove itself to have been wise. When we take a look at the difference in our most recent production on pay-option ARMs versus our older production on pay-option ARMs, what we find is that the primary difference is the quality of a customer as defined by FICO scores. That is that the older production has a lower FICO score on average and a lower FICO score range in the most recent production. And we believe that the poor performances of those vintages are a function of the quality of the customer and we are using FICO as a surrogate for that.

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Mark Tonnesen – Triad Guaranty Inc. – President and CEO

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We believe that it is the quality of the customers as well as the product design that will ultimately be the source of product performance, and for right now, we're happy with that.

*　　*　　*

Ken Jones – Triad Guaranty Inc. – SVP and CFO

And Mike, maybe I should make one other comment. The other part of the 100% and the greater than 95s, is a general belief that the pricing on those products is appropriate. I believe that that's true. I believe that the risk reward on those products is probably well assessed. ***And at the price that you get for that product is a -- has every - you have every right to believe that it will end up being profitable business.***

*　　*　　*

> **Mark Tonnesen – Triad Guaranty Inc. – President and CEO**
>
> We have focused historically on modified pool within the Alt-A segment. And what we have been, what modified pool means is that the structure includes a modification, that modification is virtually always includes a stop loss on our exposure. And sometimes includes a deductible and if it includes a deductible that affects the pricing of the product obviously. ***We like the modified pool because it caps out the kind of economic capitals that one needs to put against the, against the business and the returns are good in that business. We like the fact that it's Alt-A because Alt-A gives us the opportunity to price the product successfully. And it is supported by an under 80 loan to value. So that's been a very successful product for us in the past.*** The primary bulk business is greater than 100 rather - I am sorry greater than 80% loan-to-value product and may or may not include a stop loss. Most of that product does not include a stop loss. So it's a significantly different product. We put our toe into that into that water and we'll have to see whether are not, we continue to believe that that's a good place to invest capital.

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> **Ken Jones – Triad Guaranty Inc. – SVP and CFO**
>
> The focus on pay-option ARM takes an analysis and that's very, very detailed and that's why I've tried to summarize this by saying that the pay-option ARM product line right now is performing better on a vintage-to-vintage basis than the rest of the product. ***That is as it pertains to our most recent pay-option ARM business, which was underwritten to a quality that we think is going to be - is going to bode well for the future performance. Some of the older pay-option ARMs, and we didn't do very much of it, but some of the older pay-option ARMs in 2004 and 2005 and that's a very small bit of our business is not performing so well. And as we've analyzed that, it has a lot to do with just the quality of the customer base.***

124. In an analyst report issued the same day, Wachovia continued to give Triad an "Outperform" rating and provided a valuation range of $52 to $56 per share. Wachovia continued to give Triad a rating of "Outperform," with a valuation range of $59 to $61 per share. Wachovia also continued to tout Triad as having "***the highest quality portfolio and the strongest operating leverage in the mortgage insurance space.***"

125. Bear Stearns, in a report also issued on July 26, 2007, wrote that "[t]he company's risk/capital ratio at 16:1 appears to be higher as well, but the company also indicated that the ratio should decline during the year as the company writes less business than it did in the first half of the year."

126. Also on July 26, 2007, and in response to Defendants' positive comments about Triad's future, analyst Davenport Equity Research reiterated its "Buy" rating for Triad.

127. The market reacted positively to Defendants' statements about earnings and future prospects. To that end, Triad's stock increased over $1 per share from its close of $32.60 per share on July 25, 2007 to close at $33.63 per share on July 26, 2007 on more the double the prior day's trading volume.

128. For the reasons stated above in the Substantive Allegations section, and as detailed herein, the statements contained in ¶¶121-123, which touted, among other things, the Company's capital levels and needs, the relatively low risk associated with its insurance policies, the Company's underwriting standards, and the Company's contingency reserves, were materially false and misleading when made or omitted material facts to make such statements not false or misleading because:

(a) Triad had far greater exposure to losses as a result of its practice of under-pricing Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(b) Triad had far greater exposure to losses as a result of its practice of under-estimating risk on its Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(c) The Company failed to engage in proper underwriting practices for its book of business related to insurance written in 2006 and 2007, including the insurance related to its Alt-A and pay-option ARM products (*see, e.g.*, ¶¶44-58);

(d) The Company lacked effective internal controls to detect manipulation in the pricing and risk assessment processes (*see, e.g.*, ¶¶48-49);

(e) Triad had no reasonable basis to state that it was "comfortable with [its] capital position" (*see, e.g.*, ¶¶36-58, 67-75);

(f) Triad was not focused on loan quality (*see, e.g.*, ¶¶36-58);

(g) Triad was inaccurately evaluating Alt A mortgages, some of which it was pricing as if the mortgages were prime (*see, e.g.*, ¶¶44-45);

(h) The Company failed to disclose the true risks associated with its ability to continue to write new business (*see, e.g.*, ¶¶67-75);

(i) As a result of its under-pricing and manipulation of risk assessment models, Triad was inadequately funding its contingency reserve (*see, e.g.*, ¶¶54-56);

(j) Triad was significantly understating its risk-to-capital ratio because it was undervaluing the risk associated with its insurance policies and not reserving capital commensurate with its actual risk (*see, e.g.*, ¶¶54-56); and

(k) The effort to reassure investors about Triad's contingency reserves, credit quality, and risk-to-capital ratio was part of a scheme to inflate the stock price.

129. As a result of the foregoing, Defendants' positive statements about the Company, its earnings, financial condition, guidance and prospects were lacking in a reasonable basis at all times and materially false and misleading. Moreover, any risk warnings that may have been provided by Defendants in their Class Period statements were not meaningful, were themselves false and misleading, and do not shield Defendants from liability on the basis that such statements were "forward-looking" in that when such statements were made, as detailed above in the Substantive Allegations section, Defendants had actual knowledge of the falsity of the statements being made, recklessly disregarded contrary information demonstrating the falsity of such statements and/or Defendants omitted material facts that would have made such statements not false.

130. On August 9, 2007, Triad filed its quarterly report for the second quarter of fiscal year 2007 on Form 10-Q with the SEC, the period ended June 30, 2007. The 2007 first quarter 10-Q reaffirmed the financial results and statements announced in the press release above in ¶121. In addition, it contained the following false statements:

- "... the number of Modified Pool defaults subject to deductibles and those without deductibles increased at June 30, 2007 from June 30, 2006. This is reflective of the strong growth in the Modified Pool insurance portfolio over the past three years."

- "Our objective is controlled, profitable growth in both Primary and Modified Pool business while adhering to our risk management strategies."

131. Moreover, Defendants Tonnesen and Jones signed SOX certifications consistent with that set forth in ¶88 above. Defendants also attested to the same effectiveness of disclosure controls and procedures as set forth in ¶89 above.

132. As a result of the false statements contained in the Company's 2007 second quarter 10-Q, shares of Triad securities continued to trade at artificially inflated levels as the stock closed at a price of $27.40 per share on August 9, 2007, up from a close of $27.03 on August 8, 2007.

133. For the reasons stated above in the Substantive Allegations section, and as detailed herein, the statements contained in ¶130-131, which touted, among other things, the success of the Company's Modified Pool portfolio and risk management strategies, were materially false and misleading when made or omitted material facts to make such statements not false or misleading because:

(a) Triad had far greater exposure to losses as a result of its practice of under-pricing Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(b) Triad had far greater exposure to losses as a result of its practice of under-estimating risk on its Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(c) The Company lacked effective internal controls to detect manipulation in the pricing and risk assessment processes (*see, e.g.*, ¶¶48-49);

(d) The Company failed to disclose the true risks associated with its ability to continue to write new Modified Pool business (*see, e.g.*, ¶¶67-75);

(e) Triad was not "adhering to [its] risk management strategies" (*see*, *e.g.*, ¶¶36-58);

(f) As a result of its under-pricing and manipulation of risk assessment models, Triad was inadequately funding its contingency reserve (*see*, *e.g.*, ¶¶54-56);

(g) The effort to reassure investors about Triad's contingency reserves, credit quality, and risk-to-capital ratio was part of a scheme to inflate the stock price; and

(h) The Company's Form 10-Q was materially false and misleading because it failed to disclose (in violation of Item 303 of regulation S-K) these materially adverse conditions to the market.

134. As a result of the foregoing, Defendants' positive statements about the Company, its earnings, financial condition, guidance and prospects were lacking in a reasonable basis at all times and materially false and misleading. Moreover, any risk warnings that may have been provided by Defendants in their Class Period statements were not meaningful, were themselves false and misleading, and do not shield Defendants from liability on the basis that such statements were "forward-looking" in that when such statements were made, as detailed above in the Substantive Allegations section, Defendants had actual knowledge of the falsity of the statements being made, recklessly disregarded contrary information demonstrating the falsity of such statements and/or Defendants omitted material facts that would have made such statements not false.

VI. THE RISK FROM DEFENDANTS' FRAUDULENT SCHEME BEGINS TO MATERIALIZE

135. Despite its positive statements about its financial, liquidity, and capital positions, the risk from Defendants' fraudulent scheme began to materialize when, after the market closed on August 27, 2007, the Company reported on Form 8-K with the SEC that it had drawn the entire $80 million principal amount of an unsecured revolving credit facility which it entered into on June 28, 2007. In its Form 8-K, the Company revealed:

> SECTION 2-FINANCIAL INFORMATION
>
> ITEM 2.03 CREATION OF A DIRECT FINANCIAL OBLIGATION OR AN OBLIGATION UNDER AN OFF-BALANCE SHEET ARRANGEMENT OF A REGISTRANT
>
> Triad Guaranty Inc. (the "Company") maintains an $80 million, unsecured revolving credit facility (the "Credit Facility"), which was entered into pursuant to that certain Credit Agreement ("Credit Agreement") dated as of June 28, 2007, among Bank of America, N.A. ("Agent"), Branch Banking & Trust Company, LaSalle Bank, National Association (all three banks collectively, "Current Lenders") and Banc of America Securities LLC. The Credit Facility, which expires in 2010, was entered into to provide short-term liquidity for insurance operations and general corporate purposes. The Credit Agreement contains an option that allows the Company to increase the Credit Facility to an aggregate total of $100 million.
>
> * * *
>
> On August, 22, 2007, the Company drew down the entire $80 million principal amount of the Credit Facility under a Eurodollar rate borrowing. The principal amount of this loan will bear interest at 5.685% for the interest period ending November 23, 2007 ("Maturity Date"). Interest on this loan is due on the Maturity Date. The principal amount must be paid on the Maturity Date unless the Company elects to prepay the loan or extends the loan by giving notice three business days prior to the Maturity Date. Should the Company elect to extend the loan; the Company will be required to notify the Agent in writing of the amount, type of borrowing (base or Eurodollar rate) and interest rate period of the loan continuation. The loan can only be accelerated by an event of default. The proceeds of the loan were placed in short-term investments

> pending future use, if any. Although the Company has no immediate needs for additional liquidity, in light of current market conditions, the Company drew on the Credit Facility to provide it with greater financial flexibility.

136. Market reaction was swift and sharply negative. After closing at a price of $25 per share on August 27, 2007, the stock slid $6 per share, or 24% in one day to close at $19 per share on August 28, 2007 on trading volume over six times the previous day's volume.

137. In a report issued on August 28, 2007, Bear Stearns warned the market that "the impact [of drawing down the entire $80 million credit facility] of any potential action by any of the ratings' agencies is substantial and the risk is certainly greater than zero, and probably higher than it was yesterday or last week. Therefore even at 0.5x book value, the uncertainty surrounding the company continues to concern us."

138. As the market absorbed the Company's announcement and analyst concerns, the stock slid another $2.80 per share to close at $16.20 per share on August 29, 2007. In just two days, the price of Triad securities plummeted by 35.2%.

139. The following day, on August 30, 2007, Fitch Ratings downgraded the long-term issuer and senior debt ratings of Triad to "A" from "A+." Fitch also downgraded the insurer financial strength rating on Triad Guaranty Insurance Corp. to "AA-" from "AA."

140. Then, on August 31, 2007, Defendants sought to reassure the market about the Company's future prospects and liquidity. In a press release, Defendants stated in pertinent part:

> Triad Guaranty Inc. (Nasdaq: TGIC) today responded to declines in its stock price this week following an announcement on Monday, August 27, that it had borrowed $80 million under its revolving line of credit. Mark K. Tonnesen, President and CEO of Triad Guaranty Inc., said, "Following this

announcement on Monday, our stock price declined $7.20 or 32.5% in the subsequent two days of trading. While one can never predict how the market will respond to any announcement, we were surprised at the reaction."

"***The decision to draw down these funds was made by the Board of Directors at a regularly scheduled Board meeting and not in response to any liquidity issues. In fact, at June 30, 2007, we had $26.7 million cash on hand and a very liquid portfolio of municipal and corporate bonds at our disposal. These bonds, totaling $618 million, of which $592 million are municipal bonds, have an average credit quality at the AAA level***. The decision to borrow these funds was made within the context of the historically conservative philosophy of Triad Guaranty against the backdrop of widespread volatility and liquidity concerns in the capital markets, where access to the capital markets was becoming a daily issue for some organizations. We believed it was prudent to have funds on hand and on our balance sheet in the face of this uncertainty. This was especially true given the relatively modest cost associated with obtaining the funds. The proceeds of the loan are being held at the holding company and are invested in short-term instruments."

"Our rationale for this draw-down was echoed by Rodney Clark, a credit analyst at Standard & Poor's in New York. Regarding Triad Guaranty's draw down, he was quoted in Bloomberg News as stating, 'There's a presumption in the market that these draws on credit are an act of desperation. I think they're actually proof that they do have access and liquidity. We don't see anything that might be a major liquidity crunch [for Triad].'"

Mr. Tonnesen concluded, "It is clear that the mortgage industry is under pressure. Home sales have slowed, home prices are retreating, mortgage originations are falling, foreclosures are up and delinquencies are on the rise. ***As we navigate these turbulent times we are relying on our balance sheet and reserves and not the vagaries of the bond or mortgage-backed securities markets to pay our claims.*** As Fitch reported yesterday, 'Triad's ratings incorporate the company's solid balance sheet fundamentals and the strong credit quality of the company's insured portfolio.'"

141. Defendants' reassurances had the desired effect of artificially propping up the price of Triad stock. On September 4, 2007, the next trading day after the August 31, 2007 announcement, Triad shares closed at $17.56 per share, up 11.1% from a close of $15.80 per share on August 30, 3007.

142. For the reasons stated above in the Substantive Allegations section, and as detailed herein, the statements contained in ¶140, which touted, among other things, the Company's capital levels and needs, liquidity, and the Company's contingency reserves, were materially false and misleading when made or omitted material facts to make such statements not false or misleading because:

(a) Triad had far greater exposure to losses as a result of its practice of under-pricing Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(b) Triad had far greater exposure to losses as a result of its practice of under-estimating risk on its Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(c) The Company failed to disclose the true risks associated with its ability to continue to write new business (*see, e.g.*, ¶¶67-75;

(d) As a result of its under-pricing and manipulation of risk assessment models, Triad was inadequately funding its contingency reserve (*see, e.g.*, ¶¶54-56);

(e) Triad was significantly under-capitalized compared to the risks it faced (*see, e.g.*, ¶¶54-58);

(f) Triad was significantly understating its risk-to-capital ratio because it was undervaluing the risk associated with its insurance policies and not reserving capital commensurate with its actual risk (*see, e.g.*, ¶¶54-56); and

(g) The effort to reassure investors about Triad's contingency reserves, credit quality, and risk-to-capital ratio was part of a scheme to inflate the stock price.

143. On October 24, 2007, after the close of trading, Triad issued a press release entitled "Triad Guaranty Inc. Increases Reserves Substantially in the Third Quarter, Reports Net Loss of $31.8 Million." The release stated in part:

> Triad Guaranty Inc. (Nasdaq: TGIC) today reported a net loss for the quarter ended September 30, 2007 of $31.8 million compared with net income of $19.4 million for the same quarter in 2006. The diluted loss per share was $2.13 for the third quarter of 2007 compared to diluted earnings per share of $1.30 for the third quarter of 2006. Realized investment gains, net of taxes, had no impact on diluted per share amounts for the third quarter of 2007 or 2006.
>
> * * *
>
> Mr. Tonnesen continued, "***Triad is known for its efforts to maintain a high quality portfolio and we remain committed to this objective. Nevertheless, our results demonstrate that we are not immune from the forces at play. While it is true that there are many favorable trends in our business, including persistency, improved underwriting and mortgage insurance penetration, we remain cautious regarding the state of the market***. During the quarter, we and our customers significantly tightened guidelines. Our near term goals are to invest in areas of loss mitigation, help all stakeholders better understand our business through increased transparency, and support our customers as they seek quality underwriting decisions."
>
> Total insurance in force reached $68.0 billion at September 30, 2007 compared with $53.9 billion at September 30, 2006. Insurance in force included Primary of $45.3 billion and Modified Pool of $22.7 billion at September 30, 2007, compared with $32.1 billion and $21.8 billion, respectively, for the comparable period in 2006. New insurance written during the third quarter of 2007 totaled $4.4 billion compared with $6.2 billion written in the third quarter of 2006. Primary new insurance written for the third quarter of 2007 was $4.4 billion compared to $3.3 billion in the third quarter of 2006. ***The Company had no Modified Pool transactions in the third quarter of 2007 compared with $3.0 billion for the same period of 2006.*** The underlying volume of structured bulk transactions comprising both

> Primary and Modified Pool business may fluctuate significantly from quarter to quarter.

*   *   *

144. The Company also reported a risk-to-capital ratio of 17.8:1 as of September 30, 2007.

145. The market reacted negatively to this announcement, causing Triad's stock price to plummet by 30.94% on unusually high trading volume.

146. Then, on October 25, 2007, the Company hosted a conference call with various securities analysts. Defendants Tonnesen and Jones participated in this call. During the call, the Individual Defendants again expressed confidence in the Company's capital position and sought to reassure investors about the Company's future prospects:

> **Ken Jones – Triad Guaranty Inc. – SVP and CFO**
>
> *   *   *
>
> On a risk adjusted basis, we were well in excess of the AAA risk-to-capital ratio using standard in force risk adjusted capital model. On page 7 of our supplemental information, we have included the different components of our capital position. During the third quarter, in response to liquidity crisis that was impacting the mortgage markets, we drew down all of our $80 million credit facility, indicating our ability to access the capital markets in spite of the turmoil. ***We presently have $100 million of liquidity in the holding company, providing significant financial flexibility.***
>
> *   *   *
>
> **Mark Tonnesen – Triad Guaranty Inc. – President and CEO**
>
> *   *   *
>
> ***Another area of concern is the primary bulk product, which as Ken mentioned earlier, we had ceased originating.*** This product which is concentrated in 2007 accounts for only 13% of our total portfolio, but early payment default trends are an area of significant focus. It should be noted that

this portfolio consists of 68%, 100% LTV, which we have noted as a source of concern going forward. ***The final area of concern is our modified pool business, although we stopped writing this business in the first quarter and while losses will be limited by deductible and stop loss provisions within the structures, we are finding the defaults rising where the first is accompanied by a simultaneous second. So, what does this lead us to conclude? We must tighten and have tightened guidelines; we must continue to educate lenders on the problem areas we see; we must stop doing business where performance problems persist and take action to limit our exposure on high-LTV lending in soft markets. Is there good news? Most definitely. First of all, we have avoided some of the worst markets, sub-prime and second lien. We believe that this is the major reason why our current delinquency rate is below the industry rate. It is also the reason we believe that our capital requirements as analyzed by S&P are above the AAA level.***

* * *

Continuing on the good news front, there does exist evidence that important positive changes in the market are emerging and a more stringent and pragmatic underwriting environment has been created. We're also encouraged by the decline in simultaneous seconds, as this will boost MI volume as well as the implementation of more stringent underwriting guidelines focused on agency conforming products by lenders. This is prudent and it is good for the mortgage insurance industry. We also believe that continuation of tax deductibility for MI will provide for a more attractive product offering.

Lastly, we continue to find that our message regarding quality is being echoed by the marketplace. Our customer relationships are expanding. For example, we expect that the number of customers with which we do more than $25 million of new insurance written to increase by more than 65% this year. We are also having success in building and enhancing quality relationships. As we continue to advance our agenda of quality, we do realize that we will forego some volume opportunities. On the other hand, reduced volume is also useful as we work to place our limited capital against the best opportunities. But as I said, customers have joined us in this quest for quality. At a recent MBA conference, I was thanked by one lender for providing them advice in early 2006, which helped that lender avoid a risky segment of the all pay market. It is this type of active role that we take in the business that our customers find so valuable. Finally, in Canada we are finding that the story of alliance and partnership resonates with the major lenders and we continue to be encouraged.

So in conclusion, we are disappointed in the short-term results and we have taken aggressive action to reduce or seize business in problem areas. We have identified areas of significant concern and provided detail in our supplemental information to help the investor community better project our ultimate results. We are encouraged on a number of fronts and look forward to the hard work ahead.

* * *

Steve Stelmach – FBR Capital Markets – Analyst

Hi, good morning. You guys mentioned your $100 million of liquidity at the holding company level. How should we think about that in terms of sustaining you guys through what's going to be a pretty difficult couple of years ahead of you. You think that's enough capital or is there a scenario where you see a need to actually go out and try to raise capital even at these sort of depressed levels in some sort.

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

Thanks, Steve.

Steve Stelmach – FBR Capital Markets – Analyst

Sure.

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

Right now, we take a look at our capital and we gave additional information in the supplement, which I would direct you to. We have $600 million plus of hard capital on the balance sheet; we have a $100 million of excess of loss coverage; we have a $185 million of current captive balances; and we would anticipate an additional $200 million to flow to those captives over time. It's clear right now that we have got pressures on the short term, but as I mentioned, those pressures get alleviated for the captive portfolio and you will note in the supplemental information that we gave you good detail to analyze the large proportion of business that we have got covered by captives. That gets alleviated over time, if the current loss rates continue. ***So, for right now, we look at the $100 million in the holding company as giving us a number of degrees of freedom, any of which could help our business as we proceed through these times.***

* * *

Rajiv Patel – SuNova Capital – Analyst

Okay. That clears that up and then just a follow-up to that, so if the captives do kick in in 2009 or later rather than '08, the capital adequacy assumptions you guys are kind of giving out with $100 million of capital at the holding company and such, do those contemplate kind of potentially losing money next year and the potential for, if you do lose money, will you still feel that you have enough capital under those scenarios and what sort of discussions have you had with the regulators under that assumption?

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

What we have done, Rajiv, is given the information to the analyst community to make those assumptions. You take a look at the work that Steve did and I don't know -- I don't have any information regarding how he did it but in his analysis, I think he projected future revenues of about $1.3 billion and future losses of around $950 million. If that -- ***those kind of analyses suggest that capital will not be an issue.***

* * *

147. During the same conference call, Defendant Tonnesen was asked about the Company's decision to stop writing modified pool insurance, and failed to disclose the Company's severe underassessment of the risk associated with these transactions:

Rajiv Patel – SuNova Capital – Analyst

Hey guys, thanks. Just two follow-ups. Your decision to stop rating bulk, is that more kind of market serving or is it just to preserve capital?

Mark Tonnesen - Triad Guaranty Inc - President and CEO

And there are two types of -- thanks, Rajiv, it's a good question. There are two types of bulk business. ***One is primary bulk and primary bulk is written with either, well, basically with deep coverage at over 80% LTV. We have made a decision to stop doing that business over our concerns about the risk associated with that business. On the modified pool business, which has been the bulk of the writings and a significant contributor to our profitability, we have bid indicatively since the beginning of the second quarter, end of first quarter. And the reason that we have done that is that that market is in a lot of turmoil, that products that are coming in are***

changing. We had an affinity to the high FICO, low LTV to pull below 80 LTV all pay business. That business mix has changed, and we are continuing to work with all of our customers to enter that marketplace at the appropriate time.

148. In an analyst report issued the same day, Bear Stearns lowered its rating on Triad to "Underperform."

149. Despite the Company's mounting losses and dramatically increased reserves, investors were comforted by Defendants' positive statements about the Company capital position and future prospects. As a result, shares of Triad securities closed dramatically higher, at $8.53 per share, on October 26, 2007, up $2.49 per share, or 41.2 %, from a closing price of $6.04 on October 25, 2007.

150. For the reasons stated above in the Substantive Allegations section, and as detailed herein, the statements contained in ¶¶143-144 and ¶¶146-47, which touted, among other things, the Company's capital levels and needs, the Company's liquidity, and the Company's risk levels, were materially false and misleading when made or omitted material facts to make such statements not false or misleading because:

(a) Triad had far greater exposure to losses as a result of its practice of under-pricing Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(b) Triad had far greater exposure to losses as a result of its practice of under-estimating risk on its Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(c) The Company lacked effective internal controls to detect manipulation in the pricing and risk assessment processes (*see, e.g.*, ¶¶48-49);

(d) The Company failed to disclose the true risks associated with its ability to continue to write new business (*see, e.g.*, ¶¶67-75);

(e) As a result of its under-pricing and manipulation of risk assessment models, Triad was inadequately funding its contingency reserve (*see, e.g.*, ¶¶54-56);

(f) Triad was significantly understating its risk-to-capital ratio because it was undervaluing the risk associated with its insurance policies and not reserving capital commensurate with its actual risk (*see, e.g.*, ¶¶54-56); and

(g) The effort to reassure investors about Triad's contingency reserves, credit quality, and risk-to-capital ratio was part of a scheme to inflate the stock price.

151. As a result of the foregoing, Defendants' positive statements about the Company, its earnings, financial condition, guidance and prospects were lacking in a reasonable basis at all times and materially false and misleading. Moreover, any risk warnings that may have been provided by Defendants in their Class Period statements were not meaningful, were themselves false and misleading, and do not shield Defendants from liability on the basis that such statements were "forward-looking" in that when such statements were made, as detailed above in the Substantive Allegations section, Defendants had actual knowledge of the falsity of the statements being made, recklessly disregarded contrary information demonstrating the falsity of such statements and/or Defendants omitted material facts that would have made such statements not false.

152. On November 9, 2007, Triad filed its quarterly report for the third quarter of fiscal year 2007 on Form 10-Q with the SEC, the period ended September 30, 2007. The 2007 third quarter 10-Q reaffirmed the financial results and statements announced in the press release above in ¶143. In addition, it contained the following false statement:

- Our objective is controlled, profitable growth in both Primary and Modified Pool business while adhering to our risk management strategies.

153. Moreover, Defendants Tonnesen and Jones signed SOX certifications consistent with that set forth in ¶88 above. Defendants also attested to the same effectiveness of disclosure controls and procedures as set forth in ¶89 above.

154. As a result of the false statements contained in the Company's 2007 third quarter 10-Q, shares of Triad securities continued to trade at artificially inflated levels as the stock closed at a price of $8.58 per share on November 9, 2007, up from a close of $6.69 on November 8, 2007, a one-day rise of 28.2%.

155. For the reasons stated above in the Substantive Allegations section, and as detailed herein, the statement contained in ¶¶152-153, which touted, among other things, the success of the Company's Modified Pool portfolio and risk management strategies, were materially false and misleading when made or omitted material facts to make such statements not false or misleading because:

(a) Triad had far greater exposure to losses as a result of its practice of under-pricing Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(b) Triad had far greater exposure to losses as a result of its practice of under-estimating risk on its Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(c) The Company lacked effective internal controls to detect manipulation in the pricing and risk assessment processes (*see*, *e.g.*, ¶¶48-49);

(d) Triad was not adhering to its stated risk management strategies (*see*, *e.g.*, ¶¶36-58);

(e) The Company failed to disclose the true risks associated with its ability to continue to write new Modified Pool business (*see, e.g.*, ¶¶67-75);

(f) As a result of its under-pricing and manipulation of risk assessment models, Triad was inadequately funding its contingency reserve (*see, e.g.*, ¶¶54-56);

(g) The effort to reassure investors about Triad's contingency reserves, credit quality, and risk-to-capital ratio was part of a scheme to inflate the stock price; and

(h) The Company's Form 10-Q was materially false and misleading because it failed to disclose (in violation of Item 303 of regulation S-K) these materially adverse conditions to the market.

156. As a result of the foregoing, Defendants' positive statements about the Company, its earnings, financial condition, guidance and prospects were lacking in a reasonable basis at all times and materially false and misleading. Moreover, any risk warnings that may have been provided by Defendants in their Class Period statements were not meaningful, were themselves false and misleading, and do not shield Defendants from

liability on the basis that such statements were "forward-looking" in that when such statements were made, as detailed above in the Substantive Allegations section, Defendants had actual knowledge of the falsity of the statements being made, recklessly disregarded contrary information demonstrating the falsity of such statements and/or Defendants omitted material facts that would have made such statements not false.

157. On February 13, 2008, after the close of trading, Triad issued a press release entitled "Triad Guaranty Inc. Reports $75.0 Million Loss for Fourth Quarter Reflecting Further Deterioration in the Housing and Mortgage Markets." The release stated in pertinent part:

> Triad Guaranty Inc. (Nasdaq: TGIC) today reported a net loss for the quarter ended December 31, 2007 of $75.0 million compared with net income of $8.1 million for the same quarter in 2006. The diluted loss per share was $5.05 for the fourth quarter of 2007 compared to diluted earnings per share of $0.54 for the fourth quarter of 2006. Realized investment losses, net of taxes, had no impact on diluted per share amounts for the fourth quarter of 2007 or 2006.
>
> * * *
>
> Mr. Tonnesen continued, "During the fourth quarter, we took a leadership role in our industry by tightening underwriting guidelines. Our new guidelines, which address loan to value limitations, credit scores and loan documentation, and incorporate volume limitations in distressed markets, led to our reduced fourth quarter production and are expected to further limit production in 2008. The Company has developed and is actively pursuing a plan to manage and enhance its capital resources. Although, at this time, we can give no assurance that we will be able to successfully implement our plan, we realize these efforts are critically important to the future of Triad Guaranty. Thus, enhancing capital resources is a top priority. Capital management dictated our decision during the quarter to withdraw from Canada and contribute this capital to our U.S. insurance subsidiary."
>
> * * *

158. The Company also reported a risk-to-capital ratio of 20.5:1 as of December 31, 2007.

159. Then, on February 14, 2008, the Company hosted a conference call with various securities analysts. Defendants Tonnesen and Jones participated in this call. During the call, the Individual Defendants again sought to reassure investors about the Company's long-term prospects and downplayed the capital risks then-facing Triad:

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

* * *

> The rapid and significant deterioration in the housing and mortgage markets and the resulting impact on our portfolio performance has prompted us to concentrate primarily on four strategic imperatives. First, we are focused on our objective of writing quality business. Second, we are committed to improving our capital resources. Third, we are adding resources and creating new strategies to help mitigate losses. And lastly, we are working to manage our talent and reduce expenses appropriately during these turbulent times. The prospects of declining home prices and continued uncertainty in the economy have made us cautious as we write new business going forward.
>
> In this regard, during the fourth quarter, we implemented tighter underwriting guidelines. Our new underwriting guidelines address loan-to-value limitations, credit scores and loan documentation and also incorporate volume limitations in distressed markets. Additionally, we have eliminated products and programs that present high volatility. ***Although we believe that these guidelines will go a long way toward ensuring a long-term quality portfolio***, the short-term consequence will be to restrict our over-all volume of business. This is evidenced by our fourth quarter production which fell by 39% from the third-quarter levels and 56% from our fourth quarter 2006. While our actions may limit or eliminate our business with certain lenders that do not have quality products that meet our guidelines, we remain committed to maintaining positive customer relationships with most of our key lenders during these turbulent times. Our sales force has done a remarkable job implementing our restrictions and educating our customers on the need to do so.

* * *

So in conclusion, we are disappointed by our short-term results, and we have taken aggressive action to reduce or cease our business in problem areas. ***We are actively producing a plan to manage and enhance our existing capital, and while we cannot predict the outcome of these results we are dedicating substantial resources to this priority.***

The coming year presents many challenges but I believe that we are prepared for the hard work ahead.

* * *

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

* * *

Our point of view is that most of the business, the vast majority of the business that we have written is fine, and some of the business that we have written is bad. And the bad parts of the portfolio are concentrated in places where home prices are under pressure. What we are looking for before we -- before we relax about the overall quality of the business available to us is we want to see some stabilization in home prices and perhaps more importantly, a balance in supply and demand. We continue to see the months of supply increase in the -- of homes increase in the distressed markets, and we are looking to see that trend stop. When supply and demand get into more reasonable -- into a more reasonable balance, we are going to have a much improved confidence about the business being offered.

Meanwhile, we continue to work hard on the problem areas, that minority of the portfolio which is causing distress on our P&L.

* * *

Mark Tonnesen – Triad Guaranty Inc. – President and CEO

* * *

First of all, our primary focus as we are evaluating the options going forward is our current stockholder -- our current stockholder base and the long-term success of the Company. So, in each and every single one of the strategies, we evaluated first and foremost from a current stockholder perspective. So obviously, strategies have different effects on the -- on delusion and -- and that influences greatly our view as to the opportunities that might be available. So I would tell you that in addition to the management team's current involvement in all of the capital raising activities, the Chairman of our Board, Will Ratliff has been intimately involved. We have also established at the Board level a special committee to review financing and capital-raising alternatives, and as

> Will is a significant shareholder himself, ***we feel very, very confident that all of our activities are undergoing the scrutiny that our shareholders would want us to undertake.***

160. Despite the Company's mounting losses and increased reserves, Defendants' positive statements about the Company's future prospects and efforts to shore up capital had the desired effect of steadying the price of Triad securities. In fact, on the day before the earnings announcement, February 13, 2008, Triad closed at a price of $6.01 per share. By February 19, 2008, the price of Triad shares had increased to $6.58 per share on heavy trading volume, an increase of 9.48%.

161. For the reasons stated above in the Substantive Allegations section, and as detailed herein, the statements contained in ¶¶157-159, which touted, among other things, the Company's ability to raise capital, were materially false and misleading when made or omitted material facts to make such statements not false or misleading because:

(a) Triad had far greater exposure to losses as a result of its practice of under-pricing Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(b) Triad had far greater exposure to losses as a result of its practice of under-estimating risk on its Modified Pool and other structured bulk insurance than the Company told investors (*see, e.g.*, ¶¶36-58);

(c) The Company lacked effective internal controls to detect manipulation in the pricing and risk assessment processes (*see, e.g.*, ¶¶48-49);

(d) The Company failed to disclose the true risks associated with its ability to continue to write new business (*see, e.g.*, ¶¶67-75);

(e) As a result of its under-pricing and manipulation of risk assessment models, Triad was adequately funding its contingency reserve (*see, e.g.*, ¶¶54-56);

(f) Triad was significantly understating its risk-to-capital ratio because it was undervaluing the risk associated with its insurance policies and not reserving capital commensurate with its actual risk (*see, e.g.*, ¶¶54-56); and

(g) The effort to reassure investors about Triad's contingency reserves, credit quality, and risk-to-capital ratio was part of a scheme to inflate the stock price.

162. As a result of the foregoing, Defendants' positive statements about the Company, its earnings, financial condition, guidance and prospects were lacking in a reasonable basis at all times and materially false and misleading. Moreover, any risk warnings that may have been provided by Defendants in their Class Period statements were not meaningful, were themselves false and misleading, and do not shield Defendants from liability on the basis that such statements were "forward-looking" in that when such statements were made, as detailed above in the Substantive Allegations section, Defendants had actual knowledge of the falsity of the statements being made, recklessly disregarded contrary information demonstrating the falsity of such statements and/or Defendants omitted material facts that would have made such statements not false.

163. Despite the Company's glowing statements about the risk levels associated with the insurance it had written, long-term prospects, successes of its Modified Pool

business, and capital position, the risk from Defendants' fraud fully materialized when, after the market closed on April 1, 2008, Triad filed its annual report for fiscal year 2007 on Form 10-K with the SEC, the period ended December 31, 2007. The 2007 10-K disclosed, for the first time, the dire financial condition facing the Company. To that end, the Company announced: (a) that it had not been successful in obtaining any new capital commitments to date and would likely need to raise capital no later than the second quarter of 2008 in order to continue writing insurance and (b) the potential for having its portfolio placed in a run-off. In that case, Fannie Mae and Freddie Mac would have the right to effectively cancel Triad's policies and transfer the risk to other, better-capitalized insurers. Moreover, Triad's ability to write new policies would be severely reduced or eliminated.

164. Analyst and market reaction to Triad's disclosures was swift. On April 2, 2008, Bear Stearns declared that Triad was in a "True Catch-22" and that, "without a capital injection it is difficult to see how Triad can keep its risk/capital ration below 22x (the threshold for its $80 million credit facility) or 25x (the threshold imposed by most state insurance commissioners)." Bear Stearns continued to rate Triad as "Underperform."

165. Also on April 2, 2008, Fitch Ratings downgraded Triad's insurer financial strength from "A-" to "BBB-."

166. Upon these revelations and analyst commentary, the market punished Triad stock. Shares of Triad, which closed at $5.25 per share prior to the filing of the 2007 10-K on April 1, 2008, plummeted to $2.15 per share on April 4, 2008 as the market absorbed the news, a staggering loss of 59% on extremely high trading volume.

VII. POST-CLASS PERIOD FALLOUT AND FURTHER MATERIALIZATION OF RISK

167. After the close of the Class Period, Triad continued to report increasing troubles with its capital position that ultimately forced the Company to cease writing all new insurance policies.

168. In particular, on May 12, 2008, Triad issued a press release reporting a first quarter net loss of $150 million, compared with net income of $17.3 million for the first quarter of 2007. The Company also announced plans to liquidate its Canadian subsidiary. The press release stated:

> Triad Guaranty Inc. (Nasdaq: TGIC) today reported a net loss for the quarter ended March 31, 2008 of $150.0 million compared with net income of $17.3 million for the same quarter in 2007. The diluted loss per share was $10.09 for the first quarter of 2008 compared to diluted earnings per share of $1.16 for the first quarter of 2007. Realized investment gains, net of taxes, decreased the loss per share by $0.12 in the first quarter of 2008 while increasing the earnings per share by $0.03 in the first quarter of 2007.
>
> Mark K. Tonnesen, President and Chief Executive Officer, said, "The negative trends we encountered during the second half of 2007 continued to impact us during the first quarter of 2008. Housing prices remain under pressure across the country and the distressed markets of Florida, California, Arizona and Nevada continue to be particularly affected. Our reserves for existing defaults increased by $174.6 million during the first quarter, reflecting continued growth in risk in default, with the distressed markets contributing 67% of the growth in reserves. Additionally, we recorded a net $49.8 million pre-tax charge to recognize a premium deficiency. Also, we have decided to liquidate our Canadian subsidiary and recorded a $2 million pre-tax charge to reflect the cost associated with winding down this operation."

* * *

169. Then, on June 19, 2008, Triad announced that its efforts to appeal its suspension as an approved mortgage insurer of Freddie Mac were denied, that its

negotiations with another company for a capital infusion had failed, and that it would enter a run-off and cease writing new insurance policies:

> Triad Guaranty Inc. (Nasdaq: TGIC) announced today that it has ended its negotiations with Lightyear Capital LLC to form a new mortgage insurance company. Triad also reported today that Freddie Mac informed Triad that the appeal of its subsidiary's suspension as an approved mortgage insurer has been denied. As a result of these developments, Triad's subsidiary, Triad Guaranty Insurance Corporation, ***will cease issuing commitments for mortgage*** insurance effective July 15, 2008 and will work with its customers, the Illinois Division of Insurance and each of the GSEs to assure an orderly transition of its business to run-off.

* * *

170. On this news, shares of Triad, which were only trading at $2.05 per share on June 18, 2008, closed down $0.83 per share, or 40.5%, to $1.22 on June 19, 2008 on extremely heavy trading volume (1,235,400 shares).

171. Shortly after announcing the Company would no longer be writing new insurance policies, Triad announced the retirement of Defendant Tonnesen. In a press release issued on July 17, 2008, the Company stated:

> Triad Guaranty Inc. (Nasdaq: TGIC) announced today that its President and Chief Executive Officer, Mark K. Tonnesen, will retire from the company on August 15, 2008. William Ratliff, Chairman of Triad's Board of Directors, will assume these positions on an interim basis, in addition to his current role, effective July 18, 2008.
>
> ***Following the determination by the company's Board earlier this year that Triad would ultimately transition its business into run-off, Mr. Tonnesen and the company agreed to revise his employment agreement and announced that Mr. Tonnesen would retire by year-end.*** Under his revised employment agreement, Mr. Tonnesen will remain a consultant to Triad for two years following his retirement.

> On June 19th, Triad announced that as of July 15th its subsidiary, Triad Guaranty Insurance Corporation, would cease issuing commitments for mortgage insurance and transition its business into voluntary run-off. This followed unsuccessful efforts to raise capital and to participate in the formation of a new mortgage insurer.
>
> ***"My plan was to retire at an appropriate time," explained Mr. Tonnesen. "Now that the company's fundamental business and mission have changed, that time is here.*** And, with Will at the helm, we can rest assured that company values will be maintained and that the Board and management will be completely aligned in terms of the strategy going forward."
>
> The company also announced that it has begun the process of identifying a successor for Mr. Tonnesen.

172. In subsequent news releases, Triad continued to report staggering losses. On August 4, 2008, the Company announced a net loss of $198.8 million in the second quarter of 2008.

173. The following day, on August 5, 2008, Triad entered into an Agreed Corrective Order with the Illinois Division of Insurance (the "Division"). The Corrective Order was implemented as a result of Triad's decision to cease writing new mortgage guaranty insurance and to commence a run-off of its existing insurance in force as of July 15, 2008. Among other things, the Corrective Order:

- Required TGIC to submit a corrective plan to the Division;
- Prohibited all stockholder dividends from TGIC to its parent company without the prior approval of the Division;
- Prohibited interest and principal payments on TGIC's surplus note to its parent company without the prior approval of the Division;
- Restricted TGIC from making any payments or entering into any transaction that involves the transfer of assets to, or liabilities from, any affiliated parties without the prior approval of the Division;

- Required TGIC to obtain prior written approval from the Division before entering into certain transactions with unaffiliated parties;
- Required TGIC to meet with the Division in person or via teleconference as necessary; and
- Required TGIC to furnish to the Division certain reports, agreements, actuarial opinions and information on an ongoing basis at specified times.

174. Thereafter, on November 10, 2008, Triad reported a net loss of $160.1 million for the third quarter of 2008. For fiscal 2008, as the Company announced on February 27, 2009, Triad suffered a net loss of $631.2 million.

VIII. ADDITIONAL SCIENTER ALLEGATIONS

175. The Individual Defendants acted with scienter in that they knew or recklessly disregarded that the public documents and statements issued or disseminated in the name of the Company were materially false and misleading, and knowingly or severely recklessly substantially participated or acquiesced in the issuance or dissemination of such statements or documents as primary violators of the federal securities laws.

176. Indeed, the Individual Defendants, by virtue of their receipt of information reflecting the true facts regarding Triad and its business practices, their control over and/or receipt of Triad's allegedly materially misleading misstatements and/or their associations with the Company that made them privy to confidential proprietary information concerning Triad, were active and culpable participants in the fraudulent scheme alleged herein. The Individual Defendants knew and/or severely recklessly disregarded the falsity and misleading nature of the information, which they caused to be disseminated to the investing

public. The ongoing fraud as described herein could not have been perpetrated over a substantial period of time, as has occurred, without the knowledge and/or severe recklessness and complicity of the personnel at the highest level of the Company, including the Individual Defendants. (*See* ¶¶20-24).

177. In addition to the numerous allegations throughout the Complaint, herein incorporated by reference, demonstrating the Individual Defendants' scienter, for the reasons further detailed herein, each of the Individual Defendants had knowledge of or recklessly disregarded that the public statements and documents the Company issued or disseminated were materially false and misleading.

178. Specifically, the Individual Defendants were members of Triad's Risk Management Committee, which was tasked with overseeing pricing and the risk being borne by the Company. Through monthly meetings, the Individual Defendants were kept apprised of pricing and loss rates on the Company's portfolio. Then, in March 2007, the Individual Defendants were specifically told about the under-pricing and undervaluing of risk occurring in the Company's structured bulk channel. *See* Ex. A. These claims were backed by an independent consulting firm that confirmed what was reported to senior executives, including the Individual Defendants, in March 2007. Moreover, long before the March 2007 presentation, numerous top-level employees expressed deep concerns over the Company's risk management and pricing practices and about Foster in particular (*see, e.g.*, ¶¶61-66). Also, throughout the Class Period, the Individual Defendants attended weekly operations committee meetings with other senior executives where the overall operations of the

Company were routinely discussed (*see, e.g.*, ¶60). The Individual Defendants also had access to internal Company documents, such as the "Monthly Claim Payments and Pipeline Detail Report," that set forth the inappropriately low amounts that Triad was reserving for defaults (*see, e.g.*, ¶57).

179. In addition, Defendants undertook the affirmative obligation to obtain knowledge in order to ensure that the Company's disclosures to the market were truthful by executing SOX certifications (*see, e.g.*, ¶¶88).

180. Likewise, Defendants repeatedly certified that the Company's internal controls and procedures over financial reporting were effective (*see, e.g.* ¶104). However, as confirmed by the former Vice President of Risk Analytics and contrary to the Individual Defendants' attestations, Triad lacked sufficient internal controls in at least two significant ways. First, as described above, Triad's risk modeling on Modified Pool insurance was manipulated to such a degree that it amounted to no risk modeling at all and left the Company significantly undercapitalized when compared to the risk the Company assumed in writing Modified Pool insurance. Second, also with regard to Modified Pool insurance, there was a conflict of interests between the Company's risk and pricing modeling in that both models were managed by the same person: Foster.

181. Finally, Defendants' public statements alleged to be false and misleading herein all relate to the Company's core operations. To be sure, as a mortgage insurance company, the evaluations of risk and capital reserves, as well as developing and following pricing models commensurate with the risk undertaken, are central components of Triad's

business model which, as senior executives, the Individual Defendants were, or should have been, aware of. Moreover, as a mortgage insurance company, Triad was obligated to comply with numerous state insurance regulations governing, *inter alia*, reserves and risk-to-capital ratios. Because the Individual Defendants were tasked, by law, to comply with such regulations, the Individual Defendants knew, or should have known, about Triad's calculations of reserves and other items mandated by state insurance laws and regulations.

IX. PRESUMPTION OF RELIANCE: FRAUD ON THE MARKET DOCTRINE

182. The market for Triad's publicly traded securities was open, well-developed and efficient at all times. As a result of these materially false and misleading statements and failures to disclose, Triad's publicly traded securities traded at an artificially inflated price during the Class Period. Lead Plaintiff and other members of the Class purchased or otherwise acquired Triad's publicly traded securities relying upon the integrity of the market price of those securities and the market information relating to Triad, and have been damaged thereby.

183. At all relevant times, the market for Triad's securities was an efficient market for the following reasons, among others:

(a) Triad's stock met the requirements for listing, and was listed and actively traded on NASDAQ, a highly efficient and automated market;

(b) As a regulated issuer, Triad regularly made public filings, including its Form 10-K, Forms 10-Q and related press releases with the SEC and NASDAQ;

(c) Triad regularly communicated with public investors via established market communication mechanisms, including through regular disseminations of press releases on the national circuits of major newswire services and through other wide-ranging public disclosures, such as communications with the financial press and other similar reporting services; and

(d) Triad was widely followed by securities analysts employed by major brokerage firms such as Davenport & Company, Fitch Ratings, Wachovia Capital Markets, and Bear Sterns, and who wrote research reports, which were distributed to the brokerage firms' sales force, and the public at large. Each of these reports was publicly available and entered the public market place.

184. As a result of the foregoing, the markets for Triad's securities promptly digested current information regarding Triad from all publicly available sources and reflected such information in the prices of Triad securities.

185. Under these circumstances, all purchasers of Triad's securities during the Class Period suffered similar injury through their purchase of Triad's securities at artificially inflated prices and a presumption of reliance applies.

186. At the times they purchased or otherwise acquired Triad's securities, Lead Plaintiff and other members of the Class were without knowledge of the facts concerning the wrongful conduct alleged herein and could not reasonably have discovered those facts. As a result, the presumption of reliance applies. Lead Plaintiff will also rely, in part, upon the presumption of reliance established by a material omission.

187. In sum, Lead Plaintiff will rely, in part, upon the presumption of reliance established by the fraud-on-the-market doctrine in that:

(a) Defendants made public misrepresentations or failed to disclose facts during the Class Period;

(b) The omissions and misrepresentations were material;

(c) The Company's securities traded in an efficient market;

(d) The misrepresentations alleged would tend to induce a reasonable investor to misjudge the value of the Company's securities; and

(e) Lead Plaintiff and the other members of the Class purchased the Company's securities between the time Defendants misrepresented or failed to disclose material facts and the time the true facts were disclosed, without knowledge of the misrepresented or omitted facts.

X. LOSS CAUSATION

188. As detailed herein, Defendants' fraudulent scheme artificially inflated Triad's stock price by failing to disclose that: (a) Triad had far greater exposure to losses as a result of its practice of under-pricing Modified Pool and other structured bulk insurance than the Company told investors; (b) Triad had far greater exposure to losses as a result of its practice of under-estimating risk on its Modified Pool and other structured bulk insurance than the Company told investors; (c) the Company failed to engage in proper underwriting practices for its book of business related to insurance written in 2006 and 2007, including the insurance related to its Alt-A and pay-option ARM products; (d) the Company lacked

effective internal controls to detect manipulation in the pricing and risk assessment processes; (e) the Company failed to disclose the true risks associated with its ability to continue to write new business; (f) as a result of its under-pricing and manipulation of risk assessment models, Triad was inadequately funding its contingency reserve; (g) Triad was significantly understating its risk-to-capital ratio because it was undervaluing the risk associated with its insurance policies and not reserving capital commensurate with its actual risk; and (h) the effort to reassure investors about Triad's contingency reserves, liquidity, credit quality, and risk-to-capital ratio was part of a scheme to inflate the stock price.

189. These false and misleading statements, individually and collectively, concealed Triad's true financial circumstances and future business prospects, resulting in the stock being artificially inflated until, as indicated herein, the relevant truth about Triad was revealed. While each of these misrepresentations was independently fraudulent, they were all motivated by Defendants' desire to artificially inflate Triad's stock price and the image of its future business prospects to give the market the false notion that Triad's business was appropriately capitalized and on solid footing. Defendants' false and misleading statements had the intended effect and caused, or were a substantial contributing cause, of Triad's stock trading at artificially inflated levels throughout the Class Period.

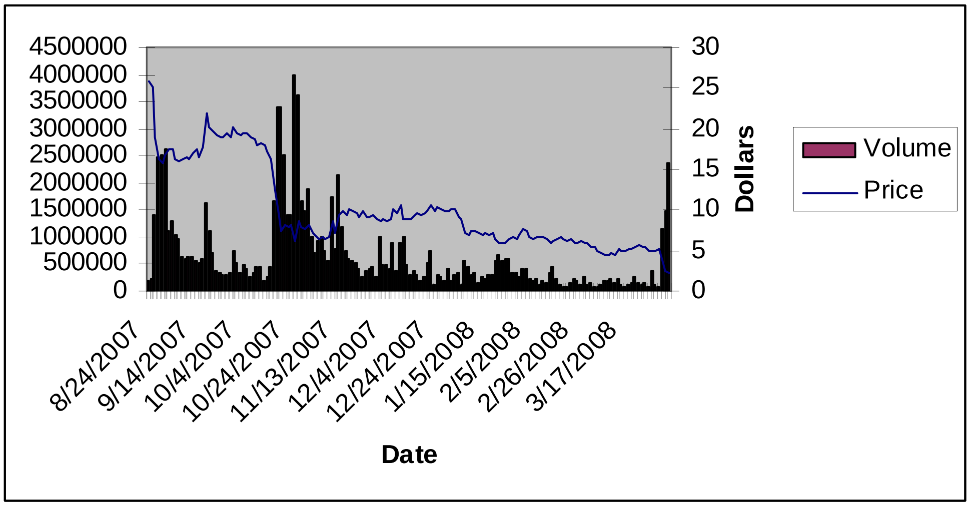
190. As stated in Section VI, the true picture of Defendants' illicit scheme, and the Company's true financial condition was not revealed to the market all at once. Rather, beginning on August 27, 2007, when the Company announced that it had drawn the entire $80 million principal amount of an unsecured revolving credit facility which it had entered

into on June 28, 2007, the market began to ask questions, causing the truth to emerge, and the risk caused by Defendants' fraud materialized through a series of partial revelations which cast doubt on the veracity of the Company's Class Period statements, for example:

- **August 27, 2007**: The Company filed a Form 8-K, revealing that on August 22, 2007, the Company drew down the entire $80 million principal amount of its Credit Facility with Bank of America Securities, LLC, Branch Banking & Trust Company, LaSalle Bank, National Association and Banc of America Securities LLC. The Company stated that in light of market conditions it drew on this Credit Facility to provide itself with greater flexibility. As a result of this revelation, Triad's stock price fell 24% in one day to close at $19 per share on August 28, 2007, on trading volume over six times the previous day's volume.

- **October 24, 2007**: Triad issued a press release reporting a net loss of $31.8 million for the quarter ended September 30, 2007, and that it had increased its reserves substantially. In an analyst report issued the next day, Bear Sterns lowered its rating on Triad to "Underperform."

191. As a result of this series of partial revelations of the true operating condition of the Company, the truth began to make its way into the marketplace, and as the risk caused by Defendants' fraud began to materialize, doubt was cast on the veracity of Defendants' prior public statements. Additionally, these partial revelations were the natural and direct consequence (*i.e.*, materialization of the risk) of the fraud described herein. As a result of the market becoming increasingly aware of Triad's problems, the artificial inflation began to slowly fall out of Triad's stock price, as detailed in the chart below:



192. This stock drop would have been even more significant had the full truth regarding Triad's business and financial condition been known. However, in August of 2007, in the face of market concerns and uncertainty regarding the Company's increasing loss reserves and market conditions, Defendants continued to make false and misleading statements in order to maintain an appearance that the Company was on solid footing and to artificially prop up Triad's stock price, for example:

- "The decision to draw down these funds was made by the Board of Directors at a regularly scheduled Board meeting and not in response to any liquidity issues. In fact, at June 30, 2007, we had $26.7 million cash on hand and a very liquid portfolio of municipal and corporate bonds at our disposal. These bonds, totaling $618 million, of which $592 million are municipal bonds, have an average credit quality at the AAA level." ¶140.

- "As we navigate these turbulent times we are relying on our balance sheet and reserves and not the vagaries of the bond or mortgage-backed securities markets to pay our claims. As Fitch reported yesterday, 'Triad's ratings incorporate the company's solid balance sheet fundamentals and the strong credit quality of the company's insured portfolio.'" ¶140.

- "Triad is known for its efforts to maintain a high quality portfolio and we remain committed to this objective. . . ." ¶143.

- "We presently have $100 million of liquidity in the holding company, providing significant financial flexibility." ¶146.

- "We are actively producing a plan to manage and enhance our existing capital, and while we cannot predict the outcome of these results we are dedicating substantial resources to this priority. . . .The coming year presents many challenges but I believe that we are prepared for the hard work ahead." ¶159.

- "Our point of view is that most of the business, the vast majority of the business that we have written is fine . . . ." ¶159.

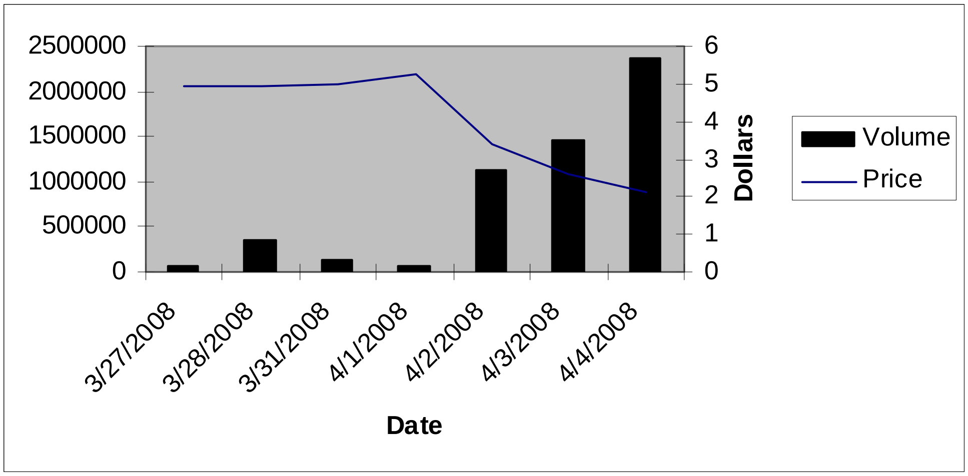
- ". . . we feel very, very confident that all of our activities are undergoing the scrutiny that our shareholders would want us to undertake." ¶159.

193. These false and misleading statements and omissions, among others, had the intended effect of preventing the market from learning the full truth and keeping the Company's stock price artificially inflated throughout the Class Period. The true picture of Triad's business, operations and finances was finally disclosed to the market on April 1, 2008, when the Company filed its annual report for fiscal year 2007 on Form 10-K with the SEC, disclosing for the first time the dire financial condition facing the Company. Indeed, the Company announced that it had not been successful in obtaining any new capital commitments and would need to significantly augment its capital resources in the second quarter of 2008 in order to continue writing new insurance policies. Otherwise, the Company would seek to implement a plan to "run off". If that occurred, Fannie Mae and Freddie Mac had the right to effectively cancel Triad's policies and transfer the risk to other

better-capitalized insurers. This would also stymie Triad's ability to write new policies, if not eliminate it entirely.

194. When Triad provided the market with these revelations of its true financial condition, it was an indication to the market that Defendants' prior Class Period statements were false and misleading. As a result of the information revealed to the market on April 1, 2008, which made its way into the marketplace over the subsequent trading days, the market cast doubt on the veracity of Defendants' prior statements, causing Triad's stock to drop approximately 59%, as it fell from $5.25 after the market closed on April 1, 2008 to close at $2.15 on abnormally high trading volume on April 4, 2008.

195. The market's negative reactions to Triad's April 1, 2008 revelations are demonstrated in the stock chart below:



196. The rapid decline in Triad's stock price following the Company's April 1, 2008 disclosure was a direct and foreseeable consequence of the revelation of the falsity of Defendants' Class Period misrepresentations and omissions to the market, as well as the materialization of the risk created by Defendants' fraud. Thus, the revelation of truth and the

materialization of the risk created by Defendants' fraud at the close of the Class Period, as well as the resulting clear market reaction, support a reasonable inference that the market understood that Defendants' prior public statements were false and misleading.

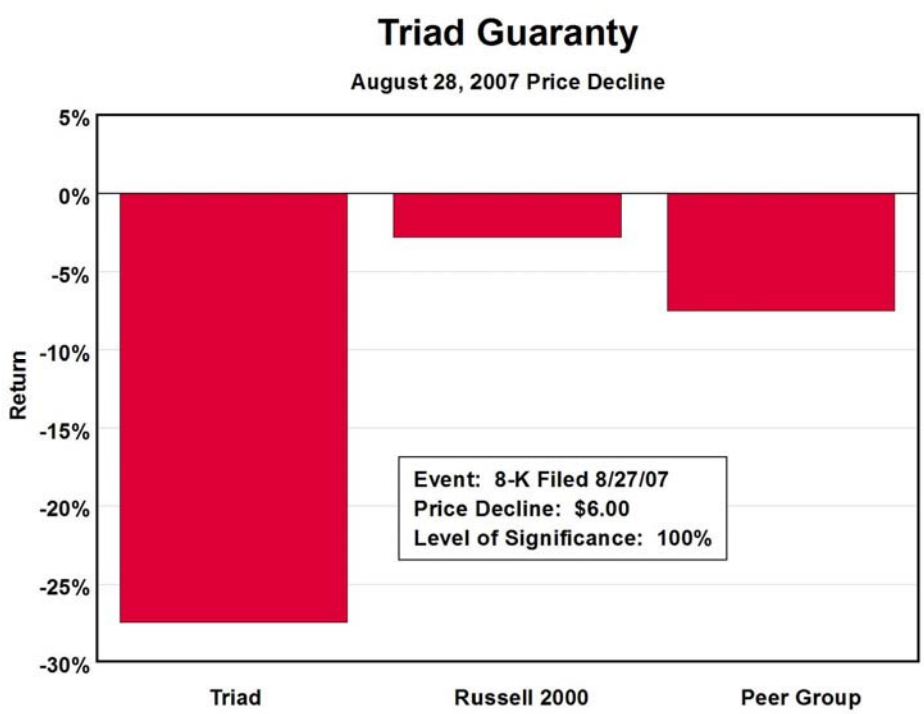
197. In sum, as the truth about Defendants' prior misrepresentations and concealments was revealed, and the risk created by Defendants' fraud materialized, the Company's stock price quickly sank, the artificial inflation came out of the stock, and Lead Plaintiff and members of the Class suffered economic losses.

198. The declines in Triad's stock price following these disclosures were a direct result of the nature and extent of the revelations made to investors and the market regarding Triad's true financial condition, its inability to obtain any new capital commitments, and that it was facing a run-off that would prevent it from writing any new policies, that had been concealed or misrepresented by Defendants' scheme and misstatements.

199. There are well-accepted methodologies available for determining with known error rates whether stock price declines of Triad's common stock during the Class Period are the result of non-Triad specific macroeconomic, industry, or sector factors, for example, the contraction of the housing industry, or overall economy. Applying these methodologies and taking into account non-Triad specific macroeconomic, industry, or sector factors, the timing and magnitude of Triad's stock price declines negate any inference that the losses suffered by Lead Plaintiff were caused by changed market conditions, macroeconomic or industry factors or Company-specific facts unrelated to the Defendants' fraudulent conduct. After extracting general market and industry conditions between August 27, 2007 and

August 29, 2007, October 24, 2007 and October 25, 2007, and April 1, 2008 and April 4, 2008, the price of Triad's stock on those dates reacted with a high statistical significance to the revelations detailed above.

200. Indeed, while the price of Triad's stock declined 27.44% between August 27, 2007 and August 28, 2007,[16] the Russell 2000 Index ("Russell 2000") and the Equally-Weighted Index of Returns of MGIC Investment Corp, Radian Group, and PMI Group ("Peer Group") did not experience similar declines. Indeed, as demonstrated in the chart below, on August 28, 2007, the Russell 2000 was down by only 2.78% and the Peer Group was down by only 7.51%:



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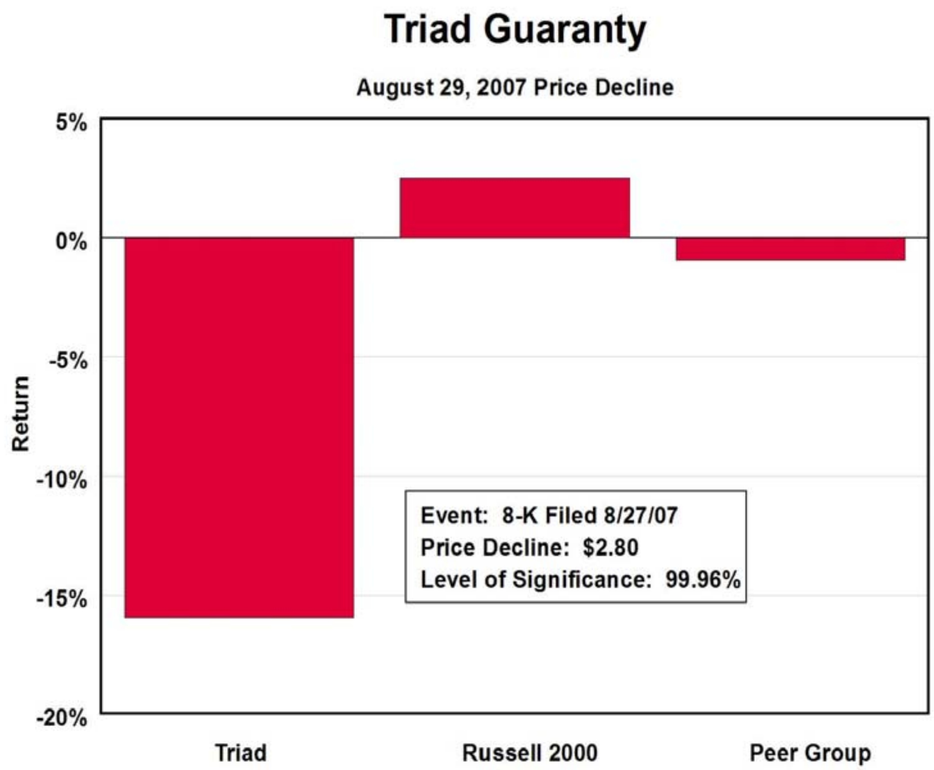
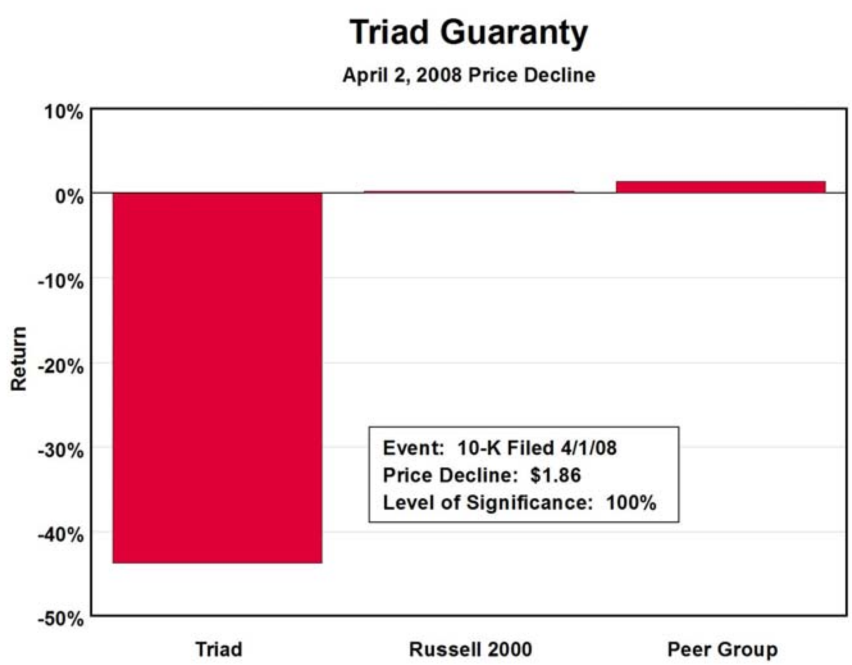
16 The statistical returns in ¶¶200-205 are calculated on a logarithmic basis.

201. Likewise, although Triad's stock price declined by 15.94% between August 28, 2007 and August 29, 2007, the Russell 2000 was up by 2.51% and the Peer Group was down by only .91%. This is further evidenced in the chart below:

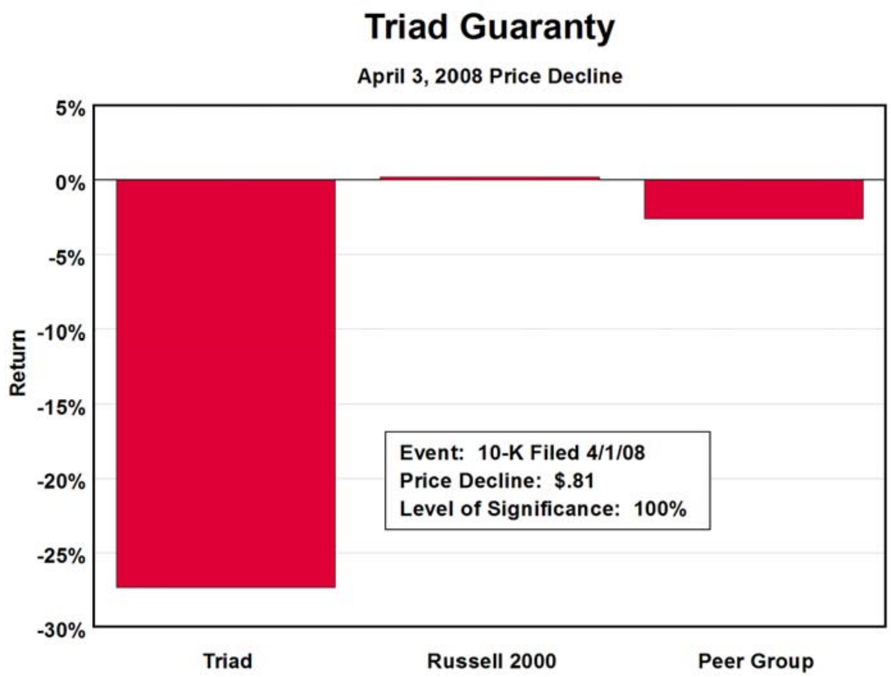


202. Similarly, while Triad's stock declined by 30.94% between October 24, 2007 and October 25, 2007, the Russell 2000 declined by only .59% and the Peer Group declined by only 15.94%. This is further evidenced in the chart below:

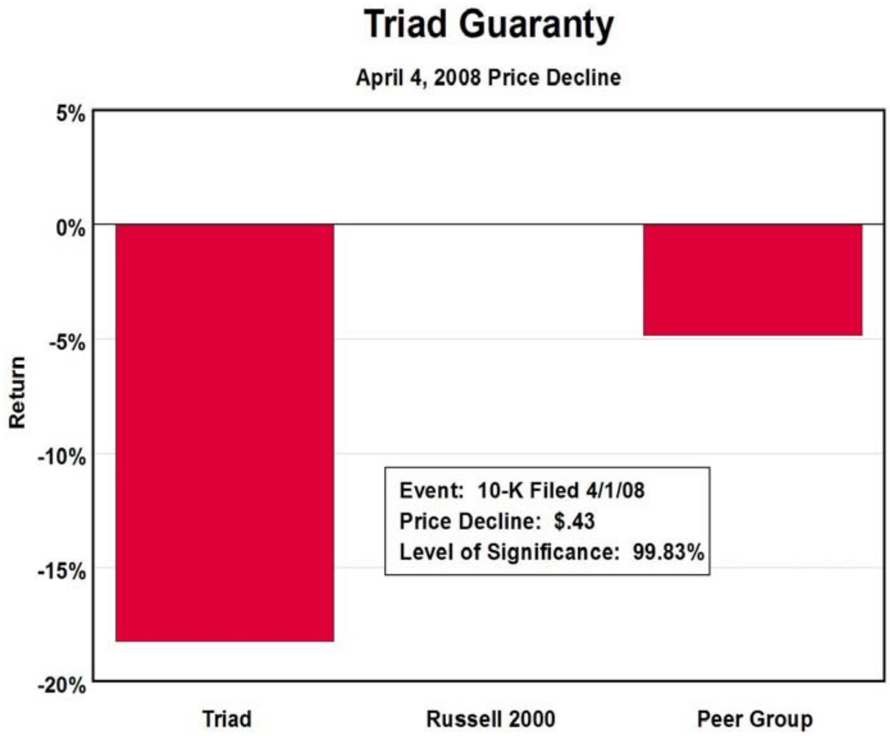
203. Additionally, while Triad's stock dropped by a staggering 43.74% between April 1, 2008 and April 2, 2008, the Russell 2000 increased by .23% and the Peer Group increased by 1.48%, as demonstrated in the chart below:



204. While Triad's stock continued to drop 27.30% between April 2, 2008 and April 3, 2008, the Russell 2000 increased by .18% and the Peer Group only declined by 2.6%, as demonstrated in the chart below:



205. Finally, while Triad's stock dropped another 18.23% between April 3, 2008 and April 4, 2008, the Russell 2000 increased by .02% and the Peer Group declined by only 4.83%, as demonstrated in the chart below:



206. Accordingly, the economic loss, *i.e.*, damages, suffered by Lead Plaintiff and members of the Class were a direct and proximate result of Defendants' scheme and misrepresentations and omissions which artificially inflated Triad's stock price and the subsequent significant decline in the value of Triad's stock when the truth concerning Defendants' prior misrepresentations and fraudulent conduct entered the marketplace.

XI. NO SAFE HARBOR

207. The statutory safe harbor provided for forward-looking statements under certain circumstances does not apply to any of the allegedly false statements pleaded in this Complaint. The statements alleged to be false and misleading herein all relate to then-existing facts and conditions. In addition, to the extent certain of the statements alleged to be false may be characterized as forward-looking, they were not identified as "forward-looking

statements" when made, there was no statement made with respect to any of those representations forming the basis of this Complaint that actual results could differ materially from those projected, and there were no meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the purportedly forward-looking statements. In the alternative, to the extent that the statutory safe harbor is intended to apply to any forward-looking statements pleaded herein, Defendants are liable for those false forward-looking statements because at the time each of those forward-looking statements was made, the speaker had actual knowledge that the forward-looking statement was materially false or misleading, and/or the forward-looking statement was authorized or approved by an executive officer of Triad who knew that the statement was false when made.

XII. PLAINTIFF'S CLASS ACTION ALLEGATIONS

208. Lead Plaintiff brings this action as a class action pursuant to Federal Rule of Civil Procedure 23(a) and (b)(3) on behalf of a class consisting of all those who purchased or otherwise acquired the publicly-traded securities of Triad between October 26, 2006 and April 1, 2008, inclusive, and who were damaged thereby (the "Class"). Excluded from the Class are Defendants, the Officers and Directors of the Company, at all relevant times, members of their immediate families and their legal representatives, heirs, successors or assigns and any entity in which Defendants have or had a controlling interest.

209. This action is properly maintainable as a class action because:

(a) the members of the proposed Class in this action are dispersed throughout the United States and are so numerous that joinder of all Class members is impracticable. While the exact number of Class members is unknown to Lead Plaintiff at this time and can only be ascertained through appropriate discovery, Lead Plaintiff believes that Class members number in the thousands. During the Class Period, millions of shares of Triad common stock were traded publicly on NASDAQ under the symbol "TGIC." As of March 6, 2009, there were 15,206,709 shares of common stock outstanding.

(b) Lead Plaintiff's claims are typical of those of all members of the Class because all have been similarly affected by Defendants' actionable conduct in violation of federal securities laws as alleged herein;

(c) Lead Plaintiff will fairly and adequately protect the interests of the Class and has retained counsel competent and experienced in class action litigation. Lead Plaintiff has no interests antagonistic to, or in conflict with, the Class that Lead Plaintiff seeks to represent;

(d) A class action is superior to other available methods for the fair and efficient adjudication of the claims asserted herein because joinder of all members is impracticable. Furthermore, because the damages suffered by individual members of the Class may be relatively small, the expense and burden of individual litigation make it virtually impossible for Class members to redress the wrongs done to them. The likelihood of individual Class members prosecuting separate claims is remote;

(e) Lead Plaintiff anticipates no unusual difficulties in the management of this action as a class action; and

(f) The questions of law and fact common to the members of the Class predominate over any questions affecting individual members of the Class.

210. Among the questions of law and fact common to the Class are:

(a) Whether Defendants' acts and/or omissions as alleged herein violated the federal securities laws;

(b) Whether the Company's Class Period public statements and filings misrepresented and/or omitted material facts;

(c) Whether Defendants acted with knowledge or with reckless disregard for the truth in misrepresenting and/or omitting material facts;

(d) Whether Defendants knew or were severely reckless in disregarding that the statements made by them were false and misleading;

(e) Whether Defendants participated in and pursued the common course of conduct complained of herein;

(f) Whether the prices of Triad's publicly-traded securities were artificially inflated as a result of Defendants' material misrepresentations and/or omissions during the Class Period;

(g) Whether Defendants violated the Exchange Act by the acts alleged herein; and

(h) The extent of damage sustained by Class members and the appropriate measure of damages.

COUNT I

FOR VIOLATIONS OF SECTION 10(b) OF THE EXCHANGE ACT AND RULE 10b-5 PROMULGATED THEREUNDER AGAINST TRIAD AND THE INDIVIDUAL DEFENDANTS

211. Lead Plaintiff repeats and re-alleges each and every allegation set forth above as if fully set forth herein.

212. During the Class Period, Defendants carried out a plan, scheme and course of conduct which was intended to and, throughout the Class Period, did: (i) deceive the investing public, including Lead Plaintiff and other Class members, as alleged herein regarding Triad's business, operations and management and the intrinsic value of Triad's securities; (ii) artificially inflate and maintain the market price of Triad's publicly traded securities; and (iii) cause Lead Plaintiff and other members of the Class to purchase Triad's publicly traded securities at artificially-inflated prices. In furtherance of this unlawful scheme, plan and course of conduct, Defendants, and each of them, took the actions set forth herein.

213. Defendants: (a) employed devices, schemes, and artifices to defraud; (b) made untrue statements of material fact and/or omitted to state material facts necessary to make the statements not misleading; and (c) engaged in acts, practices and a course of business which operated as a fraud and deceit upon the purchasers of the Company's securities in an effort to maintain artificially high market prices for Triad's securities in violation of §10(b) of the

Exchange Act and Rule 10b-5. Defendants are sued as primary participants in the wrongful and illegal conduct charged herein.

214. In addition to the duties of full disclosure imposed on Defendants as a result of making affirmative statements and reports, or participation in the making of those statements and reports to the investing public, they had a duty to promptly disseminate truthful information that would be material to investors in compliance with the integrated disclosure provisions of SEC Regulation (17 C.F.R. §210.01, *et seq.*) and S-K (17 C.F.R., §229.10, *et seq.*) and other SEC regulations, including accurate and truthful information about the Company's operations, financial condition and performance so that the market prices of the Company's publicly traded securities would be truthful, complete and accurate information.

215. Defendants, individually and in concert, directly and indirectly, by the use, means or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct to conceal adverse material information about the business, practices, performances, operations and future prospects of Triad as specified herein.

216. Defendants employed devices, schemes and artifices to defraud, while in possession of material adverse non-public information and engaged in acts, practices, and a course of conduct as alleged herein in an effort to assure investors of Triad's value and performance and continued substantial growth, which included the making of, or the participation in the making of, untrue statements of material facts and omitting to state material facts necessary in order to make the statements made about Triad and its business

operations and future prospects in the light of the circumstances under which they were made, not misleading, as set forth more particularly herein, and engaged in transactions, practices and a course of business which operated as a fraud and deceit upon the purchasers of Triad's securities during the Class Period.

217. Each of the Defendants' primary liability, and the Individual Defendants' controlling person liability, arises from the following facts: (i) the Individual Defendants were high-level executives and/or directors at the Company during the Class Period and members of the Company's management team or had control thereof; (ii) each of these Individual Defendants, by virtue of his responsibilities and activities as a senior officer and/or director of the Company was privy to and participated in the creation, development and reporting of the Company's internal budgets, plans, projections and/or reports; (iii) Defendants enjoyed significant personal contact and familiarity with the other Defendants and were advised of and had access to other members of the Company's management team, internal reports and other data and information about the Company's financial condition, performance, and operations at all relevant times; and (iv) the Individual Defendants were aware of the Company's dissemination of information to the investing public which they knew or recklessly disregarded was materially false and misleading.

218. Defendants had actual knowledge of the misrepresentations and omissions of material facts set forth herein, or acted with reckless disregard for the truth in that they failed to ascertain and to disclose such facts, even though such facts were available to them. Such Defendants' material misrepresentations and/or omissions were done knowingly or

recklessly and for the purpose and effect of concealing Triad's operating condition and business prospects from the investing public and supporting the artificially inflated price of its securities. As demonstrated by Defendants' overstatements and misstatements of the Company's business, operations and projections throughout the Class Period, Defendants, if they did not have actual knowledge of the misrepresentations and omissions alleged, were reckless in failing to obtain such knowledge by deliberately refraining from taking those steps necessary to discover whether those statements were false or misleading.

219. As a result of the dissemination of the materially false and misleading information and failure to disclose material facts, as set forth above, the market prices of Triad's securities were artificially inflated during the Class Period. Unaware that market prices of Triad's publicly traded securities were artificially inflated, and relying directly or indirectly on the false and misleading statements made by Defendants, or upon the integrity of the market in which the securities trade, and/or on the absence of material adverse information that was known to or recklessly disregarded by Defendants but not disclosed in public statements by Defendants during the Class Period, Lead Plaintiff and the other members of the Class acquired Triad's securities during the Class Period at artificially high prices and were damaged thereby.

220. At the time of said misrepresentations and omissions, Lead Plaintiff and other members of the Class were ignorant of their falsity, and believed them to be true. Had Lead Plaintiff and the other members of the Class and the marketplace known of the true performance, business practices, prospects and intrinsic value of Triad, which were not

disclosed by Defendants, Lead Plaintiff and other members of the Class would not have purchased or otherwise acquired their Triad securities, or, if they had acquired such securities during the Class Period, they would not have done so at the artificially inflated prices which they paid.

221. By virtue of the foregoing, Defendants have violated §10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder.

222. As a direct and proximate result of Defendants' wrongful conduct, Lead Plaintiff and the other members of the Class suffered damages in connection with their respective purchases and sales of the Company's securities during the Class Period.

COUNT II

FOR VIOLATIONS OF SECTION 20(a) OF THE EXCHANGE ACT AGAINST INDIVIDUAL DEFENDANTS

223. Lead Plaintiff repeats and re-alleges the allegations set forth above as though fully set forth herein. This claim is asserted against all of the Individual Defendants.

224. The Individual Defendants acted as controlling persons of Triad within the meaning of §20(a) of the Exchange Act as alleged herein. By virtue of their high-level positions, and their ownership and contractual rights, participation in and/or awareness of the Company's operations and/or intimate knowledge of the false financial statements filed by the Company with the SEC and disseminated to the investing public, the Individual Defendants had the power to influence and control and did influence and control, directly or indirectly, the decision-making of the Company, including the content and dissemination of the various statements which Lead Plaintiff contends are false and misleading. The

Individual Defendants were provided with or had unlimited access to copies of the Company's reports, press releases, public filings and other statements alleged by Lead Plaintiff to be misleading prior to and/or shortly after these statements were issued and had the ability to prevent the issuance of the statements or cause the statements to be corrected.

225. In particular, each of these Individual Defendants had direct and supervisory involvement in the day-to-day operations of the Company and, therefore, is presumed to have had the power to control or influence the particular transactions giving rise to the securities violations as alleged herein, and exercised the same.

226. As set forth above, Triad and the Individual Defendants each violated §10(b) and Rule 10b-5 by their acts and omissions as alleged in this complaint. By virtue of their positions as controlling persons, the Individual Defendants are liable pursuant to §20(a) of the Exchange Act. As a direct and proximate result of Defendants' wrongful conduct, Lead Plaintiff and other members of the Class suffered damages in connection with their purchases of the Company's securities during the Class Period.

PRAYER FOR RELIEF

WHEREFORE, Lead Plaintiff, on its own behalf and on behalf of the Class, prays for relief and judgment, as follows:

(A) Declaring that this action may be maintained as a class action pursuant to Rule 23(a) and (b)(3) of the Federal Rules of Civil Procedure on behalf of the Class defined herein;

(B) Awarding compensatory damages in favor of Lead Plaintiff and the other Class members against all Defendants, jointly and severally, for all damages sustained as a result of Defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;

(C) Awarding Lead Plaintiff and the Class pre-judgment and post-judgment interest, as well as their reasonable costs and expenses, attorneys' and experts' witness fees incurred in this action; and

(D) Such other and further relief as the Court may deem just and proper.

JURY TRIAL DEMANDED

Lead Plaintiff hereby demands a trial by jury.

DATED: March 30, 2012

ROBBINS GELLER RUDMAN & DOWD LLP
PAUL J. GELLER
JACK REISE
STEPHEN R. ASTLEY

/s/ JACK REISE

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Liaison Counsel

CERTIFICATE OF SERVICE

I hereby certify that on March 30, 2012, I electronically filed the foregoing with the Clerk of the Court using CM/ECF. I also certify that the foregoing document is being served this day on all counsel of record or *pro se* parties either via transmission of Notices of Electronic Filing generated by CM/ECF or in some other authorized manner for those counsel or parties who are not authorized to receive electronically Notices of Electronic Filing.

s/JACK REISE
JACK REISE