

In GE Probe, Ex-Staffers Say Insurance Risks Were Ignored

Former employees tell SEC the company failed to acknowledge worsening results in insurance business



GE's offices in Boston. The company earlier this year disclosed a shortfall in reserves for long-term-care policies would require more than \$15 billion in funding. Photo: gunther/EPA/Shutterstock

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Federal investigators are questioning former employees of [General Electric](#) Co. [GE -5.92%](#) about intricate details in a legacy insurance business that led to accounting problems at the conglomerate in the past year.

The insurance business failed to internally acknowledge worsening results over the years, according to several former GE employees who said they have been interviewed by government lawyers. They described in interviews for this article examples of what they call lax managerial oversight and buried risks that ultimately kept the company from booking bigger reserves.

The investigation by the Securities and Exchange Commission started, the company said, after GE earlier this year disclosed that a shortfall in those reserves for long-term-care policies would require more than \$15 billion in funding. That surprise was part of a series of problems that have pushed GE shares to their lowest levels in years and [prompted GE to decide to break itself apart](#) and oust its chief executive.

GE has denied allegations of fraud made in a shareholder lawsuit and says it is cooperating with the government investigators. A GE spokeswoman said the company won't comment on the specifics of continuing legal matters and said it is "exploring every option to manage and mitigate risk" from the insurance business.

"We've recently brought in new seasoned leaders with deep and diverse backgrounds to manage through the complexities," the spokeswoman said.

The shareholder lawsuit cites accounts from several former employees and alleges the accounting fueled a yearslong fraud that inflated GE's results. Investigators have reviewed the lawsuit and spoken with some of those employees, people familiar with the matter say. GE denies the claims and has moved to have the case dismissed.

"I wouldn't say what I saw was smoke," said a former employee at the company's finance arm, GE Capital, who left in 2016. "But there was enough concern that I decided to leave because I didn't want to be there when there was smoke." This person spoke to SEC investigators this summer, the person said.

This person was hired to help improve the governance of the reserve process at GE's insurance business, but left after growing concerned that senior executives in the division were changing numbers and their methodology without providing supporting evidence, the person said in an interview. The person detailed examples to the SEC, the person said. The reasons for the changes weren't clear, this person said.

[The SEC's Boston office opened a probe](#) of the company in November 2017 that focused on revenue accounting in its power division. After GE disclosed the insurance shortfall in January, the probe was expanded to include that review as well, according to the company.

Last month, GE said it was also [the subject of a criminal probe by the Department of Justice](#).

David Chase, a former SEC enforcement attorney now in private practice in Miami, said the entrance of the Justice Department into an accounting probe is unusual because of the dependence on subjective assessments and opinion in accounting decisions.

"Accounting cases are very difficult to prove," he said, adding that the claims can turn into a battle of expert witnesses. No charges have been filed by the SEC or the Justice Department, and Mr. Chase cautions that the focus of an investigation isn't always known.

Representatives of the SEC and Justice Department declined to comment.

Besides the insurance charge, the investigators are also looking at how GE's power business used complex contract accounting rules to report revenue long before the related cash actually arrived, [along with a \\$22 billion write-off](#) in the same business, the company has disclosed.

It is unclear how far along the investigators are in their work. Some prominent former GE executives haven't been contacted, people familiar with the matter said.

The shareholder lawsuit was brought by pension funds and other investors in federal court in the Southern District of New York in November 2017. The suit, several legal complaints consolidated into one, cites testimony from unnamed GE employees who allege that cash-flow models used to determine required reserves were altered for unknown reasons. One person claims to have informed GE's external auditor, according to the complaint.

GE Insurance Timeline

What executives told investors about problems with General Electric Co.'s legacy long-term-care insurance, which resulted in a \$15 billion shortfall in January 2018.

'We have the stub insurance piece, which has got virtually no returns associated with it.'

--finance chief Jeff Bornstein

'We recently have had adverse claims experience in a portion of our long-term-care portfolio and we will assess the adequacy of our premium reserves.'

--finance chief Jeff Bornstein

'We're in the process of performing an actuarial analysis of claims reserves in our insurance business. Until that review has been completed, we have deferred the decision to pay GE Capital dividends to GE.'

--finance chief Jeff Bornstein

'We're not taking a second-half GE Capital dividend of about \$3 billion. And as we go through this process, at this point, I do expect the charge to be more than that.'

--finance chief Jamie Miller

'Clearly, in hindsight, we underappreciated the risk in this book. Similar to the rest of the industry, the assumptions we made at that time have played out differently.'

--CEO John Flannery

Source: Thomson Reuters transcripts

GE's court filings say management mistakes, not fraud, were to blame for the company's problems. "Federal securities laws provide remedies only for fraud, not for unsuccessful business strategies," GE's lawyers wrote.

Many investors were surprised by the insurance situation, partly because GE executives had repeatedly declared that it had shed its insurance risk. The company spun off most of its insurance holdings into [Genworth Financial](#) Inc. in 2004 and [sold much of the rest](#) to Swiss Reinsurance Co. two years later.

But GE kept the risk for a bloc of long-term-care insurance policies, written by GE Capital until 2006. Such policies pay for nursing homes and assisted-living facilities. They proved to be [an expensive problem for the insurance industry, which underestimated](#) how much the policies would need to pay out.

GE removed the disclosure of the long-term-care liabilities from part of its annual report for 2012 and didn't put them back until this past February. That's when GE reported insurance liabilities of \$38 billion, up from \$11.1 billion the previous year, according to SEC filings.

In court filings, GE says the exclusion was a "normal business decision" and reversing it doesn't mean the previous financial statements were fraudulent. GE says the reserve increase followed a detailed review of the long-term-care portfolio after the company noticed a surge in claims in early 2017, which altered expectations for the future of the business.

Another former GE Capital employee said it was clear at the time of the 2004 Genworth IPO that a bloc of long-term-care policies were toxic. They couldn't be part of the IPO, which was considered the "good book" of assets, the person said, so GE agreed to cover the risk.

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The move was made to raise as much money as possible with the Genworth IPO, people familiar with the decision said. The shareholder lawsuit cites unnamed former employees saying this as well.

Genworth's registration document from the time details the arrangement, saying that the excluded policies "do not meet our target return thresholds."

Genworth's other long-term-care policies weren't doing well either, with losses totaling about \$2 billion. Other insurers took charges for their long-term-care policies. GE didn't make adjustments—until this year.

"GE Capital still sat on an undisclosed ticking time bomb," the shareholder suit alleges, "that seriously threatened GE's long term health."

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