Expert Report Prepared For:

Weiner Brodsky Kider PC

By:

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Report Date: April 21, 2014

In the matter of: PHH Corporation, *et al.*

Administrative Proceeding Before the Consumer Financial Protection Bureau

File No: 2014-CFPB-0002

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Exhibits

I. Introduction and Scope of Review

The Consumer Financial Protection Bureau ("CFPB") has commenced an action against PHH Corporation, PHH Mortgage Corporation, PHH Home Loans, LLC, Atrium Insurance Corporation, and Atrium Reinsurance Corporation (the "PHH Entities"), alleging that they are in violation of the Real Estate Settlement Procedures Act ("RESPA"), and accompanying regulations. More specifically, the CFPB maintains that certain reinsurance agreements entered into by various private mortgage insurance ("PMI") companies with Atrium Insurance Corporation, a subsidiary of PHH Corporation, did not meet the risk transfer actuarial and accounting standards and, thus, violated RESPA's prohibition against kickbacks and unearned fee splits.

I have been retained by Weiner Brodsky Kider PC on behalf of the PHH Entities to review the reinsurance agreements Atrium entered into with United Guaranty Insurance Company, Genworth Insurance Company, CMG Insurance Company and Radian Insurance Company and to respond to certain positions taken by the CFPB's expert, Mark Crawshaw. Specifically, I have been asked to:

1) Discuss the responsibility for the accounting for reinsurance contracts and the treatment of such contracts on a company's financial statements.
2) Discuss the use by Dr. Crawshaw of a "multi-book year" analysis in determining whether a reinsurance contract meets the risk transfer test under Financial Accounting Standards Board ("FASB") Accounting Standard Codification ("ASC") 944 "Financial Services-Insurance" ("FASB ASC 944").
3) Opine on the methodology and analysis performed by Atrium's consulting actuary, Milliman, Inc. ("Milliman"), and whether it was reasonable for Atrium's accountants to rely on those reports and account for the various arrangements as reinsurance.
4) Opine on the CFPB's contention that the ceding premium was excessive compared to the risk assumed by Atrium.

II. Expert Qualifications

I have been a Certified Public Accountant ("CPA") for over 35 years specializing in the property and casualty insurance and reinsurance industry. Besides being a CPA, I am also a Chartered Property Casualty Underwriter and have served on various professional committees of the American Institute of Certified Public Accountants, the New York State Society of Certified Public Accountants, and the Society of Insurance Financial Management. Over the years I have made numerous presentations on insurance and reinsurance accounting.

During my tenure as a practicing accountant and auditor, I have served numerous large, complex insurance and reinsurance clients and have reviewed hundreds of reinsurance transactions and financial statement filings.

A copy of my current Curriculum Vitae, including my current and past employment and professional affiliations, is provided in Appendix A.

My hourly billing rate on this assignment is $600. I have not authored or co-authored any articles or publications in the past ten years. In the preceding four years, I was retained as an expert witness by Kasowitz, Benson, Torres & Friedman LLP on behalf of their client, Fairfax Financial Holdings Limited in connection with *Fairfax Financial Holdings and Crum & Forster Holdings Corp. v. S.A.C. Capital Management, LLC, et al.* (Superior Court of New Jersey Law Division: Morris County, Docket No. MRS-L-2032-6). My compensation is not contingent on my opinions or the outcome of this case.

III. Work Performed and Materials Reviewed

In order to evaluate the subject reinsurance contracts, I reviewed Atrium's reinsurance contracts pertaining to this matter, as well as hundreds of pages of documents comprised of the Atrium audited financial statements, reports issued by their consulting actuaries and other related documents (set forth in Appendix B).

IV. Background

A reinsurance contract in its simplest form is "insurance for insurance companies." It is a contract between a "ceding" insurance company (also known as the "cedant") to transfer some of its insurance risk to another "assuming" insurance company.

The vast majority of insurance companies utilize reinsurance on a regular basis, and it is generally accepted to be a standard part of overall corporate strategy in the insurance industry. Two forms of reinsurance contracts commonly utilized by the reinsurance industry include proportional and non-proportional reinsurance. The type of reinsurance contract utilized will vary based on the financial and risk strategies employed by the companies involved.

Proportional reinsurance is a type of reinsurance in which the reinsurer shares similar proportions of the premiums earned and the claims incurred by the cedant, plus certain associated expenses. Quota share treaties and surplus line treaties are examples of proportional reinsurance.

Non-proportional reinsurance is a type of reinsurance in which the reinsurer does not share similar proportions of the premiums earned and the claims incurred by the cedant plus certain associated expenses. An example of non-proportional reinsurance is excess-of-loss reinsurance. This type of reinsurance covers specified losses incurred by the cedant in excess of a stated amount (the excess) up to a higher amount, for example $5 million excess of $1 million.

In addition to the "traditional" form of reinsurance described above, another form of reinsurance called "finite" reinsurance may be used to manage a company's overall risk profile. Finite reinsurance contracts contain most of the same features as traditional contracts, but they are generally more structured in that they often have more specific or defined limits on the amount of insurance risk assumed by the reinsurer, and accordingly can be less costly for the ceding insurer. Finite reinsurance is commonly used within the industry, provides similar benefits to the ceding company as "traditional" reinsurance, and is subject to the same accounting and regulatory requirements. Although finite contracts may provide for less risk transfer (*e.g.,* indemnification) by the cedant, they must still meet the accounting literature risk transfer requirements to qualify for reinsurance accounting.

Reinsurance accounting and disclosure is challenging because it frequently involves accounting for complex contracts that embody varying degrees and types of risk which, in turn, may create uncertainty about the range of possible outcomes. As a consequence, each reinsurance transaction must be evaluated on its own facts and circumstances. The issues surrounding the accounting and reporting for reinsurance contracts are not new, as evidenced by the extensive literature from regulatory bodies, along with extensive guidance and interpretations that have evolved over the past 30 years.

In order to qualify for reinsurance accounting and provide a current income statement benefit to the cedant, all reinsurance agreements (whether characterized by the parties as "traditional" or "finite") must transfer insurance risk to the reinsurer. The risk transfer standards require that (a) the reinsurer assumes significant insurance risk (underwriting risk and timing risk) under the reinsured portions of the underlying insurance agreements; and (b) it is reasonably possible that the reinsurer may realize a significant loss from the transaction.

Reinsurance accounting provides for the following:

- Amounts paid for prospective reinsurance (covering losses that may be incurred as a result of future insurable events) shall be reported as prepaid reinsurance premiums and amortized over the remaining contract period in proportion to the amount of insurance protection provided. The amortization has a direct impact on earnings by charging premiums ceded (an expense on the income statement).

- Reinsurance receivables shall be recorded on the balance sheet to reflect the amount recoverable from the reinsurer. Changes in the estimated amount of the liabilities relating to the underlying reinsured contracts shall be recognized in earnings in the period of the change.

Reinsurance accounting is not permitted for prospective or retroactive contracts (covering liabilities incurred as a result of past insurable events) that do not meet the risk transfer tests. Instead deposit accounting is required for such contracts. Deposit accounting for a contract generally observes the following rules:

- The amount paid for a contract is initially recorded as a deposit asset, with no revenue or expense impact (and therefore no impact on income).

- The deposit asset is increased due to additional premium payments, and decreased due to subsequent claims paid by the reinsurer.

Retroactive reinsurance accounting is prescribed for retroactive contracts.

- Amounts paid for retroactive reinsurance shall be reported as reinsurance receivables.

    - If the amounts paid exceed the recorded liabilities the excess is charged to earnings.

    - If the recorded liabilities exceed the amounts paid, the resulting gain is deferred and amortized over the estimated settlement period.

It is important to note that the primary difference between the accounting methods described above is the timing, but not the ultimate amount, of the financial benefit of the contract. Stated otherwise, the economic outcome is not impacted by the accounting treatment of the reinsurance contract.

<u>Generally Accepted Accounting Principles</u>

U.S. generally accepted accounting principles ("GAAP") provide extensive guidance with respect to reinsurance accounting as specified in FASB ASC 944. Included in that guidance are the following concepts:

- Indemnification of the cedant against loss or liability relating to insurance risk in reinsurance of short-duration contracts requires both of the following, unless substantially all of the insurance risk has been assumed:

    a. Significant insurance risk. The reinsurer assumes significant insurance risk under the reinsured portions of the underlying insurance contracts. Implicit in this condition is the requirement that both the amount and timing of the reinsurer's payments depend on and directly vary with the amount and timing of claims settled under the reinsured contracts.

b. Significant loss. It is reasonably possible that the reinsurer may realize a significant loss from the transaction.

- The conditions are independent and the ability to meet one does not mean that the other has been met. A substantive demonstration that both conditions have been met is required for a short-duration contract to transfer risk.

- The cedant's evaluation of whether it is reasonably possible for a reinsurer to realize a significant loss from the transaction shall be based on the present values of all cash flows between the ceding and assuming enterprises under reasonably possible outcomes, without regard to how the individual cash flows are characterized. The same interest rate shall be used to compute the present value of cash flows for each reasonably possible outcome tested.

- Significance of loss shall be evaluated by comparing the present value of all cash flows with the present value of the amounts paid or deemed to have been paid to the reinsurer. If, based on this comparison, the reinsurer is not exposed to the reasonable possibility of significant loss, the ceding enterprise shall be considered indemnified against loss or liability relating to insurance risk only if substantially all of the insurance risk relating to the reinsured portions of the underlying insurance contracts has been assumed by the reinsurer.

While the accounting literature has never adopted a "bright line" as to what constitutes "significant" within the meaning of FASB ASC 944, the industry has adopted a standard that has been accepted and utilized by the accounting industry and securities and insurance regulators that is generally referred to as the "10/10" rule. This means that in order for a contract to be properly characterized as reinsurance, the reinsurer has to have a 10% or greater chance of incurring a 10% or greater present value loss under the contract at the time the contract is entered into. In order to consider whether or not the appropriate risk transfer threshold has been met, a company typically runs various scenarios of how the contract might turn out.

As described above, if the risk transfer standards are not met, the reinsurance transaction is accounted for as a "deposit." It is important to understand that the treatment of reinsurance transactions as deposits does not mean that economic risk has not been transferred or that it is somehow improper. Rather, it indicates that the nature and the amount of the risk transferred do not sufficiently conform to the *accounting definition* of risk transfer to be afforded reinsurance accounting treatment.

V. Analysis

Issue 1: The responsibility for the accounting for reinsurance contracts and the treatment of such contracts on a company's financial statements.

As discussed in the American Institute of Certified Public Accountants' ("AICPA") auditing standards, an entity's financial statements are prepared and presented by management. Management of an entity is charged with the final responsibility for the preparation and fair presentation of the financial statements in accordance with applicable accounting standards, in this case statutory accounting principles as promulgated by the National Association of Insurance Commissioners ("NAIC"). In connection with this, management's responsibilities include maintaining adequate records, selecting and applying accounting principles, and safeguarding assets.

In carrying out these responsibilities, management may decide to engage a specialist because of certain complexities or because management may not possess adequate knowledge of the field of expertise. For most insurance companies, the use of an actuarial specialist is quite common. Management may use the actuary to assist in setting loss reserves, reviewing and determining pricing models and evaluating a company's risk transfer analysis. Management is responsible for determining that the actuarial specialist has the appropriate competence and capabilities to assist in preparing the financial information. In addition, while the specialist may provide information critical to the financial statements, it is important to note that the specialist is not taking on the role of management or otherwise performing management functions. Management is responsible for understanding the services to be performed, evaluating the adequacy and results of the services performed, and accepting responsibility for the results of the services. In other words, despite the use of a specialist, such as an actuary, management is the one responsible for making the significant judgments and decisions that are necessary for the fair presentation of the company's financial statements.

In the case of Atrium, management employed Milliman as an actuarial specialist, to assist them in their evaluation of risk transfer of their reinsurance contracts, as well as HUD's requirement that compensation paid is commensurate with the value of the reinsurance. While Milliman provided expertise in this area, it was management of Atrium that would have been responsible for the final determination on these issues.

Auditors also perform an important function in connection with an entity's financial statements. Auditors conduct their audits in accordance with U.S. generally accepted auditing standards ("GAAS"). Professional standards as defined by GAAS require that auditors plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements and are fairly presented, in all material respects, in conformity with the applicable accounting principles.

An audit also includes evaluating the appropriateness of accounting policies used, and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. This would include the proper accounting for reinsurance contracts such as those entered into by Atrium. Generally, in connection with the audit, the auditor will evaluate the work of a specialist used by management. In addition, the auditor may find it necessary to utilize the work of an individual or organization possessing expertise in a field other than accounting or auditing when that work is used to assist the auditor in obtaining sufficient audit evidence. The auditor will evaluate the adequacy of the work of the auditor's specialist for the auditor's purposes, including:

a. the relevance and reasonableness of the findings and conclusions of the auditor's specialist and their consistency with other audit evidence.

b. If the work of the auditor's specialist involves the use of significant assumptions and methods,

   i. obtaining an understanding of those assumptions and methods; and

   ii. evaluating the relevance and reasonableness of those assumptions and methods in the circumstances, giving consideration to the rationale and support provided by the specialist, and in relation to the auditor's other findings and conclusions.

While specialists, such as actuaries are routinely used in insurance company audits, auditors must utilize their own professional judgment in determining the appropriateness of the specialist's findings. The use of a specialist, such as an actuary, merely supplements the audit evidence and the auditor retains sole responsibility for the audit opinion expressed. In other words, the auditor's responsibility is not reduced by his or her use of the work of an auditor's specialist.

Issue 2: Dr. Crawshaw's use of a "multi-book year" analysis in determining whether a reinsurance contract meets the risk transfer test under FASB ASC 944.

In his report, Dr. Crawshaw states "an appropriate analysis of risk transfer under Atrium's captive arrangement should account for the reality that those arrangements were intended to cover multiple book years." (Page 28). He goes on to say: "Although in practice, risk transfer is typically assessed at the inception of an arrangement, because the ultimate result of the arrangement represents such a significant deviation from the industry average, it supports my conclusions that risk transfer at the inception of the arrangement was insignificant and that Atrium did not provide genuine reinsurance service to UGI." (Page 40).

Dr. Crawshaw appears to be making two points: (1) risk transfer for the reinsurance contracts in question should be determined on a "multi-year" vs. single year basis; and (2) if one concludes based on 20/20 hindsight that the Statement of Financial Accounting Standard ("SFAS") 133, Par. 9a and 9b tests would not have been met, then no risk transfer ever took place.

Turning to Dr. Crawshaw's first point, it is common practice in the insurance industry for ceding and assuming companies to have continuing relationships and to renew their reinsurance contracts with similar terms and conditions on an annual basis. However, in evaluating whether the risk transfer requirements have been met, each year must be evaluated on its own, *i.e.*, on a single book year basis (unless it is, in fact, a multi-year, or long-duration, contract).

Insurance contracts are generally classified as either short-duration or long-duration. These classifications have a significant effect on the accounting for each type of contract. In making this determination, the definition in the guidance focuses on the period of time the insurance protection is expected to be in force and the flexibility each party has in changing the terms covered by the contract. FASB ASC 944-20-05 states: "Premiums from short-duration insurance contracts, such as most property and liability insurance contracts, are intended to cover expected claim costs resulting from insured events that occur during a fixed period of short duration. The insurance entity ordinarily has the ability to cancel the contract or to revise the premium at the beginning of each contract period to cover future insured events". It further defines "contract period" as "[t]he period over which insured events that occur are covered by the reinsured contracts. Commonly referred to as the coverage period or period that the contracts are in force." All of Atrium's contracts fall within the definition of short-duration contracts. Thus, for purposes of evaluating whether the Atrium reinsurance contracts meet the risk transfer test, each contract that covers a specific year must be evaluated on its own merits, i.e., on a single-year basis.

This view is further supported by Statements of Statutory Accounting Principles ("SSAP") 62; Paragraph 8.c. issued by the NAIC which states, "The agreement shall constitute the entire contract between the parties. . . ." Thus, each individual contract must stand on its own and the fact that similar contracts may be entered into in the future is irrelevant to the risk transfer analysis.

Dr. Crawshaw appears to agree that these are short-duration contracts under SFAS 133, in that he himself makes reference to Paragraphs 9a and 9b in his discussion of the risk transfer analysis. However, he then argues that even though these contracts are of short duration, Atrium (and their actuarial consultants, Milliman) should have used a multi-year approach in determining whether risk transfer is present.

In 2001, the FASB Emerging Issues Task Force ("EITF") issued an Agenda Committee Report on "Risk Transfer in Mortgage Reinsurance Captive Agreements". The Committee addressed several issues including:

1) Whether any analysis of risk transfer must be performed in accordance with FASB Statement no. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts.

2) Whether and how the trust fund structure should be considered in a FAS 113 cash flow analysis.

3) Whether the changes in trust fund balances give rise to a significant contract amendment at the beginning of each new book year that would require risk transfer to be reassessed.

4) Whether the FAS 113 risk transfer analysis must assume that new capital (rather than earnings retained in the trust from previous book years) is deposited in the trust fund for each book year.

5) Whether all trust fund cash flows (i.e., investment returns, taxes, and so forth) should be considered in the risk transfer analysis.

While the EITF never actually resolved any of the Issues discussed in this Committee report, it is clear that Milliman was aware of these issues in developing and completing its risk transfer analysis on behalf of Atrium, which is consistent with treating Atrium's contracts on a single year basis. Thus, it would be appropriate to conclude that the conclusions reached were based on sound principles well recognized (and accepted) by the accounting profession.

Dr. Crawshaw's second point that "the ultimate result of the arrangement represents such a significant deviation from the industry average, [that] it supports my conclusions that risk transfer at the inception of the arrangement was insignificant" is clearly contradicted by guidance provided by the FASB and the NAIC.

The FASB Staff Implementation Guidance for SFAS 113 (and SSAP 62R - Exhibit A) includes questions and answers to specific issues. In particular, Question 14 asks: "If the assessment of risk transfer changes after the initial assessment at contract inception, how should the ceding company account for the change?"

The response to that question is: "The status of a contract should be determinable at inception and, absent amendment, subsequent changes should be very rare. If the risk of significant loss was not deemed reasonably possible at inception, and a significant loss subsequently occurred, the initial assessment was not necessarily wrong, because remote events do occur. Likewise, once a reasonable possibility of significant loss has been established, such loss need not occur in order to maintain the contract's status as reinsurance".

Thus, once risk transfer for a reinsurance contract has been determined at its inception, it is not appropriate to second guess that conclusion as a result of the actual outcome.

Issue 3: Opine on the methodology and analysis performed by Atrium's consulting actuary, Millman, and whether it was reasonable for Atrium's accountants to rely on those reports and account for the various arrangements as reinsurance.

Most insurance entities utilize a "loss reserve specialist" in determining their loss reserves. The AICPA Audit and Accounting Guide for Property and Liability Insurance Companies states, "The specialist's level of competence and experience should be commensurate with the complexity of the entity's business, which is affected by such factors as the kind(s) of insurance underwritten and environmental and risk considerations." It goes on to acknowledge that many companies engage consulting actuaries to perform this task and further states, "[b]ecause the process of estimating loss reserves is complex and involves many subjective judgments, the absence of involvement by a loss reserve specialist in the determination of management's estimate may constitute a significant deficiency and possibly a material weakness in the entity's internal control".

While there is no specific discussion in the Audit Guide regarding the qualifications of those who perform risk transfer analysis, it is generally accepted that the same skill sets and complexities are involved, and in fact, it would be expected that the same individuals would participate in not only the risk transfer analysis, but also the loss reserve determination.

Further, the AICPA Auditing Standards (AU342) states: "Management is responsible for establishing a process for preparing accounting estimates." In connection with the internal control aspects surrounding the development of accounting estimates, it requires, "[a]dequate review and approval of the accounting estimates by appropriate levels of authority, including . . . consideration of the need to use the work of specialists . . . ."

The risk transfer analysis for the types of reinsurance agreements entered into by Atrium are complex and require deep knowledge of the product, the industry and the ability to create reasonable scenarios consistent with the requirements of SFAS 113. Absent having in-house expertise to perform such complex calculations, it is not only prudent to utilize the services of a recognized expert such as Milliman, but failure to do so might be viewed as a deficiency in the Company's internal control framework.

In evaluating the quality of the work performed by a specialist, the AICPA Auditing Standards AU Section 336 states that the following factors should be considered "to evaluate the professional qualifications of the specialist in determining that the specialist possesses the necessary skills or knowledge":

a. The professional certification, license, or other recognition of the competence of the specialist in his or her field, as appropriate;

b. The reputation and standing of the specialist in the views of peers and others familiar with the specialist's capability or performance; and

c. The specialist's experience in the type of work under consideration.

In my 35 years of experience, I have reviewed the risk transfer analyses prepared by scores of insurance clients, including evaluating the qualifications of specialists who prepared such analyses. Drawing on my extensive experience and applying Section 336's criteria, Milliman possesses the requisite qualifications: Milliman is a well-recognized actuarial consulting firm and at least one of the authors of their risk transfer analyses has held suitable professional designations.

To prepare my report, I was provided with, and I reviewed, Milliman risk transfer studies for the following years under the different contracts:

Radian Book Years 2004-2005

Genworth Book Years 2004-2008B

UGI Book Years 2004-2008

As with all reinsurance contracts, determining the amount of risk transfer is a matter of judgment after evaluating all the facts, both qualitative and quantitative. Whether an agreement with a reinsurer provides a transfer of risk requires a complete understanding of that contract or agreements between the ceding entity and the reinsurer, including an evaluation of all contractual features that (a) limit the amount of insurance risk to which the reinsurer is subject (e.g., experience refunds, cancellation provisions, adjustable features, or additions of profitable lines of business to the reinsurance contract) or (b) delay the reinsurer's timely reimbursement of claims.

The evaluation of whether it is reasonably possible for a reinsurer to realize a significant loss from the transaction shall be based on the present value of all cash flows between the ceding and assuming companies under reasonably possible outcomes. Milliman utilized various performance scenarios (primarily premium levels and loss ratios) and simulated pro-forma financial statements for Atrium. Milliman's reports repeatedly indicate that Atrium incurs significant losses in many of the scenarios.

Milliman assumed that the "Atrium books of business terminate at their natural expiration (i.e., either at cut-off or at the end of run-off)." Due to the cross-collateralization of book years in the respective trust funds, Milliman assumed that all reinsured losses would be satisfied through sufficient capital and multi-year cross-collateralization. Milliman acknowledges in their report that they did not consider any commutation scenarios as part of their risk transfer studies. This is consistent with accounting standards such as SSAP 62R, which provides that, "unless a commutation is expected in the scenario being evaluated, it should not be assumed in the calculation." As noted above, since reinsured losses in Milliman's scenarios would be satisfied from capital and cross-collateralization in the trust fund, commutation, as contemplated in the Atrium reinsurance agreements, would not have been an expected outcome.

Milliman's risk transfer analyses repeatedly relied on the assumption that "Atrium has no liability beyond funds available in the trust." If such a statement were accurate, Atrium's ultimate liability would be limited. Despite such a limitation, however, each of the contracts still passed the risk transfer tests performed by Milliman. In addition, Milliman's assumption of this liability limitation is considered conservative, and any additional liability on Atrium's part would only further support a finding that risk transference existed.

Based on my many years of experience, I find the reports issued by Milliman to be well constructed, and their conclusions to be based on appropriate analysis. Thus, I can see no reason why Atrium would not have relied on Milliman's work product which concluded that the reinsurance contracts in question met the appropriate risk transfer standards issued by the NAIC for purposes of preparing their financial statements.

Item 4: Opine on the CFPB's contention that the ceded premium was excessive in relation to the risk assumed by Atrium.

Paragraph 10 of SFAS 133 states:

> The cedant's evaluation of whether it is reasonably possible for a reinsurer to realize a significant loss from the transaction shall be based on the present value of all cash flows between the ceding and assuming enterprises under reasonably possible outcomes, without regard to how the individual cash flows are characterized. The same interest rate shall be used to compute the present value of cash flows for each reasonably possible outcome tested.

Paragraph 11 goes on to state:

> Significance of loss shall be evaluated by comparing the present value of all cash flows, determined as described in paragraph 10, with the present value of the amounts paid or deemed to have been paid to the reinsurer. If, based on this comparison, the reinsurer is not exposed to the reasonable possibility of significant loss, the ceding enterprise shall be considered indemnified against loss or liability relating to insurance risk only if

substantially all of the insurance risk relating to the reinsured portions of the underlying insurance contracts has been assumed by the reinsurer.

In reviewing the various reports issued by Milliman, the various scenarios presented in their analysis considered the present value of expected cash inflows (premiums) and outflows (claims) and are typical of analysis of this type. Based on that analysis, Millman concluded that the reinsurance contracts in question met the so-called 10/10 rule regarding risk transfer. In addition, Milliman also states that: "this reinsurance agreement likely . . . satisfies the test in the HUD Letter that the compensation paid does not exceed the value of the reinsurance in that the net ceded premium is reasonably related to the ceded risk . . . ."

While SFAS 113 does not directly address the "reasonableness" of the ceded premium to the ceded risk, it does tackle this issue, at least indirectly, by means of the risk transfer assessment process. In other words, if the expected ceded premium was "excessive" in relation to the expected ceded losses, then the underlying contract would be deficient with regard to risk transfer. Therefore, it is illogical to state that appropriate risk transfer may exist, but that the premiums were excessive.

VI. Opinions and Conclusions

Based upon my analysis and review of the extensive materials noted above, consideration of applicable accounting and auditing standards, and my extensive experience as a CPA, I have reached the following opinions and conclusions:

1) Responsibility for the accounting of Atrium's reinsurance contracts and their treatment on the Company's financial statements rests with Company management and not their consulting actuary. At the same time, it was perfectly appropriate for management to use the special expertise provided by Milliman in assessing whether the contracts met the risk transfer tests promulgated under GAAP and SAP.

2) Use of a "multi-book year" analysis is not an appropriate method in determining whether the Atrium reinsurance contracts meet the risk transfer test under FASB ASC 944 (SFAS 113). Further, the use of 20/20 hindsight in assessing whether the risk transfer standards were met at contract inception is inconsistent, and in fact, prohibited under GAAP/SAP.

3) The reports issued by Atrium's consulting actuary, Milliman, appear thorough, detailed, and in line with the expectations of a professional auditor. Milliman would be considered highly

qualified to perform the risk transfer analysis for these contracts, and it would be appropriate for both management and their auditors to place reliance on Milliman's work product.

4) The consideration of premiums paid for coverage received is a basic underlying principle in evaluating whether the risk transfer requirements have been met under GAAP/SAP. Risk transfer is predicated on analyzing appropriate scenarios of expected cash inflows (premiums) and outflows (claims). Were premiums "excessive" compared to expected claim outcomes, then the reinsurance contract would not meet the appropriate accounting standards. Therefore, it would be illogical to maintain that risk transfer may exist, but the premiums were excessive.

My opinions and conclusions are based upon the information and discovery obtained as of the date of this report, and I reserve the right to update my opinion upon receipt of any additional information. Further, I am prepared to explain my opinions in testimony at deposition and/or trial.

Vincent R. Burke

Vincent R. Burke, CPA

4/21/14

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