

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

THE PEOPLE OF THE STATE OF NEW YORK
by ERIC T. SCHNEIDERMAN, Attorney General of
the State of New York,

Plaintiff,

-against-

MAURICE R. GREENBERG and
HOWARD I. SMITH,

Defendants.

Index No. 401720/05

Honorable Charles E. Ramos
IAS Part 53

EXPERT REPORT OF CHARLES R. LUNDELIUS, JR., CPA/ABV/CFE

Submitted on July 28, 2014

TABLE OF CONTENTS

INTRODUCTION AND ASSIGNMENT	1
QUALIFICATIONS	1
SUMMARY OF OPINIONS	4
GIVEN THE DOCUMENTED ADEQUACY OF INTERNAL CONTROLS, IT WAS REASONABLE FOR MESSRS. GREENBERG AND SMITH TO RELY ON SUBORDINATES TO ENSURE THAT TRANSACTIONS COMPLIED WITH APPLICABLE GUIDELINES.....	5
THERE IS NOTHING FUNDAMENTALLY IMPROPER ABOUT A TRANSACTION THAT CHANGES THE BOOKING OF AN ITEM FROM ONE FINANCIAL STATEMENT CAPTION TO ANOTHER.....	9
RESULTS FROM DISCONTINUED LINES OF BUSINESS SHOULD BE REPORTED SEPARATELY FROM RESULTS FROM RECURRING BUSINESS TO ALLOW FINANCIAL STATEMENT USERS TO MAKE COMPARISONS OF RECURRING BUSINESS	10
CONSOLIDATION OF CAPCO'S FINANCIAL RESULTS WITH AIG'S FINANCIAL RESULTS WAS NOT REQUIRED.....	11
U.S. GAAP REQUIREMENTS FOR CONSOLIDATION DURING YEARS 2000-2002	13
HIERARCHY OF U.S. GAAP	14
RELEVANT U.S. GAAP RELATED TO SPECIAL-PURPOSE ENTITIES DURING 2000-2002	15
U.S. GAAP REQUIREMENTS FOR SPES AND CONSOLIDATION WAS REVISED AFTER CAPCO WAS LIQUIDATED IN 2002	20
UNRELIABLE HISTORICAL DATA COULD HAVE PREVENTED AIG FROM REASONABLY ESTIMATING ULTIMATE LOSSES ASSOCIATED WITH THE AUTO WARRANTY BUSINESS.....	21
AUTO WARRANTY LOSSES WERE REPORTED WITHIN UNDERWRITING INCOME IN STATUTORY FILINGS	24
A WRITE-DOWN OF AIRCO'S INVESTMENT IN CAPCO WAS NOT REQUIRED AS OF DECEMBER 31, 2001.....	26
THE CAPCO TRANSACTION WAS NOT MATERIAL TO AIG'S FINANCIAL STATEMENTS.....	31

THE GEN RE TRANSACTION OVERVIEW	36
THE RELEVANT REINSURANCE AGREEMENTS APPEARED TO QUALIFY FOR REINSURANCE ACCOUNTING	37
THE GEN RE TRANSACTION WAS NOT MATERIAL TO AIG'S FINANCIAL STATEMENTS.....	42

INTRODUCTION AND ASSIGNMENT

1. Defendants in this matter, Maurice R. Greenberg and Howard I. Smith, were Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), respectively, at American International Group, Inc. (“AIG”) until their departures in 2005. The plaintiff in this matter is the Attorney General on behalf of the People of the State of New York (“NYAG”).

2. I was retained by Kaye Scholer LLP, counsel to Mr. Smith, to consider the NYAG’s allegations relating to a transaction involving a cession of losses from AIG’s auto warranty business to Capco Reinsurance Company, Ltd. (“Capco”) in 2000 (the “Capco Transaction”) and an investment by an AIG subsidiary, American International Reinsurance Company Ltd. (“AIRCO”), in Capco. Specifically, I was asked to review accounting, reporting, and internal controls relevant to the Capco Transaction and AIG’s auto warranty business. I was also asked to consider the accounting and reporting related to two reinsurance agreements between AIG and a subsidiary of General Reinsurance Corporation, Inc. (“Gen Re”), effective December 1, 2000 and March 31, 2001 (the “Gen Re Transaction”).

QUALIFICATIONS

3. I am the director of the Financial Institutions Practice at Berkeley Research Group, LLC (“BRG”), in BRG’s Washington, DC office. Prior to coming to BRG, from 1989 to 1992, I served as senior vice president and Chief Financial Officer of the Markman Company, including its affiliate, Unimark Life Insurance Company.¹ At Markman, I served on the Board of Directors and was charged with corporate governance functions, which included design and supervision of a reorganization of the accounting and internal control systems. After leaving

¹ During my tenure at Markman, it was the leading marketer of long-term care insurance in the US, placing over \$40,000,000 in annual premiums written with affiliates of Primerica Insurance. Unimark reinsured business placed with Primerica.

Markman, I went to Coopers & Lybrand (now PricewaterhouseCoopers) and then Deloitte, where I investigated internal control failures and performed other forensic accounting engagements. In 2001, I went to FTI Consulting, Inc., where I continued my forensic accounting work. I left FTI Consulting, Inc. in January 2012 to head the Financial Institutions Practice at BRG.

4. Over the course of the last twenty years, I have participated in numerous investigations relating to internal controls and corporate governance, including investigations of Freddie Mac, Refco, and New York Stock Exchange specialists Van Der Moolen and LaBranch. More recently, the SEC Inspector General asked me to lead the team of experts that investigated the SEC's failure to uncover the Madoff Ponzi scheme. I also led and completed last year the independent investigation of the role of the National Futures Association in the loss of customer funds at Peregrine Financial Group, Inc.

5. From 1996 to 2006, I was appointed by the NASDAQ Stock Market Board of Directors to serve on the NASDAQ Listing Qualifications Panel ("Listing Panel"). While I served on the panel, I heard dozens of cases involving internal control failures at NASDAQ companies that were subject to delisting. Most notably, my tenure on the Listing Panel coincided with the rise of allegations of stock option backdating among high-technology companies listed on the NASDAQ. Moreover, in 2002, the passage of the Sarbanes-Oxley Act required stock exchanges to implement corporate governance rules relating to audit committee membership and qualifications through the exchange listing requirements, and I worked with NASDAQ staff in the implementation and interpretation of those standards, culminating in a presentation I made to the entire NASDAQ Listing Group in 2005 on internal control requirements under the Sarbanes-Oxley Act.

6. I am also a Certified Public Accountant, Accredited in Business Valuation and Certified in Financial Forensics by the American Institute of Certified Public Accountants (“AICPA”). In 2003, I wrote a book, peer-reviewed and published by the AICPA, titled *Financial Reporting Fraud: A Practical Guide to Detection and Internal Control*. The book discusses the evolution of internal control and corporate governance standards, the findings of the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”),² and the role of the audit committee. The AICPA published a second edition of my book in 2010.

7. I have qualified as an expert in auditing standards and internal controls in federal and state courts and at an enforcement proceeding before the National Association of Securities Dealers (now the Financial Industry Regulatory Authority). In one instance, I qualified as an expert in an NASD arbitration related to an IPO allocation proceeding brought by the NASD Department of Enforcement against Ken Langone’s broker-dealer, Invemed Associates, with regard to rule 17a-5 broker accounting and books and records requirements. My testimony included opinions on General Accepted Accounting Principles (“U.S. GAAP”), Generally Accepted Auditing Standards (“U.S. GAAS”), and SEC rules and staff accounting bulletins dealing with revenue recognition and financial statement presentation for broker-dealers.

8. My resume and testimony history are attached as Appendix A. BRG is receiving \$850 per hour for my work in this matter. BRG staff have assisted me on this matter, and their billing rates vary from \$130 to \$600 per hour. My compensation is not affected by the outcome in this case. The documents I considered in forming my opinions are listed in Appendix B.

² COSO is a voluntary, private-sector organization dedicated to guiding executive management and governance entire toward the establishment of more effective, efficient, and ethical business operations on a global basis. COSO does this by sponsoring and disseminating frameworks and guidance regarding internal controls, corporate governance, and risk management that are based on in-depth research, analysis, and best practices. See www.coso.org for additional information.

SUMMARY OF OPINIONS

9. Based on my review of these materials, and utilizing the knowledge and expertise I have obtained based on my years of experience, I summarize my opinions in this matter below.

- a. Opinion 1: Given the documented adequacy of internal controls, it was reasonable for Messrs. Greenberg and Smith to rely on subordinates to ensure that transactions complied with applicable guidelines.
- b. Opinion 2: There is nothing fundamentally improper about a transaction that changes the booking of an item from one financial statement caption to another.
- c. Opinion 3: Results from discontinued lines of business should be reported separately from results from recurring business to allow financial statement users to make comparisons of recurring business.
- d. Opinion 4: During 2000 – 2002, U.S. GAAP did not provide clear guidance about the concept of control and its place in consolidation policy, and, under relevant guidelines that focused on voting control, consolidation of Capco's financial results with AIG's financial results was not required.
- e. Opinion 5: Unreliable historical data could have prevented AIG from reasonably estimating ultimate losses associated with the auto warranty business.
- f. Opinion 6: Total underwriting losses, regardless of any reinsurance activity associated with the auto warranty business, were reported within underwriting income in statutory filings.

- g. Opinion 7: Capco had substantial assets at December 31, 2001 and AIRCO's investment in Capco had value at the relevant time. A write-down of AIRCO's investment in Capco was not required at that time.
- h. Opinion 8: The Capco Transaction was not material to AIG's financial statements.
- i. Opinion 9: The relevant reinsurance agreements between Gen Re and AIG appeared to qualify for reinsurance accounting.
- j. Opinion 10: The Gen Re Transaction was not material to AIG's financial statements.

**GIVEN THE DOCUMENTED ADEQUACY OF INTERNAL CONTROLS, IT WAS
REASONABLE FOR MESSRS. GREENBERG AND SMITH TO RELY ON
SUBORDINATES TO ENSURE THAT TRANSACTIONS COMPLIED WITH
APPLICABLE GUIDELINES**

10. This matter involves allegations of accounting improprieties. Therefore, for background purposes, I reviewed and considered the organization of AIG's accounting function. I reviewed AIG public filings, AIG organization charts, and PricewaterhouseCoopers LLP ("PwC") audit plans and work papers. In my opinion, given the documented adequacy of internal controls, it was reasonable for Messrs. Greenberg and Smith to rely on subordinates to ensure that relevant transactions complied with applicable guidelines. My analysis and the basis for my opinion are described in this section.

11. In 2000, AIG's assets exceeded \$300 billion and premium written exceeded \$30 billion.³ AIG had over 60,000 employees⁴ and had a market capitalization in excess of \$200

³ AIG Form 10-K, year ended December 31, 2000, p. 1.

⁴ AIG Form 10-K, year ended December 31, 2000, p. 1.

billion⁵ making it one of the largest companies in the U.S. AIG utilized eleven different principal insurance subsidiaries while writing insurance globally in over seventy countries, with approximately half of its revenue earned outside the U.S. Because of the size of AIG, the preparation of financial statements was a complex process that required many employees.

12. The finance group is typically responsible for the financial aspects of any firm. Due to the complexity involved in the development and accurate presentation of financial reports, larger organizations typically separate the controllership and treasury functions into stand-alone positions, which ultimately report to the CFO.⁶ The Controllers (or Comptrollers) are the chief accounting executives with primary responsibility for financial reporting.⁷

13. At the AIG corporate comptroller's level, numerous executives were involved in structuring Capco and its reinsurance of the auto warranty business, such as Joseph Umansky and Paul Brown. Mr. Umansky was a deputy comptroller and President of AIG Reinsurance Advisors.⁸ Mr. Brown, among others, reported to Mr. Umansky. According to his resume, Mr. Brown was a CPA and property and-casualty reinsurance specialist.⁹ Prior to working in AIG's corporate comptroller's group, Mr. Brown was "utilized as a technical resource to the Deloitte & Touche LLP national insurance practice."¹⁰

14. Company executives must always rely upon internal controls over financial reporting for the preparation of reliable published financial reports. In the mid-1980s, the

⁵ AIG Form 10-K, year ended December 31, 2000, p. 1; Yahoo! Finance.

⁶ Gloria L. Gaylord and Glenda E. Ried, *Careers in Accounting*, p. 19-20.

⁷ Gloria L. Gaylord and Glenda E. Ried, *Careers in Accounting*, p. 22.

⁸ <http://www.thefreelibrary.com/AMERICAN+INTERNATIONAL+GROUP+FORMS+AIG+REINSURANCE+ADVISORS,+INC.-a012336527>

⁹ AIG-F00028097-8.

¹⁰ AIG-F00028097.

National Commission on Fraudulent Financial Reporting (the Treadway Commission)¹¹ established the Committee of Sponsoring Organizations (“COSO”) to investigate and set forth a standard framework against which all companies could measure their internal controls. The result of that effort was the COSO Internal Control – Integrated Framework (“COSO Framework”), which is now considered the standard guidance on internal controls.

15. COSO defines internal controls as the processes effected by an entity’s board of directors, management and other personnel to provide reasonable assurance regarding the achievement of objectives in operations, financial reporting and compliance.¹² Thus, internal controls that meet COSO standards can be expected to provide management and Board members with reasonable assurance of reliable financial reporting and compliance with laws and regulations.

16. Guidance by the AICPA has confirmed that the COSO Framework is an appropriate standard by which an entity may assess the efficacy of their internal controls. Specifically, AU Section 319 *Consideration of Internal Control in a Financial Statement Audit* (“AU 319”) was modified in 1997 to encompass the definition and description of internal control contained in the COSO Framework.¹³

17. According to the COSO Framework, the first element of an effective internal control structure is a suitable control environment. Likewise, an independent auditor must consider an entity’s control environment when planning a financial statement audit.¹⁴ According

¹¹ The Treadway Commission was originally sponsored by the five main professional accounting associations and institutions in the United States.

¹² Committee of Sponsoring Organizations of the Treadway Commission, *Internal Control – Integrated Framework*, July 1994, p. 3.

¹³ AU 319, as amended after the issuance of Statement on Auditing Standards No. 78.

¹⁴ AU 319 was relevant 2000-2002.

to audit guidance, control environment factors include “assignment of authority and responsibility.”¹⁵

18. I have seen evidence that AIG’s independent auditor, PwC, considered it appropriate to assign authority and responsibility to AIG corporate comptrollers.¹⁶ According to PwC:¹⁷

The Corporate Comptrollers Department appears to be adequately staffed. The department is made of personnel who have been with the Company for a significant number of years and have worked in public accounting prior to joining AIG. Their skills appear to be adequate for the size and complexity of the Company.

19. AIG segments also had CFOs and comptroller groups.¹⁸ For instance, the auto warranty business was recorded in AIG’s Domestic Brokerage Group (“DBG”). According to PwC:¹⁹

DBG’s Comptroller’s Group is led by Rob Jacobson DBG CFO. He is supported by a strong group of Assistant Comptrollers who report to Bob Beier, Comptroller. Rob was previously a member of AIG Corporate group for the past year or so. Previously he was the CFO of Everest Re and before that he was a partner with Coopers & Lybrand, in the firm’s New York insurance practice.

¹⁵ AU 319, ¶25 (as of January 1, 2000).

¹⁶ See, 2000 Audit Approach and Worldwide Service Plan, November 2000, p. 5 (PWC10518629). See also PwC Step “Assess the effectiveness of the organization and key management” for the 2000 GAAP audit of DBG (PWC10058393).

¹⁷ PwC Step “Assess the reliability of overall financial reporting” for the 2002 audit of AIG (PWC10507543).

¹⁸ AIG’s operations were conducted principally through four business segments: General Insurance, Life Insurance, Financial Services, and Asset Management. General Insurance consists of two groups: the Domestic Brokerage Group and the Foreign General insurance group (AIG Form 10-K, year ended December 31, 2000, Notes to Financial Statements, Note 18, p. 81).

¹⁹ PwC Step “Assess the effectiveness of the organization and key management” for the 2000 GAAP audit of DBG (PWC10058396).

20. In my opinion, based on the documents I reviewed and the standards of the COSO Framework, Messrs. Greenberg and Smith could reasonably have expected, as PwC did, that AIG's internal controls and corporate governance structure were effective in accomplishing the control environment described in the COSO Framework and in audit guidance. Further, given the documented adequacy of internal controls, it was reasonable for Messrs. Greenberg and Smith to rely on subordinates to ensure that relevant transactions complied with applicable guidelines.

**THERE IS NOTHING FUNDAMENTALLY IMPROPER ABOUT A TRANSACTION
THAT CHANGES THE BOOKING OF AN ITEM FROM ONE FINANCIAL
STATEMENT CAPTION TO ANOTHER**

21. The NYAG contends that defendants misled the investing public by converting auto warranty underwriting losses to capital losses.²⁰ There is nothing fundamentally improper about a transaction that changes the booking of an item from one financial statement caption to another if accounted for properly.

22. For instance, reinsurance transactions can affect the income statement caption under which a transaction is recorded. For example, if AIG had purchased portfolio reinsurance for the auto warranty business, under statutory accounting practices,²¹ portfolio reinsurance is reported as a component of "other income" and not as a component of "underwriting income."²² According to AIG's SEC filings, "[U.S. GAAP] adjusted underwriting profit (loss) represents statutory underwriting profit or loss adjusted primarily for changes in deferred acquisition

²⁰ Amended Complaint, ¶3.

²¹ State insurance regulators rely on uniform quarterly and annual financial reporting. Statutory ("STAT") reporting is different from GAAP reporting, but GAAP recognizes STAT as an Other Comprehensive Basis of Accounting ("OCBOA"). STAT income statements include three categories of income: underwriting, investment, and other.

²² Statement of Statutory Accounting Principle (SSAP) No. 62 *Property and Casualty Reinsurance*, ¶¶28h – 28i, 29 (as of March 2001).

costs.”²³ Therefore, portfolio reinsurance would have appropriately removed the auto warranty losses from “underwriting profit” and relocated the losses in “other income.”

23. In addition, reclassifying underwriting losses to capital losses did not diminish the importance of those losses, contrary to assertions by the NYAG. The Financial Accounting Standards Board (“FASB”) in Statement of Financial Accounting Standards No. 97 *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments* (“SFAS 97”) directly contradicted the NYAG’s assertion that reclassifying underwriting losses to capital losses was done to minimize its importance. To the contrary, the FASB stated that capital losses were “an integral part of an insurance enterprise’s operations “and, for that reason, merit inclusion in operating income by presenting capital losses “as a component of other income, on a pretax basis.”²⁴

**RESULTS FROM DISCONTINUED LINES OF BUSINESS SHOULD BE
REPORTED SEPARATELY FROM RESULTS FROM RECURRING BUSINESS TO
ALLOW FINANCIAL STATEMENT USERS TO MAKE COMPARISONS OF
RECURRING BUSINESS**

24. In my opinion, underwriting results that excluded the discontinued auto warranty losses allowed financial statements users to properly make comparisons of recurring business. Therefore, it is my opinion that converting auto warranty losses to capital losses was not improper.

25. AIG commonly separated unique underwriting events, such as run-off or catastrophes, to allow financial statement users to make comparisons of recurring business.

²³ AIG Form 10-K, year ended December 31, 2000, p. 81.

²⁴ SFAS 97, ¶¶ 28, 74.

26. For example, AIG described its objective to achieve comparable results of recurring underwriting operations in its year 2000 Form 10-K (emphasis added):²⁵

The impact of losses caused by catastrophes can fluctuate widely from year to year, making comparisons of recurring type business more difficult. The pro forma table [presented in the Form 10-K] excludes catastrophe losses in order to present comparable results of AIG's recurring core underwriting operations.

27. When discontinuing a line of business, such as AIG's auto warranty business, a company may initiate a capital transaction, which AIG did through the use of a structured product like Capco. Moving these discontinued underwriting results was a way to signal to the market that these losses were not a part of recurring underwriting business.

28. Further, and as discussed later in this report, the full underwriting picture was disclosed to investors and analysts through the relevant AIG statutory filings.

CONSOLIDATION OF CAPCO'S FINANCIAL RESULTS WITH AIG'S FINANCIAL RESULTS WAS NOT REQUIRED

29. The Capco concept was simple: a separate entity would acquire the auto warranty business and pay claims over the remaining run-off period. The transaction would generate a capital loss to AIG. This process reflected the fact that AIG was divesting of a business line.

30. A principal issue, though, was whether Capco was separate from AIG or if it should have been consolidated with AIG. Consolidation decisions are made by considering the ownership structure of the entity and by considering relevant U.S. GAAP.

31. Capco's ownership consisted of 20,000,000 voting common shares and 8,500 non-voting preferred shares. The voting common shares were held by three individual investors

²⁵ AIG Form 10-K, year ended December 31, 2000, Management's Discussion and Analysis of Financial Condition and Results of Operations, p. 18.

(\$19,000,000) and one unrelated insurance company (\$1,000,000), Western General Insurance Ltd. (“West Gen”). The non-voting preferred shares were held by AIRCO, a subsidiary of AIG.

32. The structure of U.S. GAAP during 2000 – 2002 was quite different from the structure of U.S. GAAP today. The FASB codified U.S. GAAP in 2009. Thereafter, the FASB Accounting Standards Codification® (“ASC”) was recognized as the single source of authoritative U.S. GAAP. The ASC was the result of a 5-year project to, among other goals, simplify user access by codifying all authoritative U.S. GAAP in one spot.²⁶ Therefore, U.S. GAAP was renovated from “a standards-based model (with thousands of individual standards) to a topically based model (with roughly 90 topics).”²⁷

33. The “thousands of individual standards” that constituted pre-codification U.S. GAAP was issued in various forms by various standard setters. For example, before codification, guidance on any particular accounting topic, such as consolidation, could be found in any of the following publications:

- Accounting Research Bulletins (ARB)
- Accounting Principles Board Opinions (APB)
- Statements of Financial Accounting Standards (SFAS)
- FASB Interpretations (FIN)
- FASB Technical Bulletins (FTB)
- FASB Staff Implementation Guidance (Q&A)
- FASB Staff Positions (FSP)
- Abstracts issued by the Emerging Issues Task Force (EITF)
- AICPA Accounting Interpretations (AIN)

²⁶ FASB, About the Codification (v 4.9), pp. 4, 5.

²⁷ FASB, About the Codification (v 4.9), p. 5.

- Derivatives Implementation Group (DIG) Implementation Guidance
- AICPA Statements of Position (SOP)
- AICPA Audit and Accounting Guides (AAG)
- AICPA Practice Bulletins (PB)

34. After the 2009 codification, guidance on consolidation is found in ASC Topic 810

Consolidation.

35. Based upon my analysis of U.S. GAAP requirements for consolidation during years 2000 to 2002 compared to U.S. GAAP requirements for consolidation after 2002, it is my opinion that consolidation of Capco's financial results with AIG's financial results was not required during years 2000 to 2002. My findings are described below.

U.S. GAAP REQUIREMENTS FOR CONSOLIDATION DURING YEARS 2000-2002

36. During the relevant years, U.S. GAAP guidance about consolidation was unsystematic and unclear.

37. The applicable accounting requirement that all majority-owned subsidiaries be consolidated is from Accounting Research Bulletin No. 51 *Consolidated Financial Statements* ("ARB 51"), which states:²⁸

The usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one company, directly or indirectly, of over fifty percent of the outstanding voting shares of another company is a condition pointing toward consolidation. . . .

38. According to ARB 51, Capco satisfied the requirements for non-consolidation. Because of the hierarchy of U.S. GAAP that existed prior to ASC, absent transaction-specific guidance, an accountant need not have relied on other pronouncements when ARB 51 criteria for

²⁸ ARB 51, ¶2, as affected by SFAS No. 94.

non-consolidation were satisfied. The hierarchical structure, and the consequences of that structure, is described in the following paragraphs.

HIERARCHY OF U.S. GAAP

39. AIG's consolidated financial statements were subjected to an annual independent audit. Standard audit reports, like those issued for AIG, included the phrase "present fairly in conformity with generally accepted accounting principles." To guide auditors prior to the codification, in 1992 the Auditing Standards Board ("ASB") defined the meaning of that phrase and delineated the sources of U.S. GAAP.²⁹ In Statement of Auditing Standards No. 69 ("SAS 69"), the ASB identified four sources (Categories A through D) of established U.S. GAAP and declared that "an auditor should not express an unqualified opinion [i.e. clean opinion] if the financial statements contain a material departure from [Category A] unless, due to unusual circumstances, adherence to the pronouncements would make the statements misleading."³⁰

40. If the accounting treatment is not covered by Category A guidance, the auditor should proceed next to categories B through D, using the treatment required by the source in the highest category.³¹

41. Category A includes ARBs. Category C includes consensus positions of the FASB Emerging Issues Task Force ("EITF").³²

²⁹ Wiley GAAP 2000: Interpretation and Application of Generally Accepted Accounting Principles, P. Delaney, B. Epstein, J. Adler, ("Wiley GAAP 2000"), p. 5.

³⁰ SAS 69 is codified at AU 411 *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles in the Independent Auditor's Report* ("AU 411"), ¶5a.

³¹ AU 411, ¶7.

³² The EITF assists FASB in identifying current or emerging issues and implementation problems that may need to be placed on FASB's agenda.

42. The guidance provided by an EITF is often on narrow issues that are of immediate interest and importance.³³ For instance, EITF Issue 96-21 covered implementation issues in accounting for leasing transactions with a special-purpose entity.

43. A leading accounting textbook in 2000 cautioned about departures from Category A in U.S. GAAP:³⁴

[Category A] constitutes mandatory GAAP . . . Although the [second and third category] positions constitute GAAP, they represent preferable viewpoints, not mandatory ones. Preferable accounting principles have historically been specialized principles of particular industries which may not be transferable to other industries or to general business accounting policies.

44. According to Category A mandatory GAAP, Capco satisfied the requirements for non-consolidation.

RELEVANT U.S. GAAP RELATED TO SPECIAL-PURPOSE ENTITIES DURING 2000-2002

45. In the 1980s and 1990s, innovation in financial instruments introduced new methods of financing expansion of financial institutions. Chief among these innovations was the greater use of securitizations that bundled loans or other assets together and sold them to newly created, stand-alone special-purpose entities (“SPEs”). The SPE bought the assets from the originating financial institution to free up the firm’s capital, thereby allowing the financial institution to invest in new assets.

46. Also during the 1980s and 1990s, the EITF was identifying implementation and emerging issues related to certain SPEs. Likewise, the FASB was acting on some of these issues by supplying new accounting standards. However, the applicable accounting guidance was

³³ Wiley GAAP 2000, p. 8.

³⁴ Wiley GAAP 2000, pp. 9-10.

difficult to discern during this time. A brief summary of the relevant EITF and FASB proceedings is as follows:

- FASB created a task force in 1989 to assist with its project to issue new standards on the subject of SPEs. Also in 1989, the EITF formed a working group to develop recommendations for SPEs. Accordingly, EITF Topic D-14 was produced.
- EITF Issue 90-15 was finalized in 1991; it reached a consensus for leasing transactions that required consolidation of a SPE under certain conditions. The consensus did not include nonleasing transactions in its scope.
- FASB issued SFAS No. 125 in 1996 in an attempt to cure conflicting guidance for SPEs and the transfer and servicing of financial assets and extinguishments of liabilities. Complexities of the financial markets soon swamped the guidance of SFAS No. 125.
- EITF Issue 96-21 was finalized in 1996, referred to EITF Issue 90-15, and addressed implementation issues in accounting for leasing transactions involving SPEs. Specifically, it clarified certain conditions that would require a lessee to consolidate a SPE lessor.
- In 2000, FASB replaced SFAS No. 125 with SFAS 140. Soon after, EITF Topic D-14 was updated to state that consolidation of entities that are not considered qualifying SPEs are outside the scope of SFAS 140 and that those parties should apply existing consolidation policy guidance from sources including ARB 51, Topic D-14, and EITF Issue 90-15.

47. A detailed description of the EITF and FASB proceedings summarized above is provided in the remainder of this section.

48. The FASB previously provided guidance for two specific types of transfers of financial assets in FASB Statement No. 77, *Reporting by Transferors for Transfers of Receivables with Recourse*, and in FASB Technical Bulletin No. 85-2, *Accounting for Collateralized Mortgage Obligations (CMOs)*.³⁵ Confusion and inconsistency in accounting

³⁵ Statement of Financial Accounting Standards No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (“SFAS 140”), ¶¶120 – 124.

practices developed because the provisions of those two pronouncements provided seemingly conflicting guidance.³⁶ Also applicable was FASB Statement No. 76, *Extinguishment of Debt*. Some criticized Statement 76 as being inconsistent with Statement 77; others disagreed.³⁷ Consequently, the FASB decided that it was necessary to reconsider Statements 76 and 77, Technical Bulletin 85-2, and other guidance and to develop new standards for transfers of financial assets and extinguishments of liabilities.³⁸ The Financial Instruments Task Force was formed in January 1989 to assist the FASB with its project to issue new standards on the subject of SPEs.³⁹

49. By 1996, with input from the Financial Instruments Task Force, FASB issued Statement of Financial Accounting Standards No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (“SFAS 125”), to attempt to bring clarity to SPEs. Unfortunately, though, by its own admission, FASB did not meet its objective.

50. Complexities of the financial markets soon swamped the guidance of SFAS 125. Market participants asked the FASB to clarify or reconsider several aspects of the pronouncement.⁴⁰ Therefore, within four years of issuing SFAS 125, in 2000, FASB was compelled to issue superseding guidance in the form of Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (“SFAS 140”).

³⁶ SFAS 140, ¶¶120 – 124.

³⁷ SFAS 140, ¶¶120 – 124.

³⁸ SFAS 140, ¶¶120 – 124.

³⁹ SFAS 140, ¶¶120 – 124.

⁴⁰ SFAS 140, ¶8.

51. While the FASB Financial Instruments Task Force was working toward its goal to issue SFAS No. 125, the EITF was also working on guidance for accounting for SPEs. By 1989, the EITF, with significant urging from the SEC Observer who participated in EITF meetings, began to look at the capitalization of SPEs. EITF Topic D-14 chronicled the discussion regarding the consolidation of SPEs.⁴¹ In 1991, the EITF promulgated EITF Issue No. 90-15: *Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions* ("EITF 90-15"), which addressed SPE consolidation for leasing transactions.

52. At the time, sale-leaseback transactions were popular because, after years of high inflation in the late 1970s and early 1980s, such a transaction allowed businesses to sell major assets such as office buildings at a profit and then lease them back. In other words, the sale-leaseback transaction converted appreciated assets into income for the seller-lessee, and some sellers sponsored a SPE to buy the assets whereby the SPE would agree to the leaseback to the seller. However, this transaction only worked if the SPE was not consolidated with its seller-sponsor.

53. In an attempt to address the SEC's concerns about potential misuse of thinly capitalized SPEs, in EITF 90-15 the EITF concluded that a SPE must be consolidated with its sponsor under certain circumstances specific to leasing transactions.⁴²

54. In a Q & A section in EITF 90-15, the EITF noted that equity equal to three percent was the minimum acceptable investment that would be considered a "substantive residual equity capital investment" for purposes of EITF D-14.⁴³

⁴¹ EITF Topic D-14: *Transactions Involving Special-Purpose Entities*. All references and quotes for both EITF Issues and Topics come from AICPA Abstracts.

⁴² EITF 90-15, EITF Discussion.

⁴³ EITF 90-15, Question 3. Even if EITF 90-15 were applicable outside of the leasing context, which it was not, more than three percent of Capco equity was held by outside investors.

55. EITF 90-15, however, failed to resolve the confusion related to leasing. As a result, in 1996, the EITF issued EITF Issue No. 96-21 *Implementation Issues in Accounting for Leasing Transactions Involving Special-Purpose Entities* (“EITF 96-21”). In the Q&A section, the response to Question 7 indicated that where an investment “is financed with nonrecourse debt that is collateralized by a pledge of the investment, the investment would not meet the at-risk requirement discussed in condition 3 of Issue 90-15.”⁴⁴

56. How broadly this guidance could be taken was a matter of some debate, though. As one could discern from its title and the issues it discussed, EITF 90-15 related solely to leases. The SEC, however, suggested that it could possibly be applied outside of the leasing context on a case-by-case basis.

57. The SEC’s position, purportedly addressing issues raised in EITF 90-15 (which was a commentary on Topic D-14) was actually in conflict with the subsequent events section of Topic D-14, which stated:⁴⁵

Consolidation of qualifying SPEs by other parties, and consolidation of entities that are not considered qualifying SPEs, are outside the scope of [FASB] Statement 140. Those parties should apply existing consolidation policy guidance including AICPA Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*, Topic D-14, and Issue 90-15.

58. The conflict existed because, while the SEC suggested that EITF 90-15 could possibly be applied outside of the leasing context on a case-by-case basis, Topic D-14 prescribed that an entity not transferring financial assets to an SPE should continue to apply existing consolidation policy guidance in ARB 51, which focused exclusively on voting rights. Further,

⁴⁴ EITF 96-21, Response to Question 7.

⁴⁵ EITF Topic D-14, Subsequent Developments.

the updated Topic D-14 did not state that EITF 90-15 could be applied outside of the leasing context.

59. Further, neither ARB 51 nor the FASB Statement referenced in Topic D-14, nor any other significant source of U.S. GAAP, provided any guidance on the minimum equity required or whether that equity could come from nonrecourse loans. Issue 90-15 had the statement that “the conditions set forth in Issue 90-15 may be useful in evaluating other transactions involving SPEs” (emphasis added) and that questions on nonleasing transactions could be addressed “on a case-by-case approach” with the SEC,⁴⁶ but Topic D-14 provided no guidance outside of leasing transactions. Furthermore, EITF 90-15 only addressed leasing transactions, so the nonleasing “guidance” in the “subsequent events” section of Topic D-14 accomplished very little, except to note that ARB 51 applied.⁴⁷ Thus, ARB 51 was the applicable guidance for SPEs not related to leasing transactions.

U.S. GAAP REQUIREMENTS FOR SPES AND CONSOLIDATION WAS REVISED AFTER CAPCO WAS LIQUIDATED IN 2002

60. As time went on, an industry-standard accounting textbook observed that, “[c]ertain accounting principles which in the past were only deemed to be preferable have become mandatory principles as a result of actions taken by the FASB.”⁴⁸ Indeed, the ambiguity in U.S. GAAP about consolidation was resolved after Capco was liquidated in December 2002. FASB Interpretation No. 46 *Consolidation of Variable Interest Entities* (“FIN 46”) was issued in January 2003. A revised version of FIN 46 was issued in December 2003 (“FIN 46(R)”). FIN

⁴⁶ EITF 90-15, Response to Question 2.

⁴⁷ FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*, which was also listed as guidance in the “subsequent events” section of Topic D-14, is not applicable to issues in this matter.

⁴⁸ Wiley GAAP 2000, p. 10.

46 removed both control and majority ownership as criteria for consolidation. Instead, a new concept of “primary beneficiary” became the criteria for consolidation. Because Capco was liquidated in December 2002, neither FIN 46 nor FIN 46(R) applied to Capco.

61. It is my understanding that the basis for the conclusion that the Capco structure should have been consolidated with AIG’s financial statement was EITF Topic D-14 and EITF 96-21. However, that conclusion was flawed. As discussed above, consolidation of Capco in AIG’s financial statements was not required under ARB 51, the highest applicable category of U.S. GAAP. The lower levels of U.S. GAAP did not apply because they were specific to leasing. Therefore, based on ARB 51, an accountant analyzing Capco during the relevant time would have been reasonable in concluding that consolidation with AIG’s financial statements was not required.

**UNRELIABLE HISTORICAL DATA COULD HAVE PREVENTED AIG FROM
REASONABLY ESTIMATING ULTIMATE LOSSES ASSOCIATED WITH THE AUTO
WARRANTY BUSINESS**

62. In the Amended Complaint, the NYAG stated that AIG projected a loss of \$210 million on the auto warranty business in 1999.⁴⁹ However, it is my opinion that, in accordance with U.S. GAAP, unreliable historical data may have prevented AIG from reasonably estimating ultimate auto warranty losses in 1999.

63. In accordance with U.S. GAAP, a liability for unpaid losses (also known as “loss reserves”) is accrued when insured events occur based on the estimated ultimate cost of settling claims. Reliable historical data is critical to the development of a reasonable estimate for loss reserves.⁵⁰

⁴⁹ Amended Complaint, ¶40.

⁵⁰ AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies, May 1, 2000, ¶¶4.34 – 4.42, 4.70.

64. Stability and consistency of data are critical to the development of reasonable estimates for loss reserves. According to U.S. GAAP (emphasis added):⁵¹

Various analytical techniques exist to assist management, consulting actuaries, and independent auditors in estimating and evaluating the reasonableness of loss reserves. These techniques generally consist of statistical analyses of historical experience and are commonly referred to as loss reserve projections.

Loss reserve projections are used to develop loss reserve estimates. Understanding and assessing the variability of these estimates and the reliability of historical experience as an indicator of future loss payments require a careful analysis of the historical loss data and the use of projection methods that are sensitive to the particular circumstances. . . .

The decision to use a particular projection method and the results obtained from that method generally should be evaluated by considering the inherent assumptions underlying the method and the appropriateness of these assumptions to the circumstances. Stability and consistency of data are extremely important. Changes in variables, such as rates of claim payments, claim department practices, case-basis reserving adequacy, claim reporting rates, mix of business, reinsurance retention levels, and the legal environment, may have a significant effect on the projection and may produce distortions or conflicting results. . . .

The historical experience of an insurance entity is generally the primary source of information on which loss reserve estimates are based; therefore, the creation of reliable databases, within an insurance company, is extremely critical to the determination of loss reserve estimates. When evaluating loss reserves, the auditor should consider the reliability of the historical information generated by the insurance company.

65. According to U.S. GAAP, unreliable historical data prevents financial statement preparers, such as those at AIG, from reasonably estimating ultimate auto warranty losses. When historical data are not sufficient to resolve uncertainty about the reasonableness of loss reserve

⁵¹ AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies, May 1, 2000, ¶¶4.34, 4.35, 4.42, 4.70.

estimates, and there is a potential for a material understatement of loss reserves, management must only disclose the uncertainty (if material) and not book an expense.⁵²

66. I have reviewed several documents that demonstrate AIG's inability to reasonably estimate ultimate auto warranty losses. According to AIG actuaries and internal auditors, historical data relating to the auto warranty program was unreliable. For instance, according to Jay Morrow, an AIG actuary, in 1997:⁵³

The two overriding problems we have with Divisions 16 (Auto) and 31 (Brown and White) are the lack of statistics to properly price new business, and the lack of proper systems and procedures to monitor the results of business once it has been written. . . .

Data started to become available in October 1996, but there are still major problems that are actively being worked on by the Profit Center and the Actuarial Department. The main problems are that the data does not balance to the financial records, and we are still working on enhancing the reports to allow us to do a detailed analysis of the business. . . .

67. As another example, a special review by internal audit still revealed data issues in late 1999:⁵⁴

Our reports indicate potential problems with respect to claims handling . . . Once the claims are brought in house, we will have full access to the data and be able to perform a more thorough review and better quantify the extent of claims mishandling, overpayments, etc.

68. These data issues suggest that it was not appropriate under U.S. GAAP to record the projected losses at the time.

69. In 1998, AIG hired an external actuary, Milliman & Robertson, Inc. ("Milliman")⁵⁵ to estimate an ultimate loss ratio for the auto warranty business.⁵⁶ Milliman

⁵² AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies, May 1, 2000, ¶4.102; SFAS No. 5 *Accounting for Contingencies*.

⁵³ February 7, 1997 memo from Jay Morrow to Frank Douglas, subject: Warranty Divisions Issues (AIG-NYAGMRG 00209825-6).

⁵⁴ October 15, 1999 memorandum from Keith L. Duckett to Mr. Greenberg (AIG-NYAGMRG 00210228).

estimated a range of loss ratios.⁵⁷ However, Milliman heavily caveated the usefulness of its report. For example, Milliman specifically noted that it did not audit, verify or review data for reasonableness and consistency.⁵⁸ Milliman noted that “if the underlying data or information is inaccurate or incomplete, our analysis may likewise be inaccurate or incomplete.”⁵⁹ Milliman’s estimates were for internal AIG purposes and were not prepared in accordance with U.S. GAAP, nor were the estimates audited under U.S. GAAS.

70. AIG actuaries noted as late as September 1999 that Milliman’s assumptions were “conservative” with regard to expected mitigation efforts and that “significant improvement” of loss experience would be possible.⁶⁰ As such, AIG actuaries predicted a lower loss ratio.⁶¹

AUTO WARRANTY LOSSES WERE REPORTED WITHIN UNDERWRITING INCOME IN STATUTORY FILINGS

71. AIG’s underwriting business was conducted through various subsidiary companies. Each state insurance department requires all insurance entities licensed to write business in that state to file an annual statement, also referred to as the “convention blank,”

⁵⁵ Milliman & Robertson, Inc.: An Actuarial Analysis of Selected Automobile Warranty Experience as of September 30, 1998 (“Milliman Report”) (AIG-F 00257931-46, AIG-NYAGMRG 00275279-92; AIG-NYAGMRG 00275458-61).

⁵⁶ Milliman Report (AIG-F 00257932).

⁵⁷ Milliman Report (AIG-F 00257932, AIG-F 00257939-42); Memorandum from Susan Rivera to Evan Greenberg, September 10, 1999, Subject: Auto Warranty UEPR Run-off (AIG-F 00035538).

⁵⁸ Milliman Report (AIG-F 00257937).

⁵⁹ Milliman Report (AIG-F 00257937).

⁶⁰ Memorandum from Frank H. Douglas to M.R. Greenberg, September 10, 1999, Subject: Auto Warranty (AIG-F 00035520).

⁶¹ Memorandum from Susan Rivera to Evan Greenberg, September 10, 1999, Subject: Auto Warranty UEPR Run-off (AIG-F 00035538).

“statutory blank,” or simply “the blank,” with the state insurance commissioner for each individual insurance entity.⁶²

72. The statutory filings included Schedule P entitled “Analysis of Losses and Loss Expenses” which provided, among other information, inception-to-date premium earned, premium ceded, loss payments, loss payments ceded, loss reserves, and loss reserves ceded by line of business and by underwriting year. In other words, Schedule P included a column disclosing total underwriting results without regard to reinsurance.

73. National Union Fire Insurance Company (“NUFI”) was an AIG subsidiary involved in the auto warranty line of business.

74. Below is an excerpt from the annual statement of NUFI to the insurance department of the state of Pennsylvania. Schedule P data is reported within 36 columns for each line of business. A portion of NUFI’s Schedule P for Other Liability (columns 26 through 36) is below. Column 26 presents gross losses⁶³ for each underwriting year:⁶⁴

⁶² AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies, May 1, 2000, ¶1.45.

⁶³ The sum of columns 4 (loss payments), 6 (defense cost payments), 8 (other payments), 13 (case reserves), 15 (IBNR reserves), 19 (defense cost reserves), and 21 (other reserves).

⁶⁴ Schedule P – Part 1H – Section 1 – Other Liability – Occurrence (AIG/GEN-RE-TRANS 0004218) (emphasis added).

	Total Losses and Loss Expenses Incurred			Loss and Loss Expense Percentage (Incurred/Premiums Earned)			Nontabular Discount		34 Inter-Company Pooling Participation Percentage	Net Balance Sheet Reserves After Discount	
	26 Direct and Assumed	27 Ceded	28 Net	29 Direct and Assumed	30 Ceded	31 Net	32 Loss	33 Loss Expense		35 Losses Unpaid	36 Loss Expenses Unpaid
1 Prior	... XXX ...	... XXX ...	... XXX ...	... XXX ...	... XXX ...	... XXX ...	0	0	... XXX ...	472,201	24,321
2 1991	683,380	225,924	457,456	87.1	110.2	78.9	0	0	38.0	33,683	6,885
3 1992	664,485	190,401	474,084	86.6	90.0	85.3	0	0	38.0	37,208	3,255
4 1993	617,726	123,872	493,854	76.8	50.6	88.2	0	0	38.0	84,860	4,392
5 1994	784,523	296,908	487,615	82.3	71.2	90.9	0	0	38.0	99,597	4,357
6 1995	843,555	311,496	532,059	94.6	77.3	108.8	0	0	38.0	170,953	5,183
7 1996	750,057	288,625	461,432	89.1	72.7	103.7	0	0	38.0	115,167	1,585
8 1997	845,302	303,249	542,053	89.6	81.9	94.6	0	0	38.0	135,875	10,474
9 1998	1,349,632	908,089	441,543	104.4	102.7	107.9	0	0	38.0	212,505	8,488
10 1999	1,312,872	1,081,337	231,535	114.0	115.7	106.5	0	0	38.0	119,167	10,670
11 2000	1,363,994	1,167,740	196,254	112.1	112.3	111.0	0	0	38.0	109,805	42,197
12 Totals	... XXX ...	... XXX ...	... XXX ...	... XXX ...	... XXX ...	... XXX ...	0	0	... XXX ...	1,591,021	121,807

75. Statutory filings are available to the public and analysts. For example, SNL Financial (“SNL”) is a provider of news and data on the insurance industry, among other sectors. SNL launched insurance coverage in 1997 and offered access to statutory data.⁶⁵ According to SNL, subscribers can “evaluate every U.S. insurance company, public and private, from every possible angle.”⁶⁶

76. Thus, it is my opinion that it would have been common industry practice for analysts and investors to refer to statutory filings and the information contained therein. Therefore, underwriting losses were not hidden but were listed plainly on Schedule P.

A WRITE-DOWN OF AIRCO’S INVESTMENT IN CAPCO WAS NOT REQUIRED AS OF DECEMBER 31, 2001

77. In the Amended Complaint, the NYAG asserts that AIRCO’s investment in Capco should have been written down in 2001, that Capco’s assets were nearly depleted by the end of 2001, and that “[a]ll that remained was for AIG – which, through its subsidiary AIRCO, still held

⁶⁵ <http://www.snl.com/About-Us.aspx?name=aboutSNL> (last viewed July 3, 2014); <http://www.snl.com/Sectors/Fig/Insurance.aspx> (last viewed July 3, 2014).

⁶⁶ <http://www.snl.com/Sectors/Fig/Insurance.aspx> (last viewed July 3, 2014).

Capco stock – to determine how to account for this now worthless investment.”⁶⁷ In my opinion, the NYAG has misstated the value of Capco as of the end of 2001. My opinion is based upon my experience with valuation practices and my study of Capco’s projected financial statements and the cession statements received by Capco.

78. Capco had significant assets as of December 31, 2001. Capco was initially funded with \$210 million,⁶⁸ and made its first loss payment for \$73,184,000 on June 29, 2001.⁶⁹ Therefore, Capco’s assets at December 31, 2001 were in excess of \$136 million, subject to additions for Capco’s investment income and subtractions for Capco’s operating expenses.

79. In accordance with U.S. GAAP, AIRCO used the cost method to account for its investment in Capco.⁷⁰ This practice was disclosed in AIG’s financial statements.⁷¹ Relevant facts related to AIRCO’s investment in Capco were as follows:

- AIRCO initially purchased 8,500 Series A preferred shares in Capco for \$20,000 per share, or \$170 million total.⁷²
- AIRCO sold 5,000 of the shares to West Gen for \$4 million during 2000 and 2001.⁷³
- AIRCO carried the remaining investment at \$70 million.⁷⁴

⁶⁷ Amended Complaint, ¶54.

⁶⁸ \$20 million premium, \$170 million capital from the preferred shareholder, and \$20 million capital from the common shareholders.

⁶⁹ AIG-NYAGMRG 00168610.

⁷⁰ Relevant U.S. GAAP is discussed elsewhere in this section of the report.

⁷¹ AIG Form 10-K, year ended December 31, 2001, p. 81-82. Capco was an “other invested asset.”

⁷² August 11, 2000 Memorandum from Howard Smith (AIG-NYAGMRG 00211060).

⁷³ PWCBDA00003884; AIG-F00028122.

⁷⁴ PWCBDA00007226-40.

80. Statement of Financial Accounting Standard No. 115 *Accounting for Certain Investments in Debt and Equity Securities* ("SFAS No. 115") established standards of financial accounting and reporting for investments in equity securities that have readily determinable fair values and for all investments in debt securities. According to SFAS No. 115, the fair value of an equity security is readily determinable if sales prices or bid-and-asked quotations are currently available on a securities exchange registered with the Securities and Exchange Commission or in the over-the-counter market, provided that those prices or quotations for the over-the-counter market are publicly reported by the National Association of Securities Dealer Automated Quotations systems.⁷⁵

81. The fair value of the Capco preferred shares was not readily determinable. AIRCO's previous sales of shares to West Gen were not market transactions in either a registered or over-the-counter market and therefore did not provide evidence of readily determinable fair value. Furthermore, by the time of the 2000-2001 AIRCO/West Gen transactions, West Gen was a related party in that it was shareholder of Capco since inception, and, therefore, the transaction prices could not be used for valuation purposes.

82. With the absence of readily determinable fair values, accountants could choose to use models, such as a discounted cash flow model, to estimate fair value or choose to carry the investment at cost.⁷⁶ According to U.S. GAAP, disclosure must be made if it is not practicable for an entity to estimate the fair value of a financial instrument or a class of financial

⁷⁵ SFAS No. 115, ¶3a.

⁷⁶ Statement on Auditing Standard No. 92 *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*.

instruments.⁷⁷ Indeed, AIG disclosed that it did not utilize fair value techniques to determine the fair value of “other invested assets,” such as the investment in Capco:⁷⁸

Other invested assets: For assets for which market prices were not readily available, fair valuation techniques were not applied as AIG believes it would have to expend excessive costs for the benefits derived.

83. Therefore, it is my opinion that the decision to keep the estimated value of AIRCO’s investment in Capco at \$70 million was supported by U.S. GAAP and was fully disclosed in accordance with U.S. GAAP.

84. In addition, I performed further analysis to consider the appropriateness of the recorded value of AIRCO’s investment in Capco at \$70 million. Approximately \$160 million and \$173 million of losses were ceded to Capco from inception through the third and fourth quarters of 2001, respectively.⁷⁹ In addition, Capco was forecasted to earn \$17 million in cumulative investment income during 2000 and 2001.⁸⁰ As such, I determined that \$70 million was a reasonable valuation:⁸¹

	<u>Through Q3 2001</u>	<u>Through Q4 2001</u>
Assets	\$210 million	\$210 million
Less: Paid and Unpaid Losses	\$160 million	\$173 million
Plus: Investment Income	\$17 million	\$17 million
Value of Capco Before Future Investment Income	\$67 million	\$54 million

85. Future investment income for the years 2002 – 2006 was forecast to be \$34 million; the discounted present value of those future cash flows would have to be added to the

⁷⁷ SFAS No. 107 *Disclosures about Fair Value of Financial Instruments* ¶¶14, 15.

⁷⁸ AIG Form 10-K, year ended December 31, 2001, p. 82.

⁷⁹ Cession statement (AIG-NYAGMRG 01267329).

⁸⁰ For investment income, I used the midpoint case of Capco’s forecasted financial statements prepared in May 2000 (AIG-NYAGMRG 00210989-91).

⁸¹ I included the Q3 cession because it is not clear when Q4 figures were available to AIRCO.

estimates above to provide a complete valuation, but the book values I show above are adequate for this analysis.

86. Given the uncertainties related to projecting unpaid losses and the anticipated loss improvement due to better claims management, the above calculations, had they been performed, would indicate the value of AIRCO's investment in Capco at \$70 million was reasonable.

87. SFAS No. 115 *Accounting for Certain Investments in Debt and Equity Securities* provided guidance on how to account for a security whose value is impaired.⁸²

If the decline in fair value is judged to be other than temporary, the cost basis of the individual security shall be written down to fair value as a new cost basis and the amount of the write-down shall be included in earnings.

88. AIG corporate policy regarding an 'other-than-temporary-decline' ("OTTD") in security values was noted in PwC's audit work papers.⁸³

In October 1993, AIG corporate management established a policy statement, which has been communicated to all material operating units regarding "other than temporary declines" in security values. The policy states that if the value of a security declines 25% or more below cost or amortized cost for a period of nine months or more, an "other than temporary decline" has occurred.

89. With a \$70 million carrying value, the market would have had to reflect an impairment of at least \$17.5 million in connection with an open market transaction. Such impairment would have to last nine months or more to mandate an OTTD adjustment under AIG's 25% decline policy. In other words, the value of AIRCO's investment in Capco would have to decline to at least \$52.5 million to trigger an OTTD analysis. Since this is not the case, there would be no OTTD adjustment.

⁸² SFAS 115, ¶16.

⁸³ PwC work paper, year 2000 audit (PWC10077784). The quoted AIG corporate policy for other-than-temporary declines in the value of investments still existed in 2006 (AIG Form 10-K, year ended December 31, 2005, p. 30).

THE CAPCO TRANSACTION WAS NOT MATERIAL TO AIG'S FINANCIAL STATEMENTS

90. Staff Accounting Bulletin No. 99 *Materiality* ("SAB 99") provides guidance for assessing an item's materiality. Factors to be considered under SAB 99 include both quantitative and qualitative factors as set forth below.

91. My analysis of the qualitative factors is as follows:

- SAB 99 suggests that materiality judgments should be made with consideration for the degree of precision that is attainable in estimating a judgment item. In other words, if a precise estimate was attainable, a misstatement should be corrected. As described elsewhere in this report, I found that, in accordance with U.S. GAAP, unreliable historical data may have prevented AIG from reasonably estimating ultimate auto warranty losses. With that context, there is no indication that the Capco Transaction was qualitatively material.
- SAB 99 also considers whether the misstatement masks a change in earnings or other trends. My understanding is that it is not alleged that the Capco Transaction impacted AIG's earnings. Moreover, as described elsewhere in this report, total underwriting losses, regardless of any reinsurance activity associated with the auto warranty business, were reported within underwriting income in statutory filings. Therefore, the Capco Transaction did not mask a change in earnings or other trends and, accordingly, there is no indication that the Capco Transaction was qualitatively material.
- SAB 99 also considers whether the misstatement hides a failure to meet analysts' consensus expectations. Using the NYAG figures associated with the Capco Transaction,⁸⁴ I determined that the alleged misstatement, if corrected, would have little (less than one penny) or no effect on quarterly earnings-per-share as originally reported by AIG. Accordingly, the Capco Transaction did not hide a failure to meet analysts' consensus expectations and there is no indication that the Capco Transaction was qualitatively material.
- SAB 99 also considers whether the misstatement changes a loss into income or vice versa. The effect of the Capco Transaction was to change the booking

⁸⁴ Memorandum of Law in Support of Plaintiff's Motion for Partial Summary Judgment, September 25, 2009, pp. 44 – 46.

of an item from one income statement caption to another. Therefore, the alleged misstatement did not change a loss into income or vice versa and, accordingly, there is no indication that the Capco Transaction was qualitatively material.

- SAB 99 also considers whether the misstatement concerns a segment or other portion of the registrant's business that has been identified as playing a significant role in the registrant's operations or profitability. Based on my review of AIG's public filings, including SEC and statutory filings, AIG's auto warranty line of business was not a significant component of AIG's insurance business. For instance, AIG's General Insurance segment earned \$17 billion premium in 2000.⁸⁵ Auto warranty premium comprised less than 0.5% of that figure.⁸⁶ Therefore, the alleged misstatement did not concern a significant portion of AIG's operations and, accordingly, there is no indication that the Capco Transaction was qualitatively material.
- SAB 99 also considers whether the misstatement has the effect of increasing management's compensation. I have been asked to assume that the Capco Transaction did not increase the compensation received by Messrs. Greenberg and Smith. Further, I have not seen evidence that suggests that happened and, accordingly, there is no indication that the Capco Transaction was qualitatively material.
- SAB 99 also considers whether the misstatement involves concealment of an unlawful transaction. As described throughout this report, I found no accounting improprieties with the Capco Transaction, and accordingly, there is no indication that the Capco Transaction was qualitatively material.

92. SAB 99 also addresses the implications of ambiguous accounting guidance in the context of the books and records requirements for SEC registrants, such as AIG, to maintain records "in reasonable detail."⁸⁷ With clear accounting guidance, a misstatement should be corrected because there is no ambiguity; with unclear accounting guidance, ambiguous guidance

⁸⁵ AIG Form 10-K, year ended December 31, 2002, p. 2.

⁸⁶ Cession statement (AIG-NYAGMRG 01267329).

⁸⁷ Securities Exchange Act of 1934, Section 13(b)(2)(A).

by its very nature leaves open the question as to whether a misstatement occurred at all.

Specifically, SAB 99 states:⁸⁸

Where reasonable minds may differ about the appropriate accounting treatment of a financial statement item, a failure to correct it may not render the registrant's financial statements inaccurate "in reasonable detail." Where, however, there is little ground for reasonable disagreement, the case for leaving a misstatement uncorrected is correspondingly weaker.

93. Therefore, given the ambiguous guidance relating to SPEs during the time relevant to this matter, SAB 99 factors indicate that there may not have been a misstatement at all. Even if later it was determined that there was an alleged failure to correct the original accounting treatment, the original treatment may not have rendered AIG's financial statements inaccurate. Accordingly, there is no indication that the Capco Transaction was qualitatively material.

94. My understanding is that the NYAG has also taken the position that the Capco Transaction is quantitatively material by referencing particular components of AIG's operations. Specifically, the NYAG calculates the alleged overstatement of underwriting profit from the Capco Transaction⁸⁹ and compares that calculation to underwriting profit within the following selective sub-sets of AIG's operations: AIG's General Insurance, Domestic General Insurance, and DBG.⁹⁰

95. Analysts did not focus on two of the NYAG's selections: Domestic General Insurance and DBG (indeed, the NYAG's Exhibit 243 indicates that DBG's quarterly results

⁸⁸ SAB 99, Section 2, Immaterial Misstatements that are Intentional.

⁸⁹ The NYAG does not consider the alleged overstatement of realized losses, which greatly reduce the alleged overstatement.

⁹⁰ Plaintiff's Memorandum of Law in Opposition to Defendants' Motions for Summary Judgment, November 25, 2009, Exhibit 243.

were “not reported” in 2000 and 2001) and the NYAG has not pointed to anything that would suggest otherwise. Therefore, comparing alleged overstatements to Domestic General Insurance or DBG results is not appropriate under SAB 99.

96. In addition, with regard to AIG’s General Insurance, the NYAG inappropriately compares the alleged overstatement of underwriting results to General Insurance underwriting results. However, the NYAG does not include other General Insurance operations in its analysis. As noted elsewhere in this report, SFAS 97 stated that capital gains and losses also were “an integral part of an insurance enterprise’s operations.”⁹¹ Indeed, investing activities consistently constituted a significant portion of income earned by AIG’s General Insurance segment:⁹²

- 2002. AIG’s General Insurance segment generated nearly \$700 million⁹³ operating income. Of that, roughly \$1.2 billion was underwriting loss and approximately \$1.9 billion was generated from investing.
- 2001. AIG’s General Insurance segment generated nearly \$2.9 billion operating income. Of that, roughly \$90 million was underwriting profit and \$2.8 billion was generated from investing.
- 2000. AIG’s General Insurance segment generated \$3.5 billion operating income. Of that, roughly \$800 million was underwriting profit and \$2.7 billion was generated from investing.
- 1999. AIG’s General Insurance segment also generated approximately \$3.5 billion operating income. Of that, roughly \$700 million was underwriting profit and \$2.8 billion was generated from investing.

97. Therefore, in order to provide a proper perspective, the alleged overstatement of underwriting profits must be considered relative to AIG’s General Insurance operating income.

⁹¹ SFAS No. 97, ¶74.

⁹² AIG Form 10-K, year ended December 31, 2002, p. 2.

⁹³ This reflects the figure prior to any adjustment in the AIG 2005 10-K. Subsequent to that adjustment, the figure was approximately \$923 million.

Further, the alleged overstatement of profits should also be considered relative to AIG's net income and AIG's comprehensive income, both of which are key metrics to AIG's business.

98. As discussed above, it is my opinion that the problems with the data associated with the auto warranty business, as well as AIG's mitigation efforts, would have significantly hampered any legitimate recognition of projected future losses. However, even accepting the position that the total amount of realized capital losses from Capco over the period 2000-2003, \$163 million⁹⁴ should have been recognized as underwriting losses in 2000. That results in only a 4.6% effect to AIG's General Insurance Segment Operating Income;⁹⁵ a 2.9% effect to AIG's Net Income;⁹⁶ and a 2.9% effect to AIG's Comprehensive Income for the year 2000.⁹⁷ Obviously, were the losses to have been recognized as they were incurred over the course of several years the percentage effect would have been much lower than that.

99. For purposes of quantitative materiality, SAB 99 discussed a range of 5% - 10% as common measures.⁹⁸ Since the percentage of alleged overstatement, even when recognizing all of the losses in a single year was 4.6%, and measuring the effect on segment operating

⁹⁴ PWCSEC 014515.

⁹⁵ \$163 million (Capco Reclassification for 2000) / \$3,524 million (General Insurance Segment Operating Income from AIG's 2000 Form 10-K) = 4.6%.

⁹⁶ \$163 million (Capco Reclassification for 2000) / \$5,636 million (AIG Net Income from AIG's 2000 Form 10-K) = 2.9%.

⁹⁷ \$163 million (Capco Reclassification for 2000) / \$5,603 million (AIG Comprehensive Income from AIG's 2000 Form 10-K) = 2.9%.

⁹⁸ SAB 99: "The FASB noted that, in certain limited circumstances, the Commission and other authoritative bodies had issued quantitative materiality guidance, citing as examples guidelines ranging from one to ten percent with respect to a variety of disclosures. And it took account of contradictory studies, one showing a lack of uniformity among auditors on materiality judgments, and another suggesting widespread use of a "rule of thumb" of five to ten percent of net income" (footnotes omitted).

income, the alleged overstatement fell below the SEC's range; therefore, the alleged overstatements were quantitatively immaterial.

100. In addition, the total amount of realized capital losses from Capco over the period 2000-2003, \$163 million which were reclassified as underwriting losses into year 2000 by PwC in 2005, was immaterial by reference to numerous other meaningful pieces of AIG's financial statements.⁹⁹ For instance, this figure was 0.05% of AIG's total assets at the end of 2000¹⁰⁰ and 1.2% of AIG's General Insurance underwriting losses and loss expenses incurred in 2000.¹⁰¹ By 2003, there was no cumulative effect from Capco on surplus or net income.

101. Therefore, I found no indication that the Capco Transaction was either qualitatively or quantitatively material to AIG's financial statements.

THE GEN RE TRANSACTION OVERVIEW

102. During the fourth quarter of 2000, AIG initiated a reinsurance transaction with General Reinsurance Corporation, Inc., ("Gen Re") whereby Gen Re's subsidiary, Cologne Reinsurance Company (Dublin) Limited ("Cologne Re"), would transfer, or "cede," to AIG's subsidiary NUFI, and NUFI would assume, risks related to certain reinsurance contracts, or "treaties," entered into by Cologne Re (the "Gen Re Transaction"). Under the Gen Re Transaction, then, Gen Re was the ceding carrier and AIG was the assuming carrier. The transaction involved two treaties: one executed in the fourth quarter of 2000 and another in the first quarter of 2001. Each of the two treaties required AIG to assume a maximum of \$300 million of risk for a premium from Gen Re of \$250 million, such that AIG assumed total

⁹⁹ PWCSEC 014515.

¹⁰⁰ \$163 million (Capco Reclassification for 2000) / \$306,577 million (AIG Total Assets from AIG's 2000 Form 10-K) = 0.05%.

¹⁰¹ \$163 million (Capco Reclassification for 2000) / \$13,104 million (General Insurance Underwriting Losses and Loss Expenses from AIG's 2000 Form 10-K) = 1.2%.

maximum risk of \$600 million for total premiums of \$500 million. One of the results of the transaction was an increase in AIG's loss reserves for each quarter by \$250 million. There was no impact on net income because the premium received was offset by an equal amount of loss expense.¹⁰²

THE RELEVANT REINSURANCE AGREEMENTS APPEARED TO QUALIFY FOR REINSURANCE ACCOUNTING

103. Statement of Financial Accounting Standards No. 113 *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (SFAS 113) specifies the accounting by insurance companies for the reinsuring or ceding of insurance contracts. First, SFAS 113 requires a determination of whether a reinsurance agreement qualifies for reinsurance accounting.¹⁰³ To qualify, the reinsurance agreement must indemnify the ceding entity from loss relating to insurance risk.¹⁰⁴ If a reinsurance agreement does not indemnify the ceding entity from loss relating to insurance risk, it must be accounted for as a deposit.¹⁰⁵

104. According to SFAS 113, a reinsurance agreement that indemnifies a ceding entity from "loss relating to insurance risk" requires both of the following:¹⁰⁶

- The reinsurer assumes significant insurance risk under the reinsured portions of the underlying insurance contracts, and
- It is reasonably possible that the reinsurer may realize a significant loss from the transaction.

105. The risk transfer conditions above require judgment. As such, SFAS 113 does not provide comprehensive evaluation guidance for assessing risk transfer. The following table

¹⁰² AIG's 2005 10-K listed a \$3 million impact on Net Income for 2004.

¹⁰³ SFAS 113, ¶6.

¹⁰⁴ SFAS 113, ¶9.

¹⁰⁵ SFAS 113, ¶6.

¹⁰⁶ SFAS 113, ¶9.

summarizes SFAS 113 risk transfer conditions and the related risk transfer measurement criteria (emphasis supplied to highlight judgment items):¹⁰⁷

Risk Transfer Condition	Risk Transfer Measurement Criteria
Significant Insurance Risk	Evaluated by determining the <u>probability of a significant variation</u> in either the amount or timing of payments by the reinsurer.
Reasonably Possible	An outcome is reasonably possible if its <u>probability is more than remote</u> .
Significant Loss	Evaluated by comparing (1) the present value of all cash flows between the ceding and assuming enterprises <u>under reasonably possible outcomes</u> with (2) the present value of the amount paid to the reinsurer.

106. Over the years, the accounting profession developed a numerical benchmark requiring at least a ten percent chance of a ten percent loss to assist in applying the subjective risk transfer criteria in SFAS 113.¹⁰⁸

107. Therefore, reinsurance accounting is appropriate if there is at least a ten percent chance of a ten percent loss. For the Gen Re Transaction, the contracts reflected a potential loss of 20%. The calculation is first made by subtracting from the \$600 million maximum loss the \$500 million premium to obtain a maximum net loss of \$100 million, then dividing that \$100 million maximum net loss by the \$500 million premium. The result is a potential loss of 20%, which is twice the threshold needed, as long as there is at least a ten percent probability of a loss

¹⁰⁷ SFAS 113, ¶¶ 9, 10, 11, 64.

¹⁰⁸ See presentation by FASB staff to the International Accounting Standards Board, July 2005, regarding "Risk Transfer in Insurance and Reinsurance Contracts, US GAAP (Agenda Paper 2)."

in the 10% - 20% range.¹⁰⁹ Also, as a practical matter, reserves recognized by the reinsurer may differ from the reserve credit taken by the ceding company because the accepting and ceding companies may use different assumptions or possess different data. Specifically, auditing literature notes that “the assuming company [AIG in this case] may not have complete information relating to reinsurance activities.”¹¹⁰

108. Risk transfer assessment is made at contract inception based on facts and circumstances known at the time. I reviewed the reinsurance agreements comprising the Gen Re Transaction and noticed very few risk limiting features.¹¹¹ The following table contains common features of reinsurance agreements together with an explanation for how those features may limit risk. I have also noted which of the risk-limiting features were present in the relevant reinsurance agreements between AIG and Gen Re:¹¹²

¹⁰⁹ Loss probabilities may be determined by actuaries, though my experience is that when the potential loss is significantly above the 10% threshold, as it is here, a probability analysis is less essential.

¹¹⁰ AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies, 2000, ¶6.19.

¹¹¹ Reinsurance Agreements (AIG/GEN-RE-TRANS 00000001 – 11 and AIG/GEN-RE-TRANS 00000017 – 26).

¹¹² The first two columns in this table contain contract features described in the AICPA Audit and Accounting Guide, Property and Liability Insurance Entities, January 1, 2013, ¶6.19.

Feature	How The Feature May Limit Risk	Reinsurance Agreements Between AIG and Gen Re
Caps	Caps are used to limit the reinsurer's aggregate exposure by imposing a dollar limit or a limit expressed as a percentage of premiums on the amount of claims to be paid by the reinsurer.	AIG's limit of liability was capped at \$300 million under each of the two reinsurance agreements to aggregate to \$600 million for both. ¹¹³
Dual Triggers	Loss payments are based upon the occurrence of two events.	N/A
Loss Corridor	A mechanism that requires the ceding insurer to be responsible for a certain amount of the ultimate net loss above the ceding entity's designated retention, and below the designated limit, that would otherwise be reimbursed under the reinsurance agreement.	N/A
Payment Schedule	Features that are designed to delay the timing of reimbursement of losses so that investment income mitigates exposure to insurance risk.	N/A
Experience Account	An arrangement whereby the ceding entity shares in the favorable experience of the contract by reference to an experience account that typically tracks ceded premiums, less fees, less ceded losses incurred, plus interest.	The Experience Account earned 3% interest per year for the benefit of Gen Re. ¹¹⁴
Profit Commission	A commission feature whereby the ceding entity is provided a commission based on the reinsurer's profitability under the reinsurance contract.	N/A
Retrospectively Rated Premium	Premiums are determined after the inception of the agreement based on the loss experience under the agreement.	N/A

¹¹³ AIG/GEN-RE-TRANS 00000018; AIG/GEN-RE-TRANS 00000002.

¹¹⁴ AIG/GEN-RE-TRANS 00000021-22; AIG/GEN-RE-TRANS 00000005-6.

Feature	How The Feature May Limit Risk	Reinsurance Agreements Between AIG and Gen Re
Sliding Scale Commission	A commission adjustment on earned premiums whereby the actual ceding commission varies inversely with the loss ratio (for example, increasing payments back to the ceding entity as losses decrease and decreasing payments back to the ceding entity as losses increase), subject to a maximum and minimum.	N/A
Contingent Commission	A provision in a reinsurance agreement that provides a commission to an insurer contingent upon a specified event happening. It is intended to allow the ceding insurer to share in the profits or losses realized by the reinsurer on the business subject to the contract.	N/A
Funds Withheld	A provision under which the premium due to the reinsurer is withheld and not paid by the ceding entity.	98% of the premium due was placed in an Experience Account. ¹¹⁵
Commutation Clause	A clause in a reinsurance agreement that provides for the valuation, payment, and complete discharge of some or all obligations between the ceding entity and reinsurer, including current and future obligations for reinsurance losses incurred.	Gen Re was permitted to cancel the agreements at any time on 90 days written notice to AIG. ¹¹⁶

109. Therefore, out of 11 potentially risk-limiting features of reinsurance agreements, the Gen Re Transaction incorporated only four, and, based on my experience, those four features were common to most finite reinsurance treaties at the time.

110. Furthermore, the few risk-limiting features in the reinsurance agreements between AIG and Gen Re resulted in a treaty that was not overly complex. Complex reinsurance

¹¹⁵ AIG/GEN-RE-TRANS 00000021; AIG/GEN-RE-TRANS 00000005.

¹¹⁶ AIG/GEN-RE-TRANS 00000010; AIG/GEN-RE-TRANS 00000026.

transactions were viewed by auditors as factors potentially increasing inherent risk in an insurance company's control environment, according to U.S. GAAS.¹¹⁷

111. To conclude, the relevant reinsurance agreements contain few risk-limiting features and those few features did not give reason to assess, in 2000 and 2001, that Gen Re failed to transfer sufficient risk to AIG to satisfy the risk-transfer criteria in SFAS 113.

THE GEN RE TRANSACTION WAS NOT MATERIAL TO AIG'S FINANCIAL STATEMENTS

112. Staff Accounting Bulletin No. 99 *Materiality* ("SAB 99") provides guidance for assessing an item's materiality.

113. As previously described, AIG was a very large and complicated insurance/reinsurance company in late 2000. By December of 2000 its market capitalization was over \$200 billion, making it one of the ten largest companies in the United States.¹¹⁸ In my experience investors evaluate and invest in companies such as AIG based on their status as a "blue chip" stock, for dividend history and strength, or because they want exposure to a sector such as insurance and AIG was a recognized market leader.

114. AIG had four primary segments: General Insurance, Life Insurance, Financial Services, and Asset Management.

115. Analysts attempt to simplify complicated entities such as AIG, by identifying measures that *in aggregate* allow them to assess the standing and performance of the entity for investment decision making. In the insurance sector, these measures generally include earnings strength as well as return on equity ("ROE"), lines of business and/or geographic strength,

¹¹⁷ AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies, 2000, ¶6.43.

¹¹⁸ S&P 500 ETF history by year, <http://etfdb.com/history-of-the-s-and-p-500/2000/#2000>.

combined ratio¹¹⁹ and/or reserves, premium growth or pricing strength, and market leadership or competitive position.

116. The table below shows a summary of analyst coverage and the analysts' use of these measures in their third quarter of 2000 reports. As can be seen in the table, combined ratio and/or loss reserves are just one item out of several that factor into analysts' opinions on insurance companies.

AIG Third Quarter 2000 Analyst Attribution Summary					
Analyst Company	Earnings Strength/ROE	Lines of business and/or geographic footprint relative to competitors	Combined ratio and/or reserves	Premium Growth or Pricing Strength	Market leader and/or competitive position (acquisition strength)
Salomon Smith Barney	x	x	x	x	x
Merrill Lynch	x	x	x	x	x
PNC Advisors	x	x	x		x
Keefe, Bruyette & Woods, Inc.		x	x	x	x
Goldman Sachs	x	x	x	x	x
Friedman, Billings, Ramsey & Co	x	x	x		x
UBS	x	x	x		x
Prudential Securities	x	x	x	x	x
Advest, Inc.	x	x	x	x	x
Langen McAllenev	x	x	x	x	
Wasserstein Perella Securities, Inc.	x	x	x		x
J.P. Morgan	x	x	x	x	x
Bear Stearns	x	x	x		x
A.G. Edwards		x	x		x
Morgan Stanley	x	x	x		x
Bernstein Research Call	x	x	x	x	x
Blair, William & Co.	x	x	x	x	x
Credit Suisse First Boston	x	x	x	x	x
<i>Totals out of 18 Analysts/Firms</i>	16	18	18	11	17

117. In my experience, just one indicator such as loss reserves would not be sufficient to materially influence investors' and analysts' decisions. Furthermore, minor declines in loss

¹¹⁹The combined ratio is the sum of the loss ratio and the expense ratio and is used to measure underwriting performance. The loss ratio is paid losses divided by written premiums. The expense ratio is underwriting expenses divided by written premiums. AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies, May 1, 2000, Glossary.

reserves that are given within the context of a strong, growing, market leader such as AIG did not elicit significant concerns or change analyst opinions: not a single analyst changed their recommendation for the AIG shares because of AIG's \$59 million decline in loss reserves announced during the third quarter earnings report of 2000. In fact, the only analyst that changed his recommendation in the time period following the third quarter earnings announcement did so only because the AIG stock was more than fully valued.¹²⁰ Thus, the effect on AIG's loss reserves' of the two tranches of the Gen Re Transaction during a two quarter period was not material to analysts.

118. My analysis of the SAB 99 qualitative factors is contained in the following paragraphs:

119. SAB 99 suggests that materiality judgments should be made with consideration for the degree of precision that is attainable in estimating a judgment item. In other words, if a precise estimate was attainable, a misstatement should be corrected. As discussed above, insurance loss reserve estimates are highly variable from period to period. "Estimates" change as new business is written and commutated, companies are acquired and divested, or as experience changes. Experience changes can be due to idiosyncratic or "one-off" events or gradual systemic changes, and both can cause changes in the reported quarterly "estimates." This observation is also made in the amended complaint "Insurers are constantly assessing and reassessing their reserves"¹²¹

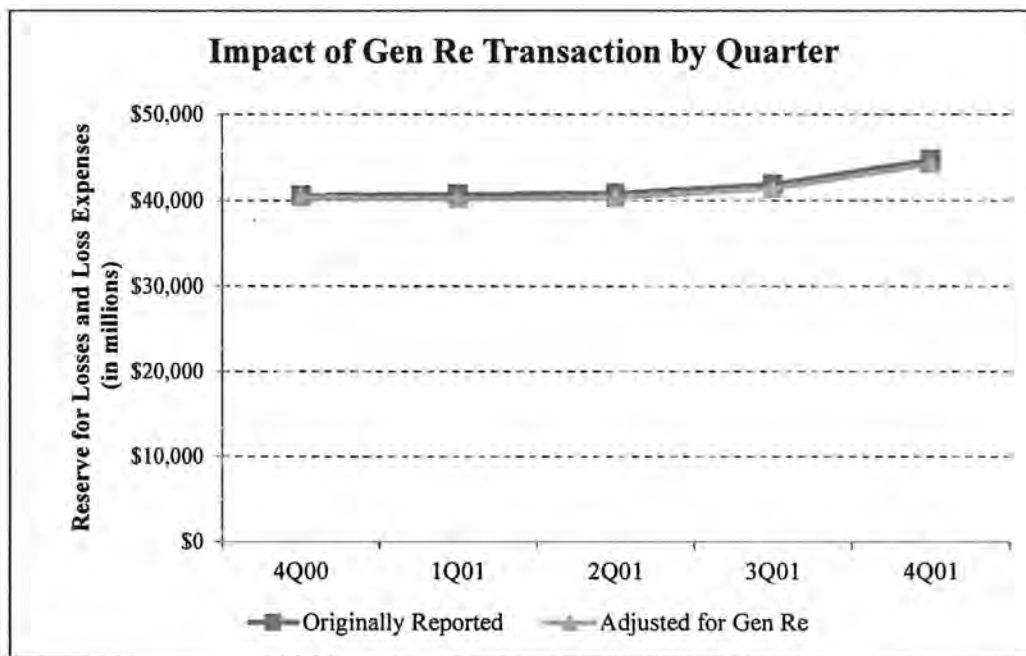
¹²⁰ UBS Warburg report, "AIG: Downgrading Rating to Buy From Strong Buy on Valuation," Michael A. Lewis, Peter C. Streit, October 26, 2000, p. 1.

¹²¹ Amended Complaint ¶18, p 5.

120. The difficulty and the resulting estimation error in reserves can be gleaned from analyst reports as well. For example, in the Sanford Bernstein report following AIG's second quarter earnings release in 2000, analysts state:¹²²

"[b]y AIG's own reckoning (as reported in their SEC filings), AIG reserve margin decreased \$110 million in 1997-98, plus another \$380 million in 1999, although AIG states that much of this was put back up in current reserves in 1999. We estimate the total margin release during 1997-99 to be \$800 million, or 2 loss ratio points; however our estimate of reserve margin at the end of 1996 is \$550 million higher than AIG's current 10K estimate of about \$500 million."

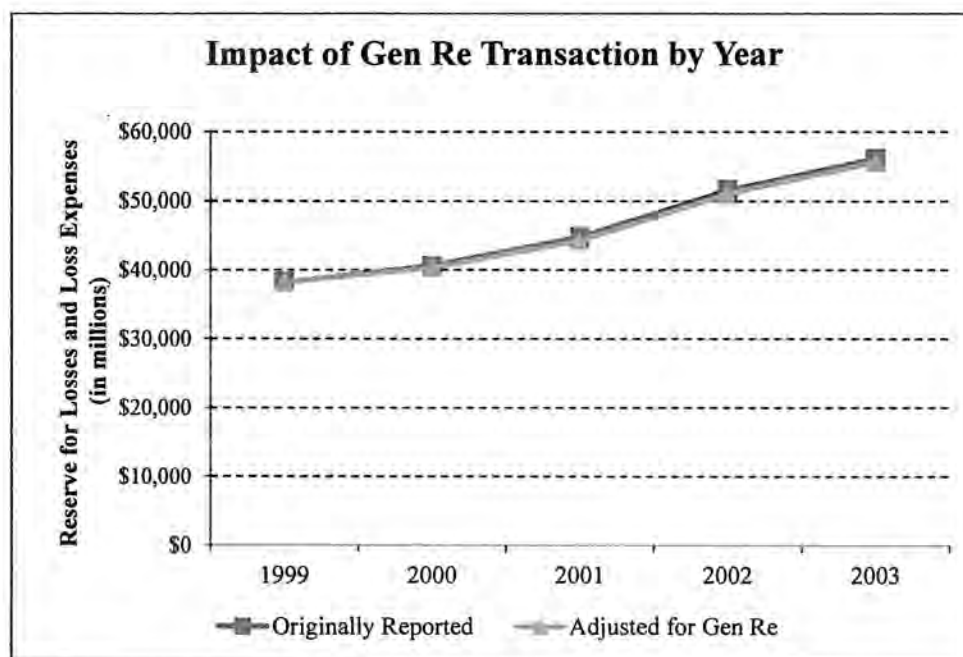
121. Thus, the quarterly changes in the loss reserves by \$250 million due to the Gen Re Transaction tranches were much smaller than the precision attainable for the constantly evolving \$40 billion in reserves on AIG's balance sheet (see chart below).



¹²² Bernstein Research Call, "American International Group (AIG): All-a-rounder," Todd R. Bault, July 18, 2000, p. 2.

122. Therefore, in light of the Sanford Bernstein estimates, the Gen Re Transaction was not quantitatively material or even qualitatively material in that accounting for the Gen Re Transaction did not replace a precise estimate with a less-precise estimate.

123. SAB 99 also considers whether the misstatement masks a change in earnings or other trends. My understanding is that it is not alleged that the Gen Re Transaction impacted AIG's earnings or earnings trends, but the trends in AIG's loss reserves. The Gen Re Transaction only altered the trend in reserve changes in two quarters, but its impact covered a period of four years, at least. In fact, the difference in AIG reserves with and without the Gen Re Transaction is practically undetectable as depicted in the chart below.



124. In my experience, a small decrease or increase in an insurance company's loss reserves, by itself, is not meaningful. This concept is expressed by several analysts:

- “We continue to believe that small quarterly changes in AIG’s \$25 billion loss reserve defy meaningful interpretation . . .”¹²³
- “. . . with all the moving parts, e.g. a slimmed down domestic brokerage book, expanding tail lines like auto insurance and Foreign General, along with excellent loss trends in Mortgage Guaranty, who can predict [the precise amount of reserve decline]?”¹²⁴
- “...a decline in reserves is not necessarily the result of reserve releases and making inferences from quarterly results is difficult.”¹²⁵
- “While from a quality of earnings standpoint it is desirable to see reserves increase and paid losses stay low, the reality is that these figures jump around. AIG had a similar situation last year in the second and fourth quarters, when loss reserves declined by \$32 million and \$95 million, respectively. We don't think this is a big deal.”¹²⁶

125. Instead, the accuracy with which reserves were previously estimated (i.e. reserve development) is meaningful. In fact, U.S. GAAP requires that insurance companies disclose details of the development of the estimate of gross losses.¹²⁷ The disclosure identifies the accuracy with which reserves were previously established.

126. For example, looking at AIG’s estimated ultimate cost of settling claims¹²⁸ as predicted at December 31, 1992, the estimated ultimate cost of settling the same claims is predicted again at every December 31 after that, until all claims are settled. Therefore, U.S.

¹²³ Salomon Smith Barney, “AIG: EPS IN LINE; STRONG MOENTUM IN DOMESTIC PROPERT/CASUALTY,” Ronald W. Frank, October 26, 2000, p. 2.

¹²⁴ Prudential Securities, “AIG REPORTS GOOD 3Q ON A BAD DAY (PART 1 OF 2),” Alice Cornish, October 26, 2000, pp. 1 – 2 (AIG/GEN-RE-TRANS 0001068).

¹²⁵ Blair, William & Co., “AIG Third Quarter: Solid, No Surprises, Reiterate Rating,” Mark Lane, October 31, 2000, p. 2.

¹²⁶ Langen McAlleney, email subject: “AIG Q3 Report; Loss Reserves – NOT A BIG DEAL,” October 26, 2000, p.1.

¹²⁷ AICPA Statement of Position 94-5 *Disclosures of Certain Matters in the Financial Statements of Insurance Enterprises*, ¶10; ASC 944-40-50-3.

¹²⁸ Paid Losses + Estimate For Reserved Losses = Estimated Ultimate Cost of Settling Claims.

GAAP disclosure requirements enable financial statement users to know how well the company estimates its loss reserves.

127. The following is an AIG disclosure about its reserve development (in millions):¹²⁹

	1992	1993	1994	1995	1996	1997	1998	1999	2000
Gross Liability Reestimated as of:									
End of Year	28,157	30,046	31,435	33,047	33,430	33,400	38,310	38,252	40,613
One Year Later	28,253	29,866	30,759	32,372	32,777	32,337	37,161	37,998	
Two Years Later	27,825	29,537	30,960	32,398	31,719	32,251	37,959		
Three Years Later	27,727	30,362	30,825	31,759	31,407	32,810			
Four Years Later	28,625	31,020	30,508	31,604	32,388				
Five Years Later	29,701	30,881	30,417	32,425					
Six Years Later	29,605	30,969	31,128						
Seven Years Later	29,929	31,546							
Eight Years Later	30,452								
Redundancy / (Deficiency)	(2,295)	(1,500)	307	622	1,042	590	351	254	

128. The table above shows, for example, that as of December 31, 2000, AIG predicted that it had underestimated loss reserves by \$2.3 billion at December 31, 1992 and had overestimated loss reserves by \$1 billion at December 31, 1996. Data provided in the table above is the type of information an analyst would have reviewed before making comments such as "AIG continues to set adequate reserves for current year business."¹³⁰ This variability in the estimation and development of loss reserves demonstrates why a decline in loss reserves over a two-quarter period is not material.

129. SAB 99 also considers whether the misstatement hides a failure to meet analysts' consensus expectations for earnings. As described previously, the Gen Re Transaction only impacted loss reserve estimates, not earnings. Accordingly, the Gen Re Transaction could not

¹²⁹ AIG Form 10-K, year ended December 31, 2000, p. 5.

¹³⁰ Goldman Sachs, "Maintaining Estimates and Recommended List Rating," Thomas V. Cholnoky, October 26, 2000, at p. 2.

hide a failure to meet analysts' consensus earnings expectations and there was no indication that the Gen Re Transaction was qualitatively material.

130. SAB 99 also considers whether the misstatement changes a loss into income or vice versa. The effect of the Gen Re Transaction was to change the booking of a balance sheet item, only. Therefore, the alleged misstatement did not change a loss into income or vice versa and, accordingly, there is no indication that the Gen Re Transaction was qualitatively material.

131. SAB 99 also considers whether the misstatement concerns a segment or other portion of the registrant's business that has been identified as playing a significant role in the registrant's operations or profitability. AIG entailed multiple subsidiaries, working groups and subdivisions. DBG was just one of those subdivisions, under the Domestic General Insurance segment of the General Insurance branch of AIG, and there was no indication that AIG management had singled out its performance. Therefore there was no indication that the Gen Re Transaction was qualitatively material from this regard.

132. SAB 99 also considers whether the misstatement affects the registrant's compliance with regulatory requirements. Since the Gen Re Transaction had no income effect and was immaterial on the balance sheet, there was no indication that it was qualitatively material from this regard.

133. SAB 99 also considers whether the misstatement affects the registrant's compliance with loan covenants or other contractual requirements. Since the Gen Re Transaction had no income effect and was immaterial on the balance sheet, there was no indication that it was qualitatively material from this regard.

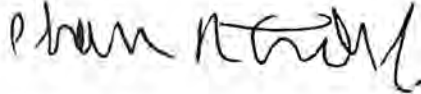
134. SAB 99 also considers whether the misstatement has the effect of increasing management's compensation – for example, by satisfying requirements for the award of bonuses

or other forms of incentive compensation, which are typically a function of corporate earnings. Since the Gen Re Transaction had no income effect, there was no indication that it was qualitatively material from this regard.

135. SAB 99 also considers whether the misstatement involves concealment of an unlawful transaction. Since the Gen Re Transaction was not unlawful, as far as AIG was concerned and knew, there was no indication that it was qualitatively material from this regard.

136. I may update this report should new information become available.

Dated: July 28, 2014



Charles R. Lundelius, Jr., CPA/ABV/CFF



Curriculum Vitae

CHARLES R. LUNDELIUS, JR.
BERKELEY RESEARCH GROUP, LLC
1800 M Street, NW, Second Floor
Washington, DC 20036

Direct: +1 202 480 2684
clundelius@brg-expert.com

Charles Lundelius is the Director of BRG's Financial Institutions Practice, specializing in regulation of and securities trading by broker-dealers, investment advisers, hedge funds, insurance companies and banks. He consults with and provides expert testimony on behalf of clients in the areas of:

- securities and accounting fraud,
- investment management,
- complex investor suitability,
- insider trading,
- stock manipulation,
- securities market regulation,
- securities valuation and share price modeling,
- financial accounting and internal control standards, and
- commodity futures trading regulation and accounting.

As an expert witness, Mr. Lundelius has testified in over thirty different cases. When the United States Securities and Exchange Commission ("SEC") identified key cases it brought relating to the 2007 financial crisis, Mr. Lundelius had testified or was asked to testify in three of those matters.¹ Also, among Mr. Lundelius' more notable consulting engagements, the SEC Inspector General asked Mr. Lundelius to lead the team investigating the SEC's failure to uncover the Madoff Ponzi scheme.

Mr. Lundelius is a Certified Public Accountant and is Accredited in Business Valuation and Certified in Financial Forensics by the American Institute of Certified Public Accountants. In addition, while a senior officer of a Financial Industry Regulatory

¹ SEC Enforcement Actions Addressing Misconduct That Led to or Arose From the Financial Crisis, 2/1/13, <http://www.sec.gov/spotlight/enf-actions-fc.shtml>.

Authority ("FINRA") broker/dealer that served as lead underwriter for securities syndications, Mr. Lundelius held a General Securities Principal license (Series 24, 7 and 63) and was a Registered Investment Adviser. Mr. Lundelius calculated and evaluated broker-dealer capital adequacy under the Net Capital Rule and prepared and filed FOCUS Reports. In 1999, Mr. Lundelius was appointed by the NASDAQ Board of Directors to serve on the NASDAQ Listing Qualifications Panel, the body that reviews the listing and delisting of securities traded on The NASDAQ Stock Market.² He term ended in 2006.

Mr. Lundelius has over 30 years of experience, including 7 years in securities and investment banking in Houston and 3 years as senior vice president and chief financial officer of a life and health reinsurance carrier in Dallas. Mr. Lundelius' securities and investment banking experience includes underwriting, portfolio management, derivatives, high-yield bond and securities and commodities market analysis. He has consulted and/or testified in the areas of the underwriting process, securities market pricing, hedge fund operations, investment suitability, securities fraud, fiduciary duties, compliance and due diligence practices. He has given testimony before an administrative hearing of the SEC, in federal and state courts, at FINRA arbitrations, and before governmental hearings. Mr. Lundelius has qualified as an expert in securities trading and valuation, Investment Adviser and Investment Company Act matters, damages, financial analysis, accounting, fiduciary duties and econometrics. Also, while working for major, international accounting firms over several years, Mr. Lundelius served as an auditor of financial institutions, including broker-dealers, banks and thrifts, in the practice of public accountancy.

In his capacity as insurance company chief financial officer, Mr. Lundelius' duties included managing the company's bond investment portfolio, financial forecasting, and regulatory reporting. In addition, Mr. Lundelius' firm participated in the National Association of Insurance Commissioners' pilot study that led to the implementation of risk-based capital measurement in the insurance industry. Concurrent with his service as insurance company CFO, Mr. Lundelius was also CFO of one of the largest managing general agencies in the U.S., writing in excess of \$40,000,000 in new premium business annually, and served as trustee of the firm's self-directed 401k pension plan. Mr. Lundelius also served on the board of directors of the life and health insurance company and the boards of several insurance marketing firms. In his present role as a consultant, Mr. Lundelius has analyzed finite reinsurance issues relating to various SEC and criminal investigations.

In 2003, Mr. Lundelius authored *Financial Reporting Fraud: A Practical Guide to Detection and Internal Control*, peer-reviewed and published by the AICPA, which is

² "NASDAQ" stands for National Association of Securities Dealers Automated Quotations.

currently used as a textbook in academic and professional courses. The second edition of the book was released in July, 2010.

Volunteering with not-for-profit organizations, Mr. Lundelius has served on finance and audit committees overseeing financial reporting, internal controls, investment management and policy, and operational issues. For a major Episcopal Church congregation in Washington, DC, Mr. Lundelius analyzed investment objectives and operating cash requirements to develop long-term investment policy, as well as processes to monitor performance. For another congregation, as chair of the finance committee, Mr. Lundelius analyzed internal controls, supervised the change in accounting systems, revised administrative and investment policies, and updated budgeting processes. Currently, under appointment by the Bishop of the Episcopal Diocese of Washington, Mr. Lundelius now serves as the Chair of the Diocesan Audit Committee, overseeing internal controls for the multi-million dollar operating budget for the diocese and its endowment funds. Mr. Lundelius also has served as a seminar instructor to church treasurers on Not-For-Profit accounting and internal control issues, and has consulted with the diocese on audit and accounting issues relating to diocesan financial statements.

Securities and Accounting Expertise

In the area of securities transactions and financial accounting, Mr. Lundelius has:

- On behalf of the SEC's Office of Inspector General, assisted in the investigation of the failure of the SEC to uncover the Madoff Ponzi scheme. Mr. Lundelius led a team of securities experts that interviewed SEC examinations staff and reviewed examinations work papers, policies and procedures and related documents. His work was cited by the Inspector General throughout the IG's report of investigation,³ and his team issued a separate report of recommendations to improve operations at the SEC Office of Compliance Inspections and Examinations.⁴ Mr. Lundelius supervised the analysis of purported trading volume on behalf of investors by comparison to trading reported by Bernard L Madoff Investment Securities LLC ("BMIS") to FINRA and NSCC,⁵ as well as

³ Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme.

<http://www.sec.gov/news/studies/2009/oig-509.pdf>.

⁴ Review and Analysis of OCIE Examinations of Bernard L. Madoff Investment Securities, LLC,

<http://www.sec-oig.gov/Reports/AuditsInspections/2009/468.pdf>.

⁵ "NSCC" is the National Securities Clearing Corporation, a subsidiary of the Depository Trust & Clearing Corporation ("DTCC"), which provides clearing, settlement, risk management, central counterparty services and a guarantee of completion for certain transactions for virtually all broker-to-broker trades involving equities, corporate and municipal debt, American depository receipts, exchange-traded funds, and unit investment trusts.

securities positions held at DTC,⁶ and he developed findings relating to how the SEC could have detected Madoff's fictitious trades. Mr. Lundelius and his team also developed recommendations for improvement of SEC broker-dealer and investment adviser examinations. In his written testimony before the US Senate Committee on Banking, Housing and Urban Affairs, the Inspector General said Mr. Lundelius and his team brought specialized experience:

... including expertise in complex financial fraud investigations, securities-related inspections and examinations, hedge fund operations, cash flow analysis and valuations, market regulation rules, market structure issues, accounting fraud, investment suitability, the underwriting process and compliance and due diligence practices.⁷

- With regard to investment advisers who recommended investments in Madoff funds, was qualified as an expert in investment adviser due diligence and testified in multiple arbitrations on the fiduciary duties of advisers.
- On behalf of KPMG LLP, was qualified in arbitration as an expert in auditing standards, investment fund operations and forensic accounting. Mr. Lundelius testified regarding the legitimate and illegitimate operations of BMIS and the presumed findings of auditors had those auditors performed extended procedures at BMIS as a service organization during the audits of funds that invested with Madoff.
- On behalf of PricewaterhouseCoopers Canada and PricewaterhouseCoopers Netherlands, testified regarding auditing standards under both US Generally Accepted Auditing Standards ("US GAAS")⁸ and International Standards on Auditing ("ISA")⁹ relating to audits of funds that invested with BMIS. Areas of testimony included the regulatory framework for broker-dealers and investment advisers, the auditors' role related to internal controls, and how the Madoff fraud was perpetrated.
- On behalf of the National Futures Association ("NFA"), led the investigation of

⁶ "DTC" is the Depository Trust Company, another subsidiary of DTCC, which effects "book-entry" changes to ownership of the securities. DTC provides securities movements for NSCC's net settlements, and settlement for institutional trades (which typically involve money and securities transfers between custodian banks and broker/dealers), as well as money market instruments.

⁷ Written Testimony of H. David Kotz, Inspector General of the Securities and Exchange Commission, Before the US Senate Committee on Banking, Housing and Urban Affairs, September 10, 2009.

⁸ Generally Accepted Auditing Standards in the United States are promulgated by the Public Company Accounting Oversight Board for SEC registrants and by the Auditing Standards Board of the AICPA for non-registrants.

⁹ International Standards on Auditing are issued by the International Auditing and Assurance Standards Board.

the failure of NFA auditors to detect fraud at Peregrine Financial Group, Inc. The investigation analyzed audit standards and the regulatory and operational aspects of future commission merchants, especially United States Commodity Futures Trading Commission (“CFTC”) Regulations 1.14, 1.15 for risk assessment, CFTC Regulations 1.20, 1.25 and 30.7 for segregated and secured funds and CFTC Regulation 1.17 for net capital. The investigation also included examination of NFA and Joint Audit Committee¹⁰ procedures. The investigation produced a report of findings¹¹ and a report of recommendations¹² for NFA.

- On behalf of the US Department of the Interior, analyzed investment practices relating to funds held in trust for Indian Nations, including adequacy of documentation, suitability of investments, and adherence to the Prudent Investor Act. Mr. Lundelius was qualified in Federal Claims Court as an expert in prudence of trust fund investments, accounting and auditing of trusts, fiduciary duties and trust fund management.
- On behalf of a pension plan, assessed the development of investment recommendations by a major registered investment adviser, including application of ERISA standards, relating to an index arbitrage strategy utilizing an unaudited intermediary. Mr. Lundelius analyzed operational due diligence performed by the adviser as well as subsequent correspondence between the adviser and the SEC and US Department of Labor.
- At a criminal trial in US District Court, was qualified as an expert in accounting, pension plans and business valuation and testified on regulations relating to operations of registered investment advisers with regard to underwritings by affiliates and the related securities and ERISA requirements for pension fund clients, including SEC and US Department of Labor rulings. Testimony also included assessment of internal controls and financial and securities reporting requirements under both the Investment Company Act and the Investment Advisers Act of 1940.
- On behalf of a \$7 billion investment adviser and under order from the SEC to examine compliance with Sections 204(a), 206(2) and 206(4) of the Investment Advisers Act of 1940 and Rules 204-2(a)(12), 206(4)-2(a) and 206(4)-(7)

¹⁰ The Joint Audit Committee is a representative committee of the audit and financial surveillance departments of U.S. futures exchanges and regulatory organizations, including representatives of the NFA and other self-regulatory organizations as well as representatives of the CFTC.

¹¹ Report of Investigation: Analysis of the National Futures Association’s Audits of Peregrine Financial Group, Inc., http://www.nfa.futures.org/news/BRG/report_of_investigation.pdf.

¹² Recommendations Report: Analysis of the National Futures Association’s Audits of Peregrine Financial Group, Inc., http://www.nfa.futures.org/news/BRG/final_recommendations_report.pdf.

thereunder, reviewed:

- Internal controls over financial reporting
- Best execution, trade allocation and compliance reporting
- Investor reporting, accuracy of answers to due diligence questionnaires, and timeliness of fund audits
- Trade monitoring, risk exposure, and controls over use of inside information, cherry-picking, and front-running
- Segregation of duties and functions for related broker-dealer
- Compliance policies and procedures, including Rule 206(4)-(7) reporting

Additional work was performed to determine if there was evidence of insider trading. Two reports were filed with the SEC's Enforcement Division in Los Angeles.

- Analyzed portfolio investments, on behalf of a pension plan, for lack of diversification under ERISA as alleged by Department of Labor, incorporating portfolio research findings on time diversification of money with Prudent Investor standards. DOL settled under favorable terms after Mr. Lundelius' presentation of findings to opposing counsel in the Office of Solicitor.
- On behalf of pension fund customer, reviewed broker/dealer due diligence procedures for real estate direct participation programs and suitability of those programs for pension fund investment, analyzing asset allocation and fund investment policies and valuing the investment interests in each real estate entity. Case was successfully settled.
- On behalf of a major California-based financial institution, analyzed the operations of a broker-dealer subsidiary of a bank holding company, including supervision of the processes used by registered representatives to assess investment suitability. Mr. Lundelius also analyzed the intersection of banking and broker-dealer regulations, particularly Federal Reserve Board Regulation R and FINRA regulations.
- On behalf of another major California-based financial institution, analyzed the operations of a broker-dealer subsidiary of a bank holding company with regard to sale of Structured Investment Vehicle (SIV-lite) Asset Backed Commercial Paper to an insurance company. Analysis included a detailed evaluation of the capital structure and vintages of the SIV-lite as well as liquidation and wind-down procedures, evaluations by Nationally Recognized Statistical Rating Organizations, and broker due diligence procedures. With regard to suitability, analysis included evaluations under the Exchange Act of 1934, Investment Advisers Act of 1940, Federal Reserve Board Regulation R, FINRA regulations and California Insurance Code requirements.

- On behalf of the former COO of Countrywide Financial Corporation, analyzed the internal control structure at Countrywide, including specific audit, credit and loan loss committees at both the management and board levels, and assessed compliance with the COSO¹³ *Internal Control - Integrated Framework* and Auditing Standards 2 and 5. In two separate reports, Mr. Lundelius analyzed the due diligence process for mortgage loan securitization at Countrywide. All reports assessed whether the COO could have reasonably relied upon corporate internal controls for the information received.
- Consulted with hedge funds and prime brokers regarding accounting policies, trading controls, risk management and due diligence procedures. Work in this field has included detection and assessment of inappropriate investment strategies (“style drift”) as well as establishing monitoring controls over short selling, margin accounts and risk exposure.
- On behalf of regional wirehouse firms, assessed validity of short positions taken in the process of underwriting Private Investment in Public Equity Securities (“PIPEs”) offerings. Analyses included compliance with short selling rules prior to PIPEs issuance, liquidity of PIPEs markets, and valuation of related securities.
- On another PIPEs matter in which the SEC alleged inflated share prices created excess compensation for an investment manager, evaluated the impact of PIPE offerings and equity lines of credit on issuer stock price, Rule 144 considerations, and valuations of securities issued.
- While serving on the NASDAQ Listing Qualifications Panel, evaluated multiple financing proposals by listed firms attempting to increase capital utilizing PIPEs, equity lines of credit, and similar vehicles.
- On behalf of a major investment bank, determined the compliance of a major futures commission merchant with accounting and valuation covenants in credit facilities. Analysis included assessment of CFTC and NFA regulatory requirements, applicable US GAAP standards,¹⁴ and reporting requirements. Commodities trading separate accounts and investments in commercial paper and futures positions were also assessed, as well as operations of a related global investment fund.
- Relating to a separate futures commission merchant, analyzed the corporate governance and financial reporting for offshore commodities pools, including trading operations, position management and reporting. Mr. Lundelius consulted

¹³ “COSO” stands for Committee of Sponsoring Organizations of the Treadway Commission.

¹⁴ “US GAAP” are the Generally Accepted Accounting Principles for the United States promulgated by the Financial Accounting Standards Board.

on third party administrator functions and duties for hedge funds, especially for foreign funds based in the Cayman Islands.

- On behalf of a futures commission merchant subject to CFTC Order, served as independent third party reviewer to assess measures implemented to correct CFTC findings of inadequate supervisory procedures (Regulation 166.3) and inadequate credit and concentration risk policies and controls.
- On behalf of a nine billion dollar hedge fund, constructed the accounting systems, procedures and policies for the initial public offering (“IPO”) of a Real Estate Investment Trust (“REIT”), including internal controls and valuation mechanisms.
- With regard to the debt and equity structure of a hedge fund, reviewed financial reporting and internal accounting records to determine treatment of subordinated debt of Bermuda and Cayman feeder investors. Mr. Lundelius also assessed accounting for redemption requests and fund leverage, as well as the calculations of fees and profit sharing.
- On behalf of a major hedge fund administrator, opined on the appropriate treatment of redemption requests under US GAAP at the master and feeder fund levels, in particular, *ASC 480 - Distinguishing Liabilities from Equity*.¹⁵ Mr. Lundelius assessed the role of a hedge fund administrator and its calculation of net asset values for fund investors.
- In a FINRA Department of Enforcement (“DOE”) action, on behalf of a leading broker-dealer marketer of non-listed public REITs, analyzed the suitability of the REIT offerings, valuation of the REITs and appropriate disclosures of REIT values and performance in customer account statements. Analysis included review of filings with FINRA Corporate Financing Department, and analysis of communications with the public and reasonable basis suitability standards.
- Testified at NASD¹⁶ arbitration in an IPO allocation proceeding brought by NASD Department of Enforcement against Ken Langone’s broker-dealer, Invemed Associates, with regard to Rule 17a-5 broker accounting and books and records requirements. Mr. Lundelius’ testimony included opinions on US GAAP, US GAAS, and SEC rules and staff accounting bulletins dealing with revenue recognition and financial statement presentation. Mr. Lundelius also analyzed

¹⁵ “ASC” refers to the Accounting Standards Codification implemented in the United States by the Financial Accounting Standards Board in 2009. References to pre-codification financial accounting standards in this *curriculum vitae* have been updated to current ASC references.

¹⁶ The National Association of Securities Dealers, Inc. (“NASD”) was the predecessor self regulatory organization to FINRA.

the impact of DOE's enforcement positions on aspects of the underwriting process such as commission rate structures and the distribution of securities to hedge funds and small investors. NASD Panel returned a decision in favor of Mr. Langone. In an unrelated matter, the Supreme Court of the United States cited the *Invemed* decision with regard to reasonableness of securities fees and commissions from customers who received Hot IPO allocations.¹⁷

- On behalf of The Reserve Fund, prepared a cost allocation study to assess profitability of investment adviser and related distribution and management entities. In action brought by the SEC, testified as to damages incurred when The Reserve Fund broke the buck in September, 2008, including assessment of investor earnings and asset recoveries. In a ruling on motions in that case, Judge Gardephe stated that Mr. Lundelius was "qualified by training and experience" to offer opinions and that he considered Mr. Lundelius' report "in connection with the parties' arguments about the disgorgement remedy sought in the complaint".¹⁸
- At an international arbitration, assessed fiduciary duties of investment advisers to clients invested in proprietary hedge funds, including reporting and governance standards of Cayman Islands and Switzerland. Issues also included portfolio management and suitability of recommendations.
- At FINRA arbitration, testified, as an expert on corporate governance and fiduciary standards, on behalf of Charles Schwab & Co. regarding the appropriate governance structure and board fiduciary duties with respect to investment selection and monitoring by a not-for-profit entity.
- On behalf of a registered investment adviser, testified at trial in California State Court on portfolio management, fiduciary duties, and damages relating to a long/short strategy fund. Jury returned a favorable verdict.
- In connection with regulatory investigations of research published by securities analysts, evaluated the discounted cash flow and working capital forecasts, including estimates of liquidity, earnings multiples and future funding needs, made by a Salomon Smith Barney analyst, working with Jack Grubman, for telecommunications securities, including equities and distressed high yield bonds, covered by SSB in connection with an NASD arbitration proceeding.
- In connection with a large internal investigation, analyzed derivatives transactions and financial models of Freddie Mac, a major originator of mortgage bond

¹⁷ *Credit Suisse Securities (USA) LLC FKA Credit Suisse First Boston LLC, et al. v. Glen Billing, et al.*, 551 U.S. 264 (2007).

¹⁸ Transcript of proceedings in United States District Court, Southern District of New York, before Hon. Paul G. Gardephe, March 28, 2012.

structured securitizations and a primary dealer in treasury bonds utilizing one of the most comprehensive hedging operations in the financial services industry. Areas of investigation included extensive interviews of trading and accounting personnel, evaluation of accounting issues, assessment of bond trading systems, financial analysis of derivative transactions (impact on duration, convexity and swaption valuation using Black-Scholes), *ASC 320 - Investments* classification, and determination of economic rationale for transactions. As part of this analysis, Mr. Lundelius also extensively reviewed and recomputed Value at Risk measurements incorporating findings from the internal investigation.

- Analyzed insider trading activities of Section 16 officers in class action and criminal prosecution matters, including valuation of vested and non-vested options, interaction with short-swing profit rule, tax implications, and SEC Rule 144 and other restrictions.
- On behalf of Lucent, analyzed damages alleged by seller due to decline in Lucent stock received as payment for firm acquired by Lucent. Damages analysis included ability of seller to hedge by use of option, costless collar, variable prepaid forward or other strategies.
- Analyzed complex derivative transactions (including Black-Scholes and Convenience Yield analyses) intended as cash flow hedges for energy commitments made by major utilities with regard to an earnings restatement and an SEC investigation. In addition, while employed by a major accounting firm, advised auditors of an international electric power company on accounting issues.
- Analyzed auditing and disclosure of derivative transactions of Safety-Kleen, a major landfill and waste disposal firm, including assessment of accounting treatment of swaptions and other instruments.
- In administrative hearing before the SEC, designed and testified regarding econometric models to determine the impact of securities trading under various market conditions, modeling securities price valuation, event analysis, the impact of institutional investor trading and the role of transfer agents. In her opinion, SEC Administrative Law Judge Foelak referenced the modeling methodology and cited extensively from Mr. Lundelius' testimony regarding his assessment of the actions that would have been taken by an "economically rational shareholder".¹⁹ At the hearing, Mr. Lundelius was qualified as an expert in securities valuation and as an expert in the price behavior of securities sold into thinly traded markets.

¹⁹ Judge Foelak's opinion is available through the SEC's web site at <http://www.sec.gov/litigation/aljdec/id173cff.htm>.

- In testimony in federal district court in Florida, refuted stock manipulation charges by SEC through analysis of market efficiency and share price movements at the time the issuer and promoters made news announcements. Mr. Lundelius discussed measures of random walk, such as Augmented Dickey Fuller tests, bid-ask spread, and stock price reaction to news entering the market. In his opinion, Senior Judge Gonzalez cited numerous statistics from Mr. Lundelius' testimony and report.²⁰
- In a similar case brought by the SEC in federal district court in Connecticut against a public company and brokers trading its stock, Mr. Lundelius testified for defendants about specific alleged matched trades and market maker quotes preceding those trades. The jury deadlocked on some counts but found for defendants on all others. In a retrial at which Mr. Lundelius testified on quote spreads and ability to "mark the close", the jury found for the defendant stock broker. Testimony in both cases included market efficiency analyses as demonstrated by Augmented Dickey Fuller tests of random walk and other measures of efficiency.
- Further to stock manipulation claims relating to the 2010 Flash Crash, advised high frequency traders on issues relating to regulation, policy and economic issues.
- On behalf of several high net worth investors, investigated misuse of insurance products, SEC Rule 144 offerings and master limited partnerships by family office operations at Merrill Lynch, Morgan Stanley, and major bank trust companies. Mr. Lundelius' engagements included the suitability of these products, including product liquidity and pricing. Estate planning was a significant issue in each case, involving the use of grantor trusts, charitable remainder trusts and other estate planning vehicles.
- For an ultra-short mutual fund, provided opinions regarding the industry practice and regulatory framework for a mutual funds' communications with the public, and the process by which communications with the public are created, reviewed, and approved. Also, Mr. Lundelius analyzed risk-return characteristics of structured finance products in the portfolio and assessed liquidity and the impact of redemptions on net asset value ("NAV").
- On behalf of a mutual fund president, filed an affidavit based on analysis of market timing transactions, disclosure of constraints on those transactions and the impact they had on fund operations. Analyzed fund Class A, B and C share

²⁰ *Securities and Exchange Commission v. David Gane, et al.*, 2005 U.S. Dist. LEXIS 607; 18 Fla. L. Weekly Fed. D 401, at 35-37.

issues, including impact on investment performance.

- On behalf of a major mutual fund sponsor and administrator, reviewed fee structure and operational controls, including NAV calculations and sales charges for the fund complex.
- On behalf of another mutual fund, consulted on NAV calculations relating to valuation and accounting issues.
- On behalf of UBS PaineWebber, testified at NASD arbitration regarding a novel concept of broker liability for allegedly recommending the wrong type of investment adviser for a wrap account, opining on classifications of investment styles used by funds managers. NASD panel found in favor of UBS.
- On behalf of CIBC Oppenheimer, testified at NASD arbitration as to the impact actions taken by a hedge fund's prime broker had on portfolio performance, including analysis of margin calls and the effect of share dispositions in thinly traded markets, as well as damages calculations.
- On behalf of an individual investor, prepared analysis of risk exposure due to portfolio concentrations in limited number of securities using margin debt. Case was successfully settled.
- On behalf of a broker-dealer, analyzed churning claims by investor who aggressively traded in his account, with turnover in excess of 24:1, while maintaining numerous other accounts at other firms which had little turnover. Case was successfully settled.
- On behalf of an individual customer, testified on supervisory procedures relating to registered representative/insurance salesman who misappropriated customer funds while cashing out various insurance policies, opining on the intersection of insurance and securities regulations relating to supervision.
- On behalf of a senior vice president of a regional broker/dealer, opined at NASD arbitration on turnover calculations used to determine churning of investor accounts.
- Testified for and consulted with investor/plaintiffs at NASD arbitration regarding stock trading manipulation scheme, broker/dealer compliance and supervisory procedures, and damages to investors, including ability to trade in a thin market and the value of shares sold into that market.
- At arbitration, testified as to propriety of closing trading windows for corporate insiders and the impact on stock price, using share-trading models, had the windows remained open for an executive wishing to exercise stock options; in addition, analyzed damages using Black-Scholes, variable prepaid forward and

share valuation models.

- On behalf of an executive of a major equipment supplier to the gaming industry accused of insider trading by the SEC, prepared an analysis of business plans and public disclosures, as well as published analysts' reports, to determine if inside information was public. In addition, Mr. Lundelius analyzed market efficiency of the gambling company stock by use of an event study and other metrics, including those metrics established by his testimony in prior cases. Business plan analysis included assessment of operations and opportunities in the Las Vegas and Macau markets, the latter involving significant evaluation of Asian gambling practices and patterns.
- In federal district court, qualified as an expert in accounting relating to auditing and accounting for share-based payments in a stock option backdating claim brought against the former CFO of Maxim Integrated. Mr. Lundelius opined on documentation standards under US GAAS and accounting for options under US GAAP, including valuation.
- Assisted New York Stock Exchange specialist firms Van Der Moolen and LaBranch with interpretation of Exchange Rules during the Exchange's investigation of specialist interpositioning and best execution violations. Engagements included analysis of trading systems and matching alleged violations identified by the Exchange with trade records from the specialists, examining for evidence of front-running and latency of trade execution. Scope of the engagements involved millions of trades.
- Consulted for defendants in a criminal action brought by the New York Attorney General against a securities broker and a promoter charged with selling fraudulent and unsuitable investments. On separate matters brought by the Manhattan District Attorney's office and the Office of the U.S. Attorney, consulted on IPO share allocations, marking the close and no-net-sales issues relating to brokers charged with stock manipulation and "pump and dump" schemes.
- Investigated accounting issues related to the bankruptcy of Global Crossing on behalf of the Special Committee of the Board of Directors, specifically reviewing fair values and revenue recognition of asset exchanges, classification of operating vs. capital (or sales-type) leases, and impact on financial reporting and debt covenants.
- On behalf of a corporate defendant, analyzed the validity of management and analysts' forecasts and their impact on the value of stock prices for \$150 million securities fraud class action suit, including analysis of accounting and sales data, revenue recognition issues, and determining when management became aware of

certain information. Due to findings on accounting issues, Judge Hilton (E.D. Va.) dismissed all accounting claims prior to trial and found for defendants immediately after plaintiffs presented their case.

Valuation and Investment Banking Expertise

With regard to valuation, due diligence and investment banking, Mr. Lundelius has:

- With regard to a hedge fund investing in small capitalization stocks, assessed market liquidity of convertible securities, including assessment of investment banking functions performed by affiliates of the hedge fund manager. Mr. Lundelius also opined on valuations of securities and determined whether markets for those securities were active in accordance with *ASC 820 - Fair Value Measurement*.
- On behalf of a major business development corporation, assessed SEC claims of improper valuations of early stage portfolio companies. Analysis included assessment of bankruptcy probabilities, valuation models and financial disclosures, as well as fair value standards under US Private Equity Valuation Guidelines and US GAAP.
- Consulted with publicly traded and privately held institutional investors on valuation of and accounting for auction-rate securities, mortgage-backed securities, credit default swaps and other alternative investment products, including analysis of market liquidity and impact of that liquidity on fair value under IFRS,²¹ US GAAP and insurance Statutory Accounting Practices. Drawing upon federal district court decisions, including those cases in which Mr. Lundelius testified, Mr. Lundelius was able to establish whether the markets were active and allowed for orderly transactions.
- On behalf of a US affiliate of a major European insurance carrier, evaluated accounting for investments and management stock options under IAS 39 and 40 and IFRS 2.
- On behalf of two major European insurance carriers, evaluated investment classifications under IAS 32, 39 and 40 and IFRS 7. Additionally, Mr. Lundelius analyzed insurance risks under IFRS 4 for reinsurance contracts and ceding agreements.
- On behalf of an individual investor, investigated the failure of a registered

²¹ "IFRS" are the International Financial Reporting Standards promulgated by the International Accounting Standards Board.

investment adviser to perform adequate due diligence relating to investments in a Ponzi scheme, including failure to register as a broker-dealer and failure to report payments from Ponzi scheme promoters.

- Consulted with institutional investors on valuation of auction-rate securities, mortgage-backed securities, credit default swaps and other alternative investment products, including analysis of market liquidity and impact of that liquidity on fair value.
- Consulted with hedge funds of funds regarding due diligence procedures for prospective fund managers.
- Valued multi-office broker-dealers and individual branch offices of AG Edwards and Advest regarding alleged raiding of registered representatives. Valuation included alleged loss of investment advisory clients and confidential information resulting from alleged interference in broker employment agreements.
- Valued and testified regarding multiple-representative day-trading operations within E*Trade in NASD arbitration. In a separate matter, valued a day-trading unit within E*Trade relating to alleged improper contract termination. Valuation also addressed alleged loss of reputation due to the contract termination.
- Valued investment advisory unit of regional broker-dealer in alleged client theft matter. Assets valued included alleged loss of client lists, trade secrets and other confidential information resulting from alleged interference by investment managers that organized the departure of key investment advisory personnel.
- Analyzed and valued electronic bond trading systems for antitrust claim, including the role of institutional investors, dealers and brokers in the trading of fixed income investments.
- On behalf of CIBC Oppenheimer, testified at NASD arbitration on investment due diligence procedures utilized to screen and monitor hedge funds, including development of relevant NASD standards and analysis of files, personnel testimony, emails and memoranda.
- Testified in Florida state court as an expert in post-acquisition disputes regarding alleged fraud in financial reporting of the purchase of a manufacturing division by a Tier One automotive manufacturer and supplier. Analysis involved extensive investigation of accounting reserves for acquisitions made by the seller to allegedly hide losses as well as quantification of damages due to alleged underperformance hidden by fraudulent accounting.
- Testified on a different matter in Florida State Court on investment due diligence procedures and findings relating to capital financing of a property and casualty

insurance carrier, including statutory accounting financial forecasts, surplus deficiencies and regulatory constraints. Mr. Lundelius was qualified as an expert in insurance company financing and acquisition due diligence.

- Testified in federal district court as damages expert in copyright infringement suit against publisher on issues involving marketing of copyright matter, direct mail advertising, and profitability.
- Testified in federal bankruptcy court regarding the allocation of purchase price to intellectual property and goodwill for assets sold by debtor, a software developer of supply chain management systems.
- As an investment banker, structured underwritings of securities offerings for Blockbuster and Precision Tune franchises, including development of accounting and cash flow forecasts, review of franchise agreements and assessments of markets to value financial interests sold to investors.
- As basis for other investment banking underwritings, valued numerous businesses and business units in the following fields: biotechnology and medical diagnostics, real estate, oil & gas, environmental remediation, wholesale and retail distribution of consumer products, office and industrial construction, automotive and motorcycle dealerships, and service firms. Investment vehicles utilized included public offerings, private placements and master limited partnerships.
- Performed due diligence investigations of direct investment programs involving real estate, oil & gas, food processing, biotechnology and medical diagnostics for a major wirehouse and other broker/dealer clients and valued restricted stock and illiquid debt and equity investments related to those programs.
- On behalf of a municipality, analyzed damages from alleged government interference in debt collection efforts by a major operator of health and fitness centers. On behalf of a major fitness celebrity, determined damages due to alleged breach of contract by a national chain of diet centers.
- On behalf of a student loan origination firm, calculated damages due to alleged servicing failures, including debt collection operations. On behalf of a regional bank, assessed damages due to alleged servicing failures on multiple consumer loan portfolios. For both engagements, portfolios of student and consumer loans aggregated to more than \$800,000,000. In a separate matter, after the collapse of a student loan originator, analyzed liability and damages relating to securitizations with over \$400,000,000 of loan pools.
- On behalf of a regional bank, assessed dealer reserve chargebacks due to loan chargeoffs for a mortgage loan originator. Work involved evaluating minimum

reserves required and performance of loans assigned to the bank.

- On behalf of Resolution Trust Corporation, documented fraudulent lending within real estate mortgage portfolio of failed thrift, analyzing failures to follow lending policies and procedures.
- On behalf of major sports stadium association, performed due diligence and valuation of multiple hotel properties, including franchises and luxury properties.
- Valued biotechnology patent utilizing offers in restricted stock from various early-stage biotechnology firms.
- Applied Capital Asset Pricing Model to intellectual property litigation for a \$60 million polyethylene process patent claim asserted by one Fortune 50 company against two other Fortune 50 companies, including regression analyses of intermediate product values, and determined the basis for an antitrust counterclaim.
- Valued semiconductor technology, including forecasts of product development life cycles and performed R&D cost analyses for patent infringement claim by a European information technology firm against a supplier to major automotive manufacturers.
- Served as expert witness on behalf of a software development firm to assess damages, determine counterclaim under software licensing agreement and value software in suit filed by a nationwide provider of multiple listing services to real estate agents.
- Testified in federal district court on behalf of multinational food processing and distribution firm regarding damages resulting from alleged breach of exclusive territory agreement with distributor.

Insurance Expertise

When numerous investigations by US and foreign regulators focused on finite reinsurance treaties, bid rigging and other insurance issues, Mr. Lundelius was called upon to assist in the analysis of auditing issues, risk transfer, adequacy of premium and internal controls.

In the course of serving on several investigations, both in the US and in Europe, Mr. Lundelius has reviewed hundreds of reinsurance treaties in both the property and casualty and life and health segments covering workers compensation, life, casualty and other risks worldwide.

Among his specific engagements, Mr. Lundelius:

- In a whistleblower complaint, assessed internal controls within a major European

insurance carrier relating to asset-liability management, specifically macro-hedging, derivative trading and segregation of duties. Analysis included review of actuarial analyses, financial statements prepared under US GAAP and IFRS, and filings with US Department of Labor and the UK Prudential Regulatory Authority.

- On behalf of a major California-based financial institution, analyzed the operations of a broker-dealer subsidiary with regard to sale of Structured Investment Vehicle (SIV-lite) Asset Backed Commercial Paper to an insurance company. With regard to suitability, analysis included evaluation of California Insurance Code restrictions on investments and requirements for investment approval, as well as assessment of Risk-Based Capital and other insurance reporting issues.
- On behalf of a major, publicly traded life insurance company, analyzed the claims made by an internal auditor whistleblower relating to hedging and segregation of duties. Analysis included assessment of macro-hedging strategy and internal control requirements under the COSO *Internal Control - Integrated Framework* and Auditing Standard 5.
- On behalf of a regional financial institution, testified, in Florida State Court, on investment due diligence procedures and findings relating to capital financing of a property and casualty insurance carrier that the Florida Department of Insurance claimed could have been rehabilitated. Mr. Lundelius reviewed statutory accounting financial forecasts, underwriting practices, forecast surplus deficiencies and assessed regulatory constraints. Mr. Lundelius was qualified as an expert in insurance company financing and acquisition due diligence.
- On behalf of a regional accounting firm, testified, in Texas State Court, regarding auditing and accounting issues relating to a workers' compensation carrier that the Oklahoma Insurance Department claimed was insolvent. Mr. Lundelius analyzed audit work papers and programs, underwriting and case reserve practices, reinsurance and regulatory examinations. Mr. Lundelius was qualified as an expert in auditing and forensic accounting, and his testimony also covered damages as a result of deepening insolvency involving valuation of the carrier on various dates.
- Consulted with a major health insurance company licensed in all US jurisdictions regarding prompt-pay requirements, including detailed analysis of underwriting, claims operations and reserves. Analyses also covered financial reporting and disclosures in SEC filings and discussions with insurance regulators.
- Was retained as an expert in reinsurance and solvency issues related to the

collapse of Reliance Insurance, a major workers compensation property and casualty carrier that was the subject of a criminal investigation. As part of his work, he analyzed statutory and GAAP financial statements and assessed issues related to auditing, internal controls, accounting for reinsurance treaties and deposits, including *ASC 944-20-05 - Reinsurance* and *SSAP 62R - Property and Casualty Reinsurance*, and analyzed changes to risk based capital.

- Has consulted on the structuring of finite reinsurance contracts and has been engaged by major US and European carriers to assess finite reinsurance arrangements, related to various SEC and regulatory investigations, involving US GAAP and SAP, foreign GAAP (Bermuda, France, Ireland, UK and Switzerland) and International Financial Reporting Standards. His work has included conducting internal investigations of treaty negotiations with insurance brokers and counterparties, risk transfer analyses among captives and affiliates, and assessment of auditing and accounting practices and associated internal controls, including *SSAP 61 - Life, Deposit-Type and Accident and Health Reinsurance* and *SSAP 62R - Property and Casualty Reinsurance*, as well as *ASC 944-20-05 - Reinsurance* and *IFRS 4 - Insurance Contracts*.
- Advised on restructuring of bank credit facilities for major reinsurer and its offshore special purpose reserve credit trusts for Regulation XXX, including review of *ASC 825 - Financial Instruments* and *SSAP 27 - Disclosure of Information about Financial Instruments* disclosures. Analysis involved assessment of subprime and other illiquid instruments and determination of market values under both GAAP and SAP.
- Advised on strategic decisions relating to runoff for a \$13 billion life and health reinsurer, including assessment of regulatory restrictions imposed by US, Bermudan, Irish, British and Cayman regulators, liquidity and cash flow forecasting, and US risk-based capital requirements and related capital requirements in foreign jurisdictions. The engagement also involved extensive analysis of special purpose vehicles, including *ASC 810-10 - Consolidation – Variable Interest Entities* and *ASC 860 - Transfers and Servicing* issues, as well as *ASC 825 - Financial Instruments* and related *SSAP 27 - Disclosure of Information about Financial Instruments*.
- On behalf of a major property and casualty insurance carrier's US operations, has consulted on bid rigging and market conduct investigations by numerous state insurance commissions.
- With regard to sales of insurance products to wealthy families, has determined suitability relative to alternative investments.

- On behalf of major health insurer, consulted on unlocking of *ASC 944-20 - Insurance Activities* reserves, including discussions with SEC staff, and advised on *ASC 825 - Financial Instruments* and *SSAP 27 - Disclosure of Information about Financial Instruments* issues.
- On behalf of a major health insurance carrier, analyzed classifications and disclosures of investments under *SSAP 27 - Disclosure of Information about Financial Instruments* and directed negotiations with NAIC SVO²² on re-classification of securities.
- Has conducted internal investigations of corporate officers relating to existence of reinsurance side agreements, documentation of risk transfer analyses, and violations of auditing standards and internal controls.
- Has presented findings to the staff of the US SEC and to auditors

Previously, Mr. Lundelius served as CFO of a life and health insurance carrier that reinsured books of business placed with major insurance companies. As CFO, the scope of duties Mr. Lundelius performed included the following:

- Valuation of books of business and insurance company operating units for purposes of financial reporting and capital acquisition.
- Negotiation of reinsurance treaties and surplus debenture financing.
- Management of variable life and annuity investment products through captive sales force.
- Development of integrated financial and regulatory forecasting systems, including re-scoping of general ledger and chart of accounts.
- Management of and financial reporting for government bond investment portfolio.
- Participation in the NAIC pilot study for implementation of risk-based capital adequacy standards.
- Implementation of product line profitability reporting systems.
- Design of hierarchical agent commission and debit advance systems.
- Discussions with auditors and SEC regarding applications of GAAP, including *ASC 944-20 - Insurance Activities*, especially *ASC 944-20-05 - Long Duration Contracts and Reinsurance*.

²² "NAIC SVO" is the Securities Valuation Office of the National Association of Securities Commissioners in the United States.

- Managing the audit process, internal audit and auditor inquiries.
- Translation of actuarial data and projections into financial and regulatory formats.
- Interaction with regulators, investment bankers and commercial lenders.
- Financial management of underwriting and claims functions.

Publications and Selected Speeches

- “SEC’s Expanded Use of Administrative Proceedings: How an Expert Can Help”, *Westlaw Journal Derivatives*, Vol. 20, Issue 15, June 20, 2014.
- “SEC Guidance on Reg FD for Social Media Communication”, *Corporate Compliance Insights*, May 29, 2013, co-authored with Karina Bjelland.
- Speaker, Hedge Fund Regulation Conference, London, United Kingdom, November 22, 2010.
- “Hedge Fund Disclosure: The Best Defense for an Industry Under Siege”, by Adam Cohen with contribution from Charles Lundelius, *FTI Journal*, Spring 2010, Issue 2.
- “Keeping Track of Funds To Avoid Getting Sued and Other Nasty Things”, presentation at the Treasurers Workshop sponsored by the Episcopal Diocese of Washington, December, 2008.
- “Insurers Face Repercussions of New Accounting Options”, *National Underwriter Property & Casualty*, December 10, 2007, co-authored with Mark Radke and John Pruitt of Dewey & LeBoeuf, LLP.
- Presentation and panel discussion at the International Reinsurance Summit, Bermuda, June 8, 2007, on reinsurance investigations and auditing procedures involving side agreements and other issues.
- “Risk Analyses Unique to Emerging Markets,” *Financier Worldwide*, March, 2007.
- “Reinsurance Accounting Issues,” Presentation for Practicing Law Institute *Reinsurance Law and Practice* seminar, October 7, 2005.
- “Where to find fraud in closely held companies”, *The Practicing CPA*, November 2003 [adaptation of Chapter 5 of *Financial Reporting Fraud: A Practical Guide to Detection and Internal Control*].
- “Disclosing Guesswork,” *The National Law Journal*, September 8, 2003.
- “Balance sheet becomes breeding ground for fraud”, *Journal of Accountancy*,

May 2003 [adaptation of Chapter 4 of *Financial Reporting Fraud: A Practical Guide to Detection and Internal Control*].

- *Financial Reporting Fraud: A Practical Guide to Detection and Internal Control*, a book published by the American Institute of Certified Public Accountants, first edition 2003, second edition 2010.
- “Risk Management and the Audit Committee,” (co-author) *The Corporate Board*, September/October 2002
- Before the American Institute of CPAs’ National Conference on Fraud:
October 31, 2002 - “CPA’s Role in Securities Litigation”
October 2, 2003 - “Forensic Accounting Case Studies”
- “Reducing the Risk of Financial Statement Fraud,” Chapter 10 of *The CPA’s Handbook of Fraud and Commercial Crime Prevention*, American Institute of Certified Public Accountants, March 2001.
- Presentation on financial reporting issues at the Eastern Region Fraud Conference, November 3, 2000.
- “Role of Forensic Accounting in Securities Class Action Law Suits,” presentation at the New York office of Fried, Frank, Harris, Shriver & Jacobson, January 25, 2000.
- “Post Reform Act Standards for Pleading and Proving Scienter,” seminar sponsored by Deloitte & Touche LLP and Kirkpatrick & Lockhart LLP, October 19, 1999.
- “How Much Is A Stock Worth?” article in *Hearsay* (published by Deloitte & Touche LLP), May 1999.
- “Beyond SAS 82: International Issues in Fraud & Forensic Accounting,” before the faculty and students of the University of Virginia McIntire School of Commerce, October 21, 1998.

Certifications

Certified Public Accountant

Accredited in Business Valuation

Certified in Financial Forensics



Professional Affiliations

American Institute of Certified Public Accountants

Beta Alpha Psi Honorary Accounting Fraternity

Beta Gamma Sigma Honorary Business Fraternity

Education

M.B.A. with a concentration in Finance, Tulane University, 1980

B.S. in Commerce with a major in Accounting, University of Virginia, 1978

CHARLES R. LUNDELIUS, JR., CPA/ABV/CFF
Expert Testimony Case History
Page 1

<i>Year</i>	<i>Case</i>	<i>Court/ Agency</i>	<i>Case or Docket No.</i>	<i>Party Represented</i>	<i>Deposition</i>	<i>Trial/ Hearing</i>
2014	Massachusetts Mutual Life Insurance Company v Countrywide Financial Corporation, <i>et al.</i>	U.S. Dist. Ct., Massachusetts	11-cv-10414-MRP	Respondent	1	
2014	Hillcrest Children's Center, <i>et al.</i> v. Charles Schwab & Co., Inc.	Financial Industry Regulatory Authority	13-00664	Respondent		1
2014	Acument Global Technologies, Inc., <i>et al.</i> v. Towers Watson & Co., <i>et al.</i>	U.S. Dist. Ct., S.D. New York	1:12-cv-00506-LLS	Plaintiff	1	
2014	Pasha Anwar, <i>et al.</i> v. Fairfield Greenwich Limited, <i>et al.</i>	U.S. Dist. Ct., S.D. New York	09-cv-118	Defendant	1	
2013	Pine Street Associates, L.P. v. Southridge Partners, L.P., Southridge Capital Management, LLC, and Southridge Advisors, LLC	Supreme Court of the State of New York, County of New York	652109/2010	Respondent	1	
2013	Eastham Capital Appreciation Fund LP, <i>et al.</i> , v. KPMG LLP	International Institute for Conflict Prevention & Resolution		Respondent		1
2013	Texas A&M Foundation v. Strategic Investment Management, L.P. and Strategic Investment Partners, Inc.	American Arbitration Association	16 148 Y 00396 10	Claimants		1
2013	Anders and Elizabeth Hejlsberg, derivatively on behalf of Cornerstone Alternative Fixed Income Fund, L.P., as a Limited Partner, v. Cornerstone Portfolio GP, LLC, Keith J. Schafer, Robert Trenner, Kenneth Hart and Cornerstone Advisors, Inc.	American Arbitration Association	75-512-Y-000062-12 JMLE	Claimants	1	
2012	Securities and Exchange Commission v. Southridge Capital Management LLC, Southridge Advisors LLC, and Stephen M. Hicks	U.S. Dist. Ct., Connecticut	3:10-cv-01685	Defendant	1	
2012	Securities and Exchange Commission v. Kimon P. Daifotis and Randall Merk	U.S. Dist. Ct., N.D. California	CV-11-cv-137	Defendant	1	
2012	State Compensation Insurance Fund v. Metropolitan West Securities LLC, Wachovia Bank, N.A.; <i>et al.</i>	U.S. Dist. Ct., N.D. California	CV 09 2959 JSW (EDL)	Defendant	1	
2011	Securities and Exchange Commission v. Lisa C. Berry	U.S. Dist. Ct., N.D. California	C-07-04431 RMW	Defendant	1	

CHARLES R. LUNDELIUS, JR., CPA/ABV/CFF
Expert Testimony Case History
Page 2

2011	Securities and Exchange Commission v. R. Brooke Dunn and Nicholas P. Howey	U.S. Dist. Ct., Nevada	2:09-CV-02213-PMP-LRL	Defendant	1	
2011	Securities and Exchange Commission v. Reserve Management Company, Inc., Resrv Partners, Inc., Bruce R. Bent, Sr. and Bruce R. Bent II	U.S. Dist. Ct., S.D. New York	09 Civ. 4346 (PGG)	Defendant	1	
2011	Hampton Investments, Ltd.; Oakdale Investments, Ltd.; Seacliff Investments, Ltd.; and Stephen Finlay v. GPS Partners, LLC; GPS New Equity Fund (Cayman), Ltd.; and GPS Income Fund (Cayman), Ltd.	American Arbitration Association	50512 T 00097 10	Defendant		1
2010	Elliot Horowitz v. Gardner Lewis Asset Management	California Superior Court for the County of Los Angeles	BC406551	Defendant	1	1
2009 - 10	Securities and Exchange Commission v. Carl W. Jasper	U.S. Dist. Ct., N.D. California	CV 07-6122	Defendant	1	1
2008	Charles O. Bradley Trust, et al., v. Zenith Capital, LLC, et al.	U.S. Dist. Ct., N.D. California	C 04 2239 JSW (EMC)	Plaintiff	1	
2008	Kim Holland, Insurance Commissioner of the State of Oklahoma, in her capacity as Receiver of Petrosurance Casualty Company, in liquidation, and on behalf of Insureds and Creditors v. Charles Ray Lovelace; Murrell, Hall, McIntosh & Co., PLLP, et al.	District Court - 44 th Judicial District, Dallas County, Texas	04-01687-B	Defendant	3	1
2006	Steven Maass v. E*Trade Professional Trading, LLC, et al.	Financial Industry Regulatory Authority	03-01763	Respondent		1
2006 - 8	Securities and Exchange Commission v. Competitive Technologies, Inc., et al.	U.S. Dist. Ct., Connecticut	3:04-cv-1331-JCH	Defendant	1	2
2005 - 6	The Osage Nation and/or Tribe of Indians of Oklahoma v. The United States of America	Federal Claims Ct.	99-550 & 00-169 L	Defendant	1	1
2005 - 6	Breed Technologies, Inc. v. AlliedSignal, Inc.	FL Cir. Ct., 10 th Dist.	G-99-2478	Plaintiff	3	2
2005	In re: Galaxy Computer Services, Inc.	U.S. Dist. Ct., E.D. Va.	CA 1:2004CV1036	Plaintiff		1
2005	National Association of Securities Dealers Department of Enforcement v. Invemed Associates, LLC	Financial Industry Regulatory Authority	Disciplinary Proceeding No. 030014	Respondent		1
2005	Jo Ann Oster, et al. v. CIBC World Markets Corp., et al.	Financial Industry	03-07585	Respondent		1

CHARLES R. LUNDELIUS, JR., CPA/ABV/CFE
Expert Testimony Case History
Page 3

		Regulatory Authority				
2004	National Rural Electric Cooperative Association, et al. v. Breen Capital Services Corporation, <i>et al.</i>	U.S. Dist. Ct., New Jersey	2:00cv00722	Plaintiff	1	
2004	U.S. v. Nathan A. Chapman, Jr.	U.S. Dist. Ct., Maryland	WDQ-03-0301	Defendant		1
2004	Securities and Exchange Commission v. David Gane, <i>et al.</i>	U.S. Dist. Ct., S.D. Florida Miami Division	03-61553-CIV- Seitz/Bandstra	Defendant	1	1
2004	Mountain States Mutual Casualty Company v. UBS PaineWebber, Inc.	Financial Industry Regulatory Authority	02-05813	Respondent		1
2003	Hermann Holdings, Ltd., et al. v. Lucent Technologies Inc.	U.S. Dist. Ct., N.D. Texas	3:01-CV-0625-G	Defendant	1	
2003	In re: The Receivership of Dealers Insurance Company	Second Judicial Circuit Court, Leon County, Fl.	94-4009-A	Defendant	1	1
2002	In re: SpaceWorks, Inc.	U.S. Bankruptcy Court, Md.	01-17875-PM	Unsecured Creditors	1	1
2001	InterVest Financial Services, Inc. v. Bear Stearns Co., Inc., <i>et al.</i>	U.S. Dist. Ct., E.D. Pa.	99-CV-5463	Defendant	1	
2001	Carabetta v. Novadigm, Inc., <i>et al.</i>	American Arbitration Association	74 160 01455 00 AD1	Plaintiff	1	1
2000	Bennett v. Wheat First Union, <i>et al.</i>	Financial Industry Regulatory Authority	99-02219	Plaintiff		1
1999	Helman v. Mendelson, <i>et al.</i>	Circuit Court of Maryland for Montgomery County	CA 195927 cons 195925	Plaintiff	1	
1999	In the Matter of WHX Corporation	United States Securities and Exchange Commission	3-9634	Respondent		1
1999	American Federal Savings Bank v. Harry L. Leavy	Circuit Court of Maryland for Montgomery County	167641-V	Plaintiff		1

CHARLES R. LUNDELIUS, JR., CPA/ABV/CFE
Expert Testimony Case History
Page 4

1998	Berliner Specialty Distributors v. Conopco a/k/a Good Humor-Breyers Ice Cream	U.S. Dist. Ct., E.D. Va.	98-143-A	Defendant	1	1
1998	Associated Financial Group v. Chevy Chase Bank	U.S. Dist. Ct., E.D. Va.	2-97 CV 985	Defendant	1	
1997	White v. Cahoon and Anchor National, <i>et al.</i>	U.S. Dist. Ct., N.D. Miss.	4:95 CV 374-B-B	Plaintiff	1	
1997	Powter v. Nutri/System L.P. <i>et al.</i>	U.S. Bkcty. Ct., C.D. Cal.	LA 95-10009-SB	Plaintiff	1	
1997	Weiner, <i>et al.</i> v. Dickinson & Co., <i>et al.</i>	Financial Industry Regulatory Authority	95-04047	Plaintiff		1
1996	Robinson v. R&R Publishing, Inc.	U.S. Dist. Ct., D.C.	95-CA-00833	Plaintiff/ Cross-Defendant		1
1996	Frank W. Griswold, III, <i>et al.</i> v. The United States of America	U.S. Dist. Ct., M.D. Fla.	93-565-CIV-T-23A	Defendant	1	
1995-1996	In the Matter of Lend Lease Trucks, Inc.	Pennsylvania Department of Revenue and Board of Finance and Revenue	421919 MCRT	Petitioner	1	1
1995	Simos v. Metzger Construction Co. and Sub-Zero Freezer Co.	125 th Judicial Dist. Ct. of Harris Co., Tex.	91-016216	Plaintiff		1
1994	Forman Brothers, <i>et al.</i> , v. The Law Firm of Graham & James, <i>et al.</i>	Superior Ct. for the District of Columbia	CA 92-7919	Defendant	1	
1994	Stoneman v. Stoneman	Henrico Co., Va. Cir. Ct.	CH-91-001234	Plaintiff	1	*
1994	Ace Sign v. Southwestern Bell Yellow Pages, Inc.	58 th Judicial Dist. Ct., Jefferson Co., Tex.	A-137,152	Defendant	1	
1993	UST Services, Inc., v. Southwestern Bell Yellow Pages, Inc.	234 th Judicial Dist. Ct., Harris Co., Tex.	91-055806	Defendant	1	
1992-1994	Tele-A-Call Answering Service v. Southwestern Bell Yellow Pages, Inc.	122 nd Judicial Dist. Ct., Galveston Co. Tex.	90CV0917	Defendant	1	1

* Deposition testimony entered at trial.

Appendix B: Materials Considered In Forming My Opinions

Bates Numbered Documents

- AIG-F 00028122-26
- AIG-F 00035520
- AIG-F 00035538
- AIG-F 00257931-46
- AIG/GEN-RE-TRANS 00000001 – 11
- AIG/GEN-RE-TRANS 00000017 – 26
- AIG/GEN-RE-TRANS 0001068
- AIG/GEN-RE-TRANS 0004164-281
- AIG/GEN-RE-TRANS 0004218
- AIG/GEN-RE-TRANS 0004375-503
- AIG-NYAGMRG 00168610
- AIG-NYAGMRG 01267329
- AIG-NYAGMRG 00209825-6
- AIG-NYAGMRG 00210228
- AIG-NYAGMRG 00210989-91
- AIG-NYAGMRG 00211060
- AIG-NYAGMRG 00275279-92
- AIG-NYAGMRG 00275458-61
- PWCSEC014515
- PWCBDA00003884
- PWCBDA00007226-40
- PWC10058393
- PWC10058396
- PWC10077784
- PWC10507543
- PWC10518629
- PWC-PCAOB 377057
- PWC-PCAOB 406518-25

- PWCLLP01297887-90
- PWCLLP-144-00307135-38

Accounting Documents

- AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies, May 1, 2000
- AICPA Audit and Accounting Guide, Property and Liability Insurance Entities, January 1, 2013
- AICPA Statement of Position 94-5 *Disclosures of Certain Matters in the Financial Statements of Insurance Enterprises*
- ARB 51, as affected by SFAS No. 94
- ASC 944-40-50-3
- AU 319 (as of January 1, 2000)
- AU 319, as amended after the issuance of Statement on Auditing Standards No. 78
- Committee of Sponsoring Organizations of the Treadway Commission, Internal Control – Integrated Framework, July 1994
- EITF 90-15, EITF Discussion
- EITF 96-21, Response to Question 7
- EITF Topic D-14
- FASB, About the Codification (v 4.9)
- FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*
- Gloria L. Gaylord and Glenda E. Ried, *Careers in Accounting*
- Wiley GAAP 2000: Interpretation and Application of Generally Accepted Accounting Principles, P. Delaney, B. Epstein, J. Adler
- Presentation by FASB staff to the International Accounting Standards Board, July 2005, regarding “Risk Transfer in Insurance and Reinsurance Contracts, US GAAP (Agenda Paper 2)”
- Staff Accounting Bulletin No. 99 *Materiality* (“SAB 99”)
- SAS No. 69 as codified at AU 411 *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles in the Independent Auditor’s Report* (“AU 411”)
- SAS No. 92 *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*
- Securities Exchange Act of 1934, Section 13(b)(2)(A)
- SFAS No. 5 *Accounting for Contingencies*

- SFAS No. 97 *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*
- SFAS No. 107 *Disclosures about Fair Value of Financial Instruments*
- SFAS No. 113 *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*
- SFAS No. 115 *Accounting for Certain Investments in Debt and Equity Securities*
- SFAS No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*

Statement of Statutory Accounting Principle (SSAP) No. 62 *Property and Casualty Reinsurance*, (as of March 2001)

SEC Filings

- AIG Form 10-K, year ended December 31, 1999
- AIG Form 10-K, year ended December 31, 2000
- AIG Form 10-K, year ended December 31, 2001
- AIG Form 10-K, year ended December 31, 2002
- AIG Form 10-K, year ended December 31, 2003
- AIG Form 10-K, year ended December 31, 2004
- AIG Form 10-K, year ended December 31, 2005
- AIG Form 10-Q, all quarters, years 1999-2005

Websites

- <http://www.snl.com/About-Us.aspx?name=aboutSNL> (last viewed July 3, 2014)
- <http://www.snl.com/Sectors/Fin/Insurance.aspx> (last viewed July 3, 2014)
- <http://etfdb.com/history-of-the-s-and-p-500/2000/#2000>
- <http://finance.yahoo.com/>
- <http://www.thefreelibrary.com/AMERICAN+INTERNATIONAL+GROUP+FORMS+AIG+REINSURANCE+ADVISORS,+INC.-a012336527>

Miscellaneous

- Bernstein Research Call, "American International Group (AIG): All-a-rounder", Todd R. Bault, July 18, 2000
- Blair, William & Co., "AIG Third Quarter: Solid, No Surprises, Reiterate Rating", Mark Lane, October 31, 2000

- Goldman Sachs, "Maintaining Estimates and Recommended List Rating", Thomas V. Chohnoky, October 26, 2000
- Langen McAlleney, email subject: "AIG Q3 Report; Loss Reserves – NOT A BIG DEAL", October 26, 2000
- Salomon Smith Barney, "AIG: EPS IN LINE; STRONG MOENTUM IN DOMESTIC PROPERT/CASUALTY", Ronald W. Frank, October 26, 2000
- UBS Warburg report, "AIG: Downgrading Rating to Buy From Strong Buy on Valuation", Michael A. Lewis, Peter C. Streit, October 26, 2000