UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

PLUMBERS, PIPEFITTERS & MES LOCAL UNION NO. 392 PENSION FUND, On Behalf Of Itself And All Others Similarly Situated, Plaintiff, vs. FAIRFAX FINANCIAL HOLDINGS LIMITED, ODYSSEYRE HOLDINGS CORP., V. PREM WATSA, TREVOR J. AMBRIDGE, GREG TAYLOR, M. JANE WILLIAMSON, ROBERT HARTOG, ANTHONY F. GRIFFITHS, BRADLEY P. MARTIN, BRANDON SWEITZER, and PRICEWATERHOUSECOOPERS, LLP CHARTERED ACCOUNTANTS, TORONTO ONTARIO, CANADA, Defendants.	Case No. CLASS ACTION COMPLAINT

TABLE OF CONTENTS

Page

Page

Page

Page

Page

Plaintiff Plumbers, Pipefitters & MES Local Union No. 392 Pension Fund (the "Pension Fund"), on behalf of itself and all others who purchased securities listed or registered on an American exchange and issued by Fairfax Financial Holdings Limited ("Fairfax" or the "Company") between and including May 21, 2003 and March 22, 2006 (the "Class Period"), alleges the following upon information and belief, except as to those allegations concerning the Pension Fund, which are alleged upon personal knowledge. Plaintiff's information and belief are based upon, among other things: (a) an investigation conducted by and through its attorneys that included, but was not limited to, interviews with former employees of Fairfax, Fairfax's subsidiaries and companies affiliated with and doing business with Fairfax; (b) review and analysis of filings made by Fairfax with the Securities and Exchange Commission ("SEC"); (c) review and analysis of SEC filings made by companies affiliated with Fairfax such as Crum & Forster ("C&F") and OdysseyRe Holdings Corp. ("OdysseyRe"), among others; (d) the complaints and other documents filed in *Spyro C. Contogouris, et al. v. PricewaterhouseCoopers, LLP, et al.*, No. 06-9668 (E.D. La.) and *Fairfax Financial Holdings Limited, et al. v. S.A.C. Capital Management, LLC, et al.*, No. L-002032-06 (N.J. Super. Ct. Law. Div.), as well as papers filed in *Fairfax Financial Holdings Limited, et al. v. S.A.C. Capital Management, LLC, et al.*, No. 06-4197 (D.N.J.); (e) press releases, public statements, news articles, securities analysts' reports and other publications disseminated by or concerning Fairfax, Fairfax's subsidiaries and/or the other Defendants; and (f) other publicly available information about Fairfax, Fairfax's subsidiaries and/or the other Defendants. Plaintiff believes that further substantial evidentiary support will exist for the allegations after a reasonable opportunity for discovery. Most of the facts supporting the allegations contained herein are known only to Defendants or are within their control.

Moreover, the running of the statute of limitations pursuant to 28 U.S.C. §1658(b) for the claims asserted herein has been tolled from April 11, 2006 (the date the initial complaint was filed in the action entitled *Kenneth Parks and William Seymour v. Fairfax Financial Holdings Limited, et al.*, Master File No. 06-cv-2820 (S.D.N.Y.) for claims against Defendants (defined below), through and including June 14, 2011 (the date that the Second Circuit Court of Appeals denied the Pension Fund's appeal of the Southern District of New York's order granting defendants' motion to dismiss for lack of subject matter jurisdiction).

I. OVERVIEW OF CLAIMS

1. Fairfax defrauded investors by inflating the value of its assets and concealing its lack of liquidity over the course of several years through, *inter alia*: fraudulently accounting for reinsurance contracts which were, in essence, loans by, among other things, failing to employ adequate risk transfer tests to determine if reinsurance contracts qualified for "reinsurance" rather than "deposit" accounting; maintaining ineffective controls while assuring investors that the Company's controls were effective; using privately held foreign assets domiciled in jurisdictions with lax oversight to permit the Company to manipulate its investment income; failing to properly account for losses in companies that should have been consolidated with Fairfax; improperly accounting for intercompany transactions; and using "investments" to funnel money to cash strapped subsidiaries. Despite its effort to conceal its illegal financial trickery, Fairfax's fraud was demonstrated by the three financial restatements it issued, which showed that Fairfax inflated shareholder equity by at least 15% on a year to year basis prior to and during the Class Period.

2. Information regarding Fairfax's financial manipulations initially came to light as a result of state and federal investigations into the reinsurance industry. In November 2004, the SEC and Attorney General for the State of New York began inquiries into the use of so-called

"finite reinsurance" contracts (although there are various types of finite reinsurance contracts, generally, finite reinsurance contracts are reinsurance contracts through which risk is transferred to the reinsurer, but with risk transfer usually being limited in some way) by major insurers and reinsurers to manage their earnings and assets.

3. Although Fairfax's subsidiaries, and then the Company itself, were subjects of the investigation, the Company repeatedly denied any wrongdoing.

4. Despite Fairfax's denials of any wrongdoing, however, in February 2006, OdysseyRe, Fairfax's largest subsidiary, announced that it was restating financial results from fiscal year 2001 through the first nine months of 2005 to correct errors related to finite reinsurance contracts. At the time of this announcement, V. Prem Watsa ("Watsa"), Fairfax's Chairman and Chief Executive Officer ("CEO"), denied that Fairfax had improperly used finite reinsurance contracts at the parent level.

5. In March 2006, Fairfax revealed that Watsa's February statements were blatantly false. In fact, Fairfax not only revealed that the SEC had subpoenaed records of all of Fairfax's finite reinsurance contracts in the previous year, more shockingly, the Company revealed that the SEC had subpoenaed Watsa personally in connection with his February 2006 denials of Fairfax's use of finite reinsurance contracts. Fairfax's March 2006 announcement also disclosed that the Company's auditor, PricewaterhouseCoopers LLP Chartered Accountants, Toronto, Ontario Canada ("PWC") received a subpoena from the SEC in the United States and letter requesting cooperation in Canada.

6. Fairfax's stock collapsed in response to these disclosures, but Watsa and Fairfax sought to reassure the market, going so far as to blame short-sellers of the Company's stock for the collapse of Fairfax's stock price. Indeed, on July 26, 2006, Fairfax filed a five billion dollar lawsuit in the Superior Court of New Jersey Law Division: Morris County, against certain

analysts and hedge-funds accusing them of conspiring to spread false rumors about Fairfax's financial strength. The short-seller defendants subsequently removed the case to the U.S. District Court for District of New Jersey.

7. Months after learning of the SEC subpoenas, investors were given more bad news. On July 29, 2006, Fairfax revealed that the Company would have to restate its financials going back to 2001. According to Watsa, this "very embarrassing" development was related to the Company's commutation - or cancellation - of a finite reinsurance contract with Swiss Re and would impact shareholder equity by $175 million to $190 million.

8. In fact, the restatement, when it was finally completed in November 2006, was more than just embarrassing to Fairfax. It revealed that the Company was utterly without internal controls, contrary to what it - and its auditors - had specifically stated just eight months earlier. Contrary to Watsa's assurances, Fairfax was accounting improperly for finite reinsurance contracts and other intercompany transactions. In stark contrast to Watsa's earlier estimate of the magnitude of Fairfax's restatement, its effect was to reduce shareholder equity – or the net value of Fairfax's assets – by more than $400 million for fiscal years 2003 through 2005. The restatement amounts to a 15-20% decrease in shareholder equity in each of these years.

9. With respect to the Company's accounting for finite reinsurance contracts, Fairfax's restatement admitted, "[f]ollowing an internal review, it was determined that the information currently available is ***insufficient to support reinsurance accounting***. The company has restated the accounting for the contracts to apply the deposit method of accounting rather than reinsurance accounting." (Emphasis added.) As explained below, under AICPA Accounting Standards Executive Committee Statement of Position "SOP" 98-7, "deposit accounting" is applied to insurance and reinsurance contracts that do not transfer insurance risk.

Fairfax's mea culpa restatement did not change the fact that, throughout the Class Period, Fairfax misrepresented its financial appearance by, *inter alia*, improperly accounting for reinsurance contracts which did not transfer risk as reinsurance. Under the accounting rules, Fairfax should have accounted for these reinsurance contracts as debt rather than reinsurance. Fairfax's restatement admits that the Company improperly accounted for these contracts and when the truth was revealed, Fairfax restated shareholder equity by 15-20%.

10. Confidential witnesses interviewed by Plaintiff's counsel reveal that Fairfax's restatement did not come as a surprise to Fairfax's employees. As well as detailing the rampant internal control deficiencies that existed for years throughout Fairfax, these confidential sources confirm that Watsa had a hand in every aspect of the Company's operations. Moreover, at OdysseyRe, according to a confidential witness, there were no procedures to assess whether finite reinsurance contracts met the necessary prerequisites for risk transfer – a critical component in determining whether reinsurance contracts receive "reinsurance" as opposed to "deposit" accounting treatment. Thus, Fairfax was utilizing reinsurance accounting knowing that it could not justify the application of this accounting treatment.

11. In addition to abusing finite reinsurance contracts, Fairfax engaged in a number of other deceptive acts to conceal its true financial appearance.

12. First, Fairfax manipulated investment income to mask its poor financial performance. Specifically, in the aftermath of the devastating 2005 hurricane season (including Hurricanes Katrina and Rita), the Company reported a $498 million loss. Miraculously, however, Fairfax reported that its investment profits added $402 million to its bottom line that very year. But these "investment profits" came mostly from foreign privately held investments whose values were determined by Fairfax. By using phony gains from unlisted foreign investments, Fairfax was able to mask the impact of the disastrous hurricanes of 2005.

13. Second, Fairfax simply ignored reporting losses associated with investments that should have been consolidated with the Company's financial results. As admitted in the Company's restatement, Fairfax was obligated to consolidate $30.9 million in losses from its investment in Zenith National Investment Corporation ("Zenith") between 1999 and 2001. When the proper adjustments were made – in 2006 – shareholder equity was decreased by $11.6 million and $16.8 million as of September 30, 2005 and December 31, 2004, respectively.

14. Third, the Company erroneously accounted for various intercompany transactions by: incorrectly eliminating gains and losses on intercompany purchases and sales of portfolio investments; writing-off unreconciled intercompany balances; incorrectly eliminating intercompany advances and related foreign currency accounting; and failing to reduce receivables when cash was collected by subsidiaries. Moreover, as reported by confidential witnesses, Fairfax improperly shifted money to its subsidiaries through fake investments when the subsidiaries needed infusions of cash.

15. Finally, the Company's internal controls – which were repeatedly touted to investors as effective – were a complete failure, and provided no effective means to communicate the Company's true financial appearance to investors. Various confidential witnesses have come forward with information revealing that management (and specifically Watsa) was made aware of Fairfax's (and/or its subsidiaries') ineffective controls long before the Company's restatement in 2006. Indeed, one witness reported that she wrote a report on the state of OdysseyRe's controls. According to this witness, the report, which was given to top Fairfax executives including Watsa, determined that, as part of a pass/fail audit, OdysseyRe's controls were a "fail." OdysseyRe's controls received a failing grade because, according to this witness, the company took six months to close its books, employees were forced to hand calculate OdysseyRe's financials, there were no processes in place to track bids (so OdysseyRe's

employees were bidding against one another for the same projects), employees signed their own expense checks and forecasting was based on "total guesswork."

16. Even though the market began correcting the inflation in Fairfax's shares caused by the Company's various schemes to hide its true financial condition in June 2005, investors only fully learned of the severity of the Company's schemes on March 22, 2006, after Fairfax issued a "Subpoena Update" announcing that the SEC was looking into statements made by Watsa during a February 2006 conference call with analysts.

17. As the layers of lies and deception were peeled away, the Company's investors lost millions as the price of Fairfax's securities declined as pieces of the Defendants' scheme was disclosed to the market beginning in June 2005. On June 24, 2005, Fairfax issued a press release stating that Fairmont Specialty Group ("Fairmont"), a subsidiary of Fairfax, received a subpoena from the SEC demanding documents regarding any non-traditional insurance product transactions entered into by Fairmont. On September 7, 2005, Fairfax issued a press release stating that the Company received another subpoena from the SEC regarding its use of non-traditional insurance products.

18. On October 10, 2005, several news articles reported that the Justice Department had joined the SEC's investigation of Fairfax. In response, Fairfax's shares fell from $168.17 on October 7, 2005, to close at $149.00 on the following trading day (October 10, 2005), a decline of 11.4%. After initially denying that the Company received a subpoena from the Justice Department (on October 10, 2005), the following day, Fairfax issued a "clarification," in which Fairfax now stated the Justice Department would review documents produced to the SEC.

19. Finally, the price of Fairfax's shares collapsed in response to the Company's March 22, 2006 disclosures, suffering its biggest single day decline in approximately three years,

falling from $130.90 to $113.93 per share, representing a decline in market capitalization of approximately $300 million, or approximately 13% of its value.

20. After the March 22nd press release, Fairfax securities continued to trade well below their Class Period value as more bad news flooded the market. Specifically, the Company delayed the filing of its annual report, OdysseyRe - one of Fairfax's largest subsidiaries - announced the need to restate its own financial reports for, *inter alia*, improperly accounting for finite reinsurance contracts, and Fairfax restated its own financial reports a few days after the Company filed a lawsuit against short-sellers for allegedly manipulating the price of its securities. Between the end of the Class Period and June 19, 2006, Fairfax's shares closed at an average price of $115.

II. PARTIES

21. Plaintiff, the Pension Fund, is a collectively bargained, multi-employer Plan established and maintained by the Plumbers, Pipe Fitters & Mechanical Equipment Service Local Union No. 392, the Mechanical Contractors Association of Cincinnati (MCA), and the Cincinnati Chapter of the Mechanical Service Contractors of America (MCSA). Roughly 3,100 union members participate in the Pension Fund, which has approximately $211 million in total assets. During the Class Period, the Pension Fund purchased Fairfax securities that were artificially inflated by Defendants' conduct as detailed herein. The Pension Fund suffered losses as a result of its purchases of Fairfax's securities when part of the Defendants' fraud was revealed. During the Class Period, the Pension Fund purchased 2,300 shares of Fairfax subordinate voting shares ("common stock"), resulting in an approximate loss of $32,000 due to Defendants' wrongful acts.[1]

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[1] All amounts herein are in US Dollars unless otherwise noted. Amounts in Canadian Dollars are identified as "C$__," "CAD," "Cdn" or "CND."

22. Defendant Fairfax is a financial services holding company which, through its subsidiaries, is engaged in property and casualty insurance and reinsurance, investment management and insurance claims management. The Company is a Canadian corporation with its principal executive offices located at 95 Wellington Street West, Suite 800, Toronto, Ontario Canada M5J 2N7. Fairfax's subordinate voting shares are traded on the New York and Toronto stock exchanges. Fairfax's subordinated voting shares are listed on the Toronto Stock Exchange under the symbol "FFH.SV" and on the New York Stock Exchange ("NYSE") under the symbol "FFH." In addition to OdysseyRe (discussed below), Fairfax's principal subsidiaries include:

(a) Northbridge Financial ("Northbridge"): based in Toronto, Northbridge Financial provides property and casualty insurance products through its Commonwealth, Federated, Lombard and Markel subsidiaries, primarily in the Canadian market as well as in selected U.S. and international markets. In 2005, Northbridge's net premiums written were Cdn$1,188.5 million. At the end of 2005, the company had capital of Cdn$1,026.8 million and there were 1,573 employees;

(b) Falcon Insurance ("Falcon"): based in Hong Kong, Falcon writes property and casualty insurance to niche markets in Hong Kong. In 2005, Falcon net premiums written were HK$231.7 million.[2] At the end of 2005, the company had capital and surplus of HK$274.2 million and there were 116 employees;

(c) First Capital: based in Singapore, First Capital writes property and casualty insurance primarily to Singapore markets. In 2005, First Capital's net premiums written

[2] "HK" refers to the Hong Kong Dollar.

were SGD$27.8 million.[3] At the end of 2005, the company had capital and surplus of SGD$74.4 million and there were 33 employees;

(d) The U.S. runoff group: The U.S. runoff group consists of the company resulting from the December 2002 merger of TIG and International Insurance;

(e) The European runoff group: The European runoff group consists of RiverStone Holdings and Dublin, Ireland-based nSpire Re;

(f) The Resolution Group (TRG)/RiverStone Group: The Resolution Group (TRG) and the RiverStone Group (run by TRG management) manage the U.S. and the European runoff groups. TRG/RiverStone has 411 employees in the U.S., located primarily in Manchester, New Hampshire and Dallas, and 136 employees in its offices in the United Kingdom;

(g) Group Re: Group Re primarily constitutes the participation by CRC (Bermuda), Wentworth (based in Barbados) and nSpire Re in the reinsurance programs of Fairfax's subsidiaries, by quota share or through participation in those subsidiaries' third party reinsurance programs, on the same terms as the third party reinsurers. In 2005, its net premiums written were $326.5 million;

(h) Cunningham Lindsey Group Inc.: Cunningham Lindsey Group Inc. provides a wide range of independent insurance claims services, including claims adjusting, appraisal and claims and risk management services, through a worldwide network of branches in Canada, the United States, the United Kingdom, continental Europe, the Far East, Latin America and the Middle East. In 2005, revenue totaled Cdn$432.2 million. At the end of 2005, the group had 3,627 employees located in 289 offices;

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[3] "SGD" refers to the Singapore Dollar.

(i) MFXchange ("MFX"): established in 2002 and is based in Parsippany, New Jersey with offices in Toronto, Dallas and Ireland. MFX designs, creates and markets a full range of state of the art technology products and services for the insurance industry, including the insurance, reinsurance and runoff subsidiaries of Fairfax;

(j) Hamblin Watsa Investment Counsel ("Hamblin Watsa"): Hamblin Watsa was founded in 1984 and provides investment management to the insurance, reinsurance and runoff subsidiaries of Fairfax; and

(k) C&F: a wholly owned, indirect subsidiary of Fairfax. C&F is organized under the laws of Delaware and it maintains its principal place of business in Morristown, New Jersey. C&F is a national commercial property and casualty insurance company in the United States writing a broad range of commercial coverage. Its subsidiary Seneca Insurance provides property and casualty insurance to small businesses and certain specialty coverages. Since January 1, 2006, the specialty niche property and casualty and accident and health insurance business formerly carried on by Fairmont Insurance is being carried on as the Fairmont Specialty division at C&F. In 2005, C&F's net premiums written were $866.9 million.

23. The bulk of Fairfax's operating assets are located within the United States, and the Company has admitted its reliance on the United States to drive its business. *See, e.g.*, Fairfax's 2003 Annual Report at 49 ("the majority of the company's operations are in the United States or conducted in U.S. dollars . . . ."); *see also* Fairfax's Prospectus, filed with the SEC on Form F-10 on March 23, 2004, at 1 ("The United States is our largest market, accounting for 56.0% of net premiums earned for the year ended December 31, 2003 . . . .").

24. Defendant OdysseyRe is a Delaware corporation with its principal offices located at 300 First Stamford Place, Stamford, Connecticut, 06902. OdysseyRe, through its operating subsidiaries, underwrites treaty and facultative reinsurance as well as specialty insurance

business, with principal locations in the United States, Toronto, London, Paris, Singapore and Latin America. In 2005, OdysseyRe's net premiums written were $2,314.1 million. Prior to the completion of OdysseyRe's initial public offering in June 2001, OdysseyRe was wholly owned by Fairfax. At all times during the Class Period, OdysseyRe was majority owned by Fairfax. As of December 31, 2005, Fairfax owned 80.2% of OdysseyRe's common shares. As of October 28, 2009, OdysseyRe once again become a wholly-owned subsidiary of Fairfax. During the Class Period, OdysseyRe's financial results were consolidated with those of Fairfax and reported in Fairfax's periodic financial reports. In addition to Watsa, who was the Chairman of OdysseyRe, Winslow Bennett ("Bennett"), Anthony F. Griffiths ("Griffiths"), Robert Hartog ("Hartog") and Brandon Sweitzer ("Sweitzer") all served as OdysseyRe board members in 2005.

25. Defendant Watsa is the founder of Fairfax and continues to serve as the Company's CEO and Chairman. During the Class Period, Watsa served as Chairman of OdysseyRe as well as Vice President of Hamblin Watsa and chairman of Northbridge, C&F, and Lindsey Morden Group Inc. According to Fairfax's March 31, 2006 Management Proxy Circular, Watsa held slightly less than a majority of the total votes attached to all of Fairfax's shares:

> The Sixty Two Investment Company Limited (''Sixty Two'') owns 50,620 subordinate voting shares and 1,548,000 multiple voting shares, representing 47.6% of the total votes attached to all classes of our shares (100% of the total votes attached to the multiple voting shares and 0.3% of the total votes attached to the subordinate voting shares). V. Prem Watsa, our Chairman and a director, controls Sixty Two and himself beneficially owns an additional 255,552 subordinate voting shares and exercises control or direction over an additional 2,100 subordinate voting shares. These shares, together with the shares owned directly by Sixty Two, represent 48.4% of the total votes attached to all classes of our shares (100% of the total votes attached to the multiple voting shares and 1.8% of the total votes attached to the subordinate voting shares). To the knowledge of our directors and officers, there are no other persons who beneficially own (directly or indirectly) or exercise control or direction over more than 10% of the votes attached to any class of our shares . . . .

During the Class Period, Watsa signed false and misleading SEC filings and knowingly issued false statements about Fairfax's (and its subsidiaries') financial health.

26. Defendant Trevor J. Ambridge ("Ambridge") was, until May 13, 2005, the Company's Chief Financial Officer ("CFO"). During the Class Period, Ambridge signed false and misleading SEC filings and knowingly issued false statements about Fairfax's (and its subsidiaries') financial health.

27. Defendant Greg Taylor ("Taylor") was appointed to succeed Ambridge as Fairfax's CFO on May 13, 2005. During the Class Period, Taylor signed false and misleading SEC filings and knowingly issued false statements about Fairfax's (and its subsidiaries') financial health. Prior to serving as Fairfax's CFO, Taylor worked as Northbridge's CFO.

28. Defendant M. Jane Williamson ("Williamson") was, at all relevant times, the Company's Vice President and Chief Accounting Officer. During the Class Period, Williamson signed SEC filings that contained false and misleading statements.

29. Defendant Hartog was, at all relevant times, the Company's director and served on the Company's audit committee. During the Class Period, Hartog signed SEC filings that contained false and misleading statements.

30. Defendant Griffiths served on the Company's audit committee during the Class Period and signed SEC filings that contained false and misleading statements.

31. Defendant Bradley P. Martin ("Martin") was, at all relevant times, the Company's Vice President and Corporate Secretary. During the Class Period, Martin signed SEC filings that contained false and misleading statements.

32. Defendant Sweitzer serves on the Company's governance, nominating and compensation committees. During the Class Period, Sweitzer signed SEC filings that contained false and misleading statements.

33. Defendants Watsa, Ambridge, and Taylor are referred to hereinafter as the "Officer Defendants." The Officer Defendants, because of their positions with the Company, possessed the power and authority to control the contents of Fairfax's quarterly reports, press releases and presentations to securities analysts, money and portfolio managers and institutional investors, *i.e.*, the market. Each of the Officer Defendants was provided with copies of the Company's reports and press releases alleged herein to be misleading prior to or shortly after their issuance and had the ability and opportunity to prevent their issuance or cause them to be corrected. Because of their positions and access to material non-public information available to them, each of these defendants knew that the adverse facts specified herein had not been disclosed to and were being concealed from the public and that the positive representations which were being made were then materially false and misleading. The Officer Defendants are liable for the false statements pleaded herein, as those statements were each "group-published" information, the result of the collective actions of the Individual Defendants (defined below).

34. The defendants referenced above in ¶¶25-32 are referred to herein as the "Individual Defendants."

35. Defendant PWC has served as Fairfax's auditor since 1974. PWC consistently issued "clean audit" opinions for Fairfax's financial reports throughout the Class Period. On March 22, 2006, Fairfax issued a press release stating that PWC received a subpoena from the SEC in the United States and a letter requesting cooperation in Canada.

36. Fairfax, OdysseyRe, the Officer Defendants, Williamson, Hartog, Griffiths, Martin, Sweitzer and PWC are collectively referred to herein as "Defendants."

III. GROUP PLEADING

37. As officers, directors, and/or controlling persons of a publicly-held company whose securities trade on the NYSE, and governed by the provisions of the federal securities

laws, each of the Officer Defendants had a duty to promptly disseminate accurate and truthful information with respect to the financial reporting and the publicly-reported quarterly and annual results of operations of Fairfax, so that the market price of the Company's publicly-traded securities would be based upon truthful, accurate and complete information.

38. The Officer Defendants are liable for the materially false and misleading statements and omissions of material fact in Fairfax's SEC filings and press releases as such statements represent "group-published" information, disseminated to the public as a result of their collective action. It is appropriate to treat the Officer Defendants as a group and to presume that the false and misleading information conveyed in the public filings, press releases and other publications, as alleged herein, are the collective actions of this narrowly defined group of defendants. By virtue of their high-level positions within Fairfax, the Officer Defendants directly participated in the management of the Company, were directly involved with the day-to-day operations and were privy to confidential non-public information concerning the operations of Fairfax, as alleged herein. The Officer Defendants were involved in drafting, reviewing and/or disseminating the false and misleading financial statements that were issued by Fairfax, approved or ratified these statements and, therefore, adopted them as their own.

39. By reason of their positions with the Company, the Officer Defendants attended management and/or board of directors meetings, and had access to internal Company documents, reports and other information, including adverse non-public information regarding Fairfax's business, operations, products and future prospects, and including non-public information concerning its use of and accounting for finite reinsurance contracts as well as the effectiveness of the Company's internal controls. In addition, pursuant to Section 302 of the Sarbanes-Oxley Act, 15 U.S.C. §7241, the Officer Defendants, during the Class Period, were required to certify the accuracy of Fairfax's financial reporting and designing, evaluating, and reporting on the

effectiveness of, internal controls at Fairfax. The Officer Defendants are therefore responsible for the truthfulness and accuracy of the Company's public reports, SEC filings and press releases referred to in this Complaint.

40. The Officer Defendants were responsible for the truthfulness and accuracy of the Company's public statements regarding: (1) use of and accounting for finite reinsurance contracts; and (2) Fairfax's internal controls. Each of the Officer Defendants signed many of the Company's Class Period SEC filings, as more fully described herein, and certain of these SEC filings contained certifications by the Officer Defendants attesting to the effectiveness and adequacy of the Company's internal controls. Based upon such signed certifications, the Officer Defendants are responsible for the truthfulness and accuracy of Fairfax's public reports, press releases and other statements concerning, among other things, the Company's use of and accounting for finite reinsurance and the Company's financial results, as detailed herein. Accordingly, the Officer Defendants are primarily liable for the materially false and misleading representations and omissions of material facts contained within these statements.

41. The Officer Defendants participated in preparing and/or approving the public reports and other statements and communications described above and discussed more fully herein. Each of the Officer Defendants knew or recklessly disregarded the fact that the false and misleading statements and omissions complained of herein would adversely affect the integrity of the market for Fairfax's stock, and would cause the price of Fairfax's common stock to become artificially inflated. Each of the Officer Defendants acted knowingly or in such a reckless manner as to constitute a fraud and deceit upon Plaintiff and the putative class (the "Class").

IV. CONFIDENTIAL WITNESSES

42. Several former employees of Fairfax and its subsidiaries have provided Plaintiff and its attorneys with information concerning Defendants' fraudulent scheme and misrepresentations. These witnesses gave information on a confidential basis, and each is designated as "CW__," as stated below.

43. CW1 worked as an investment advisor at OdysseyRe between 2000 and 2001. CW1 was directly involved with the reporting of OdysseyRe's financial figures as he/she was responsible for assembling OdysseyRe's investment information for use in its monthly and quarterly reports. As detailed below, CW1 provided information concerning OdysseyRe's internal controls and Watsa's involvement with OdysseyRe.

44. CW2 worked as a claims examiner for OdysseyRe between 1999 and 2004. CW2 provided information concerning OdysseyRe's internal recordkeeping and run off operations.

45. CW3 worked as an account representative for Fairfax from 2004 to mid-2005. CW3 provided information concerning Fairfax's operations and management.

46. CW4 worked as a senior investment accountant at Fairfax's headquarters in Ontario, Canada from the beginning of 2003 to 2004. CW4 personally met with Watsa and provided reports that were reviewed by Fairfax's managers, including Watsa and Williamson, "regular[ly]" during finance meetings. CW4 reported to Jerry McGuire ("McGuire"), who in turn reported directly to Williamson. CW4 provided information on Fairfax's controls and the Company's recordkeeping and financial reporting practices.

47. CW5 was hired as an audit consultant for OdysseyRe for eight months in 2003. As detailed below, CW5 described OdysseyRe's internal controls as "scary" and stated that OdysseyRe's audit was "definitely a fail." CW5 informed class counsel that it was his/her

responsibility to ensure that all department heads, including Watsa, received a copy of his/her audit report.

48. CW6 worked as a senior financial analyst for Hudson, a subsidiary of OdysseyRe, between 2003 and 2004. This witness's job entailed journal entry and ledger account analysis/reconciliation and review of quarterly and year end reports. CW6 provided information about Hudson's internal controls and its recordkeeping and financial reporting practices. According to CW6, Hudson's numbers were "rolled up to OdysseyRe" each quarter.

49. CW7 worked as a programmer and senior analyst at OdysseyRe between 2003 and 2006. CW7 provided information about Watsa's involvement at OdysseyRe.

50. CW8 joined Fairfax in 2001 to help the Company develop e-business opportunities for MFX. CW8 worked at MFX until 2006. CW8 provided information about MFX's relationship with Fairfax, including MFX's questionable billing practices and Fairfax's use of MFX to "funnel money elsewhere."

51. CW9 last worked as an executive within OdysseyRe's internal audit department in 2004. CW9 began his/her career at OdysseyRe in 1987 working for OdysseyRe's predecessor company. As detailed below, CW9 provided information about OdysseyRe's lack of risk transfer tests for finite reinsurance contracts and the pressure placed on OdysseyRe to appear profitable.

V. JURISDICTION AND VENUE

52. The claims asserted herein arise under and pursuant to Sections 11 and 15 of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. §§77k, 77o, Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §§78j(b), 78t(a), and Rule 10b-5 promulgated under Section 10 of the Exchange Act, 17 C.F.R. §240.10b-5.

53. This Court has jurisdiction over the subject matter of this action pursuant to Section 27 of the Exchange Act, 15 U.S.C. §78aa, 28 U.S.C. §1331 and 28 U.S.C. §1367.

54. Venue is proper in this District pursuant to Section 27 of the Exchange Act, 15 U.S.C. §78aa, and 28 U.S.C. §1391(b). Many of the acts and transactions forming the basis for the claims in this action, including the preparation and dissemination of materially false and misleading information, and the failure to disclose material information, occurred in substantial part in this District.

55. In connection with the acts and omissions alleged in this Complaint, Defendants, directly and/or indirectly, used the means and instrumentalities of interstate commerce, including, without limitation, the mails, interstate telephone communications and the facilities of the national securities markets.

56. This Court has subject matter jurisdiction over the claims of all Class members who purchased Fairfax securities listed or registered on an American stock exchange. As detailed herein, the interests of all investors were adversely affected by the Defendants' misconduct. Defendants' fraudulent conduct artificially inflated the price of the Company's securities during the Class Period, and affected the integrity of the prices paid for Fairfax securities.

57. As stated in Fairfax's SEC filings, the bulk of the Company's operating assets were located during the Class Period within the United States, and the Company readily admits its reliance on the United States to drive its business. *See e.g.*, Fairfax's 2003 Annual Report at 49 ("the majority of the company's operations are in the United States or conducted in U.S. dollars. . . ."); Fairfax's Prospectus, filed with the SEC on Form F-10 on March 23, 2004, at 1 ("The United States is our largest market, accounting for 56.0% of net premiums earned for the year ended December 31, 2003. . . .").

VI. CLASS ACTION ALLEGATIONS

58. This is a class action on behalf of purchasers and acquirers of Fairfax's securities during the Class Period pursuant to Federal Rules of Civil Procedure 23(a) and (b)(3) on behalf of a class consisting of all persons or entities who purchased and/or acquired Fairfax securities listed or registered on an American stock exchange during the Class Period, and who suffered a loss as a result of said purchase or acquisition.

59. Excluded from the Class are: (a) Defendants and their officers and directors, employees, affiliates, legal representatives, heirs, predecessors, successors and assigns, and any entity in which any Defendant has a controlling interest or of which any Defendant is a parent; (b) all Defendants, their immediate families, employees, affiliates, legal representatives, heirs, predecessors, successors and assigns, and any entity in which any of them has a controlling interest; and (c) any plan or fund established by or on behalf of the Company or any of its subsidiaries for the benefit of past, current, or future employees of the Company or any of its subsidiaries.

60. The members of the Class are located in geographically diverse areas and are so numerous that joinder of all members is impracticable. Throughout the Class Period, Fairfax's subordinate voting shares were traded on the New York and the Toronto stock exchanges. While the exact number of Class members is unknown to Plaintiff at this time, and can only be ascertained through appropriate discovery, Plaintiff believes that there may be hundreds of thousands of members in the proposed Class. Record owners and other members of the Class may be identified from records maintained by Fairfax or its transfer agent and other market intermediaries may be notified of the pendency of the action by mail, using the form of notice similar to that customarily used in securities class actions.

61. Common questions of law and fact exist as to all members of the Class and predominate over any questions affecting solely individual members of the Class. The questions of law and fact common to the Class include whether the Defendants: (a) violated the Exchange Act; (b) violated the Securities Act; (c) omitted and/or misrepresented material facts; (d) knew or recklessly disregarded that their statements were false; (e) artificially inflated the value of Fairfax's securities during the Class Period; and (f) the extent of and appropriate measure of damages.

62. Plaintiff's claims are typical of the claims of the members of the Class, as Plaintiff and members of the Class sustained damages arising out of Defendants' violations of federal law as complained of herein.

63. Plaintiff will fairly and adequately protect the interests of the members of the Class and has retained counsel competent and experienced in class actions and securities litigation. Plaintiff has no interests antagonistic to or in conflict with those of the other Class members.

64. A class action is superior to other available methods for the fair and efficient adjudication of the controversy since joinder of all members of the Class is impracticable. Furthermore, because the damages suffered by the individual Class members may be relatively small, the expense and burden of individual litigation make it impossible for the Class members individually to redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

VII. HISTORY AND BACKGROUND OF FAIRFAX

65. Fairfax's evolution into the insurance behemoth that it is today began in 1984, when Watsa and a former colleague, Tony Hamblin, founded an investment management firm, called Hamblin Watsa Investment Counsel. This company was to implement the principles of

"value-investing" - searching for long-term growth options in undervalued companies - that Watsa had embraced early in his career as an investment analyst. Starting with a $30,000 investment in 1984, Hamblin and Watsa soon began managing pension funds for numerous companies based on these principles.

66. According to Watsa, in an interview with the *Globe and Mail* newspaper in January 2006, encouraged by another former colleague - and now a Vice President at Fairfax - Francis Chou, he began exploring Warren Buffet's ("Buffet") business strategies. Buffet had accumulated tremendous wealth for shareholders of his company, Berkshire Hathaway, by acquiring companies with large amounts of cash to invest, such as insurance companies, and then investing this cash for greater returns than these insurance companies could otherwise achieve with their assets. Watsa embraced Buffet's strategy for Fairfax and thus began to acquire struggling insurance companies for below their book value. He then sought to turn around their core operations and, using his investment acumen, achieve greater returns for increased profits.

A. Fairfax Expands Through Acquisitions

67. In 1985, Watsa acquired a moribund Canadian trucking insurance company called Markel Financial Holdings ("Markel"). The company was controlled by Steven Markel and Watsa believed that a cash infusion would energize Markel's family business to bring in more premiums and free up reserves for other investments. With cash from Hamblin Watsa, Watsa become Chairman and CEO of Markel. In 1987, Watsa reorganized Markel and the company was renamed Fairfax Financial Holdings Limited.

68. Through the 1980s and 1990s, Fairfax grew by acquisition and created huge shareholder gains through these acquisitions. Between 1985 and 1992, Fairfax acquired several Canadian insurance subsidiaries operating in the areas of property and casualty insurance,

investment management, insurance claims management, and life insurance. Thus, from 1985 to 1992, Fairfax's revenues grew from C$17 million to C$286.8 million.

69. In 1993, Fairfax began what would evolve into a significant expansion into the U.S. property and casualty commercial insurance market. Fairfax's acquisition of U.S. based companies focused on financially distressed or run-off insurance companies and these acquisitions were financed by a combination of debt and the issuance of Fairfax subordinated voting shares.

70. Fairfax's acquisition binge propelled its stock to incredible returns. From an offering price of C$3.25 in 1985, by 1998, Fairfax's stock was trading on the Toronto Stock Exchange for prices as high as C$500 per share and Watsa believed that Fairfax was invincible. Moreover, Fairfax's investors' expectations were raised year after year as the Company promised to earn high returns. As stated in Fairfax's 2000 Proxy Circular, "The Corporation's focus is on earning a superior (20% or more) return on shareholders' equity over the long term. . . ." Although later Circulars changed "20% or more" to "superior" returns, Fairfax has kept shareholders' expectations high throughout the Class Period. As late as February 2005, Watsa emphasized to investors Fairfax's goal to earn shareholders a 15% return on equity.

B. The Acquisition of TIG and Crum & Forster

71. Fairfax's acquisition of U.S. based companies culminated in the acquisition of C&F in March 1998 from the Xerox Corporation for $565 million. The acquisition surprised industry insiders as the Xerox Corporation had been trying to sell C&F for a number of years due to its lackluster performance. Watsa believed that he could improve C&F's operations and benefit from its large asset base.

72. Watsa was so confident in his strategy that he acquired yet another struggling U.S. based insurer, TIG Holdings ("TIG"), which served specialty commercial markets, for $847

million. Again, the acquisition surprised industry insiders because of TIG's widely recognized failings.

73. In acquiring TIG and C&F, Watsa believed that he could use dividends from these companies for investment to continue to fuel Fairfax's growth. However, in order for TIG and C&F to remit dividends to Fairfax, Watsa had to ensure that these new subsidiaries were properly reserved to handle their liabilities.

74. Under the state laws in which C&F and TIG operated, Fairfax's U.S. subsidiaries could not pay dividends to its parent stockholder unless they were able to demonstrate adequate reserves. Fairfax shored up C&F's and TIG's reserves through internal reinsurance with its Irish subsidiary, InSpire Re. InSpire Re, in turn, had to prove to U.S. regulators that it had adequate liquidity to reinsure Fairfax's U.S. subsidiaries by furnishing letters of credit evidencing its liquidity. InSpire Re obtained these letters of credit from lenders, based on Fairfax's liquidity. Thus, in order for this elaborate balancing act to work, Fairfax had to have adequate liquidity.

75. Fairfax assumed tremendous liability in connection with the TIG acquisition. These liabilities strained its existing reserves so much so that Fairfax obtained a $1 billion "stop loss," or finite reinsurance treaty with a subsidiary of Swiss Re to shore up Fairfax's reserves (the "Swiss Re Cover"). Pursuant to the Swiss Re Cover, Fairfax was able to cede losses (for which it would otherwise have to maintain reserves) to Swiss Re and record the amount ceded to Swiss Re as a reinsurance receivable (an asset). This stop loss treaty was assigned to InSpire Re. In turn, InSpire Re provided reinsurance to TIG. With the acquisition of the Swiss Re Cover, Watsa told shareholders that it was his belief that both TIG and C&F were adequately reserved.

76. Despite these assurances, reserves at TIG and C&F in succeeding years proved wholly inadequate to cover these companies' losses. In each of the years 2000, 2001 and 2002, Fairfax was forced to recognize reserve deficiencies at TIG and C&F.

77. TIG's and C&F's reserve deficiencies were due to a number of factors. Both C&F and TIG, at the time of their acquisition, had endemic and long-standing problems in the quality of the claims they were underwriting and, accordingly, had suffered large losses on their policies. In addition, both acquisitions were made at the beginning of what was widely recognized as a "soft-pricing" cycle in the insurance industry. During soft pricing cycles, competition among insurers is at its highest and insurers are forced to take on riskier business for lower premiums. The cycle is reversed when catastrophes cause premiums to escalate. Finally, in the years following TIG's and C&F's acquisition, unexpected losses in the property and casualty business as a result of the terrorist attacks of September 11, 2001 and natural disasters had escalated claims. Because of the cash shortage resulting from reserve shortfalls at TIG, Watsa decided to sell almost 20% of OdysseyRe in a public offering in December 2001.

78. On March 8, 2002, Watsa wrote to shareholders:

> As I write this letter to you, I must say that I am shocked at our atrocious results over the last three years and I sincerely apologize to you, our shareholders. As it is for myself and most of our Board members, Fairfax officers and Hamblin Watsa principals, for many of you your investment in our company constitutes a significant portion of your net worth, which makes these results more painful. As always, we have disclosed the past, studied it and learned from it, and we continue to be focused on performing for you as we have done prior to the past three years. Our loss in 2001 emanated from the large losses we suffered in the third quarter of 2001 which prompted my letter of November 3, 2001 to you (reproduced in Appendix A) and also prompted us to have our first ever conference call to explain the losses and answer all your questions. As the letter explains, our third quarter loss was a result of two negative surprises: World Trade Center losses and reserve deficiencies. The reserve deficiencies at C&F and TIG were particularly embarrassing because we had recognized reserve deficiencies in 2000 and, in fact, had told you in last year's Annual Report that we did not expect this to be repeated in 2001. As our letter indicated, these deficiencies were an industry phenomenon (the U.S. industry reported in excess of US$8 billion in adverse reserve development in 2001) and our management teams had been running their companies for only two years. Against the backdrop of the worst insurance market in 30 years, it has taken longer for us to recognize and fix the problems of the past – much longer than we had expected when we purchased both these companies.

79. By the end of 2002, TIG's and C&F's reserve deficiencies had become severe enough to threaten Fairfax's balancing act and cause a financial tailspin. The capital Watsa required to invest was tied up in reserves; thus, Watsa was deprived of the funds needed to maintain liquidity and profitability. Without liquidity and profitability, Fairfax faced downgrades by insurance and credit rating agencies which would, in turn, increase the cost of underwriting profitable business and thus increase the cost of capital.

80. Indeed, in 2002 and 2003, there were ample signs that Fairfax was heading into a tailspin. In 2002, Fairfax posted its first reported loss of $346 million.

81. The losses suffered by TIG and C&F were exacerbated by reduced credit ratings by ratings agencies in the wake of the criticism of the adequacy of Fairfax's reserves. In December 2002, Fairfax, in an effort to extract a dividend from TIG, discontinued TIG's lines of business and placed the subsidiary into run-off. This move was necessary in order for Fairfax to release assets that were being held in trust by state regulators for the benefit of TIG claimants.

82. As explained by Fairfax in its 2002 Annual Report:

> We merged TIG and IIC effective December 16, 2002 and, with the California Department of Insurance's approval, distributed $1.25 billion of assets to Fairfax, including 33.2 million of TIG's 47.8 million shares of OdysseyRe Holdings, all of the shares of Commonwealth (GAAP equity of approximately $207 million) and all of the shares of Ranger Insurance (GAAP equity of approximately $136 million). ***These distributed securities will initially be held in trust for TIG's benefit. If the US$300 million adverse development cover described above is placed externally to California's satisfaction, then up to US$300 million of securities will be released from the trust.*** If at the end of 2003 TIG has US$500 million of statutory surplus, a risk-based capital of 200% and a net reserves to surplus ratio of less than 3:1, substantially all of the remainder of these assets will be released from the trust. We continue to expect to meet these tests at the end of 2003 and are also working on acquiring the cover at a reasonable cost.

(Emphasis added.)

83. Watsa intended that the encumbered TIG assets would be used to secure lines of credits and get Fairfax much needed cash for investing.

C. Watsa Tries to Raise Money for Fairfax to Meet Regulator's Liquidity Requirements

84. Faced with a one year time frame to boost Fairfax's liquidity in order to release TIG's assets, Watsa began fervently raising cash for Fairfax.

85. Almost simultaneous with the winding up of TIG's business, on December 18, 2002, Fairfax listed its subordinate voting shares on the NYSE. The listing on the NYSE was intended to allow Fairfax greater access to investors in the United States. In May 2003, Watsa sold 29% of Northbridge Financial, the only profitable North American insurance subsidiary, raising approximately Cdn$200 million. He also sold $300 million in a private placement note offering of C&F debt.

86. For Watsa, however, listing on the NYSE had unintended consequences: greater scrutiny of his company's business by stock analysts.

87. Shortly after Fairfax's shares began trading on the NYSE, analysts started to question the transparency of Fairfax's disclosures and, in particular, questioned the adequacy of the Company's reserves.

88. On January 16, 2003, John Gwynn ("Gwynn"), an analyst with Morgan Keegan, issued a report which, *inter alia*, raised concerns that Fairfax's reserves were not adequate and questioned the Company's use of off-balance sheet funding and finite reinsurance. Gywnn claimed that, based on his calculations, Fairfax was vastly underestimating the size of its liabilities and, in fact, the Company was under-reserved by almost $5 billion. Gwynn later revised this figure to $3 billion. Gwynn also claimed that the Company was using a high rate of reinsurance recoverables on the balance sheet as a percentage of net worth.

89. In March 2003, Fitch reduced the rating of some of Fairfax's debt to junk status.

90. Reinsurance is accounted for on a company's balance sheet as an asset. When an insurer acquires a reinsurance contract, the reinsurance strengthens assets, while the premium is charged against income as an expense.

91. In response to the issues raised by Morgan Keegan's January 16, 2003 report, Fairfax made several statements seeking to reassure investors that the Company was operating under the highest ethical standards and that the issues raised by Morgan Keegan were without any merit.

92. Specifically, in the first response to the report, which came by way of a press release dated January 20, 2003, Watsa stated:

> Fairfax has always been run with honesty and integrity and has always intended to provide comprehensive disclosure in its Annual Report. If Fairfax's operations encountered difficulties, we faced them head-on, reported them candidly and absorbed their impact. We have consistently looked to protect the downside and concentrated on creating options to ensure that we could meet our obligations.
>
> From the beginning, our reserves have been reviewed by company actuaries, by an actuary at Fairfax and by one or more independent actuaries and have been subject to regulatory review. Our reserves have received careful consideration and have been established using accepted actuarial practice. The valuation methodology for reserves employed in a recently issued research report on Fairfax suffers fatally from the inherent limitations admitted by that report and a complete lack of knowledge of the factual details necessary to produce a reserve calculation. We are certain that the loss reserve deficiencies suggested by that report are totally wrong and have no validity whatsoever.

93. Again in the Narrative Description of Business, which was filed as an exhibit to the Company's 2002 Annual Report (filed with the SEC on Form 40-F on May 21, 2003) and signed by Watsa, Fairfax and Watsa sought to comfort investors by stating:

> We listed on the NYSE on December 18, 2002 as we suggested we might. We were warmly welcomed and on January 14, 2003, the NYSE reported that there were almost 2 million shares shorted! Soon after, there was a spate of negative articles and reports on Fairfax, including a report containing seriously misleading commentary on Fairfax's reserves.
>
> We have always tried to give very full disclosure in our annual reports, and we expand that disclosure if we discover that there are areas where enhanced disclosure would be useful (this year, for instance, our MD&A includes

> significantly expanded disclosure on our ORC Re subsidiary and our asbestos and pollution reserves).
>
> * * *
>
> The strengths that we have at Fairfax are formidable and have not changed from the ones I listed for you in the 2001 annual report. Your management team has truly been tested in the last few years and has every intention to do well by you (as we did in spades in 2002), irrespective of circumstances. ***As discussed earlier in this letter, our businesses – our insurance, reinsurance and investment operations – are performing magnificently***.

(Emphasis added.)

94. These assurances, however, as set forth below, were false.

VIII. THE FRAUDULENT SCHEME TO INFLATE FAIRFAX'S FINANCIALS

95. In counteracting the liquidity problems arising in 2002 and 2003, Fairfax employed a two tier strategy. At the top, above-board, tier, its efforts involved raising cash by selling debt and equity in its subsidiaries. Below-board, Fairfax resorted to a variety of tricks to deceive investors about the value of its assets. These tricks included fraudulently accounting for reinsurance contracts by, among other things, failing to employ adequate risk transfer tests to determine if reinsurance contracts qualified for "reinsurance" rather than "deposit" accounting; maintaining ineffective controls while assuring investors that the Company's controls were effective; using investment funds domiciled in foreign jurisdictions with lax oversight to permit the Company to manipulate the value of its overseas investments; failing to properly account for losses in companies that should have been consolidated into Fairfax; improperly accounting for intercompany transactions; and disguising loans as "investments" to funnel money to cash strapped subsidiaries.

A. Fairfax's Improper Use of Finite Reinsurance to Boost Reserves

96. In order for Fairfax to accomplish successful internal growth of premiums and reinsurance, Fairfax needed to separate the runoff operations, be able to convince the ratings

agencies that it was a highly rated company and establish the perception of valid reinsurance contracts with highly rated companies and manageable reserves.

97. To help accomplish this, Fairfax accounted for certain retroactive reinsurance contracts (or finite reinsurance contracts), which did not transfer a sufficient amount of risk from Fairfax to the reinsuring entity, using "reinsurance accounting" rather than "deposit accounting." As described herein, using reinsurance accounting, Fairfax was able to significantly reduce its net reserves for those losses ceded under these contracts and manipulate its reported financial results. Had the reinsurance contracts been properly accounted for using deposit accounting, Fairfax would have been exposed for what it really was – a company teetering on financial collapse because it could not meet its obligations via legitimate means. The improper use of reinsurance accounting violated Generally Accepted Accounting Principles ("GAAP"), overstated shareholders' equity and ultimately caused Fairfax's financial statements to be materially false and misleading.

98. The SEC requires that publicly traded companies present their financial statements in accordance with GAAP. *See* 17 C.F.R. §210.4-01(a)(1). GAAP consists of those principles recognized by the accounting profession as the conventions, rules, and procedures necessary to define accepted accounting practices at the particular time. Regulation S-X, to which the Company is subject to as a registrant under the Exchange Act, 17 C.F.R §210.4-01(a)(1), provides that financial statements filed with the SEC that are not prepared in compliance with GAAP are presumed to be misleading and inaccurate. However, Fairfax violated several GAAP provisions, including Statement of Financial Accounting Standard ("SFAS") No. 113, when accounting for finite reinsurance contracts.

99. Under SFAS No. 113 ¶¶9, 11, 62-63 - *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*, which is a key GAAP provision governing the

accounting by insurance enterprises for reinsurance contracts - in order for short duration contracts (property and casualty contracts) covering prospective reinsurance to qualify for favorable reinsurance accounting treatment, ***both*** of the following elements must be met: (a) the reinsurer must assume significant insurance risk; and (b) it must be reasonably possible that the reinsurer may realize a significant loss from the transaction or the reinsurer assumes substantially all of the insurance risk relating to the reinsured portions of the underlying contracts. Generally, SFAS No. 113 applies to all reinsurance contracts entered into after December 15, 1992.

100. Reinsurance contracts that do not transfer sufficient risk are classified as deposits or loans.

101. Implicit in an entity assuming risk is the requirement that both the amount and timing of the reinsurer's payment depend on and directly vary with the amount and timing of claims settled under reinsured contracts.

102. Although finite reinsurance products have been in use for nearly two decades, during the past several years, federal and state regulators have begun to investigate the propriety of certain finite reinsurance transactions and the manner in which those transactions are being accounted for by the insurers and reinsurers involved. The concern expressed by these regulators is that such finite arrangements are being improperly accounted for as reinsurance contracts under SFAS No. 113 when they are instead risk-less financing deals designed merely to distort an insurer's true financial position.

103. The key inquiry, according to regulators, is whether these transactions involve a sufficient transfer of risk from insurer to reinsurer so as to qualify as a reinsurance contract instead of a financing transaction. The rule of thumb in the industry is that a reinsurance contract is reinsurance (and thus qualifies for reinsurance accounting treatment) if the contract transfers to the reinsurer a "ten percent risk of ten percent loss."

104. Transactions that qualify as reinsurance receive more favorable accounting treatment than transactions in which there is an insufficient transfer of risk, as the latter must be reported as debt rather than reinsurance.

105. If the transaction is considered reinsurance, and the contract extinguishes the ceding insurer's liability to its insured, then the assets and liabilities associated with the transaction are removed from the ceding insurer's financial statement. If the transaction is considered reinsurance but the cedant's liability is not extinguished, then the cedant reports estimated "reinsurance receivables" as an asset on its balance sheet. If, however, there is an insufficient transfer of risk, the arrangement is more akin to a loan, and "deposit" accounting must be used (the reinsurance premium must be recorded as an asset in the ceding company's books and the payments from the reinsurer are recorded as investment income and return of deposit).

106. As admitted in Fairfax's restatements, the Company improperly assigned reinsurance contracts "reinsurance accounting" rather than "deposit accounting."

107. Regulators also are concerned that informal "side-letters" may exist as companions to finite risk reinsurance contracts (and that such letters materially alter the amount of risk that is actually transferred). In the view of investigators, such side-letters often record a separate (and secret) understanding between the insurer and reinsurer that take some or all of the elements of risk transfer out of the original contract. A basic example of a side letter involves a promise by the company that has bought reinsurance not to make a claim during the period of the agreement. Other side-letters state that, regardless of how the risks covered by a contract turn out, the reinsurer will never pay the insurer more than it has received in premiums. Side-letters also can include a "commutation clause," stating that if the risks covered by the official reinsurance transaction start to become excessive, the reinsurer has the right to cancel the whole

policy on terms that mean it still will make a profit. Needless to say, the favorable accounting treatment afforded to reinsurance contracts is not available where a side-letter, or other mechanisms, establishes that there has not been a sufficient transfer of risk.

108. The evaluation of whether it is reasonably possible for a reinsurer to realize a significant loss from the transaction is based on the present value of all cash flows between the ceding and assuming enterprises under reasonably possible outcomes. The negotiation and structuring of these contracts and the required evaluation of the necessary transfer of risk were all the responsibility of Fairfax as the ceding insurer, yet it was not until the restatement was issued on August 31, 2006, that the Company finally disclosed that they repeatedly used reinsurance accounting where the contracts did not support the required transfer of risk to the reinsurer.

109. Despite Fairfax's admission that it applied "reinsurance" rather than "deposit" accounting, confidential witnesses revealed that Fairfax simply did not have in place any risk transfer tests when dealing with finite reinsurance contracts.

110. According to CW9, a senior executive in OdysseyRe's audit department, although assessing risk was the key element for testing whether finite reinsurance contracts qualified for reinsurance accounting, Fairfax and its subsidiaries never even developed any protocols to test for risk transfer in Fairfax's finite reinsurance transactions. Thus, finite reinsurance contracts were approved for accounting under SFAS No. 113 without the necessary determination of whether these contracts transferred risk.

111. Failure to support transfer of risk results in having to account for the reinsurance contracts under the deposit method of accounting. In effect, this requires that the transaction be recorded as a ***risk-less financing transaction*** rather than a reinsurance contract with indemnification of loss or liability. Under deposit accounting in the AICPA Accounting

Standards Executive Committee Statement of Position "SOP" 98-7, *Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk* and SFAS No. 113, liabilities are not mitigated by reinsurance receivables. The reinsurance premium is simply recorded as an asset in the ceding company's books and the payments from the reinsurer are recorded as investment income and return of deposit.

112. Fairfax has admitted in its restatement that finite reinsurance contracts entered into in 2001 failed to satisfy the transfer-of-risk test and thus, had to be restated. As a result of using reinsurance accounting for these finite reinsurance contracts, among other accounting gimmicks, Fairfax was able to understate the Company's net reserves and overstate the recoverables from reinsurers under Canadian GAAP. In reversing these improper transactions, Fairfax suffered a decrease in shareholder equity during the Class Period because its finite reinsurance transactions had boosted assets by recognizing them as reinsurance receivables. Gains recognized at the time the contracts were entered into had to be reversed and, as a result, Fairfax's losses at the time that the contracts were entered into increased. Because these contracts should have been subject to deposit accounting, any investment gains recognized from the deposit had to be amortized over the length of the contract, thus increasing Fairfax's income—as reflected in the restatement—over the years following the contract.

113. As part of the restatements filed on November 10, 2006, Fairfax has disclosed the following misuse of reinsurance accounting:

(a) Fairfax restated the accounting for certain reinsurance contracts entered into in 2001 and commuted in 2004. It was determined that these contracts failed to provide a transfer of risk, as required by SFAS No. 113. Coverage related to the contracts commuted in the third and fourth quarters of 2004 totaled $665 million. These contracts were restated by Fairfax to correctly apply the deposit method of accounting in place of the reinsurance accounting. The restatement had the net effect on a Canadian GAAP basis of decreasing the 2004 net loss by $89.5 million, increasing 2003 net earnings by $18.4 million, decreasing 2002 net earnings by $11.4 million and increasing the 2001 net loss by $96.5 million. Conveniently, Fairfax's restatement does not reveal by how much these restated finite reinsurance contracts - commuted in 2004 - boosted its assets (and thus shareholders equity) in the years prior to 2004, as the restatement only indicates the effect of these restated finite reinsurance contracts on 2004 and 2005 shareholders equity. However, the cumulative impact of the restatement of shareholder equity for 2003 and 2002 was $454.1 million and $353.5 million, respectively.

(b) Fairfax also restated the accounting for a reinsurance contract entered into by a subsidiary in 1998, prior to its acquisition. The Company commuted this contract in 2002. Fairfax restated the accounting to apply the deposit method of accounting rather than reinsurance accounting as this contract also failed to transfer risk to the reinsurer. The restatement had the net effect, on a Canadian GAAP basis, of increasing the 2002 net earnings by $1.7 million, decreasing 2001 net losses by $11.9 million and decreasing the 2000 and prior net earnings by $13.6 million. Again, Fairfax does not reveal by how much this reinsurance contract boosted its assets (and thus shareholder equity) prior to 2002.

1. Retroactive Reinsurance Accounting Differences Between Canadian and US GAAP

114. There is a distinct difference between the accounting for retroactive reinsurance accounting under Canadian GAAP and US GAAP. Under US GAAP, retroactive reinsurance recoveries are recorded up to the amount of the premium paid with the excess of the claims incurred (*i.e.* liabilities ceded) over the premiums paid recorded as a deferred gain and amortized to income as the claims are paid. As a result, US GAAP earnings will be lower than Canadian GAAP at the time of claims cession, but will exceed Canadian GAAP in the future as the deferred gain is amortized into income.

115. As a result of the timing differences between Canadian and US GAAP, the Company's restatement for the inappropriate use of reinsurance accounting for the retroactive contracts discussed above, had the additional effect on a US GAAP basis of decreasing net income in 2004 by $33.2 million, decreasing net income in 2003 by $9.4 million, and increasing the net income for 2002 and prior by $42.6 million.

2. Improper Reinsurance Accounting at OdysseyRe

116. The use of improper accounting for certain reinsurance contracts was not limited to Fairfax at the parent level.

117. On March 31, 2006, OdysseyRe also restated its consolidated financial statements as of and for the years ended December 31, 2000 through 2004, as well as its financial statements for the nine months ended September 30, 2005, to correct for the improper accounting for reinsurance contracts entered into by OdysseyRe between 1998 and 2004.

118. The total cumulative impact of OdysseyRe's restatement through September 30, 2005 on Fairfax was to decrease shareholders' equity at September 30, 2005 by $4.8 million. The aggregate net effect of the restatement for each period was to increase the net loss for the nine months ended September 30, 2005 by $1.6 million, decrease 2004 net loss by $13.9 million, increase 2003 net income by $3.7 million, increase 2002 net income by $5.2 million, increase 2001 net loss by $22.7 million and decrease net income of 2000 and prior by $3.3 million.

119. According to the OdysseyRe restatement included as part of its Form 10-K filed on March 31, 2006, there were five separate reinsurance transactions restated by OdysseyRe. The GAAP violations, including the full effect on OdysseyRe's financial statements, are summarized as follows:

> OdysseyRe restated the accounting in 2002 and thereafter for a $175 million ceded reinsurance contract with Skandia for net unpaid losses and loss adjustment expenses and reserves for uncollectible reinsurance that was assigned by Skandia to nSpire Re for $97.0 million in consideration in January 1999. OdysseyRe

violated SFAS No. 113 in originally accounting for the contract as prospective reinsurance for 2002 and subsequent periods, where a benefit had been recorded in each period equal to the loss cessions made under the contract. OdysseyRe should have recorded the transactions in accordance with retroactive reinsurance accounting, where losses ceded under the contract in 2002 and thereafter should have been recorded as a deferred gain rather than as a benefit in the applicable periods. These amounts were in excess of $97.0 million. As part of the restatement, the deferred gain attributable to loss cessions made under the contract in 2002 and thereafter, is being amortized into income over the estimated remaining settlement period. The restatement adjustments under this contract resulted in a $28.6 million after-tax cumulative decrease to shareholders' equity as of September 30, 2005, with the effect of increasing the net loss for the nine months ended September 30, 2005 by $3.0 million, decreasing 2004 net income by $5.7 million, decreasing 2003 net income by $7.2 million and decreasing 2002 net income by $12.7 million. The $28.6 million after-tax cumulative decrease to shareholders' equity as of September 30, 2005 was offset by a gain of $12.5 million after-tax associated with the recognition of a deferred gain recognized for the three months ended March 31, 2006.

Timing differences as to how premiums and unearned profit commissions under property catastrophe reinsurance contracts were recognized over the coverage periods on seven reinsurance contracts purchased by us and two reinsurance contracts written by us. All of these contracts satisfied risk transfer requirements and were multi-year, retrospectively-rated contracts, or included certain features that had the effect of allowing the contracts to operate as multi-year, retrospectively-rated contracts. The contracts were restated to correct the application of Emerging Issues Task Force Issue No: 93-6 "Accounting for Multiple-Year Retrospectively-Rated Contracts by Ceding and Assuming Enterprises" ("EITF 93-6"). The two reinsurance contracts written by us remained in force as of December 31, 2005. The restated contracts involve eight unaffiliated counterparties. The corrections under these contracts resulted in a $1.3 million after-tax cumulative increase to shareholders' equity as of September 30, 2005, with the net effect of decreasing the net loss for the nine months ended September 30, 2005 by $2.3 million, increasing 2004 net income by $10.5 million, increasing 2003 net income by $10.9 million, increasing 2002 net income by $8.4 million, increasing 2001 net loss by $29.2 million and decreasing 2000 net income by $1.6 million.

The treatment of deferred ceding commissions to be received by OdysseyRe under three aggregate excess of loss reinsurance contracts they purchased. Due to the deferred nature of the ceding commissions, amounts were reflected at their present value rather than the nominal value previously recorded by us. All of these contracts satisfied risk transfer requirements and remain active as of December 31, 2005. These contracts involve two unaffiliated counterparties. The corrections under these contracts resulted in an $8.4 million after-tax cumulative decrease to shareholders' equity as of September 30, 2005, with the net effect of decreasing the net loss for the nine months ended September 30, 2005 by $0.8 million, increasing 2004 net income by $1.4 million, decreasing 2003 net income by $6.1 million, decreasing 2002 net income by $1.3 million, increasing

> 2001 net loss by $1.6 million and decreasing 2000 net income by $1.6 million. The cumulative effect of $8.4 million, after-tax, will be amortized into income in future periods.

B. Fairfax Never Adopted Procedures to Test for Risk Transfer and Was Devoid Of Internal Controls

120. Internal control is defined by The Committee of Sponsoring Organizations of the Treadway Commission ("COSO") "as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations." It appears that each of those parties at Fairfax responsible for ensuring the adequacy of the Company's controls has seriously failed the investing public. As disclosed in Management's Evaluation of Disclosure Controls and Procedures (Restated), from the first Form 40-F/A for the year ended December 31, 2005 filed on September 11, 2006, "At the time of the filing of the Annual Report on Form 40-F for the year ended December 31, 2005, our CEO and CFO concluded that our disclosure controls and procedures were effective as of December 31, 2005. ***Subsequent to that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were not effective as of December 31, 2005 because of the material weaknesses discussed below***." (Emphasis added.) Until that time, no one at Fairfax ever publicly disclosed what was well known throughout Fairfax and its subsidiaries – that Fairfax and its subsidiaries maintained woefully ineffective internal controls. It was only after the Company's restatement that the public learned that the internal controls at Fairfax and its subsidiaries were in complete shambles.

121. Fairfax identified four material weaknesses in its restated assessment of the effectiveness of internal controls over financial reporting as of December 31, 2005. However, based on the accounts of confidential witnesses interviewed by Plaintiff's attorneys, it is

abundantly clear that these weaknesses existed and continued from periods long before December 31, 2005, rendering financial reporting during each of the preceding periods unreliable and Fairfax's assurances to investors about the adequacy of its controls materially false and misleading. In fact, the most significant effect on net earnings from Fairfax's restatements took place in years 2002 and prior.

122. The material weaknesses identified by management in its restated assessment filed with Form 40-F on September 11, 2006 were:

(a) Fairfax failed to maintain an appropriate accounting and financial reporting organizational structure, including insufficient staffing and not maintaining the appropriate level of accounting knowledge, experience and training;

(b) Fairfax failed to maintain effective controls over the completeness and accuracy of period-ending financial reporting and close processes, including lack of monitoring and documentation over intercompany eliminations and reconciliation, translation of foreign currency transactions and recording of journal entries;

(c) Fairfax failed to maintain controls over accounting for derivatives in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*; and

(d) Fairfax failed to maintain effective controls over the completeness and accuracy of the income tax responsibilities.

123. Each of these identified weaknesses is fundamental to an effective internal control environment and absolutely essential to the production of complete and accurate financial statements. As a result, Fairfax violated the fundamental provisions of SFAC, No. 2, that require the principles of quality of reliability and completeness, which means that nothing is left out of

the information that may be necessary to ensure that it validly represents underlying events and conditions.

124. Watsa and Ambridge also directly violated the requirements under the United States Sarbanes Oxley Act of 2002, Section 302, *Corporate Responsibility for Financial Reports*, and Section 404, *Management Assessment of Internal Controls*. Since 2003, Watsa and Ambridge knowingly signed certifications included with the Company's filed financial statements, attesting to their responsibility for the establishment and maintenance of the internal controls at Fairfax and as to the adequacy of those internal controls, when, in fact, both of them knew that this was far from the truth. The restatements evidence the misuse of accounting principles in consolidation, investments, debt, income taxes, intercompany accounting, foreign currency translations and dividends declared. Such a comprehensive list of errors requiring restatement is indicative of a widespread lack of internal controls and a blatant disregard for the underlying fundamentals of GAAP accounting.

1. Confidential Witnesses Confirm That Fairfax's Lack of Internal Controls Was a Long Standing and Well-Known Problem

125. According to Plaintiff's confidential sources, the accounting protocols adopted by Fairfax and its subsidiaries were notoriously obsolete, sloppy and incapable of providing effective reporting to investors. Moreover, top Fairfax officials, including Watsa, received reports from certain confidential witnesses describing the ineffectiveness of Fairfax's internal controls while Watsa was touting the effectiveness of Fairfax's controls to investors.

126. For example, CW1, who was responsible for assembling OdysseyRe's investment information for use in preparation of the company's monthly and quarterly reports, stated that he was unaware of any formal internal controls at OdysseyRe.

127. Additionally, during 2003, CW5 spent eight months as an outside consultant at OdysseyRe in order to audit the subsidiary's operations. While at OdysseyRe, CW5 who worked with several high level OdysseyRe employees, including OdysseyRe's Vice President of Internal Auditing and Charles Troiano, OdysseyRe's former CFO (Troiano took over as OdysseyRe's CFO in 2001, on March 10, 2005, the company announced Troiano's retirement from OdysseyRe), echoed CW1's assessment of OdysseyRe's deficient controls. CW5 stated that his/her audit of OdysseyRe resulted in a "fail" and that he/she authored a report regarding the findings of her audit. According to CW5, it was his/her responsibility to make sure every department head, including Watsa, received a copy of his/her report.

128. Specifically, CW5 stated that "they [OdysseyRe] were twenty years behind the times," OdysseyRe's operations were "nothing but a mess," and the state of OdysseyRe's controls were "scary."

129. Indeed, CW5 provided Plaintiff's attorneys with five specific examples of what he/she described as "alarming" problems at OdysseyRe relating to the subsidiary's deficient internal controls. First, according to CW5, OdysseyRe needed six months to close its year end financials. CW5 stated that he/she had "never seen anything like it." According to CW5, most companies closed their books in six to eight weeks rather than six months. CW5 blamed OdysseyRe's inability to close its books in a timely manner on its lack of controls, which included "inappropriate" and outdated computer systems. These systems, according to CW5, forced OdysseyRe's employees to "hand calculate" the company's financial figures. In Fairfax's report on internal controls (which was included in the Company's restatement), it now admits that one of is control deficiencies was based upon "not maintain[ing] effective controls over the completeness and accuracy of period-end financial reporting and period-end close processes at

the Fairfax head office consolidation level. . . ." Fairfax's mea culpa corroborates CW5's assessment of OdysseyRe's ineffective controls.

130. Second, CW5 stated that OdysseyRe had "no tracking of [the] bid process." This deficiency, according to CW5, caused OdysseyRe to compete against itself for bids which led to several OdysseyRe employees "hedging against each other in . . . [a] makeshift system." Third, OdysseyRe did not have in place adequate controls over its expenses as its employees were permitted to sign their own expense checks. Fourth, CW5 disclosed that OdysseyRe used a twenty-year old DOS based systems called "RSG" to track its finances. RSG operated on six different versions and offered no consolidation between OdysseyRe's divisions. CW9, an executive in OdysseyRe's audit department, also stated that RSG "did not report well" and that the system caused "a lot of stress." The problems created by RSG were well known within OdysseyRe. While Watsa and Fairfax were touting the effectiveness of Fairfax (and its subsidiaries' internal controls), according to CW9, in 2004 Trioano (OdysseyRe's former CFO) paid Accenture $3 million to advise OdysseyRe on upgrading its archaic computer system. The upgrade did not occur and CW9 suspects OdysseyRe continues to use RSG.

131. Finally, according to CW5, OdysseyRe's method for forecasting was "total guesswork" done through hand calculations. The inaccuracies created by this type of process led to, in CW5's estimation, OdysseyRe's restatement.

132. Moreover, according to CW5, his/her audit was not kept a secret and "everyone" knew about CW5's audit. Indeed, CW5 provided his/her audit report to every department head at Fairfax, including Watsa.

133. The deficient internal controls reported by CW1, CW5 and CW9 were not limited to OdysseyRe.

134. According to CW3, Fairfax had an "unorganized" management. Additionally, CW6 stated that Hudson (a subsidiary of OdysseyRe) was "not organized" and, as did other subsidiaries, relied on outdated computer systems for its financial reporting. According to CW6, Hudson's antiquated computer systems forced its employees to rely on "a lot of manual calculations." The reliance on manual calculations was a problem because, according to CW6, "we could not get our numbers to match." Rather than correct the problems created by the antiquated computer system, CW6 reported that Hudson "sort of just lived with the problems."

135. The problems at the subsidiary level also infected the parent. According to CW4, who worked as a senior investment accountant at Fairfax's headquarters in Ontario, Canada from the beginning of 2003 to 2004, there were "no appropriate controls in place" at Fairfax. CW4 stated, "I have never seen anything like the situation there. The problem? . . . [N]o controls."

136. CW4's entire tenure at Fairfax was devoted to "cleaning up" reconciliations that were incorrectly done. According to this witness, he/she was only able to clean up about 80% of the information presented to him/her before its was passed up to her supervisor. This witness stated that the remaining 20% of the mistakes were "never corrected."

137. One of the problems CW4 observed in Fairfax's subsidiaries' reports was that when cash came into one of the subsidiary's accounts, the incoming cash was not matched against the receivables account.

138. CW4 also explained that Fairfax had its own traders based in Ontario and their responsibility was to book the securities for each individual subsidiary on whose behalf they invested. In CW4's case, those subsidiaries were TIG, C&F and Seneca. CW4 worked with these subsidiaries to try and match those earnings that remained as outstanding receivables on the books, even if they had been booked. CW4 stated that, for example, even if revenue was booked at $1 million two quarters earlier, the books he/she saw still indicated that the money was due.

Essentially, CW4 indicated, this made Fairfax and its subsidiaries look wealthier than they actually were.

139. Moreover, all of the information CW4 reviewed was inputted into a computer program known as "E-PAM," which was created as a package by the software company Princeton Financial Solutions. According to CW4, McGuire, Williamson and all senior management at Fairfax had access to E-PAM "at any time." According to this witness, the unmatched numbers would have been reflected on E-PAM for McGuire and Williamson to view. In addition to management having around-the-clock access to E-PAM, CW4 brought Fairfax's faulty revenue recognition issues directly to his/her superiors. Specifically, CW4 alerted her supervisor, McGuire (McGuire was one level removed from Williamson), about the problems in Fairfax's reporting. According to this witness, McGuire responded to CW4's concerns by saying, "[J]ust make it match." If the numbers did not match CW4 "let it go." According to CW4, "a lot" of money was marked as a receivable when it had already been collected.

140. CW4 also stated that at times money earned by the subsidiaries was not recognized within the proper period.

141. The problems encountered by CW4 were reported up the chain. According to CW4, he/she informed McGuire about the problems he/she faced in carrying out his/her duties. When complaints were lodged, McGuire, according to this witness, became very angry.

142. Moreover, CW4 stated that Fairfax managers were not qualified to oversee the Company's reporting. According to CW4, although McGuire reported directly to Williamson, he had not passed the exam to become a Chartered Accountant in Canada and had a difficult time executing "101" accounting procedures such as drawing T-charts for transactions. Corroborating CW4's account of incompetent managers, in the Company's report on internal controls (which was included in the Company's restatement), Fairfax admitted that one of its control deficiencies

was based upon "not maintain[ing] personnel with an appropriate level of accounting knowledge."

C. Fairfax Uses Other Gimmicks to Artificially Inflate the Value of Its Assets

1. Fairfax Uses Off-Shore Entities to Manipulate Its Investment Income

143. Finite reinsurance has not been the only illicit means by which Fairfax has deceived investors and regulators regarding the value of its assets.

144. As reported by the *New York Post*, Fairfax uses unlisted off-shore investments, that are valued at management's discretion, to support the Company's bottom line.

145. For example, in 2005, on the heels of Hurricanes Katrina and Rita, Fairfax reported a loss of $498 million. Conveniently, the performance of OdysseyRe's investment portfolio added $402 million to Fairfax's bottom line and deflected, in part, the potentially disastrous impact of 2005's Hurricanes.

146. However, almost all the impressive investment gains, which were relegated to a discrete part of Fairfax's portfolio within its wholly-owned subsidiary, the Hamblin Watsa Asia Fund, domiciled in Mauritius, were the result of the fund's directors having the ability to arbitrarily assign the assets a value. According to the *New York Post*, many of the investments in OdysseyRe's portfolio that contributed to Fairfax's numbers in 2005, were unlisted equities acquired through the Hamblin Watsa Asia Fund. The *New York Post* reported that the Company's investments in Dublin, another foreign locale, also contributed to Fairfax's bottom line in 2005.

147. Based on documents obtained by the *New York Post*, the Hamblin Watsa Asia Fund's directors have "absolute discretion" "to assign 'any reduction or increase in the value' to the unlisted equities[.]"

148. The ability to use unlisted foreign investments that can be valued simply through a director's assessment is critical to Fairfax maintaining its financial appearance because, "Fairfax is losing $15.5 million on its U.S.-traded investments, while on its unlisted foreign investments, which remain curtained off to U.S. authorities, it claims huge gains - more than $400 million."

149. Accordingly, without the benefit of Mauritius' lax oversight, Fairfax likely would not have been able to manipulate its investment portfolio as a means to mask the Company's losses in 2005.

150. Fairfax also uses the Hamblin Watsa Asia Fund to deceive insurance regulators by overstating the value of Fairfax's "qualifying" assets.

151. State insurance regulators in New Jersey and Delaware questioned Fairfax's investment in the Hamblin Watsa Asia Fund. As reported in the *New York Post*:

> New Jersey insurance examiners said Hamblin Watsa Investment Counsel, an investment manager owned by Fairfax founder and Chief Executive V. Prem Watsa, had more than 5 percent of its investments for the company in assets considered "not permitted or qualifying.
>
> The Delaware report took issue with the Hamblin Watsa Asia Fund, saying the regulatory capital of a Fairfax subsidiary, Fairmont Specialty Insurance, was affected by a large investment in the Mauritius-based money manager. Fairmont sold its $4.19 million stake in the fund.

152. According to the *New York Post*, the Delaware regulators also "recommended the company address other concerns, including a failure to fully disclose its directors' conflicts of interest, not obeying rules on 'material transactions with affiliates,' not having the correct number of directors, and not keeping track of its stockholders."

2. Fairfax Overstated Shareholder Equity in 2004 and 2005 by $28.4 Million and Understated Losses by Failing to Properly Record Its Investment in Zenith National Investment Corp.

153. In 1999, Fairfax purchased a 39% interest in the common stock of Zenith National Investment Corp. ("Zenith"). During the period from 1999 to 2001, the Company improperly

accounted for this investment, using the cost basis of accounting even though Fairfax was deemed to have the ability to exercise significant influence over Zenith. As such, Fairfax violated Accounting Principles Board ("APB") Statements No. 18, *The Equity Method of Accounting for Investments in Common Stock*, that requires the equity method of accounting for an investment in common stock be used by an investor whose investment in voting stock gives it the ability to exercise significant influence over operating and financial policies of an investee, even though the investor holds 50% or less of the voting stock.

154. By failing to account for Fairfax's Zenith investment under the equity method from 1999 to 2001, the Company avoided recording their share ($30.9 million) of Zenith's net losses during that period. As much as these effects were prior to the Class Period, by virtue of restating those amounts, Fairfax also had to restate gains recognized in 2004 and 2005 on the sale of interests in the Zenith investment. The gains were decreased as a result of reducing the carrying amount of the Zenith investment by the amount of losses from 1999 to 2001. These corrections resulted in $11.6 million and $16.8 million cumulative decreases in shareholders' equity as of December 30, 2005 and December 31, 2004, respectively.

3. Fairfax Fails to Properly Account for Investments in Convertible Bonds and Other Fixed Income Securities

155. Fairfax also failed to properly account for convertible bond securities and other fixed income securities with embedded derivatives which were held as investments. The securities that were restated were held as investments by the Company and were purchased between 2001 and 2005. These securities were carried at fair value in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, due to their designation as available for sale, with corresponding changes in their fair value recorded as a component of other comprehensive income within shareholders' equity. The treatment for these investments was restated to correct for the application of SFAS No. 133. Under SFAS No. 133,

changes in the fair value attributable to the embedded option in a convertible bond or other security is required to be recognized in income through realized gains or losses rather than unrealized gains and losses, a component of shareholders' equity, as previously reported by the Company. The corrections had no cumulative effect on shareholders' equity at December 31, 2004, and had the net effect of decreasing the 2004 net loss by $8.0 million, and increasing 2003 net earnings by $6.5 million. For each of those years, there is a corresponding offsetting change in other comprehensive income. Fairfax did a second restatement as management identified an additional error in its previously reported restated results as of and for the year ended December 31, 2005. In the original restatement for FAS No. 133 described in (i) above, management incorrectly calculated the net income and other comprehensive income components for certain instruments sold during the year. The corrections had the effect of increasing the 2005 net loss by $26.8 million with offsetting increases in the unrealized net appreciation of investments included in other comprehensive income (loss).

D. Erroneous Accounting for Intercompany Transactions that Boosted Shareholder Equity

156. Fairfax erroneously accounted for various intercompany transactions including incorrect eliminations of gains and losses on intercompany purchases and sales of portfolio investments, write-offs of unreconciled intercompany balances, incorrect elimination of intercompany advances, and related foreign currency accounting. These omissions resulted in an unsupported net asset having been recorded in the consolidated financial statements of the company.

157. Although the Company made no further disclosures as to the specifics of these transactions, it is clear that Fairfax violated Accounting Research Bulletin ("ARB") No. 51, *Consolidated Financial Statements*, and SFAS No. 52, *Foreign Currency Translation*. ARB No. 51 states, "In the preparation of consolidated statements, intercompany balances and transactions

should be eliminated. This includes intercompany open account balances, security holdings, sales and purchases, interest, dividends, etc. As consolidated statements are based on the assumption that they represent the financial position and operating results of a single business enterprise, such statements should not include gain or loss on transactions among the companies in the group. Accordingly, any intercompany profit or loss on assets remaining within the group should be eliminated."

158. Moreover, SFAS No. 52 requires any gains and losses on long-term intercompany foreign currency transactions not be included in determining net income but rather to be reported as translation adjustments in Accumulated other comprehensive income ("AOCI"). Fairfax's restatement adjustments resulted in a $157.7 million and $166.1 million cumulative decrease in shareholders' equity as of September 30, 2005 and December 31, 2004 respectively, comprised of a cumulative increase in retained earnings of $1.3 million and a cumulative net charge to the currency translation account ("CTA") of $159.0 million as of September, 2005, and a cumulative decrease in retained earnings of $7.1 million and a cumulative net charge to the CTA of $159.0 million as of December 31, 2004. The corrections had the net effect of decreasing the Company's 2005 net loss by $8.5 million, decreasing 2003 net earnings by $10.8 million, decreasing 2002 net earnings by $1.7 million, increasing the net earnings of 2001 and prior years by $5.4 million.

159. Fairfax violated SFAS No. 52 by recording realized foreign currency gains and losses of a subsidiary in accounts payable rather than in earnings during the period 2000 to 2005. According to SFAS No. 52, a transaction gain or loss realized upon settlement of a foreign currency transaction generally shall be included in determining net income for the period in which the transaction is settled. The corrections resulted in a cumulative effect of a cumulative decrease of $40.9 million in shareholders' equity at December 31, 2004 and had the net effect of

decreasing the net loss for the nine months ended December 30, 2005 by $8.3 million, increasing the 2004 net loss by $14.7 million, decreasing 2003 net earnings by $12.8 million, increasing 2002 net earnings by $23.2 million, and decreasing the net earnings of 2001 and prior by $44.9 million.

160. Fairfax failed to properly account for certain investments received in purchase acquisitions under APB No. 16, *Business Combinations*, which requires all identifiable assets acquired be assigned a portion of the cost of the acquired company, normally equal to their fair values at date of acquisition. The restatement corrections had no cumulative effect on shareholders' equity as of September 30, 2005 and a $9.8 million cumulative decrease in shareholders' equity at December 31, 2004, and had the net effect of decreasing the net loss for the nine months ended September 30, 2005 by $9.8 million, decreasing 2002 net earnings by $7.9 million, and decreasing the net earnings of 2000 and prior years by $1.9 million.

161. Fairfax improperly recorded losses on foreign exchange contracts that hedged the 1999 acquisition funding for TIG as a charge to the CTA. The Company improperly recorded the transaction under both Canadian GAAP and US GAAP. Under Canadian GAAP, the losses related to the foreign exchange contract should have been recorded as a revision to the goodwill in the purchase accounting of the Odyssey America Re subsidiary and credited to the CTA in the amount of $23.8 million. Under US GAAP, the foreign exchange contract did not qualify for hedge accounting under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. Under the Canadian GAAP restatements, the related unamortized goodwill balance at September 30, 2005 and December 31, 2004 was $17.6 million. Retained earnings had a $6.2 cumulative decrease at September 30, 2005 and December 31, 2004. Under US GAAP, the $23.8 million in losses were reclassified from goodwill to opening retained earnings at January 1, 2004.

162. Fairfax repeatedly issued financial statements containing accounting errors originally arising primarily in the head office consolidation process during 2000 and prior years. In so doing, the Company violated ARB No. 51, which states, "In the preparation of consolidated statements, intercompany balances and transactions should be eliminated. This includes intercompany open account balances, security holdings, sales and purchases, interest, dividends, etc. As consolidated statements are based on the assumption that they represent the financial position and operating results of a single business enterprise, such statements should not include gain or loss on transactions among the companies in the group. Accordingly, any intercompany profit or loss on assets remaining within the group should be eliminated; the concept usually applied for this purpose is gross profit or loss." The Company's restatements resulted in a $25.3 million cumulative decrease in shareholders' equity as of September 30, 2005 and December 31, 2004, and had the net effect of decreasing net earnings of 2000 and prior years by $25.3 million.

163. Fairfax inappropriately accounted for income taxes in accordance with SFAS No. 109, *Accounting for Taxes*, as follows:

(a) Fairfax improperly recognized the tax impact of an intercorporate dividend. The correction resulted in a $17.2 million cumulative decrease in shareholders' equity at December 31, 2004, and had the net effect of increasing the 2004 net loss by $13.8 million, and decreasing 2003 net earnings by $3.4 million; and

(b) Fairfax improperly recorded the income tax effects on certain foreign currency contracts hedging the company's U.S. dollar investments in subsidiaries in the pre-2004 period that were recorded in earnings rather than in the CTA. The corrections had the net effect of decreasing the 2004 net loss by $4.0 million, decreasing 2003 net earnings by $2.9 million, and decreasing 2002 net earnings by $13.0 million.

164. Fairfax also restated certain items that had little or no effect on current net earnings but were further evidence of the Company's repeated violations of the fundamental principles of GAAP accounting. These items include:

(a) Fairfax failed to timely record a dividend declared in 2004 in the amount of $22.5 million and instead recorded it in 2005. This violated APB No. 4, *Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises*, which recognizes that increases in liabilities specifically arise upon transfers between an enterprise and its owners (dividend declaration) as the declaration date governs the incurrence of the legal liability by the Company. The restatement had the effect of increasing liabilities and decreasing shareholders' equity as at December 31, 2004 by $22.5 million;

(b) Fairfax failed to properly record the balance sheet reclassification of common shares owned by the company as an increase in treasury stock rather than as an increase in other assets. The Company violated APB No. 6, *Status of Accounting Research Bulletins, Chapter 1B - Treasury Stock*, which requires when a corporation's stock is acquired for purposes other than retirement, or when ultimate disposition has not yet been decided, the cost of acquired stock may be shown separately as a deduction from the total of capital stock, capital surplus, and retained earnings, or may be accorded the accounting treatment appropriate for retired stock. The restatement resulted in increases in treasury stock of $17.3 million and $17.4 million at September 30, 2005 and December 30, 2004, respectively, and corresponding decreases in shareholders' equity of $17.0 million and $17.4 million as of September 30, 2005 and December 31, 2004, respectively;

(c) The Company disclosed restatement adjustments for other unrelated adjustments of an immaterial nature individually that were either timing differences in the recording of amounts or corrections. The adjustments resulted in a aggregate increase in shareholders' equity of $3.6 million as of September 30, 2005 and a $59.2 million aggregate cumulative decrease in shareholders' equity as of December 31, 2004, comprised of a $30.5 million cumulative decrease in retained earnings, a $33.8 million cumulative net charge to the CTA and a $5.1 million cumulative increase in common stock. It is impossible to know the specific GAAP provisions violated by the Company as they provided no further details as to the nature of these transactions; and

(d) Fairfax failed to record the minimum pension liability under US GAAP in accordance with SFAS No. 87, *Employers' Accounting for Pensions*, which requires that an additional minimum liability must be recognized if an unfunded accumulated benefit obligation exists and the liability already recognized as unfunded accrued pension cost is less than the unfunded accumulated benefit obligation. The corrections resulted in increasing 2004 AOCI by $1.4 million and increasing 2003 AOCI by $0.3 million.

165. Moreover, Fairfax "shifted" money through subsidiary "investments." As reported by CW8, whenever MFX needed money, a new "investment" seemed to come in from another Fairfax subsidiary.

166. CW8 also stated that Watsa directed MFX to use a London based company called MI2G for IT consulting work. CW8 reported that he felt "certain" that Watsa was using MI2G, which he decried as "grossly over billing" Fairfax, to "funnel" money elsewhere.

167. CW8 reported that he/she was one of only four people who would have been aware that MI2G was over billing Fairfax. The other three people who, according to CW8, knew of this practice were Watsa, Sammy Y. Chan, President of Fairfax Asia, and Sanjay Thaqarai, a former MFX employee.

E. Fairfax's Accounting Tricks Have Their Intended Effect

168. The use of finite reinsurance and other accounting gimmicks to shore up reserves had the intended effect on Fairfax's stock price. On July 30, 2004, Watsa, during a telephone call with analysts, emphasized the importance of Fairfax achieving an investment grade ranking:

> Finally, I wanted to highlight the most important objective that we have for Fairfax; to be rated as investment grade again. We plan to accomplish this as I said last quarter in the old-fashioned way, by producing excellent results and reducing our leverage at the holding company. In this regard our objective is to significantly reduce if not eliminate all maturities in the next five years. We have exchanged 40 percent of the 540 million coming due in 2005 and 2008 for our bonds due in 2012. We are working on the rest of the maturities.

169. On October 28, 2004, Fairfax announced that it would issue $300 million, or 2.4 million subordinate voting shares, to a number of institutional investors, including Southeastern Asset Management and Markel Corp. (no relation to Fairfax subsidiary Markel Insurance Co.). Commenting on the transaction, Watsa stated that the Company was raising significant equity at this time because of its "high priority of improving its ratings and deleveraging significantly. A strong financial position with cash in excess of $600 million after this issue is the best way to handle uncertainty in our industry and in the economy generally."

170. In response to Watsa's comments, the Company's share price soared. The stock, which had closed at $124.65 per share on October 28, 2004, gained $22.44 per share the following day (to close at $147.09). By the close of trading on November 15, 2004, Fairfax's shares stood at $160.75 per share – a 22.46% increase since the October 28th close. Fairfax's shares continued to climb over the next several weeks, reaching as high as $176.60 per share as of the close of trading on December 6, 2004. The Company's stock price still stood at $163.70 per share as February 2005 came to a close.

171. In late 2004, Fairfax announced that it had sold $200 million of its 7.75% Notes at an issue price of 99%. In connection with this transaction, Watsa stated that the Company's "financing goals for 2004 were to significantly deleverage our balance sheet, remove refinancing

risk and maintain significant cash at the holding company. ***When we close this debt issue, our equity financing announced on October 28, 2004 (which is subject to regulatory approval), and our debt tender offer, I believe we will have clearly met these goals***." (Emphasis added.)

172. On February 10, 2005, the Company reported its fourth quarter and year-end 2004 results. The results reflected lower profits for the fourth quarter stemming from realized losses and the repurchase of outstanding debt and the placements of other reserves at subsidiaries (namely C&F). Quarterly revenues also declined over the prior period. Notwithstanding these facts, during a conference call on February 11, 2005, Watsa touted the Company's financial strength, stating that Fairfax had "strengthened [its] financial position" in 2004 and that "we are very excited about the prospects for our company in 2005 with excellent underwriting and investment capability that should serve our shareholders well over the long term."

173. Two months later, on March 4, 2005, Fairfax asserted its compliance with those governance practices deemed standard under the securities laws. In that regard, the Company stated in a press release that "its 2004 Annual Report . . . include[d] a report by management concluding that the [C]ompany's internal control over financial reporting was effective as of December 31, 2004, and an opinion by Fairfax's independent auditors to the same effect. Neither management's report nor the auditors' [sic] opinion identified any material weaknesses in internal controls over financial reporting." The Company's stock price gained $0.27 per share on that day to close at $165.48. During that same month, the Company boasted that its "intrinsic value" had increased significantly in 2004 "because of the excellent performance of our ongoing insurance and reinsurance companies."

F. Fairfax Denies Wrongdoing in the Face of Regulatory Probes

174. On June 24, 2005, the Company issued a press release announcing that its subsidiary, Fairmont Specialty Group ("Fairmont"), had received a subpoena from the SEC

regarding any non-traditional insurance product transactions entered into between General Re and Fairmont.

175. While the Company's stock price declined by $3.00 per share on June 24, 2005, within a number of days, the share price had rebounded (by the end of June 2005, Fairfax's shares were trading at $166.00 per share). The shares stood at $175.07 as July 2005 came to a close; but slipped to $167.55 by the end of August 2005.

176. On September 7, 2005, Fairfax issued a press release stating that "the Fairfax group ha[d] received a subpoena" from the SEC "requesting documents regarding any non-traditional insurance/reinsurance product transactions entered into by the entities in that group and any non-traditional insurance/reinsurance products offered by the entities in that group." On that news, the Company's shares declined by $1.36 from the prior day's close of $166.15. Two weeks later (on September 21, 2005), Fairfax's shares were trading at $160.92.

177. On September 26, 2005, Fairfax issued another press release under the headline: "Fairfax Receives Further Document Request as Part of SEC Loss Mitigation Products Investigation." While the headline was spun to give the impression that the new subpoena was just an extension of the finite reinsurance investigation, the text of the press release indicated otherwise. There, the Company indicated that the SEC had requested "documents regarding any transactions in securities of Fairfax Financial, the compensation for such transactions and the trading volume or share price of such securities." Thus, it now appeared that securities regulators were investigating Fairfax on two different fronts (the trading of Fairfax securities, as well as the Company's use of finite insurance instruments). On that same day, the *Wall Street Journal* reported that sources familiar with the federal probe of finite risk reinsurance stated that investigators were seeking to determine if Fairfax had improperly burnished its financial

statements with nontraditional insurance pacts, including contracts with affiliated, offshore reinsurers.

178. Fairfax also held its third annual investor conference on September 26, 2005. At that time, the Company downplayed the significance of the SEC subpoenas – suggesting that they were tied solely to an industry-wide governmental investigation of reinsurance practices:

> We got the subpoena. It's, as you pointed out in your article, it's an industry investigation. . . . Any time we get a subpoena, we put it out. And the information we've said publicly we will provide all of the information that the SEC needs as far as any nontraditional or finite reinsurance is concerned. So there's about 30 companies, as you know, who got a subpoena from the SEC. We happen to be among the last who got it. And we are fully cooperating with the SEC in terms of information.

179. While the Company's stock price slipped slightly on September 27, 2005 (by $0.31 per share to $162.75), Fairfax's stock increased in value over the following days – jumping to $174.10 by the close of trading on October 3, 2005. On October 7, 2005, the Company's shares were trading close to $168.00. The following day, however, Fairfax's shares took a big hit.

180. On October 10, 2005, the *Wall Street Journal* reported that federal prosecutors in New York had joined what it termed "a continuing probe by the [SEC] of [the Company's] financial statements in recent years." According to the *Wall Street Journal*, the U.S. Attorney's office in Manhattan had launched its probe "in recent weeks" and was "working in tandem, as it often does, with the SEC." The *Wall Street Journal* added that the SEC's investigation into Fairfax's books had reached "an advanced stage," with regulators interviewing several witnesses and experts. Prior to the release of the *Wall Street Journal* article, Fairfax had not disclosed the federal prosecutors' probe.

181. The *Wall Street Journal* reported that "a number of nontraditional reinsurance pacts struck by different companies have come under the spotlight. Authorities are concerned

that some of these companies have used the policies to understate losses and boost earnings. They do so, authorities say, by disguising loans as reinsurance proceeds, while booking the transactions with favorable insurance accounting."

182. On the heels of the October 10, 2005 *Wall Street Journal* article, Fairfax issued a press release. However, rather than being candid (and describing the details and scope of the U.S. Attorneys' investigation), Fairfax was coy, stating only that "it ha[d] not received a subpoena or other information request from the U.S. Attorney's Office." Yet, the very next day Fairfax was compelled to issue a "clarification," stating that while it understood that the U.S. Attorney's office for the Southern District of New York would review information that the Company provided to the SEC, Fairfax had not been informed that it was a "target" of an investigation.

183. As a result of the Company's October 10, 2005 disclosure (and the *Wall Street Journal* report), the Company's share price dropped dramatically. On that one day alone, the Company's stock lost $19.17 per share (to close at $149.00). By the end of October 2005, Fairfax's stock price stood at $150.00 per share (down 13.84% from its close on October 3, 2005).

184. At the close of trading on February 8, 2006, Fairfax's stock price stood at $150.45 per share. The following day, Fairfax reported its fourth quarter results. During a February 10, 2006 investor conference call, Watsa was asked to discuss the OdysseyRe restatement (and the pending subpoenas). At that time, he asserted that an internal review of Fairfax's finite reinsurance contracts had found accounting issues only with those at OdysseyRe:

> TOM MACKINNON, ANALYST, SCOTIA CAPITAL: Good morning. In the press release you mentioned that OdysseyRe had announced the result of an internal review. It is finite contracts and they had to do a minor restatement in the release that you put out that it is not going to have any material impact on you. But have you done an internal review of all your finite contracts and if so, what was the result of that?

> PREM WATSA: Yes, that is a good question, Tom. We have of course with the focus on the industry on finite contracts, we have done a complete review of all our companies, all our contracts, and across Fairfax and its subsidiaries, across Fairfax and one or two of the - a few contracts that we have had at the holding company. And I am happy to tell you that that's the OdysseyRe restatement were the only ones that did come up. . . . ***[W]e are happy to say that we have been a full review by us and by our independent auditors and those were the only ones that came up***.

(Emphasis added.) The Company's shares declined by $4.78 per share to close at $147.00 at the end of that day.

G. The Truth Begins to Emerge: the March 22, 2006 Press Release

185. Shortly after Watsa declared that after a "complete review of all our companies, all our contracts, and across Fairfax and its subsidiaries . . . the OdysseyRe restatement were the only ones that did come up," on March 22, 2006, Fairfax issued a press release titled, "SEC Subpoena Update."

186. The March 22, 2006 press release stated that SEC subpoenas had been issued to the Company and its affiliates and reiterated that the U.S. Attorney's office for the Southern District of New York was reviewing documents produced to the SEC by the Company and was participating in the investigation of the matters being probed by the SEC. The Company also announced that it had "prepared presentations and provided documents to the SEC and the U.S. Attorney's office" and that "its employees, including senior officers, have attended or have been requested to attend interviews conducted by the SEC and the U.S. Attorney's office."

187. At this same time, the Company noted that Fairfax and Watsa had both received subpoenas from the SEC in connection with Watsa's comments on the February 10, 2006 investor conference call concerning the internal review of the Company's finite insurance contracts.

188. Specifically, the Subpoena Update noted that:

> As part of the 2005 year-end reporting and closing process, Fairfax and its subsidiaries internally reviewed all of the contracts on the list provided to the SEC

> and some additional contracts as deemed appropriate. That review led to the restatement by OdysseyRe. That review also led to some changes in accounting for certain contracts at nSpire Re which were immaterial at the consolidated Fairfax level.

189. Thus, while Watsa was seeking to assure investors that Fairfax's improper use of finite reinsurance contracts was limited to OdysseyRe, the Company had months earlier provided the SEC with a list of contracts which led to "changes in accounting" at another Fairfax subsidiary.

190. The Company added that it "continues to respond to requests for information from the SEC" and that "there can be no assurance that the SEC's review of documents provided will not give rise to further adjustments."

191. The Company further stated that the SEC also had issued subpoenas to "various third parties involved in the matters which are the subject of the SEC subpoenas" issued to the Company, including the Company's independent auditors, and a shareholder.

192. Fairfax further noted that it was possible "that other governmental and enforcement agencies will seek to review information related to these matters, or that the company, or other parties with whom it interacts, such as customers or shareholders, may become subject to direct requests for information or other inquiries by such agencies." The Company also indicated that it could not predict the outcome from these continuing inquiries, or the ultimate effect on its business, "which effect could be material and adverse."

193. The press release was interpreted by the markets as indicating that Fairfax had, in earlier comments, improperly downplayed the pending governmental investigations and subpoenas. The press release (which represented Fairfax's first detailed disclosure of the breadth of the governmental investigations of its operations), sent the Company's securities (both debt and equity) into a tailspin.

194. Following the Company's March 22, 2006 disclosure, Fairfax's stock suffered its biggest single day decline in approximately three years, falling from $130.90 to $113.93 per share, representing a decline in market capitalization of approximately $300 million, or approximately 13% of its value.

195. In order to deflect attention away from the Company's conduct and the government's investigation, on July 26, 2006 Fairfax filed a suit against several short sellers alleging, *inter alia*, that the defendants manipulated the price of the Company's securities.

196. The following day the Company announced that it needed to restate its financial results and as a result shareholders' equity would be reduced by $225 to $240 million. The Company's July 27, 2006 press release stated:

> During its review of the accounting implications of the above-announced commutation of the Swiss Re Cover, management identified various non-cash accounting errors arising primarily in 2001 and prior.
>
> At the end of 2001, Fairfax converted its consolidation process to a new consolidation accounting system which provided increased sophistication and control processes to deal with Fairfax's growth in size and international scope. Management previously believed that a consolidation journal entry related to the Swiss Re Cover was correct. However, when management began calculating the accounting impact of the commutation of the Swiss Re Cover, it determined that this historical consolidation journal entry did not eliminate and was instead associated with other erroneous non-cash accounting matters arising, as noted above, primarily in 2001 and prior.
>
> Upon the recommendation of management, the Audit Committee of Fairfax's Board of Directors decided today to restate Fairfax's financial statements for prior periods affected. Accordingly, although the restated amounts have not been finalized, Fairfax estimates that the impact of the restatement will be a decrease in shareholders' equity as at March 31, 2006 in an estimated range of $175 to $190 million (comprised in part of a reduction in the currency translation account and in part a reduction in retained earnings) related to the matters described in the preceding paragraph and, since all previously unrecorded errors, regardless of materiality, are included in a restatement, an estimated approximate $50 million related to previously unrecorded differences existing at March 31, 2006. These figures represent Fairfax's best current estimates of the effects of the restatement. Fairfax will also include in the restatement corrections of certain unrelated errors of an immaterial nature and corrections of certain previously recorded unrelated entries into the periods in which they occurred.

> Fairfax believes that its current accounting system and internal controls appropriately address the former problem discovered, as described above, in the consolidation process. As part of the restatement process, Fairfax will assess the impact of this former problem on its control assessment under section 404 of the Sarbanes-Oxley Act.
>
> * * *
>
> Until this restatement is completed, Fairfax's previously published annual and interim financial statements should not be relied upon. Fairfax anticipates that the restatement will be completed by the end of August 2006.

197. On August 31, 2006, the Company announced that it had "filed its interim report for the six months ended June 30, 2006 and its restated consolidated financial statements and related disclosures pursuant to the restatement previously announced on July 27, 2006 . . . [and] as a result of the restatement, shareholders' equity decreased $235.3 million as at March 31, 2006. . . ."

198. The Company's restated Management Discussion and Analysis ("MD&A") for the year ended December 31, 2005 (filed with the SEC on Form 6-K on September 5, 2006), admitted that the Company maintained ineffective controls and that the defective controls "resulted in the restatement of the [C]ompany's consolidated financial statements for the years ended December 31, 2001 through 2005 and related disclosures."

IX. FAIRFAX'S RESTATEMENT REVEALS THAT ITS FINANCIAL STATEMENTS FAILED TO COMPLY WITH GAAP AND SEC REGULATIONS

A. Fairfax's Financial Statements Failed to Comply with Basic GAAP Principles

199. GAAP are those principles recognized by the accounting profession as the conventions, rules, and procedures necessary to define accepted accounting practices at a particular time. Those principles are the official standards accepted by the SEC and promulgated in part by the American Institute of Certified Public Accountants ("AICPA"), a private professional association, through three successor groups it established: the Committee on

Accounting Procedure; the Accounting Principles Board (the "Board"); and the Financial Accounting Standards Board (the "FASB") with the permission of the SEC (Accounting Series Release 150).

200. The SEC requires that public companies prepare their financial statements in accordance with GAAP. As set forth in SEC Rule 4-01(a) of SEC Regulation S-X, "[f]inancial statements filed with the [SEC] which are not prepared in accordance with [GAAP] will be presumed to be misleading or inaccurate." 17 C.F.R. §210.4-01(a)(1). Management is responsible for preparing financial statements that conform to GAAP. As noted by AICPA auditing standards ("AU"), §110.02:

> Financial statements are management's responsibility . . . [M]anagement is responsible for adopting sound accounting policies and for establishing and maintaining internal controls that will, among other things, record, process, summarize, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements. The entity's transactions and the related assets, liabilities and equity are within the direct knowledge and control of management… Thus, the fair presentation of financial statements in conformity with Generally Accepted Accounting Principles is an implicit and integral part of management's responsibility.

201. Fairfax's financial statements filed with the SEC during the Class Period violated the following provisions of GAAP, among others discussed below:

(a) The principle that financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions. (FASB Statement of Financial Accounting Concepts "SFAC" No. 1);

(b) The principle that financial reporting should provide information about the economic resources of an enterprise, the claims to those resources, and the effects of transactions, events, and circumstances that change resources and claims to those resources. (SFAC No. 1);

(c) The principle that financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it. To the extent that management offers securities of the enterprise to the public, it voluntarily accepts wider responsibilities for accountability to prospective investors and to the public in general. (SFAC No. 1);

(d) The principle that financial reporting should provide information about an enterprise's financial performance during a certain time period. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance. (SFAC No. 1);

(e) The principle that the quality of reliability and, in particular, of representational faithfulness leaves no room for accounting representations that subordinates substance to form. (SFAC No. 2);

(f) The principle that financial reporting should be reliable in that it represents what it purports to represent. That information should be reliable as well as relevant is a notion that is central to accounting. (SFAC No. 2);

(g) The principle of completeness, which means that nothing is left out of the information that may be necessary to ensure that it validly represents underlying events and conditions. (SFAC No. 2);

(h) The principle that conservatism be used as a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered. (SFAC No. 2);

(i) The principle that contingencies and other uncertainties that affect the fairness of presentation of financial data at an interim date shall be disclosed in interim reports in the same manner required for annual reports. (APB Opinion No. 28);

(j) The principle that disclosures of contingencies shall be repeated in interim and annual reports until the contingencies have been removed, resolved, or have become immaterial. (APB Opinion No. 28);

(k) The principle that management should provide commentary relating to the effects of significant events upon the interim financial results. (APB Opinion No. 28); and

(l) The principle that disclosure of accounting policies should identify and describe the accounting principles followed by the reporting entity and the methods of applying those principles that materially affect the financial statements. (APB Opinion No. 22).

202. The foregoing provisions of GAAP were violated because: (1) Fairfax overstated their assets in each of 2003, 2004 and 2005 by $454.1 million, $369.0 million and $261.7 million respectively, by improperly accounting for finite reinsurance contracts and recklessly failing to maintain adequate internal controls; (2) Fairfax failed to disclose that it was using finite reinsurance contracts to address reserve deficiencies; and (3) Fairfax failed to alert investors that their internal accounting controls are, and have been, so lacking that they have resulted in material misstatements to the Company's financial statements for at least the past five years.

B. Fairfax's Public Filings Violated SEC Regulations by Failing to Include Information Necessary to Make Fairfax's Public Filings Not Misleading

203. The SEC regulates statements by companies "that can reasonably be expected to reach investors and the trading markets, whoever the intended primary audience." SEC Release No. 33-6504, 3 Fed. Sec. L. Rep. (CCH) 23,120, at 17,095-3, 17 C.F.R. §241.20560 (Jan. 13, 1984). Under SEC regulations, the management of a public company has a duty "to make full

and prompt announcements of material facts regarding the company's financial condition." SEC Release No. 34-8995, 3 Fed. Sec. L. Rep. (CCH) 23,120A, at 17,095, 17 C.F.R. §241.8995 (Oct. 15, 1970). The SEC has emphasized that "[i]nvestors have legitimate expectations that public companies are making, and will continue to make, prompt disclosure of significant corporate developments." SEC Release No. 18271, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) 83,049, at 84,618 (Nov. 19, 1981).

204. In Securities Act Release No. 6349 (Sept. 8, 1981), the SEC stated that:

> [I]t is the responsibility of management to identify and address those key variables and other qualitative and quantitative factors, which are peculiar to and necessary for an understanding and evaluation of the individual company.

205. In Accounting Series Release 173, the SEC reiterated the duty of management to present a true representation of a company's operations:

> [I]t is important that the overall impression created by the financial statements be consistent with the business realities of the company's financial position and operations.

206. Item 3 of Form 40-F and Item B of Form 6-K, Management's Discussion and Analysis of Financial Condition and Results of Operations, require the issuer to furnish information required by Item 303 of Regulation S-K [17 C.F.R. §229.303].

207. On May 18, 1989, the SEC issued an interpretive release (Securities Act Release No. 6835, May 18, 1989) which stated, in relevant part:

> The MD&A requirements are intended to provide, in one section of a filing, material historical and prospective textual disclosure enabling investors and other users to assess the financial condition and results of operations of the registrant, with particular emphasis on the registrant's prospects for the future. As the Concept Release states:
>
> The Commission has long recognized the need for a narrative explanation of the financial statements, because a numerical presentation and brief accompanying footnotes alone may be insufficient for an investor to judge the quality of earnings and the likelihood that past performance is indicative of future performance. MD&A is intended to give the investor an opportunity to look at the company through the eyes of management by providing both a short and long term analysis

> of the business of the company. The Item asks management to discuss the dynamics of the business and to analyze the financials.

208. The SEC has thus stated, "[I]t is the responsibility of management to identify and address those key variables and other qualitative and quantitative factors which are peculiar to and necessary for an understanding and evaluation of the individual company."

209. SEC Staff Accounting Bulletin No. 101 ("SAB 101"), Revenue Recognition in Financial Statements, drawing from Regulation S-K, Article 303, and Financial Reporting Release No. 36, also reiterated the importance of the MD&A in financial statements:

> Management's Discussion & Analysis (MD&A) requires a discussion of liquidity, capital resources, results of operations and other information necessary to an understanding of a registrant's financial condition, changes in financial condition and results of operations. This includes unusual or infrequent transactions, known trends, or uncertainties that have had, or might reasonably be expected to have, a favorable or unfavorable material effect on revenue, operating income or net income and the relationship between revenue and the costs of the revenue. Changes in revenue should not be evaluated solely in terms of volume and price changes, but should also include an analysis of the reasons and factors contributing to the increase or decrease. The Commission stated in Financial Reporting Release (FRR) 36 that MD&A should 'give investors an opportunity to look at the registrant through the eyes of management by providing a historical and prospective analysis of the registrant's financial condition and results of operations, with a particular emphasis on the registrant's prospects for the future.'

(Emphasis added; footnotes omitted.)

210. In discussing results of operations, Item 303 of Regulation S-K requires the registrant to "[d]escribe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." The Instructions to Paragraph 303(a) further state, "[T]he discussion and analysis shall focus specifically on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results." 17 C.F.R. §229.303(a)(l)-(3) and Instruction 3.

211. In addition, the SEC, in its May 18, 1989 Interpretive Release No. 34-26831, has indicated that registrants should employ the following two-step analysis in determining when a

known trend or uncertainty is required to be included in the MD&A disclosure pursuant to Item 303 of Regulation S-K: (a) a disclosure duty exists where a trend, demand, commitment, event or uncertainty is both presently known to management; and (b) it is reasonably likely to have a material effect on the registrant's financial condition or results of operations.

212. As more fully set forth below, however, the MD&A section of Fairfax's filings with the SEC during the Class Period failed to comply with the foregoing SEC regulations because: (1) Fairfax failed to disclose that the true purpose for its retroactive reinsurance contracts was to free up liquidity needed to fund the operations of it's unprofitable and run-off acquisitions; (2) Fairfax failed to disclose that it intended to commute these contracts from inception, despite incurring significant charges to use the contracts to lower its net reserves on its balance sheet; and (3) Fairfax failed to alert investors that its internal accounting controls are, and have been, so lacking that they have resulted in material misstatements to the Company's financial statements for at least the past five years.

C. Fairfax's Restatements

213. Fairfax, in disclosing the events leading to its restatements, has consistently maintained that "[t]he restatement of the [C]ompany's consolidated financial statements followed an internal review of the [C]ompany's consolidated financial statements and accounting records that was undertaken in contemplation of the commutation of the Swiss Re corporate insurance cover." In actuality, the Company's unwinding of inappropriate and erroneous accounting that piled up over the previous five plus years was the result of a race against the SEC and Eliot Spitzer.

214. As disclosed in Fairfax's press release dated June 24, 2005, the Company announced that its Fairmont subsidiary had received a subpoena from the SEC requesting documents regarding any "non-traditional" insurance product transactions between Fairmont and

General Re. Based on the current attention that insurance companies involved with finite reinsurance products were facing from New York Attorney General Eliot Spitzer and the SEC, Watsa knew that requests on the remainder of the Fairfax companies would not be far behind. On September 7, 2005, Fairfax announced that it had received a subpoena from the SEC requesting documents on any "non-traditional" insurance or reinsurance products offered by any of the Fairfax owned companies. On September 26, 2005, the Company received a further subpoena from the SEC as part of its investigation. As the SEC investigation was beginning, Fairfax scrambled to unwind, unravel and disclose the improper accounting it had perpetuated and released in the past. Watsa knew investor and regulator perception would be much better if Fairfax announced a restatement ahead of any findings from an SEC investigation and may well limit the level of scrutiny on certain Fairfax transactions.

215. Fairfax's effort to quickly remedy its accounting manipulations was so significant that Fairfax's audit fees almost doubled from $14.6 million for the year ended December 31, 2004 to $26.0 million for the year ended December 31, 2005. In explaining how it had discovered its accounting mess, Fairfax claimed that the restatement was simply the result of an internal review of accounting records that had occurred in the course of the Company commuting - or terminating - the Swiss Re Cover. While this explanation was very convenient, it was, clearly, completely contrived as most of the restated items had absolutely nothing to do with the accounting for the Swiss Re Cover.

216. On July 27, 2006, Fairfax announced that it was preparing a restatement of its financial statements and until the restatement is complete, previously published annual and interim financial statements should not be relied upon. As it turned out, Fairfax restated its previously issued financial statements as of and for the years ended December 31, 2001 through 2005 and all related disclosures. The Company also filed restated financial statements as of and

for the three and six months ended March 31, 2006 and June 30, 2006 and related disclosures. On November 2, 2006, the Company announced that it would be further amending December 31, 2005 US GAAP net income. As such, Fairfax admitted that its financial statements issued for each of these periods were false and that the misstatements of net income were material. APB No. 20 provides that financial statements should only be restated in limited circumstances; that is, when there is a change in a reporting entity, there is a change in accounting principles used, or to correct an error in previously issued financial statements. Fairfax's restatements are not due to a change in reporting entity or a change in accounting principles, but rather to correct errors in previously issued financial statements, rendering those statements materially false.

217. Fairfax's two restatements included 18 different restatement items on a Canadian GAAP basis and six additional items to restate US GAAP earnings. In addition, OdysseyRe, an 80% owned publicly-traded subsidiary of Fairfax, also filed two restatements of its consolidated financial statements as of and for the years ended December 31, 2000 through 2004 and for its financial statements for the nine months ended September 30, 2005. These OdysseyRe restatements included another five restatement items. In total, 29 separate restatement items effected the restated Fairfax financial statements.

218. The following chart shows the net effect the restatements had on shareholders equity on the balance sheets on both Canadian and US GAAP basis at each of the dates indicated.

Effect of Restatement on Shareholders' Equity					
(in millions)	**9/30/05**	**6/30/05**	**3/31/05**	**12/31/04**	**12/31/03**
Increase (decrease) in Shareholders' Equity (Canadian GAAP)	$(300.2)	$(312.6)	$(333.2)	$(369.0)	$(415.4)
Increase (decrease) in Shareholders' Equity (US GAAP)	$(412.7)	$(426.0)	$(435.3)	$(465.2)	$(491.3)
US GAAP Shareholders' Equity	$2,728.1	$2,661.1	$2,800.6	$2,878.5	$2,462.9

as originally filed					

219. The above chart of the effect of Fairfax's restatements confirms that the originally filed financial statements were all materially misstated. Shareholders' equity (under US GAAP), the net book value of the Company, was overstated by at least 15% in each of the originally filed financial statements.

D. The SEC's June 25, 2009 "No Action" Letter

220. On June 25, 2009, the SEC sent Fairfax's investigation counsel a letter regarding the SEC investigations captioned "Fairfax Financial Holdings, Ltd. (NY-7532); Certain Loss Mitigation Insurance Products (NY-6749)." The letter states, in relevant part:

> These investigations have been completed as to Fairfax Financial Holdings Ltd., against whom we do not intend to recommend any enforcement action by the Commission. We are providng this information under the guidelines in the final paragraph of Securities Act Release No. 5310 (copy attached).

June 25, 2009 Ltr. from Leslie Kazon, Ass't. Reg'l. Dir., SEC, New York Reg'l. Office, to Jonathan J. Greenblatt, Shearman & Sterling LLP, at 1. The letter attached Securities Release No. 5310.

221. The final paragraph of Securities Act Release No. 5310 states, in pertinent part:

> The Commission is instructing its staff that in cases where such action appears appropriate, it may advise a person under inquiry that its formal investigation has been terminated. . . . Even if such advice is given, however, it must in no way be construed as indicating that the party has been exonerated or that no action may ultimately result from the staffs investigation of that particular matter. All that such a communication means is that the staff has completed its investigation and that at that time no enforcement action has been recommended to the Commission. The attempted use of such a communication as a purported defense in any action that might subsequently be brought against the party, either civilly or criminally, would be clearly inappropriate and improper since such a communication, at the most, can mean that, as of its date, the staff of the Commission does not regard enforcement action as called for based upon whatever information it then has. Moreover, this conclusion may be based upon various reasons, some of which, such as workload considerations, are clearly irrelevant to the merits of any subsequent action.

Securities Act Release No. 5310 (Sept. 27, 1972).

222. As Securities Act Release No. 5310 makes clear, the SEC's "no action" letter did not signal that Fairfax had been exonerated, and attempting to use the letter as a defense in a civil action "would be clearly inappropriate and improper" because the letter means only that, at that time, the SEC determined, for undisclosed reasons, not to take additional action against Fairfax.

X. THE DEFENDANTS' FALSE AND MISLEADING STATEMENTS DURING THE CLASS PERIOD

223. Prior to, and during the Class Period, Defendants made numerous public statements misstating Fairfax's financial results and omitting material facts. As a result, the Company's publicly reported financial results and other public statements disseminated during the Class Period were materially false and misleading causing the price of Fairfax's securities to be artificially inflated. When the truth about Fairfax's unlawful scheme was finally disclosed, investors in Fairfax lost hundreds of millions of dollars as the price of the Company's shares collapsed.

The 2002 Annual Report

224. On May 21, 2003, the Company filed its annual report for the year ending December 31, 2002, on Form 40-F ("2002 Annual Report"), which stated:

> The total assets of Fairfax have increased from $32.0 billion as at December 31, 1999 to $35.1 billion as at December 31, 2002. During this same period common shareholders' equity has increased from $3.1 billion to $3.4 billion. For the year ended December 31, 1999 Fairfax had revenue of $5.8 billion and net earnings of $124.2 million. For the year ended December 31, 2002 Fairfax had revenue of $8.0 billion and net earnings of $415.7 million.

225. The Company also reported net investment income as $1,395.4 million CAD.

226. Under U.S. GAAP, the Company reported net earnings of $613.3 million CAD, net earnings per share of $42.61, total assets as $35,722.3 million CAD, and total liabilities as $31,438.9 million CAD.

227. Defendants knew, or recklessly disregarded, that the statements from the 2002 Annual Report concerning the Company's assets, shareholder equity, revenue and net income

were materially false and misleading because of Fairfax's use of finite reinsurance, which did not involve a sufficient transfer of risk and overstated the Company's reported assets, shareholder equity, revenue and net income. As disclosed in the Company's restatements, earnings under Canadian GAAP were overstated by $268 million while earnings under U.S. GAAP were overstated by $194 million for periods covered by, and prior to, the 2002 Annual Report. Moreover, the Company's restatement also revealed that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated during this period. Additionally, the Company's assets were overstated and its liabilities were understated because the Company deceptively accounted for certain reinsurance contracts under the reinsurance accounting method rather than deposit accounting method. Under the proper accounting method, reinsurance contracts which did not involve a sufficient transfer of risk should have been accounted for as financing rather than reinsurance increasing liabilities and reinsurance receivables would be reduced for such contracts thereby decreasing assets. Further, net earnings, revenue and investment income were overstated because Fairfax inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions.

228. Under the heading "Provision for claims," the 2002 Annual Report stated:

> Claim provisions are established by the case method as claims are reported. For reinsurance, the provision for claims is based on reports and individual case estimates received from ceding companies. The estimates are regularly reviewed and updated as additional information on the estimated claims becomes known and any resulting adjustments are included in earnings. A provision is also made for management's calculation of factors affecting the future development of claims including claims incurred but not reported (IBNR) based on the volume of business currently in force and the historical experience on claims.

229. With respect to the establishment of provisions for claims and reinsurance, the 2002 Annual Report stated:

> The company reflects third party reinsurance balances on the balance sheet on a gross basis to indicate the extent of credit risk related to third party reinsurance and its obligations to policyholders and on a net basis in the statement of earnings to indicate the results of its retention of premiums written.

230. Defendants knew, or recklessly disregarded, that the statements from the 2002 Annual Report concerning the Company's provision for claims were materially false and misleading because Fairfax employed finite reinsurance contracts, which did not involve a sufficient transfer of risk, to overstate its financial appearance and understate its net provisions for claims.

231. With respect to Fairfax's controls, the 2002 Annual Report stated:

> The Registrant's principal executive officer and principal financial officer, after evaluating the effectiveness of the Registrant's disclosure controls and procedures (as defined in Exchange Act Rules 13a-14(c) and 15d-14(c)) as of a date within 90 days prior to the filing date of this annual report on Form 40-F (the "Evaluation Date"), have concluded that, as of the Evaluation Date, the Registrant's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Registrant and its consolidated subsidiaries would be made known to them by others within those entities.

232. The 2002 Annual Report also included certifications from Watsa and Ambridge, wherein the two Defendants stated:

> 1. I have reviewed this annual report on Form 40-F of the registrant, Fairfax Financial Holdings Limited;
>
> 2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
>
> 3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
>
> 4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
>
> > (a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated

subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

(c) Presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (and persons performing the equivalent function):

(a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

233. Defendants knew, or recklessly disregarded, that the statements from the 2002 Annual Report concerning the effectiveness of Fairfax's controls were materially false and misleading because, as the Company has now admitted, it maintained ineffective controls during the period covered by the statement and certifications. The Company's ineffective controls led, in part, to the Company's restatements.

234. With respect to OdysseyRe, Fairfax stated:

OdysseyRe had an underwriting profit of $20.3 in 2002 compared with an underwriting loss of $214.7 in 2001 and a combined ratio of 99.1% in 2002 compared to 115.4% in 2001. The substantial improvements in 2002 were a result of management's underwriting actions, including improvements in pricing as well as terms and conditions, and the company's opportunistic expansion into better performing lines of business. Net premiums written increased by 67.8% in

> 2002 to $2,489.4 as a result of improved market conditions, including improved pricing and industry consolidation.[4]

235. The Company further stated:

> OdysseyRe was exceptionally well positioned for 2002 as it had cut back its business in the soft markets of the late 90s and had already taken its large reserve charges. Andy Barnard and his management team had an outstanding year with a combined ratio of 99.1% and net premiums written up 68%. OdysseyRe had gross premiums written of US$1.8 billion and net written premiums of US$1.6 billion all across the world. Combined with exceptional investment results, OdysseyRe earned 21% on shareholders' equity in 2002. All of OdysseyRe's major divisions had exceptional performance, as Mike Wacek led the Americas to a combined ratio of 99.2% and a 58.3% increase in net written premiums, Lucien Pietropoli led Euro-Asia to a combined ratio of 99.8% with an 83.4% increase in net premiums written, and Brian Young led the London market operations to a combined ratio of 97.5% with an 87.9% increase in net premiums written. . . . Congratulations and much gratitude to Andy Barnard and his team at OdysseyRe.

236. Defendants knew, or recklessly disregarded, that the statements from the 2002 Annual Report concerning OdysseyRe were materially false and misleading because, as the Company has now admitted (through OdysseyRe's restatement), OdysseyRe's reported financial results were misstated because they "[included] accounting errors associated with certain reinsurance contracts entered into by [OdysseyRe] . . . between 1998 and 2004."

237. Fairfax also sought to comfort investors' concerns about the Company's reserves by stating:

> We listed on the NYSE on December 18, 2002 as we suggested we might. We were warmly welcomed and on January 14, 2003, the NYSE reported that there were almost 2 million shares shorted! Soon after, there was a spate of negative articles and reports on Fairfax, including a report containing seriously misleading commentary on Fairfax's reserves.
>
> We have always tried to give very full disclosure in our annual reports, and we expand that disclosure if we discover that there are areas where enhanced disclosure would be useful (this year, for instance, our MD&A includes significantly expanded disclosure on our ORC Re subsidiary and our asbestos and

[4] Figures and amounts are in Cdn$ and in millions, except per share amounts, unless otherwise indicated.

> pollution reserves). Because we are always concerned for our long term investors, we have decided to have conference calls after our earnings releases. There will continue to be no earnings guidance – quarterly or annually – but we will be open to answering any questions that shareholders or others may have. Although we are very much against quarterly conference calls because of their short term focus and promotional nature, we were guided by the greater concern that our investors not suffer from misleading information. We also plan to continue to have an annual investor meeting in New York, likely in the fall.
>
> As in past annual reports, we have listed for you the risks in our business as simply as we could (this year beginning on page 114). They are many and very real. Your management team is constantly focusing on these risks and trying to minimize them. Similar to last year, I want to highlight the ones on reinsurance recoverables, the future income tax asset and ratings as well as claims reserves, including asbestos and pollution reserves. We have extensive disclosure and discussion on all of these risks in the MD&A, which we encourage you to review. Although there can be no guarantees that these risks will not hurt us – that's why they're risks – you can be certain that we face them analytically and honestly and that we have some of the best people in the industry, including particularly the extensive TRG team under the leadership of Dennis Gibbs, working with us every day to minimize them.
>
> The strengths that we have at Fairfax are formidable and have not changed from the ones I listed for you in the 2001 annual report. Your management team has truly been tested in the last few years and has every intention to do well by you (as we did in spades in 2002), irrespective of circumstances. As discussed earlier in this letter, our businesses – our insurance, reinsurance and investment operations – are performing magnificently.

The foregoing statement was made in a letter signed by Watsa and filed as an exhibit to the 2002 Annual Report.

238. Defendants knew, or recklessly disregarded, that the statements from the 2002 Annual Report concerning Fairfax's reserves and disclosures to investors were materially false and misleading because Defendants knew or were reckless in not knowing that Fairfax and its subsidiaries used reinsurance contracts that did not involve a sufficient transfer of risk to manipulate Fairfax's financial results. Moreover, while Fairfax was reassuring investors that it provided them with accurate disclosures, the Company maintained woefully ineffective controls. The Company's restatement was based, in part, on Fairfax's ineffective controls during the time period covered by the 2002 Annual Report.

239. The audited portions of the consolidated financial statements included in the 2002 Annual Report were signed by Watsa and given a "clean audit" opinion by PWC.

240. Specifically, PWC stated:

> We have audited the consolidated balance sheets of Fairfax Financial Holdings Limited as at December 31, 2002 and 2001 and the consolidated statements of earnings, retained earnings and cash flows for each of the years in the three year period ended December 31, 2002. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.
>
> We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.
>
> ***In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2002 and 2001 and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2002 in accordance with Canadian generally accepted accounting principles***.

(Emphasis added.)

241. PWC knew, or recklessly disregarded, that its statements in the 2002 Annual Report were materially false and misleading. As evidenced by Fairfax's restatement, the financial reports covered by PWC's "clean audit" opinion were materially false and required restating. Moreover, as admitted by Fairfax and as disclosed by several confidential sources Fairfax did not maintain effective controls during the time period covered by PWC's "clean audit."

Watsa Announces Plans to Purchase 250,000 Share Because the Shares Are "Attractive"

242. On June 7, 2003, *Globe and Mail* reported that Watsa planned to buy 250,000 shares of Fairfax because the shares remained "attractive."

243. Watsa knew, or recklessly disregarded, that his statement that Fairfax's shares were "attractive" was materially false and misleading, because the value of Fairfax's shares were artificially inflated by the Company's improper use of finite reinsurance contracts. Moreover, Watsa knew that he would not purchase 250,000 shares when making this statement. Indeed, in the week following the June 7, 2003, *Globe and Mail* report, Watsa purchased only 30,000 shares of Fairfax rather than the 250,000 shares he said he would purchase.

The July 25, 2003 F-10 Registration Statement

244. On July 25, 2003, Fairfax filed a registration statement, on Form F-10, with the SEC seeking to register up to $200,000,000 USD aggregate principal amount of 5% Convertible Senior Debentures due 2023 and the subordinate voting shares issuable upon the conversion, redemption, purchase or maturity thereof (the "July 25, 2003 F-10"), which was signed by Eric P. Salsberg, Watsa, Ambridge, Williamson, Bennett and Griffiths.

245. In addition to incorporating the statements from the 2002 Annual Report, the July 25, 2003 F-10 stated:

> We maintain reserves to cover our estimated ultimate unpaid liability for losses and loss adjustment expenses with respect to reported and unreported claims incurred as of the end of each accounting period. Our success is dependent upon our ability to accurately assess the risks associated with the businesses that we reinsure or insure. If we fail to accurately assess the risks we assume, we may fail to establish appropriate premium rates and our reserves may be inadequate to cover our losses, which could have a material adverse effect on our financial condition or reduce our net income.
>
> At December 31, 2002, we had net unpaid loss and loss adjustment expense reserves of approximately $11.0 billion. We incurred losses and loss adjustment expenses of $4.6, $4.2 and $3.7 billion for the years ended December 31, 2002, 2001 and 2000, respectively.
>
> Reserves do not represent an exact calculation of liability, but instead represent estimates involving actuarial and statistical projections at a given point in time of our expectations of the ultimate settlement and administration costs of claims incurred. We utilize both proprietary and commercially available actuarial models, as well as historical insurance industry loss development patterns, to assist in the establishment of appropriate claim reserves. In contrast to casualty losses, which frequently can be determined only through lengthy and

> unpredictable litigation, non-casualty property losses tend to be reported promptly and usually are settled within a shorter period of time. Nevertheless, for both casualty and property losses, actual claims and claim expenses paid may deviate, perhaps substantially, from the reserve estimates reflected in our financial statements. Variables in the reserve estimation process can be affected by both internal and external events, such as changes in claims handling procedures, economic inflation, legal trends and legislative changes. Many of these items are not directly quantifiable, particularly on a prospective basis.

246. The July 25, 2003 F-10 also reported the following figures (under U.S. GAAP) as of March 31, 2003: $2,827.3 million CAD ($3,499.3 million CAD adjusted) as total debt; $3,218.2 million CAD ($3,218.2 million CAD adjusted) for total shareholders' equity; and 44.1% (49.4% adjusted) for debt/total capitalization.

247. Defendants knew, or recklessly disregarded, that the statements from the July 25, 2003 F-10 were materially false and misleading for the reasons alleged in ¶¶231-48.

248. Defendants knew, or recklessly disregarded, that the statements from the July 25, 2003 F-10 regarding Fairfax's total debt, shareholders' equity, and net debt to capitalization ratios were materially false and misleading, because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported shareholder equity and understated its reported debt. Additionally, the Company's reported debt was understated because the Company deceptively accounted for certain reinsurance contracts under the reinsurance accounting method rather than deposit accounting method. Under the proper accounting method, reinsurance contracts which did not involve a sufficient transfer of risk should have been accounted for as financing rather than reinsurance thereby increasing Fairfax's reported debt. Moreover, the statements concerning Fairfax's reserves were materially false and misleading because Defendants knew or were reckless in not knowing that Fairfax and its subsidiaries used reinsurance contracts that did not involve a sufficient transfer of risk to manipulate Fairfax's financial results.

The Second Quarter 2003 Press Release

249. On July 31, 2003, Fairfax issued a press release announcing its financial results for the second quarter and first six months of 2003. In the second quarter 2003 press release, Fairfax reported total revenue for three months ended June 30, 2003, as $2,284.3 million CAD, EBIT and non-controlling interests as $462.1 million CAD, net earnings as $246.2 million CAD and net earnings per share as $17.15 CAD. For the first six months of 2003, Fairfax reported total revenue as $4,316.3 million CAD, EBIT and non-controlling interests as $719.5 million CAD, net earnings as $400.8 million CAD and net earnings per share as $27.75 CAD.

250. The second quarter 2003 press release and Fairfax's interim report for the six months ended June 30, 2003, were filed with the SEC as exhibits to Form 6-K on August 1, 2003 ("August 1, 2003 6-K"). The August 1, 2003 6-K repeated the financial figures from the second quarter 2003 press release and also reported shareholders' equity as $3,494 million CAD (under U.S. GAAP) and book value per share as $234.73 million CAD (under U.S. GAAP) as of June 30, 2003.

251. Defendants knew, or recklessly disregarded, that the statements from the August 1, 2003 6-K and the second quarter 2003 press release concerning the shareholder equity was materially false and misleading because of Fairfax's use of finite reinsurance, which did not involve a sufficient transfer of risk, overstated shareholder equity during the period covered by the August 1, 2003 6-K. Moreover, the Company's restatement also revealed that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated. Further, net earnings, revenue and investment income were overstated because Fairfax inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions.

252. With respect to OdysseyRe, the August 1, 2003 6-K reported the following figures: underwriting profit of $32.7 million CAD; combined ratio of 97.6%; gross premiums written of $1,569.4 million CAD; net premiums written of $1,504.2 million CAD; net premiums earned of $1,352.4 million CAD; operating income of $65.8 million CAD; realized gains of $223.8 million CAD; and pre-tax income of $342.5 million CAD. In commenting on the results, the Company stated:

> The reinsurance group produced an excellent underwriting profit in the second quarter. Its combined ratio for the three months ended June 30, 2003 decreased to 96.1% compared to 98.8% last year demonstrating continued disciplined commitment to underwriting profitability and opportunistic portfolio growth. Net premiums written increased by 40.0% in the second quarter of 2003 compared to 2002 as insurance and reinsurance market conditions continued to improve on a global basis, providing the key factor for growth. Premium growth in North America was due mainly to increased pricing both at the insurance and reinsurance levels while premium growth in the Euro Asia division reflected opportunities capitalizing on competitor withdrawals, particularly in Europe. . . .

253. Defendants knew, or recklessly disregarded, that the statements from the August 1, 2003 6-K concerning OdysseyRe were materially false and misleading because, as the Company has now admitted (through OdysseyRe's restatement), OdysseyRe's reported financial results were misstated because they "[included] accounting errors associated with certain reinsurance contracts entered into by [OdysseyRe] . . . between 1998 and 2004."

The August 11, 2003 Prospectus

254. On August 11, 2003, the Company filed a base shelf prospectus relating to the securities registered by the July 25, 2003 F-10 (the "August 11, 2003 Prospectus"). The August 11, 2003 Prospectus incorporated by reference, *inter alia*, the 2002 Annual Report and financial results for the second quarter and first six months of 2003.

255. Defendants knew, or recklessly disregarded, that the statements from the August 11, 2003 Prospectus, were materially false and misleading for the reasons set forth in ¶¶231-48, 256-60.

The Third Quarter 2003 Press Release

256. On October 31, 2003, Fairfax issued a press release announcing its financial results for the third quarter and first nine months of 2003. In the third quarter 2003 press release, Fairfax stated that the Company "continued to produce excellent underwriting performance in the 2003 third quarter." The Company also reported total revenue for three months ended September 30, 2003, as $1,641.9 million CAD, EBIT and non-controlling interests as $3.2 million CAD, net earnings as ($20 million) CAD and net earnings per share as ($1.67) CAD. For the first nine months of 2003, Fairfax reported total revenue as $5,958.2 million CAD, EBIT and non-controlling interests as $722.7 million CAD, net earnings as $380.8 million CAD and net earnings per share as $26.08 CAD.

257. The third quarter 2003 press release and Fairfax's interim report for the nine months ended September 30, 2003, were filed with the SEC as exhibits to Form 6-K on November 3, 2003 ("November 3, 2003 6-K"). The November 3, 2003 6-K repeated the financial figures from the third quarter 2003 press release and also reported shareholders' equity as $3,421.9 million CAD (under U.S. GAAP) and book value per share as $231.37 million CAD (under U.S. GAAP) as of September 30, 2006.

258. Defendants knew, or recklessly disregarded, that the statements from the third quarter 2003 press release and the statements in the November 3, 2003 6-K release concerning shareholder equity were materially false and misleading because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported shareholder equity during the period covered by the November 3, 2003 6-K. Moreover, the Company's restatement also admitted that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP covered by these statements were overstated. Further, net earnings, revenue and investment income were overstated because Fairfax inappropriately valued

privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions.

259. With respect to OdysseyRe, the November 3, 2003 6-K reported the following figures for the three months ended September 30, 2003: underwriting profit of $25.4 million CAD; combined ratio of 96.5%; gross premiums written of $892.4 million CAD; net premiums written of $820.6 million CAD; net premiums earned of $724.1 million CAD; operating income of $59.8 million CAD; realized gains of $30.1 million CAD; and pre-tax income of $89.9 million CAD. In commenting on the results, the Company stated:

> The reinsurance group produced an excellent underwriting profit in the third quarter. Its combined ratio for the three months ended September 30, 2003 decreased to 96.5%, including catastrophe losses of approximately $35.9 (US$26.0), compared to 99.9% last year. The company demonstrates a continued disciplined commitment to underwriting profitability and opportunistic portfolio growth. In U.S. dollars, net premiums written in the third quarter of 2003 increased by 38.6% over 2002 as insurance and reinsurance market conditions continued to improve on a global basis. Premium growth in North America was due to increased pricing both at the insurance and reinsurance levels, while premium growth in the Euro Asia division reflected increased opportunities due to catastrophe losses, competitor withdrawals and asset impairments, particularly in Europe. . . .

260. Defendants knew, or recklessly disregarded, that the statements from the November 3, 2003 6-K concerning OdysseyRe were materially false and misleading because, as the Company has now admitted (through OdysseyRe's restatement), OdysseyRe's reported financial results were misstated because they "[included] accounting errors associated with certain reinsurance contracts entered into by [OdysseyRe] . . . between 1998 and 2004."

Fairfax Announces Financial Results for 2003

261. On February 6, 2004, Fairfax issued its financial results for the three months and year ended December 31, 2003 (the "February 6, 2004 Press Release"). The February 6, 2004 Press Release was filed with the SEC on Form 6-K on February 9, 2004 and stated:[5]

> Fairfax Financial Holdings Limited announces that it earned US$271.1 million in 2003, the ***largest annual profit in its history***. Other 2003 operating highlights were as follows:
>
> * * *
>
> • Realized gains on investments in 2003 totalled US$845.9 million compared to US$469.5 million in 2002.
>
> * * *
>
> • Common shareholders' equity per basic share increased by 29.1% to US$192.81 at December 31, 2003 from US$149.31 at the end of 2002. Total common shareholders' equity increased to US$2.7 billion at December 31, 2003 from US$2.1 billion at December 31, 2002.
>
> * * *
>
> • At December 31, 2003, TIG met the three financial tests necessary to permit the release of securities from the trust established in connection with the reorganization of TIG at the end of 2002, subject to California regulatory approval.

(Emphasis added.)

262. The Company reported total revenue, net earnings and net earnings per share as $1,575.4 million, $6.6 million and $0.51, respectively for the fourth quarter of 2003. For all of 2003, the Company reported total revenue as $5,713.9 million, net earnings as $271.1 million and net earnings per share as $18.55. Fairfax reported the following under U.S. GAAP for 2003:

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[5] The February 6, 2004 Press Release states, "As the majority of the company's operations are in the United States or conducted in U.S. dollars, effective December 31, 2003, the [C]ompany is reporting its consolidated financial statements in U.S. dollars, in order to provide more meaningful information to its financial statement users. Consequently, throughout this release, amounts are expressed in U.S. dollars and (except per share amounts) in $ millions, unless otherwise indicated. . . ."

net earnings of $104.3 million, net earnings per share of $6.66 and shareholders' equity of $2,462.9 million.

263. Defendants knew, or recklessly disregarded, that the statements from the February 6, 2004 Press Release concerning the Company's assets, liabilities and shareholder equity were materially false and misleading because of Fairfax's use of finite reinsurance, which did not involve a sufficient transfer of risk, overstated the Company's reported assets and shareholder equity. Moreover, the Company's restatement also revealed that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated in the periods covered by the statements. Additionally, the Company's assets were overstated and its liabilities were understated because the Company deceptively accounted for certain reinsurance contracts under the reinsurance accounting method rather than deposit accounting method. Under the proper accounting method, reinsurance contracts which did not involve a sufficient transfer of risk should have been accounted for as financing rather than reinsurance, which would have increased liabilities and decreased assets because reinsurance receivables would decrease. Further, the Company's earnings were overstated because Fairfax inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions.

264. Referring to OdysseyRe's performance the Company stated:

> OdysseyRe produced an excellent underwriting profit in 2003. Its combined ratio for the year improved to 96.9%, compared to 99.1% last year. The company demonstrates a continued disciplined commitment to underwriting profitability and opportunistic portfolio growth. Net premiums written in 2003 increased by 32.0% over 2002 as insurance and reinsurance market conditions continued to improve on a global basis. Premium growth in North America was due to increased pricing both at the insurance and reinsurance levels, while premium growth in the Euro Asia division reflected increased opportunities due to catastrophe losses, competitor withdrawals and asset impairments, particularly in Europe.

265. Defendants knew, or recklessly disregarded, that the statements from the February 6, 2004 Press Release concerning OdysseyRe were materially false and misleading because, as the Company has now admitted (through OdysseyRe's restatement), OdysseyRe's reported financial results were misstated because they "[included] accounting errors associated with certain reinsurance contracts entered into by [OdysseyRe] . . . between 1998 and 2004."

The February 17, 2004 Prospectus Supplement

266. On February 17, 2004, the Company filed a prospectus supplement relating to the securities registered by the July 25, 2003 F-10 (the "February 17, 2004 Prospectus"). The February 17, 2004 Prospectus incorporated by reference, *inter alia*, 2002 Annual Report and the financial results for the first nine months of 2003. The February 17, 2004 Prospectus also attached the February 6, 2004 Press Release.

267. Defendants knew, or recklessly disregarded, that the statements incorporated into the February 17, 2004 Prospectus, were materially false and misleading for the reasons set forth ¶¶231-48, 263-67-, 268-72.

The 2003 Annual Report

268. On March 10, 2004, the Company filed its annual report for the year ended December 31, 2003, as an exhibit to Form 6-K ("2003 Annual Report"),[6] which repeated the financial figures from the February 6, 2004 Press Release.

269. Included in the 2003 Annual Report was a letter to shareholders signed by Watsa, which stated:

> 2003 was a very gratifying year as we earned the ***highest profit in our history*** and achieved a combined ratio of 97.6% at our ongoing insurance and reinsurance operations, in spite of some external pressures. We made a 10.9% return on average shareholders' equity in 2003 (compared to about 11.2% for the S&P/

[6] All figures in the 2003 Annual Report are reported in USD.

> TSX and about 12.8% for the S&P 500). In 2003, our first year of U.S. dollar reporting, we earned $271.1 million or $18.55 per share compared to $263.0 million or $18.20 per share in 2002 (all dollar amounts in this letter are U.S. dollars unless noted otherwise). Book value per share increased 29.1% to $192.81 (aided significantly by the strong Canadian dollar) while our share price increased 127% to $174.51 from $77.01 at year-end 2002. And we accomplished all this while not deviating from our guiding principles, which we have again reproduced in Appendix A.
>
> Our record results in 2003 again came from excellent underwriting and investment performance. . . .

(Emphasis added.)

270. Watsa's statements were materially false and misleading because Watsa knew that Fairfax used finite reinsurance, which did not involve a sufficient transfer of risk, to overstate the Company's assets and reported shareholder equity while understating liabilities. Accordingly, Fairfax's historical profits were based on, in part, its improper use of finite reinsurance contracts. Further, net earnings and revenue were overstated because Fairfax inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions.

271. The 2003 Annual Report also stated:

> The company reflects third party reinsurance balances on the balance sheet on a gross basis to indicate the extent of credit risk related to third party reinsurance and its obligations to policyholders and on a net basis in the statement of earnings to indicate the results of its retention of premiums written.
>
> In order to control the company's exposure to loss from adverse development of reserves or reinsurance recoverables on pre-acquisition reserves of companies acquired or from future adverse development on long tail latent or other potentially volatile claims, and to protect capital, the company obtains vendor indemnities or purchases excess of loss reinsurance protection from reinsurers. For excess of loss reinsurance treaties (other than vendor indemnities), the company generally pays the reinsurer a premium as losses from adverse development are ceded under the treaty. The company records both the premium charge and the related reinsurance recovery in its consolidated statement of earnings in the period in which the adverse development is ceded to the reinsurer.

272. Defendants knew, or recklessly disregarded, that the statements concerning third party reinsurance balances were materially false and misleading because Fairfax employed finite reinsurance contracts, which did not involve a sufficient transfer of risk, during the period covered by these statements. Accordingly, Fairfax's reinsurance balances included contracts that should have been accounted for under the deposit method rather than receiving reinsurance treatment.

273. Fairfax also reported $25,539.6 million for total assets and shareholders' equity of $2,462.9 million under U.S. GAAP in the 2003 Annual Report.

274. Defendants knew, or recklessly disregarded, that the statements from the 2003 Annual Report concerning the Company's assets and shareholder equity were materially false and misleading because of Fairfax's use of finite reinsurance, which did not involve a sufficient transfer of risk. Fairfax's improper accounting for these contracts overstated the Company's reported assets and shareholder equity.

275. The Company also reported net investment income as $1,176.0 million.

276. The Company's investment income figure was overstated because Fairfax used off-shore investment vehicles where directors were permitted to value investment income at their discretion as a means to inflate its financial appearance.

277. With respect to OdysseyRe, Fairfax stated:

> OdysseyRe produced an excellent underwriting profit in 2003. Its combined ratio in 2003 improved to 96.9%, compared to 99.1% last year and 115.4% in 2001. The company demonstrated a continued disciplined commitment to underwriting profitability and opportunistic portfolio growth. Net premiums written in 2003 increased by 32.0% over 2002 as insurance and reinsurance market conditions continued to improve on a global basis. Premium growth in North America was due to increased pricing both at the insurance and reinsurance levels, while premium growth in the Euro Asia division reflected increased opportunities due to catastrophe losses, competitor withdrawals and asset impairments, particularly in Europe. Cash flow from operations at OdysseyRe improved to $554.1 in 2003 from $214.2 in 2002.

278. Defendants knew, or recklessly disregarded, that the statements from the 2003 Annual Report concerning OdysseyRe were materially false and misleading because, as the Company has now admitted (through OdysseyRe's restatement), OdysseyRe's reported financial results were misstated because they "[included] accounting errors associated with certain reinsurance contracts entered into by [OdysseyRe] . . . between 1998 and 2004."

279. The Company's "Guiding Principles," attached as Appendix A to the 2003 Annual Report stated, "We provide complete disclosure annually to our shareholders."

280. Defendants knew, or recklessly disregarded, that the statements from the 2003 Annual Report concerning Fairfax's "complete" disclosure to shareholders were materially false and misleading because the Defendants knew or were reckless in not knowing that Fairfax and its subsidiaries used reinsurance contracts that did not involve a sufficient transfer of risk to manipulate Fairfax's financial results. The improper use of such contracts overstated assets and shareholder equity while understating liabilities. Investors did not learn about Fairfax's improper use of finite reinsurance contracts until 2006. Accordingly, Fairfax's statement that the Company provided shareholders complete disclosures was false.

281. The 2003 Annual Report also included a signed certifications from PWC giving the Company a "clean audit," which certified:

> We have audited the consolidated balance sheets of Fairfax Financial Holdings Limited as at December 31, 2003 and 2002 and the consolidated statements of earnings, retained earnings and cash flows for each of the years in the three year period ended December 31, 2003. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.
>
> We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

> In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2003 in accordance with Canadian generally accepted accounting principles.

282. PWC knew, or recklessly disregarded, that its statements in the 2003 Annual Report were materially false and misleading. As evidenced by Fairfax's restatement, the financial reports covered by PWC's "clean audit" opinion were materially false and required restating. Moreover, as admitted by Fairfax and as disclosed by several confidential sources Fairfax did not maintain effective controls during the time period covered by PWC's "clean audit."

The March 10, 2004 Supplemental Prospectus

283. On March 10, 2004, the Company filed a prospectus supplement relating to the securities registered by the July 25, 2003 F-10 (the "March 10, 2004 Supplemental Prospectus"). The March 10, 2004 Supplemental Prospectus incorporated by reference, *inter alia*, the MD&A discussion from the 2003 Annual Report.

284. Defendants knew, or recklessly disregarded, that the statements incorporated into the March 10, 2004 Supplemental Prospectus, were materially false and misleading for the reasons set forth in ¶¶275-89.

The 2004 Proxy

285. On March 17, 2004, Fairfax filed the Management Proxy Circular on Form 6-K with the SEC (the "2004 Proxy"), which stated:

> Fairfax has, since current management acquired control in 1985, clearly stated the following principles with respect to its structure, objectives and manner of operating:
>
> – The Corporation's focus is on earning a superior return on shareholders' equity over the long term, at the expense of short term profits if necessary, so as to achieve long term growth in book value per share. This can only be achieved if Fairfax and its subsidiaries are operated for the long term benefit of customers, employees and shareholders.

> – The Corporation should always be soundly financed.
>
> *   *   *
>
> – Honesty, integrity and good faith are essential in all of Fairfax's relationships and dealings. Internally, the hallmark of Fairfax's people is that they are non-political team players.
>
> – While being entrepreneurial in pursuing opportunities, Fairfax emphasizes downside protection and the minimization of the risk of capital loss: the Corporation will not be jeopardized by any one project.
>
> – Annual disclosure to the shareholders will be complete, detailed, straightforward and balanced. Beyond this and all requisite disclosure, comment to the media is rarely necessary and other publicity is not constructive: Fairfax believes that results ultimately prevail. However, in fairness to its shareholders and investors, after each release of quarterly or annual financial results, Fairfax holds a conference call to discuss those results.

286. The Company further stated, "The Corporation regards the first value in its longstanding and regularly repeated Guiding Principles – 'Honesty and integrity are essential in all our relationships and will never be compromised' – as its code of ethics. Given the inviolability of this value and the structures and manners of operating described above, the Corporation believes that this simple but all-encompassing statement, without detailed elaboration, is a sufficient code."

287. Fairfax further declared:

> As noted above, Mr. Watsa has a fixed salary with no bonus or other profit participation and no grant of stock incentives. Any stock incentive granted to other management is regarded as long term: such grants are made infrequently, are not intended to be replaced and are expected to be held, not traded. This is consistent with the Corporation's policy to focus on the long term and not to provide financial forecasts or earnings guidance. ***Further, the Corporation does not engage in transactions in which Mr. Watsa, any other of its executives or any member of their families has a personal interest***.

(Emphasis added.)

288. The Defendants knew, or recklessly disregarded, that the Company's statement stating "the Corporation does not engage in transactions in which Mr. Watsa, [or] any other of its executives or any member of their families has a personal interest" was materially false and

misleading, because Fairfax, from 1984, used Hamblin Watsa to provide Fairfax and its subsidiaries "investment management" services. According, to the Company's Management Proxy Circular (dated March 31, 2006), "[Watsa] has served as Vice President of Hamblin Watsa investment Counsel Ltd. since 1985." Moreover, as stated in the Company's Management Proxy Circular (dated March 1, 2002):

> After the Corporation's acquisition of Hamblin Watsa Investment Counsel Ltd. in late 1992, Mr. Watsa commenced receiving an annual salary of $250,000, but no bonus, from the Corporation. Mr. Watsa continued to receive remuneration from Hamblin Watsa, consisting of a base annual salary of $200,000 and his percentage participation, along with all other Hamblin Watsa executives, in the profit sharing pool available to Hamblin Watsa employees pursuant to a formula established at the time of the Corporation's acquisition of Hamblin Watsa. The pool in any year consisted effectively of one-half of the amount, if any, by which Hamblin Watsa's revenues in the year exceeded its annual revenues in 1992, less any increase in expenses over annual expenses in 1992. Mr. Watsa declined to accept his participation in this pool for 1999. ***Commencing in 2000, Mr. Watsa has agreed that his aggregate compensation from the Corporation and Hamblin Watsa will consist of an annual salary of $600,000, with no bonus or other profit participation***.

(Emphasis added.) Accordingly, part of Watsa's compensation during the time period covered by the 2004 Proxy included compensation he received for his position at Hamblin Watsa.

The March 23, 2004 F-10 and Prospectus

289. On March 23, 2004, Fairfax filed a registration statement, on Form F-10, with the SEC seeking to register up to $222,500,000 senior notes and a prospectus offering to exchange up to $275,000,000 of 7 3/8% notes due 2006 and $170,000,000 of 6 7/8% notes due 2008 (the "March 23, 2004 Prospectus"). The March 23, 2004 Prospectus was signed by Martin, Watsa, Ambridge, Williamson, Bennett and Hartog and included a signed consent letter from PWC permitting the use of their clean audit opinion from the 2003 Annual Report.

290. The purpose of the exchange offer was purportedly "[t]o reduce and refinance a portion of . . . [the Company's] outstanding debt and diversify . . . [the Company's] debt maturity profile consistent with . . . [the Company's] deleveraging plan."

291. In the March 23, 2004 Prospectus Fairfax stated:

> At December 31, 2003, we had cash and invested assets of $12.6 billion, total assets of $25.0 billion and shareholders' equity of $2.9 billion.

292. Defendants knew, or recklessly disregarded, that the statements from the March 23, 2004 Prospectus concerning the Company's assets and shareholder equity were materially false and misleading because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported assets and shareholder equity.

The April 20, 2004 F-10

293. On April 20, 2004, Fairfax filed a registration statement on Form F-10 seeking to register up to $750 million in securities (the "April 20, 2004 F-10"). The April 20, 2004 F-10 was signed by Martin, Watsa, Ambridge, Williamson, Griffiths and Hartog and incorporated by reference several documents including: the audited consolidated financial statements and the notes for the years ended December 31, 2003 and 2002 and earnings, retained earnings and cash flow statements for each of the years in the three year period ended December 31, 2003, together with the report of the auditors thereon; management's discussion and analysis for the annual consolidated financial statements for the years ended December 31, 2003 and 2002; Fairfax's 2004 Proxy (the Company did not incorporate parts of the 2004 Proxy entitled, "Executive Compensation", "Performance Graph" and "Statement of Corporate Governance Practices"). The April 20, 2004 F-10 also included a signed letter by PWC consenting to the use of their "clean audit" opinions included with the 2003 Annual Report.

294. Defendants knew, or recklessly disregarded, that the statements incorporated into the April 20, 2004 F-10, including the 2002 Annual Report, the 2003 Annual Report and the 2004 Proxy were materially false and misleading, for the reasons set forth in ¶¶231-48, 275-89, 292-95.

The First Quarter 2004 Press Release and Interim Report

295. On April 29, 2004, Fairfax issued a press release announcing its financial results for the first quarter of 2004. The April 29, 2004, press release and the first interim report for the three months ended March 31, 2004 (the "First Quarter 2004 Report") were filed as exhibits to Form 6-K on April 30, 2004. In the April 29, 2004 press release, Fairfax reported total revenue for three months ended March 31, 2004, as $1,484.8 million, EBIT and non-controlling interests as $82.4 million, net earnings as $39.5 million and net earnings per share as $2.63. Fairfax also stated:

> Fairfax Financial Holdings Limited continued to produce excellent underwriting performance in the 2004 first quarter. The combined ratio of its insurance and reinsurance operations was 95.7% for the quarter, with every operating company producing a combined ratio below 100%, compared to a combined ratio of those operations of 98.2% for the first quarter of 2003.

296. The First Quarter 2004 Report also reported assets as $24,733.5 million, liabilities as $19,075.8 million and shareholders' equity as $2,923.3 million. Under U.S. GAAP, Fairfax reported total assets as $25,295.1 million and shareholders' equity as $2,525.3 million.

297. Defendants knew, or recklessly disregarded, that the statements from the April 29, 2004 press release and the First Quarter 2004 Report concerning the Company's assets and shareholder equity were materially false and misleading because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported assets and shareholder equity. Moreover, the Company's restatement also revealed that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated in the periods covered by the April 29, 2004 press release and the First Quarter 2004 Report. Additionally, the Company's assets were overstated and its liabilities were understated because the Company deceptively accounted for certain reinsurance contracts under the reinsurance accounting method rather than deposit accounting method. Under the proper accounting method, reinsurance contracts which did not involve a sufficient transfer of risk

should have been accounted for as financing rather than reinsurance. Further, net earnings, revenue and investment income were overstated because Fairfax inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions.

298. With respect to OdysseyRe, the First Quarter 2004 Report reported the following figures: underwriting profit of $27.2 million; combined ratio of 95.0%; gross premiums written of $629.5 million; net premiums written of $553.2 million; net premiums earned of $546.3 million; operating income of $63.6 million; realized gains of $13.1 million; and pre-tax income of $76.7 million. In commenting on the results, the Company stated:

> OdysseyRe's combined ratio improved to 95.0% from 99.0% last year, reflecting the impact of prior pricing actions on underwriting profitability. Net premiums written increased by 12.9% in the first quarter of 2004 compared to the first quarter of 2003 as OdysseyRe continued to opportunistically expand in certain classes of business in EuroAsia, the London market and the U.S. insurance segment, while premiums in the Americas division were flat. . . .

299. Defendants knew, or recklessly disregarded, that the statements from the First Quarter 2004 Report concerning OdysseyRe were materially false and misleading because, as the Company has now admitted (through OdysseyRe's restatement), OdysseyRe's reported financial results were misstated because they "[included] accounting errors associated with certain reinsurance contracts entered into by [OdysseyRe] . . . between 1998 and 2004."

The First Quarter 2004 Conference Call

300. On April 30, 2004, Fairfax held a conference call with analysts to discuss the Company's results for the first quarter of 2004 (the "April 30, 2004 Conference Call"). During the April 30, 2004 Conference Call, Watsa highlighted Fairfax's objective to "be rated as investment-grade again."

301. In commenting on Fairfax's push to become an investment grade company and its financial results for the quarter, Watsa stated:

> Next I want to highlight the most important objective that we have today for Fairfax, to be rated as investment-grade again. ***We plan to accomplish this in the old-fashioned way, by producing excellent results and reducing our leverage at the holding company***. . . .
>
> Overall then we are very pleased with our first-quarter. The combined ratio of all our insurance and re insurance operations was 95.7 percent with every operating company producing a combined ratio below 100 percent with conservative reserving. Underwriting profits increased to 44 million from 15 million last year and net premiums written were up approximately 14 percent.

(Emphasis added.)

302. Watsa's statements concerning the way Fairfax planned to accomplish its results were materially false and misleading because Watsa knew that Fairfax used and would continue to use finite reinsurance, which did not involve a sufficient transfer of risk, to overstate the Company's assets and reported shareholder equity while understating liabilities. Further, Watsa also knew that the Company's financial performance (including net earnings, revenue and investment income) was overstated because Fairfax inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions.

303. With respect to OdysseyRe, Watsa stated, "[Fairfax] created OdysseyRe which is a very successful company today."

304. However, Watsa knew, or recklessly disregarded, that his statements concerning OdysseyRe's "success[]" were materially false and misleading because, as the Company has now admitted (through OdysseyRe's restatement), OdysseyRe's reported financial results were misstated because they "[included] accounting errors associated with certain reinsurance contracts entered into by [OdysseyRe] . . . between 1998 and 2004." Moreover, public and

confidential sources revealed that all of OdysseyRe's investment decisions were run through Watsa and that Watsa was the one who decided to reintroduce finite reinsurance contracts into OdysseyRe's portfolio.

The 2003 40-F

305. On May 18, 2004, Fairfax filed, on Form 40-F (or as exhibits thereto): its annual report for the year ended December 31, 2003, the management proxy circular, the audited financial statements and notes, the MD&A, the narrative business description, the consolidated financial summary, PWC's consent, Watsa's and Ambridge's 13a-14(a), 15d-14(a) and Section 1350 certifications and (the "2003 40-F"). The 2003 40-F repeated the financial figures and statements from the February 6, 2004 Press Release, the 2003 Annual Report and the 2004 Proxy. Additionally, in commenting on the Company's internal controls the 2003 40-F reported:

> The Registrant's chief executive officer and its chief financial officer, after evaluating the effectiveness of the Registrant's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this annual report on Form 40-F, have concluded, based upon such evaluation, that the Registrant's disclosure controls and procedures were effective as of the end of such period.

306. The 2003 40-F included signed certifications from Watsa and Ambridge stating:

> 1. I have reviewed this annual report on Form 40-F of Fairfax Financial Holdings Limited;
>
> 2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
>
> 3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this report;
>
> 4. The issuer's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the issuer and have:

> (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
>
> (b) Evaluated the effectiveness of the issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
>
> (c) Disclosed in this report any change in the issuer's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting; and
>
> 5. The issuer's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the issuer's auditors and the audit committee of the issuer's board of directors (or persons performing the equivalent functions):
>
> (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the issuer's ability to record, process, summarize and report financial information; and
>
> (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal control over financial reporting.

307. Watsa and Ambridge also signed certifications under Section 1350 which stated, *inter alia*, "The Annual Report on Form 40-F for the year ended December 31, 2004 (the 'Report') of the Company fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company."

308. The 2003 40-F included a signed consent from PWC permitting the Company to use the clean audit letter appearing in the Company's 2003 Annual Report.

309. Defendants knew, or recklessly disregarded, that the financial statements repeated by the 2003 40-F Report were materially false and misleading for the reasons stated in ¶¶275-89,

268-72, 292-95. Moreover, statements concerning the adequacy of Fairfax's internal controls were made by Fairfax, Watsa and Ambridge either knowingly or with reckless disregard for the truthfulness of such statements. As admitted by the Company and PWC, Fairfax did not maintain appropriate controls between 2001 and 2005. The deficient controls led, in part, to Fairfax restating its financial results for the period covered by the 2003 40-F.

The June 2, 2004 Supplemental Prospectus

310. On June 2, 2004, Fairfax filed a supplemental prospectus to the April 20, 2004 F-10 (the "June 2, 2004 Supplemental Prospectus"). The June 2, 2004 Supplemental Prospectus offered to exchange up to $22,049,000 aggregate principal amount 7 3/4% senior notes due 2012 for up to $22,049,000 aggregate principal amount of registered 7 3/4% senior notes due 2012. The June 2, 2004 Supplemental Prospectus incorporated by reference several documents including: the audited consolidated financial statements and the notes for the years ended December 31, 2003 and 2002 and earnings, retained earnings and cash flow statements for each of the years in the three year period ended December 31, 2003, together with the report of the auditors thereon; management's discussion and analysis for the annual consolidated financial statements for the years ended December 31, 2003 and 2002; Fairfax's 2004 Proxy (the Company did not incorporate parts of the 2004 Proxy entitled, "Executive Compensation", "Performance Graph" and "Statement of Corporate Governance Practices").

311. Defendants knew, or recklessly disregarded, that the documents incorporated into the June 2, 2004 Supplemental Prospectus were materially false and misleading for the reasons stated in ¶¶231-48, 275-89, 292-95.

312. The June 2, 2004 Supplemental Prospectus also reported total debt as $2,392.4 million ($2,493.3 million under U.S. GAAP), shareholders' equity as $2,923.3 million ($2,525.3 million under U.S. GAAP), debt as a percentage of total capitalization as 41.5% (45.6% under

U.S. GAAP) and net debt as a percentage of total capitalization as 36.4% (40.2% under U.S. GAAP).

313. Defendants knew, or recklessly disregarded, that the statements from the June 2, 2004 Supplemental Prospectus regarding Fairfax's total debt, shareholders' equity, total and net debt to capitalization ratios were materially false and misleading, because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported shareholder equity and understated its reported debt. Moreover, the Company's restatement also revealed that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated in the June 2, 2004 Supplemental Prospectus. Further, shareholders' equity was also overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions. Additionally, the Company's reported debt was understated because the Company deceptively accounted for certain reinsurance contracts under the reinsurance accounting method rather than deposit accounting method. Under the proper accounting method, reinsurance contracts which did not involve a sufficient transfer of risk should have been accounted for as financing rather than reinsurance thereby increasing Fairfax's reported debt.

The Second Quarter 2004 Press Release and Interim Report

314. On July 29, 2004, Fairfax issued a press release announcing its financial results for the second quarter of 2004. The July 29, 2004, press release and the second interim report for the six months ended June 30, 2004 (the "Second Quarter 2004 Report") were filed as exhibits to Form 6-K on July 30, 2004. In the July 29, 2004 press release, Fairfax reported total revenue for three months ended June 30, 2004, as $1,435.1 million, EBIT and non-controlling interests as $133.5 million, net earnings as $46 million and net earnings per share as $3.13. Fairfax also stated:

> Fairfax Financial Holdings Limited continued to produce excellent underwriting performance in the 2004 second quarter. The combined ratio of its insurance and reinsurance operations was 94.9% for the quarter, with every operating company producing a combined ratio below 100%, compared to a combined ratio of those operations of 98.5% for the second quarter of 2003.
>
> Other 2004 second quarter highlights were as follows (comparisons are to the second quarter of 2003, except as otherwise indicated):
>
> * * *
>
> Common shareholders' equity per basic share increased to US$196.53 from US$192.81 at December 31, 2003.

315. Defendants knew, or recklessly disregarded, that the statements from the July 29, 2004 press release concerning shareholders' equity were materially false and misleading because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated shareholders' equity. Moreover, the Company's restatement also revealed that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated in the July 29, 2004 press release. Further, the statements regarding the Company's "excellent results" were false and misleading because Fairfax's net earnings, revenue and investment income were overstated because the Company inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions.

316. The Second Quarter 2004 Report, repeated the financial figures from the July 29, 2004 press release and also reported assets as $24,525 million and liabilities as $21,033.4 million. Under U.S. GAAP, Fairfax reported total assets as $24,859.7 million and shareholders' equity as $2,351.2 million.

317. Defendants knew, or recklessly disregarded, that the statements from the Second Quarter 2004 Report concerning shareholders' equity were materially false and misleading because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated shareholders' equity. The Company's restatement also revealed that

Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated in the Second Quarter 2004 Report. Moreover, Defendants knew, or recklessly disregarded, that the statements from the Second Quarter 2004 Report concerning the Company's assets were materially false and misleading because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported assets. Additionally, the Company's liabilities were understated because the Company deceptively accounted for certain reinsurance contracts under the reinsurance accounting method rather than deposit accounting method. Under the proper accounting method, reinsurance contracts which did not involve a sufficient transfer of risk should have been accounted for as financing rather than reinsurance.

318. With respect to OdysseyRe, the Second Quarter 2004 Report reported the following figures: underwriting profit of $31.1 million; combined ratio of 94.6%; gross premiums written of $612.0 million; net premiums written of $550.1 million; net premiums earned of $580.1 million; operating income of $66.0 million; realized gains of $30.4 million; and pre-tax income of $96.4 million. In commenting on the results, the Company stated:

> OdysseyRe's combined ratio improved in the second quarter to 94.6% from 96.2% last year, reflecting the impact of prior pricing actions on underwriting profitability and extremely strong results from the EuroAsia division and London market. Net premiums written remained flat in the second quarter of 2004 compared to the second quarter of 2003 as OdysseyRe continued to expand in certain classes of business in EuroAsia and the U.S. insurance segment, while premiums in the Americas division (primarily U.S. treaty business) and the London market declined. . . .

319. With respect to the Company's insurance and reinsurance companies, Fairfax stated, "Operating results at the company's insurance and reinsurance companies have been improving as a result of company efforts and the favourable insurance environment (which is now moderating). Apart from reserve strengthenings which have occurred, individual quarterly

results have been (and will continue to be) significantly impacted by realized gains (or losses), the timing of which is not predictable."

320. Defendants knew, or recklessly disregarded, that the statements from the Second Quarter 2004 Report concerning OdysseyRe and Fairfax's insurance and reinsurance companies were materially false and misleading because, as the Company has now admitted (through OdysseyRe's restatement), OdysseyRe's reported financial results were misstated because they "[included] accounting errors associated with certain reinsurance contracts entered into by [OdysseyRe] . . . between 1998 and 2004." Moreover, the statements concerning OdysseyRe's "reserve strengthenings" were materially false and misleading because the Defendants knew or were reckless in not knowing that OdysseyRe used reinsurance contracts that did not involve a sufficient transfer of risk to manipulate Fairfax's financial results.

The Second Quarter 2004 Conference Call

321. On July 30, 2004, Fairfax held a conference call with analysts to discuss the Company's results for the second quarter of 2004 (the "July 30, 2004 Conference Call"). During the July 30, 2004 Conference Call, Watsa highlighted Fairfax's reported financial figures for the second quarter of 2004 and stated that "we were very pleased with our second quarter." In response to a question from an analyst about Fairfax's underwriting business, Watsa stated that the "possibilities for underwriting profits are still significant."

322. With respect to the Company's efforts to become investment grade, Watsa stated:

> Finally, I wanted to highlight the most important objective that we have for Fairfax; to be rated as investment grade again. We plan to accomplish this as I said last quarter in the old-fashioned way, by producing excellent results and reducing our leverage at the holding company.

323. Watsa's statements concerning the way Fairfax planned to accomplish its results and the Company results were materially false and misleading because Watsa knew that Fairfax used and would continue to use finite reinsurance, which did not involve a sufficient transfer of

risk, to overstate the Company's assets and reported shareholder equity while understating liabilities.

The August 25, 2004 Supplemental Prospectus

324. On August 25, 2004, Fairfax filed a supplemental prospectus to the April 20, 2004 F-10 (the "August 25, 2004 Supplemental Prospectus"). The August 25, 2004 Supplemental Prospectus offered $95 million aggregate principal amount of 7 3/4% senior notes due 2012. The August 25, 2004 Supplemental Prospectus incorporated by reference several documents including: the audited consolidated financial statements and the notes for the years ended December 31, 2003 and 2002 and earnings, retained earnings and cash flow statements for each of the years in the three year period ended December 31, 2003, together with the report of the auditors thereon; management's discussion and analysis for the annual consolidated financial statements for the years ended December 31, 2003 and 2002; Fairfax's 2004 Proxy (the Company did not incorporate parts of the 2004 Proxy entitled, "Executive Compensation", "Performance Graph" and "Statement of Corporate Governance Practices"); and Fairfax's interim consolidated financial statements accompanying notes for the six-month periods ended June 30, 2004 and 2003.

325. The August 25, 2004 Supplemental Prospectus repeated the financial information from the July 29, 2004 press release.

326. The August 25, 2004 Supplemental Prospectus also reported total debt as $2,345.3 million ($2,446.6 million under U.S. GAAP), shareholders' equity as $2,955.8 million ($2,351.2 million under U.S. GAAP), debt as a percentage of total capitalization as 40.2% (45.9% under U.S. GAAP) and net debt as a percentage of total capitalization as 36.9% (42.6% under U.S. GAAP).

327. Defendants knew, or recklessly disregarded, that the statements incorporated into the August 25, 2004 Supplemental Prospectus, including the 2002 Annual Report, the 2003 Annual Report, the 2004 Proxy and the July 29, 2004 press release were materially false and misleading, for the reasons set forth in ¶¶231-48, 275-89, 292-95, 321-27.

328. Defendants knew, or recklessly disregarded, that the statements from the August 25, 2004 Supplemental Prospectus regarding Fairfax's total debt, shareholders' equity, total and net debt to capitalization ratios were materially false and misleading, because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported shareholder equity and understated its reported debt. Moreover, the Company's restatement also revealed that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated in the August 25, 2004 Supplemental Prospectus. Additionally, the Company's reported debt was understated because the Company deceptively accounted for certain reinsurance contracts under the reinsurance accounting method rather than deposit accounting method. Under the proper accounting method, reinsurance contracts which did not involve a sufficient transfer of risk should have been accounted for as financing rather than reinsurance thereby increasing Fairfax's reported debt.

The Third Quarter 2004 Press Release and Interim Report

329. On October 28, 2004, Fairfax issued a press release announcing its financial results for the third quarter of 2004. The October 28, 2004, press release and the third interim report for the nine months ended September 30, 2004 (the "Third Quarter 2004 Report") were filed as exhibits to Form 6-K on October 29, 2004. In the October 28, 2004 press release, Fairfax reported total revenue for three months ended September 30, 2004, as $1,418.4 million, EBIT and non-controlling interests as ($115.3) million, net earnings as ($108.9) million and net earnings per share as ($8.08).

330. The Third Quarter 2004 Report, repeated the financial figures from the October 28, 2004, press release and also reported assets as \$25,680.6 million, portfolio investments as \$13,616.1 million, liabilities as \$19,055.8 million and shareholders' equity as \$2,863.9 million. Under U.S. GAAP, Fairfax reported net earnings as (\$90.7) million, net earnings per share as (\$6.76), total assets as \$26,009.6 million and shareholders' equity as \$2,279.6 million.

331. Defendants knew, or recklessly disregarded, that the statements from the October 28, 2004 press release and the Third Quarter 2004 Report concerning the Company's assets and shareholder equity were materially false and misleading because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported assets and shareholder equity. Moreover, the Company's restatement also revealed that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated in the periods covered by the statements. Further, net earnings, revenue and investment income were overstated because Fairfax inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions. Additionally, the Company's assets were overstated and its liabilities were understated because the Company deceptively accounted for certain reinsurance contracts under the reinsurance accounting method rather than deposit accounting method. Under the proper accounting method, reinsurance contracts which did not involve a sufficient transfer of risk should have been accounted for as financing rather than reinsurance.

332. With respect to OdysseyRe, the Third Quarter 2004 Report reported the following figures: underwriting profit of (\$44.6) million; combined ratio of 107.7%; gross premiums written of \$754.2 million; net premiums written of \$671.2 million; net premiums earned of

$580.3 million; operating income of $2.3 million; realized gains of $20.2 million; and pre-tax income of $22.5 million. In commenting on the results, the Company stated:

> OdysseyRe's combined ratio of 107.7% in the third quarter (92.8% excluding the $85.7 of losses from the third quarter hurricanes), as compared to 96.5% in 2003, reflects the impact of prior pricing actions on underwriting profitability and strong results from the EuroAsia division and the London market, offset by the effect of the third quarter hurricanes. Net premiums written increased 15.3% in the third quarter of 2004 compared to 2003 as OdysseyRe continued to expand in certain classes of business in EuroAsia, the London market and the U.S. insurance segment, while premiums in the Americas division (primarily U.S. treaty business) declined. OdysseyRe's cash flow from operations for the third quarter and first nine months of 2004 was $226.5 and $458.3 respectively as compared to $126.7 and $258.3 for the third quarter and first nine months respectively of 2003. . . .

333. Defendants knew, or recklessly disregarded, that the statements from the Third Quarter 2004 Report concerning OdysseyRe were materially false and misleading because, as the Company has now admitted (through OdysseyRe's restatement), OdysseyRe's reported financial results were misstated because they "[included] accounting errors associated with certain reinsurance contracts entered into by [OdysseyRe] . . . between 1998 and 2004."

Fairfax Explains Its Need for More Capital

334. On October 28, 2004, Fairfax announced plans to issue $300 million of subordinate voting shares (2,406,741 shares) to a number of institutional investors, including Markel Corporation ($100 million) and Southeastern Asset Management ($150 million) (the "$300 Million Offering Press Release"). In commenting on the issuance, Watsa stated:

> Fairfax is raising significant equity at this time because of its high priority of improving its ratings and deleveraging significantly. A strong financial position with cash in excess of $600 million after this issue is the best way to handle uncertainty in our industry and in the economy generally. So when Steven Markel, Vice Chairman of Markel Corporation, with one of the best insurance company track records, and Mason Hawkins, founding partner of Southeastern Asset Management, one of our largest shareholders with one of the best investment track records, offered to buy shares, we took advantage of the opportunity.
>
> The significant flexibility that this equity issue provides the holding company, together with the disciplined underwriting operations that we have built, our

> runoff expertise and our investment acumen, will allow us to recoup the 5% dilution to book value quite easily.

335. Defendants knew, or recklessly disregarded, that the statements from the $300 Million Offering Press Release were materially false and misleading, because the Defendants needed an infusion of cash not to continue Fairfax's deleveraging plan or improve the Company's ratings but to mask its poor financial health.

The October 28, 2004 Supplemental Prospectus

336. On October 28, 2004, Fairfax filed a supplemental prospectus to the April 20, 2004 F-10 (the "October 28, 2004 Supplemental Prospectus"). The October 28, 2004 Supplemental Prospectus offered 2,406,741 subordinate voting shares in the United States and in Ontario and British Columbia. The October 28, 2004 Supplemental Prospectus stated that, "We [Fairfax] have applied to list the Subordinate Voting Shares sold by us under this prospectus supplement on the Toronto Stock Exchange and the New York Stock Exchange."

337. The October 28, 2004 Supplemental Prospectus incorporated by reference several documents including: the audited consolidated financial statements and the notes for the years ended December 31, 2003 and 2002 and earnings, retained earnings and cash flow statements for each of the years in the three year period ended December 31, 2003, together with the report of the auditors thereon; management's discussion and analysis for the annual consolidated financial statements for the years ended December 31, 2003 and 2002; Fairfax's 2004 Proxy (the Company did not incorporate parts of the 2004 Proxy entitled, "Executive Compensation", "Performance Graph" and "Statement of Corporate Governance Practices"); and Fairfax's interim consolidated financial statements accompanying notes for the six-month periods ended June 30, 2004 and 2003.

338. The October 28, 2004 Supplemental Prospectus also reported total debt as $2,401 million ($2,500.8 million under U.S. GAAP) and shareholders' equity as $2,863.9 million ($5,279.6 million under U.S. GAAP).

339. Defendants knew, or recklessly disregarded, that the statements incorporated into the October 28, 2004 Supplemental Prospectus, including the 2002 Annual Report, the 2003 Annual Report, the 2004 Proxy and the July 29, 2004 press release were materially false and misleading, for the reasons set forth in ¶¶231-48, 275-89, 292-95, 321-27.

340. Defendants knew, or recklessly disregarded, that the statements from the August 25, 2004 Supplemental Prospectus regarding Fairfax's total debt and shareholders' equity were materially false and misleading, because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported shareholder equity and understated its reported debt. Moreover, the Company's restatement also revealed that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated in the October 28, 2004 Supplemental Prospectus.

The Third Quarter 2004 Conference Call

341. On October 29, 2004, Fairfax held a conference call with analysts to discuss the Company's results for the third quarter of 2004 (the "October 29, 2004 Conference Call"). During the October 29, 2004 Conference Call, Watsa stated:

> Excluding the hurricane losses our combined ratio was 89.9% approximately 90% for the third quarter and 93.4% for the first nine months compared to 96.5% and 97.7% respectfully for the 2003 third quarter and nine months. ***So the trend in our underwriting results continues to be excellent***. Underwriting profits excluding these hurricanes losses would be in a record $206 million for the first nine months of 2004.
>
> Aggregate cash flow from operations for our insurance-reinsurance business was $460 million for the third quarter and $790 million for the nine months. It is important to note that each of our underwriting companies, even after the unusual hurricane activity continued to be well capitalized, with capital well in excess of the underlying ratings.

(Emphasis added.)

342. Ambridge also participated in the call and reported Fairfax's financial results. Specifically, Ambridge stated:

> Cash flow of the operating companies Northbridge, Crum & Forster, and OdysseyRe continues to be strong at 460 million for the quarter and 790 million year-to-date. For runoff for the quarter and for the 9 months ended September 30, 2004, the runoff loss excluding inter-company investment gain and the commutation loss were 17.9 million and 73.2 million respectively within previously disposed targets. Over the past several years, Fairfax has made significant progress in simplifying it's structure and making it's results more transparent to investors with the [IPO's] of OdysseyRe and Northbridge and the public issue of Crum & Forster notes.

343. Following Ambridge, Watsa stated:

> Just summing up then, insurance and reinsurance operations with annualized net written premiums in excess of 4.5 billion -- very disciplined underwriting company and continued to produce significant underwriting profits with combine ratios well below 100%. Our investment portfolio in excess of 12 billion is very well positioned to take advantage of opportunities.

344. Watsa and Ambridge knew, or recklessly disregarded, that the statements from the October 29, 2004 Conference Call were materially false and misleading, because the Defendants knew, or recklessly disregarded, that their statements concerning the reinsurance line and OdysseyRe's performance were materially false and misleading because, as the Company has now admitted (through OdysseyRe's restatement), that OdysseyRe's reported financial results were misstated. OdysseyRe's reported results "[included] accounting errors associated with certain reinsurance contracts entered into by [OdysseyRe] . . . between 1998 and 2004." Moreover, as disclosed by Fairfax in the Company's restatement, OdysseyRe's restatement had the effect of reducing shareholder equity in 2004 and 2005. Moreover, public and confidential sources revealed that all of OdysseyRe's investment decisions were run through Watsa and that Watsa was the one who decided to reintroduce finite reinsurance contracts into OdysseyRe's portfolio. Further, Watsa's and Ambridge's statements regarding the Company's performance were false and misleading because the performance the Company's net earnings, revenue and

investment income were overstated because Fairfax inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions.

The October 29, 2004 6-K

345. On October 29, 2004, Fairfax filed, as an exhibit to Form 6-K, a press release issued the previous day which announced the issuance of $300 million in subordinate voting shares (the "October 29, 2004 6-K"). In the press release, Fairfax stated:

> Fairfax Financial Holdings Limited has agreed to issue $300 million of subordinate voting shares (2,406,741 shares) to a number of institutional investors, including Markel Corporation ($100 million) and Southeastern Asset Management ($150 million), at today's closing price of $124.65 per share. Fairfax intends to use the proceeds of this issue to purchase or redeem outstanding indebtedness from time to time, based on market conditions, and for general corporate purposes.
>
> * * *
>
> Prem Watsa, CEO of Fairfax, commented: "Fairfax is raising significant equity at this time because of its high priority of improving its ratings and deleveraging significantly. A strong financial position with cash in excess of $600 million after this issue is the best way to handle uncertainty in our industry and in the economy generally. So when Steven Markel, Vice Chairman of Markel Corporation, with one of the best insurance company track records, and Mason Hawkins, founding partner of Southeastern Asset Management, one of our largest shareholders with one of the best investment track records, offered to buy shares, we took advantage of the opportunity.
>
> The significant flexibility that this equity issue provides the holding company, together with the disciplined underwriting operations that we have built, our runoff expertise and our investment acumen, will allow us to recoup the 5% dilution to book value quite easily."

346. Defendants knew, or recklessly disregarded, that the statements from the October 28, 2004 press release were materially false and misleading, because the Defendants needed an infusion of cash not to continue Fairfax's deleveraging plan or improve the Company's ratings but to mask its poor financial health.

The November 1, 2004 Supplemental Prospectus

347. On November 1, 2004, Fairfax filed a supplemental prospectus to the April 20, 2004 F-10 (the "November 1, 2004 Supplemental Prospectus") offering $300 million in subordinate voting shares. The November 1, 2004 Supplemental Prospectus incorporated by reference several documents including: the audited consolidated financial statements and the notes for the years ended December 31, 2003 and 2002 and earnings, retained earnings and cash flow statements for each of the years in the three year period ended December 31, 2003, together with the report of the auditors thereon; management's discussion and analysis for the annual consolidated financial statements for the years ended December 31, 2003 and 2002; Fairfax's 2004 Proxy (the Company did not incorporate parts of the 2004 Proxy entitled, "Executive Compensation", "Performance Graph" and "Statement of Corporate Governance Practices"); and Fairfax's interim consolidated financial statements accompanying notes for the three and nine-month periods ended September 30, 2004 and 2003.

348. The November 1, 2004 Supplemental Prospectus also reported total debt as $2,401 million ($2,500.8 million under U.S. GAAP) and shareholders' equity as $2,863.9 million ($2,279.6 million under U.S. GAAP).

349. Defendants knew, or recklessly disregarded, that the statements incorporated into the November 1, 2004 Supplemental Prospectus, including the 2002 Annual Report, the 2003 Annual Report, the 2004 Proxy and Fairfax's interim consolidated financial statements accompanying notes for the three and nine-month periods ended September 30, 2004 and 2003, were materially false and misleading, for the reasons set forth in ¶¶231-48, 263-67, 275-89, 292-95, 336-40.

350. Defendants knew, or recklessly disregarded, that the statements from the November 1, 2004 Supplemental Prospectus regarding Fairfax's total debt and shareholders'

equity were materially false and misleading, because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported shareholder equity and understated its reported debt. Moreover, the Company's restatement also revealed that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated in the November 1, 2004 Supplemental Prospectus. Further, shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions. Additionally, the Company's reported debt was understated because the Company deceptively accounted for certain reinsurance contracts under the reinsurance accounting method rather than deposit accounting method. Under the proper accounting method, reinsurance contracts which did not involve a sufficient transfer of risk should have been accounted for as financing rather than reinsurance thereby increasing Fairfax's reported debt.

The November 8, 2004 Investor Conference

351. On November 8, 2004, Fairfax held an investor conference in New York (the "November 8, 2004 Investor Conference"). Among others, Watsa and Ambridge spoke at the conference.

352. During the November 8, 2004 Investor Conference, Watsa stated:

> Our highlights very simply is to focus in this presentation -- in my section, I was going to highlight for you the fact that we are focused on building shareholder value. It's our 19th year. Our operating companies are going to present -- Northbridge, OdysseyRe, and Crum & Forster - ***and show you their excellent performance and their focus on underwriting profitability***.
>
> * * *
>
> The first, very simply is that we're focused on making a return for shareholders. That's our objective. I think the objective of any public company is to make a return to shareholders. Ours is over time to make a 15 percent return on shareholders' equity -- over time and not in any single year. We always want to be soundly financed. ***And in our annual report, we provide complete disclosure to you -- particularly the negatives of our company***. And we've done that for a long period of time. And we have felt that any of our shareholders and investors

> can read our annual report and get a sense of the company, because we believe in full and complete disclosure.
>
> *   *   *
>
> Our operating companies -- the only point on the slide is to make the point to you that they are focused on underwriting and they have strong capitalization. Each one of those companies when they present you'll see are very well capitalized -- better than the rating capitalizations that the rating agencies have on each of those companies.

(Emphasis added.)

353. Andy Bernard, President of OdysseyRe, was also given an opportunity to tout OdysseyRe during the November 8, 2004 Investor Conference. Bernard stated:

> You can see for the full year so far, our premiums are up 6 percent. The growth that we've experienced over the last several years is clearly abating. And we're expecting 2004, 2005 are going to be roughly flat, give or take 5 percent in terms of premium production.
>
> This illustrates Odyssey's underwriting performance. Again, to reinforce the underwriting culture that we have built and reinforce within Odyssey, on the left-hand side, our statutory combined ratio is compared with the industry as measured by the Reinsurance Association of America. This is all based in 2004 on the 6-month data that the Reinsurance Association of America has tabulated. But you can see over there on the left that Odyssey has consistently outperformed the industry in terms of our combined ratio.
>
> *   *   *
>
> So, summing it all up, why do we feel Odyssey is an attractive investment? Diversified book of business that we built provides earnings stability. Our strong local market presence provides a superior access to local opportunities.

354. Defendants knew, or recklessly disregarded, that the statements from the November 8, 2004 Investor Conference concerning OdysseyRe were materially false and misleading because, as the Company has now admitted (through OdysseyRe's restatement), OdysseyRe's reported financial results were misstated because they "[included] accounting errors associated with certain reinsurance contracts entered into by [OdysseyRe] . . . between 1998 and 2004." Moreover, as disclosed by Fairfax in the Company's restatement, OdysseyRe's restatement had the effect of reducing shareholder equity in 2004 and 2005. Moreover, Watsa's

statements regarding the candidness of Fairfax's disclosures were materially false and misleading because Watsa knew or was reckless in not knowing that Fairfax and its subsidiaries used reinsurance contracts that did not involve a sufficient transfer of risk to manipulate Fairfax's financial results. This was not disclosed to investors until Fairfax filed its restatement in the Fall of 2006. Further, statements regarding Fairfax's performance were false and misleading because the Company's net earnings, revenue and investment income were overstated because Fairfax inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions.

355. In discussing Fairfax's reserves, Ambridge stated:

> [T]he primary responsibility rests with operating company management and their actuaries who set the reserves quarterly. The Company actuaries certify the reserves annually for the statutory statements, the yellow books in the US. Fairfax's chief actuary, John Cloutier, reviews the reserves quarterly. We also have independent actuary reviews by Tillinghast at Crum & Forster and Milliman at nSpire Re. And we are perhaps the only public North American company to publish evaluation actuaries report on provision for claims in our annual report, something that we've done since inception in 1985.

356. Ambridge's statements concerning the Company's reserves were materially false and misleading because Ambridge knew or was reckless in not knowing that Fairfax and its subsidiaries used reinsurance contracts that did not involve a sufficient transfer of risk to manipulate Fairfax's financial results. The improper use of reinsurance contracts impacted the Company's net reserves as the Company improperly deducted reinsurance receivables from reinsurance contracts that did not transfer risk from its total reserve figure. Accordingly, Ambridge misled class members in the foregoing statement by not informing shareholders that Fairfax's net reserves were understated.

The December 6, 2004 Supplemental Prospectus

357. On December 6, 2004, Fairfax filed a supplemental prospectus to the April 20, 2004 F-10 (the "December 6, 2004 Supplemental Prospectus") offering $200 million in 7 3/4% senior notes due 2012. According to the Company, "The notes represent a further issuance of the 7 3/4% senior notes due 2012 previously issued by us in an aggregate principal amount of $266,483,000. The notes issued hereby and the 7 3/4% senior notes due 2012 previously issued by us will bear the same CUSIP number and will constitute a single series of our debt securities." The December 6, 2004 Supplemental Prospectus incorporated by reference several documents including: the audited consolidated financial statements and the notes for the years ended December 31, 2003 and 2002 and earnings, retained earnings and cash flow statements for each of the years in the three year period ended December 31, 2003, together with the report of the auditors thereon; management's discussion and analysis for the annual consolidated financial statements for the years ended December 31, 2003 and 2002; Fairfax's 2004 Proxy (the Company did not incorporate parts of the 2004 Proxy entitled, "Executive Compensation", "Performance Graph" and "Statement of Corporate Governance Practices"); and Fairfax's interim consolidated financial statements accompanying notes for the three and nine-month periods ended September 30, 2004 and 2003.

358. The December 6, 2004 Supplemental Prospectus, repeated the debt and shareholders' equity numbers as reported in the November 1, 2004 Supplemental Prospectus.

359. The statements incorporated into or repeated in the December 6, 2004 Supplemental Prospectus are materially false and misleading for the reasons set forth in ¶¶231-48, 263-67, 275-89, 292-95, 336-40, 355-56.

The January 25, 2005 F-10 Registration Statement

360. On January 25, 2005, Fairfax filed a registration statement on Form F-10 seeking to register up to $750 million in securities (the "January 25, 2005 F-10"). The January 25, 2005

F-10 was signed by signed by Martin, Watsa, Ambridge, Williamson, Bennett, Griffiths, Hartog and Sweitzer and incorporated by reference several documents including: the audited consolidated financial statements and the notes for the years ended December 31, 2003 and 2002 and earnings, retained earnings and cash flow statements for each of the years in the three year period ended December 31, 2003, together with the report of the auditors thereon; management's discussion and analysis for the annual consolidated financial statements for the years ended December 31, 2003 and 2002; Fairfax's 2004 Proxy (the Company did not incorporate parts of the 2004 Proxy entitled, "Executive Compensation", "Performance Graph" and "Statement of Corporate Governance Practices"); and Fairfax's interim consolidated financial statements accompanying notes for the three and nine-month periods ended September 30, 2004 and 2003. The January 25, 2005 F-10 also included a signed letter by PWC consenting to the use of their "clean audit" opinions included with the 2003 Annual Report.

361. The statements incorporated into the January 25, 2005 F-10 are materially false and misleading for the reasons set forth in ¶¶231-48, 263-67, 275-89, 292-95, 336-40.

362. Additionally, Fairfax stated:

> We maintain reserves to cover our estimated ultimate unpaid liability for losses and loss adjustment expenses with respect to reported and unreported claims incurred as of the end of each accounting period. Our success is dependent upon our ability to accurately assess the risks associated with the businesses that we reinsure or insure. If we fail to accurately assess the risks we assume, we may fail to establish appropriate premium rates and our reserves may be inadequate to cover our losses, which could have a material adverse effect on our financial condition and reduce our net income.
>
> * * *
>
> Reserves do not represent an exact calculation of liability, but instead represent estimates involving actuarial and statistical projections at a given point in time of our expectations of the ultimate settlement and administration costs of claims incurred. Establishing an appropriate level of claim reserves is an inherently uncertain process. We utilize both proprietary and commercially available actuarial models, as well as historical insurance industry loss development patterns, to assist in the establishment of appropriate claim reserves.

*   *   *

> If our claim reserves are determined to be inadequate, we will be required to increase claim reserves with a corresponding reduction in our net income in the period in which the deficiency is rectified. It is possible that claims in respect of events that have occurred could exceed our claim reserves and have a material adverse effect on our results of operations in a particular period and/or our financial condition. For the year ended December 31, 2003, we increased our loss and loss adjustment expense reserves relating to prior periods by $456.3 million (before recovery under the Swiss Re Cover, described in our management's discussion and analysis for the year ended December 31, 2003, which is incorporated by reference into this prospectus), primarily relating to runoff business and asbestos claims.

363. The Defendants' statements concerning the Company's reserves were materially false and misleading, because the Defendants knew or were reckless in not knowing that Fairfax and its subsidiaries used reinsurance contracts that did not involve a sufficient transfer of risk to manipulate Fairfax's financial results. The improper use of reinsurance contracts also impacted the Company's net reserves as the Company improperly deducted reinsurance receivables from reinsurance contracts that did not transfer risk from its total reserve figure. Accordingly, the Defendants misled Class members in the foregoing statement by not informing shareholders that Fairfax's net reserves were understated.

Fairfax Announces Financial Results For 2004

364. On February 10, 2005, Fairfax issued its financial results for the three months and year ended December 31, 2004 (the "February 10, 2005 Press Release"). The February 10, 2005 Press Release was filed with the SEC on Form 6-K on February 11, 2005. In the February 10, 2005 Press Release, Fairfax reported, "that it had net earnings of $5.6 million in the fourth quarter of 2004 and a net loss of $17.8 million for the 2004 year, and that it ended the year with a very strong financial position." The Company also stated:

> • Earnings from operations before income taxes were $139.1 million in 2004 (2003 — $527.5 million), after $252.7 million of losses from the third quarter hurricanes and $104.1 million of non-trading realized losses (described below).

- During 2004, the company issued $300 million of equity to long term investors, and through debt issues and a debt exchange offer issued $466.4 million of investment grade debt due in 2012, resulting in meaningful deleveraging and effectively removing any external debt maturities until 2012.

* * *

- Realized gains on investments in 2004 totaled $288.3 million, after $104.1 million of non-trading losses, compared to $845.9 million in 2003. The $104.1 million of losses consisted of $77.1 of mark to market changes in fair value, recorded as realized losses, primarily relating to the economic hedges put in place by the company against a decline in the equity markets, and $27.0 of costs, recorded as realized losses, in connection with the company's repurchase of outstanding debt at a premium to par.

* * *

- Total common shareholders' equity increased to $3.0 billion at December 31, 2004 from $2.7 billion at December 31, 2003, but because the 2004 equity issue was done below book value, common shareholders' equity per basic share decreased to $184.86 at December 31, 2004 from $192.81 at the end of 2003.

365. Under U.S. GAAP, Fairfax reported shareholders' equity as $2,878.5 million.

366. Defendants knew, or recklessly disregarded, that the statements from the February 10, 2005 Press Release regarding the Company's $300 million issuance were materially false and misleading, because the Defendants needed an infusion of cash not to continue its deleveraging plan but to mask its poor financial health. Moreover, the Defendants knew, or recklessly disregarded, that the statements from the February 10, 2005 Press Release concerning the Company's reported shareholders' equity were materially false and misleading because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported shareholder equity. Moreover, the Company's restatement also revealed that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated in the February 10, 2005 Press Release. Further, statements about Fairfax's "strong financial position" were false and misleading because the Company's net earnings, revenue and investment income were overstated because Fairfax inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the

Company failed to properly account for its investments in Zenith and other intercompany transactions.

367. For the year ended December 31, 2004, the February 10, 2005 Press Release reported Fairfax's total assets as $26,331.3 million and liabilities as $19,754.9 million.

368. Defendants knew, or recklessly disregarded, that the statements from the February 10, 2005 Press Release concerning the Company's assets were materially false and misleading because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported assets. Additionally, the Company's liabilities were understated because the Company deceptively accounted for certain reinsurance contracts under the reinsurance accounting method rather than the deposit accounting method. Under the proper accounting method, reinsurance contracts which did not involve a sufficient transfer of risk should have been accounted for as financing

369. Referring to OdysseyRe's performance the Company stated:

> OdysseyRe's combined ratio was 98.1% in 2004 (including 4.2 combined ratio points arising from the third quarter hurricanes), which marked its third consecutive year producing an underwriting profit. The combined ratio in the fourth quarter of 2004 was 95.2%, compared to 96.0% in 2003. Net premiums written increased by 9.1% in 2004, which follows increases of 32.0% in 2003 and 65.7% in 2002. During this three year period, OdysseyRe significantly expanded its presence in the global marketplace through a deliberate strategy of product and geographic diversification. For 2004, gross premiums written in the United States represented 54% of the total, with non-U.S. business producing 46%. Over the last three years, international business produced an increasing amount of OdysseyRe's premium volume. The diversification of activity OdysseyRe has achieved was responsible for its ability to produce an underwriting profit in 2004 despite incurring record hurricane losses in Florida and the Caribbean during the third quarter of 2004.
>
> Net operating cash flow amounted to $603.2 and $554.1 for the years ended December 31, 2004 and 2003, respectively. Since the end of 2001, OdysseyRe's shareholders' equity has increased by 93% on a US GAAP basis, generated entirely from retained earnings and invested asset appreciation.

370. Defendants knew, or recklessly disregarded, that the statements from the February 10, 2005 Press Release concerning OdysseyRe were materially false and misleading because, as

the Company has now admitted (through OdysseyRe's restatement), OdysseyRe's reported financial results were misstated because they "[included] accounting errors associated with certain reinsurance contracts entered into by [OdysseyRe] . . . between 1998 and 2004."

The Year End 2004 Conference Call

371. On February 11, 2005, Fairfax held a conference call with analysts to discuss the Company's results for the year ended December 31, 2004 (the "February 11, 2005 Conference Call"). During the February 11, 2005 Conference Call, Watsa stated:

> Moving on to reserves. As mentioned in previous calls, in the fourth quarter following an independent ground up study of its asbestos reserves Crum & Forster book to reserve at the independent actuaries best estimate by increasing its asbestos reserves by 100 million in the fourth quarter, which as discussed in previous calls was within its reinsurance cover. Crum & Forster's net cost in the fourth quarter for this asbestos charge was offset by redundancies. For the full year Crum & Forster had net reserve development of approximately $25 million. All in all I am very happy to report that our reserves held up very well. Any development at Northbridge and OdysseyRe was absorbed in their excellent combined ratios.
>
> *   *   *
>
> I will remind you that we have a very rigorous reserve review process that takes place annually which, even in these days of Sarbanes-Oxley, results in an annual certification of our reserves by our auditors.

372. The statements concerning the Company's reserves were materially false and misleading, because the Defendants knew or were reckless in not knowing that Fairfax and its subsidiaries used reinsurance contracts that did not involve a sufficient transfer of risk to manipulate Fairfax's financial results. The improper use of reinsurance contracts also impacted the Company's net reserves as the Company improperly deducted reinsurance receivables from reinsurance contracts that did not transfer risk from its total reserve figure. Accordingly, the Defendants misled Class members in the foregoing statement by not informing shareholders that Fairfax's net reserves were understated.

373. Ambridge also participated in the call and reported OdysseyRe's financial results. Specifically, Ambridge stated:

> OdysseyRe had a combined ratio in the fourth quarter of 95.2 percent, a full year combined ratio of 98.1 percent, compared to the 2003 combined ratio of 96.9 percent. . . .

374. Ambridge knew, or recklessly disregarded, that the statements from the February 11, 2005 Conference Call were materially false and misleading, because he knew, or recklessly disregarded, that his statements concerning OdysseyRe's performance were materially false and misleading because, as the Company has now admitted (through OdysseyRe's restatement), that OdysseyRe's reported financial results were misstated. OdysseyRe's reported results "[included] accounting errors associated with certain reinsurance contracts entered into by [OdysseyRe] . . . between 1998 and 2004." Moreover, as disclosed by Fairfax in the Company's restatement, OdysseyRe's restatement had the effect of reducing shareholder equity in 2004 and 2005.

375. Following Ambridge, Watsa stated:

> So then to sum up our priorities in 2005, our objectives in 2005 continue to be one, to achieve our targeted return on equity of 15 percent, and two, ***maintaining a strong financial position***. In terms of the first objective to achieve our targeted return on equity of 15 percent we plan to do that, we haven't mentioned to you in the past by focusing on underwriting profitability at all our insurance and reinsurance operations, by reducing our losses in runoff and offering our services to others, and finally by achieving good returns on our investment portfolios by taking advantage of opportunity.
>
> In terms of maintaining a strong financial position, we have as we have said in the past, a significant cash buffer at the holding company and we plan on reducing our financial leverage in the next few years. The combination of profitability and our strong financial position should result in our ratings improving which is a very important focus for Fairfax. So in summary we are very excited about the prospects for our company in 2005 with excellent underwriting and investment capability that should serve our shareholders well over the long term.

(Emphasis added.)

376. Watsa's statements regarding Fairfax's objective to, *inter alia*, maintain a strong financial position were materially false and misleading because Watsa knew or was reckless in

not knowing that Fairfax and its subsidiaries improperly relied on finite reinsurance contracts, that did not adequately transfer risk, to mask Fairfax's true financial condition. Accordingly, Fairfax could not "maintain[]" its "strong financial position" without continuing to improperly rely on finite reinsurance contracts that failed to adequately transfer risk to mask its true financial condition.

377. In response to a question from an analyst about the Company's reserves, Watsa stated:

> On that the reserve, we of course look at reserves every quarter. And we have our actuarial, chief actuary, John (indiscernible) and many actuaries that work with him will look at all of their reserves every quarter. We talk to Price Waterhouse Cooper of course every quarter on the reserves. But at the end of the year you know that each of our companies tends to have their own independent actuary, which helps them certify the reserves and then of course, Price Waterhouse on top of that will certify the reserve for all of the Fairfax River companies. So it's a very detailed thorough process that goes through and it's one we've had since . . . 1985.

378. The Defendants' statements concerning the Company's reserves were materially false and misleading, because the Defendants knew or were reckless in not knowing that Fairfax and its subsidiaries used reinsurance contracts that did not involve a sufficient transfer of risk to manipulate Fairfax's financial results. The improper use of reinsurance contracts also impacted the Company's net reserves as the Company improperly deducted reinsurance receivables from reinsurance contracts that did not transfer risk from its total reserve figure. Accordingly, the Defendants misled Class members in the foregoing statement by not informing shareholders that Fairfax's net reserves were understated.

The 2004 Annual Report

379. On March 8, 2005, the Company filed its annual report for the year ended December 31, 2004, as an exhibit to Form 6-K ("2004 Annual Report"), which repeated the financial figures from the February 10, 2005 Press Release.

380. Included in the 2004 Annual Report was a letter to shareholders signed by Watsa which stated:

> 2004 was the second year in our 19-year history that we lost money, due to unprecedented hurricane activity, reduced investment income as a result of our very conservative investment position, and runoff losses. We lost 1.0% on average shareholders' equity in 2004 (compared to a return on equity of about 15.5% for the S&P 500 and 12.7% for the S&P/TSX). We had a loss of $17.8 million (all dollar amounts in this letter are in U.S. dollars unless stated otherwise) or $2.16 per share in 2004 compared to a profit of $271.1 million or $18.55 per share in 2003. For the second time in our history, book value per share decreased, by 4.1% to $184.86 per share, due to the loss in 2004 and a share issue below book value, while our share price dropped 3.4% to $168.50 from $174.51 at year end 2003. ***Intrinsic value, however, increased significantly in 2004 because of the excellent performance of our ongoing insurance and reinsurance companies***. In spite of 2004, over the past 19 years, we have compounded book value by 28.7% from $1.52 per share to $184.86 per share and stock prices have followed from $2.38 to $168.50, a compound rate of 25.1% per year.
>
> While our returns left much to be desired in 2004, we made significant progress in achieving the second and third objectives in our guiding principles that we have reproduced in Appendix A. As you will see later, our financial position was significantly strengthened during 2004 and ***we have taken a big step forward to make it easier for you to understand our company by disclosing segmented balance sheets as well as income statements***.
>
> In spite of the occurrence of four major hurricanes in the U.S., our underwriting performance in 2004 was excellent. . . .

(Emphasis added.)

381. Watsa's statements concerning the Company's performance was materially false and misleading because he knowingly or recklessly failed to disclose that the Company (and its subsidiaries') improperly used finite reinsurance contracts to hide the Company's (and its subsidiaries') true financial condition. Specifically, Watsa knew, or recklessly disregarded, that Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported assets and shareholder equity. Additionally, the Company's liabilities were understated because Fairfax deceptively accounted for certain reinsurance contracts under the reinsurance accounting method rather than deposit accounting method.

Under the proper accounting method, reinsurance contracts which did not involve a sufficient transfer of risk should have been accounted for as financing rather than reinsurance. Further, statements about Fairfax's "excellent performance" were false and misleading because the Company's net earnings, revenue and investment income were overstated because Fairfax inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions. Accordingly, Watsa misrepresented Fairfax's financial condition in his signed letter included in the 2004 Annual Report.

382. In terms of the Company's reserves, Watsa stated:

> As mentioned in previous Annual Reports, we have a very rigorous reserve review that takes place annually which results in an annual certification of our consolidated reserves by PricewaterhouseCoopers. . . .

383. Watsa's statements concerning the Company's reserves were materially false and misleading, because Watsa knew or was reckless in not knowing that Fairfax and its subsidiaries used reinsurance contracts that did not involve a sufficient transfer of risk to manipulate Fairfax's financial results. The improper use of reinsurance contracts also impacted the Company's net reserves as the Company improperly deducted reinsurance receivables from reinsurance contracts that did not transfer risk from its total reserve figure. Accordingly, Watsa misled Class members in the foregoing statement by not informing shareholders that Fairfax's net reserves were understated.

384. With respect to Fairfax's controls, Watsa boasted:

> As a foreign private issuer, we were in fact not required to provide SOX 404 reports for 2004 (section 404 of the Sarbanes-Oxley legislation requires a corporation and its independent auditors to report on the effectiveness of the corporation's internal control over financial reporting). For several reasons, though, including our desire to give complete disclosure, to provide the greatest assurance to our shareholders and debtholders and to assess for ourselves the quality of our internal control over financial reporting, we voluntarily elected to provide those reports. We are very pleased that both our own and our auditors'

> SOX 404 reports are clean – that is, ***the reports conclude that we maintained effective control over financial reporting as at December 31, 2004 and do not identify any material weaknesses in these controls***.

385. The 2004 Annual Report also included a signed statement by Watsa and Ambridge which declared:

> Management has assessed the effectiveness of the company's internal control over financial reporting as of December 31, 2004 using criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the company's internal control over financial reporting was effective as of December 31, 2004.

386. Defendants knew, or recklessly disregarded, that the statements from the 2004 Annual Report concerning the effectiveness of Fairfax's controls were materially false and misleading because, as the Company has now admitted it maintained ineffective controls during the period covered by the statement and certifications. The Company's ineffective controls led, in part, to the Company's restatements.

387. The Company's "Guiding Principles," attached as Appendix A to the 2004 Annual Report stated, "We provide complete disclosure annually to our shareholders."

388. Defendants knew, or recklessly disregarded, that the statements from the 2004 Annual Report concerning Fairfax's commitment to provide complete disclosures to investors were materially false and misleading because the Defendants knew or were reckless in not knowing that Fairfax and its subsidiaries used reinsurance contracts that did not involve a sufficient transfer of risk to manipulate Fairfax's financial results. Accordingly, investors were not, contrary to Fairfax's statements, provided "complete" disclosure by Fairfax in the 2004 Annual Report.

389. The Company also reported net investment income as $655.0 million.

390. The Company's investment income figure was overstated because Fairfax used off-shore investment vehicles where directors were permitted to value investment income at their discretion as a means to inflate its financial appearance.

391. The 2004 Annual Report also included a signed certifications from PWC giving the Company a "clean audit," which certified:

> We have audited the accompanying consolidated balance sheets of Fairfax Financial Holdings Limited (the Company) as at December 31, 2004 and 2003 and the related consolidated statements of earnings, retained earnings and cash flows for each of the years in the three-year period ended December 31, 2004. We have also audited the effectiveness of the Company's internal control over financial reporting as at December 31, 2004 based on the criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and management's assessment thereof included in Management's Report on Internal Control over Financial Reporting. The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on these consolidated financial statements, an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audits.
>
> A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.
>
> We conducted our audits of the Company's consolidated financial statements in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial

statements. A financial statement audit also includes assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We conducted our audit of the effectiveness of the Company's internal control over financial reporting and management's assessment thereof in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control and performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as at December 31, 2004 and 2003 and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2004 in accordance with Canadian generally accepted accounting principles. Also, in our opinion, management's assessment that the Company maintained effective internal control over financial reporting as at December 31, 2004 is fairly stated, in all material respects, based on criteria established in Internal Control — Integrated Framework issued by the COSO. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as at December 31, 2004 based on criteria established in Internal Control — Integrated Framework issued by the COSO.

392. PWC knew, or recklessly disregarded, that its statements in the 2004 Annual Report were materially false and misleading. As evidenced by Fairfax's restatement, the financial reports covered by PWC's "clean audit" opinion were materially false and required restating. Moreover, as admitted by Fairfax and as disclosed by several confidential sources Fairfax did not maintain effective controls during the time period covered by PWC's "clean audit."

The March 8, 2005 6-K

393. In addition to filing the 2004 Annual Report, on March 8, 2005, the Company filed a press release dated March 4, 2005, as an exhibit to Form 6-K (the "March 8, 2005 6-K"), in which the Company stated:

Fairfax Financial Holdings Limited (TSX:FFH.SV) (NYSE:FFH) announces that its 2004 Annual Report, released today, includes a report by management

> concluding that the company's internal control over financial reporting was effective as of December 31, 2004, and an opinion by Fairfax's independent auditors to the same effect. Neither management's report nor the auditors' opinion identified any material weaknesses in internal controls over financial reporting.
>
> As a non-U.S. company, Fairfax is not currently required under the Sarbanes-Oxley Act to undertake an assessment of the effectiveness of its internal control over financial reporting or to obtain its independent auditors' opinion thereon. Fairfax voluntarily elected to do so, two years ahead of its compliance deadline, in order to assess for itself the integrity and quality of its internal control over financial reporting and to provide its shareholders and debtholders with the greatest assurance of the effectiveness of its internal control over financial reporting.

394. Defendants knew, or recklessly disregarded, that the statements in the March 8, 2005 6-K regarding the adequacy of Fairfax's controls were materially false and misleading, as the Company has now admitted it maintained ineffective controls during the period covered by the statement in the March 8, 2005 6-K. The Company's ineffective controls led, in part, to the Company's restatements.

The 2005 Proxy

395. On March 11, 2005, Fairfax filed the Management Proxy Circular on Form 6-K with the SEC (the "2005 Proxy") which stated:

> Our board of directors, in consultation with outside experts retained by the Board, recently reviewed our corporate governance practices. As part of this process, and by way of formalizing our governance approaches, the Board (i) approved a set of Corporate Governance Guidelines that includes the Board's written mandate, (ii) established a Governance and Nominating Committee and a Compensation Committee (in addition to the previously established Audit Committee), (iii) approved written charters for all of its committees (which charters include position descriptions for the Chair of each committee), (iv) approved a Code of Business Conduct and Ethics applicable to our directors, officers and employees and (v) established, in conjunction with the Audit Committee, a Whistleblower Policy. All of these items are available for review on our website at www.fairfax.ca under the heading "Corporate Governance".
>
> The Corporate Governance Guidelines retain and enhance the principles and practices described in prior Management Proxy Circulars as underlying our governance system. The Code of Business Conduct and Ethics is built around the first value in our longstanding and regularly reported Guiding Principles —

> "honesty and integrity are essential in all our relationships and will never be compromised".
>
> Our corporate governance practices are in compliance with all applicable rules and substantially comply with all applicable policies and guidelines, including those of the TSX and NYSE, as well as the proposed guidelines of the Canadian Securities Administrators. A description of our corporate governance practices is set out below. Appendix A of this Management Proxy Circular contains a comparison of our corporate governance practices with the specific guidelines of the TSX.

396. Defendants knew, or recklessly disregarded, that the statements in the 2005 Proxy were materially false and misleading, because the Defendants maintained ineffective controls during the period covered by the 2005 Proxy. Moreover, rather than provide shareholders with honest disclosures Fairfax did not reveal its improper use of reinsurance contracts until its restatements in the Fall of 2006.

The 2004 40-F

397. On March 31, 2005, Fairfax filed, on Form 40-F (or as exhibits thereto): the audited financial statements and notes from the 2004 Annual Report, the MD&A from the 2004 Annual Report, the narrative business description from the 2004 Annual Report, PWC's consent to use its "clean audit" opinions for the 2004 Annual Report, Watsa's and Ambridge's 13a-14(a), 15d-14(a) and Section 1350 certifications and (the "2004 40-F"). The 2004 40-F repeated the financial figures and statements from the February 10, 2005 Press Release and the 2004 Annual Report. Additionally, in commenting on the Company's internal controls the 2004 40-F reported:

> The Registrant's chief executive officer and its chief financial officer, after evaluating the effectiveness of the Registrant's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this annual report on Form 40-F, have concluded, based upon such evaluation, that the Registrant's disclosure controls and procedures were effective as of the end of such period.

398. The 2004 40-F included signed certifications from Watsa and Ambridge stating:

1. I have reviewed this annual report on Form 40-F of Fairfax Financial Holdings Limited;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this report;

4. The issuer's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the issuer and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

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

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

   (d) Disclosed in this report any change in the issuer's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting; and

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

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

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

399. Watsa and Ambridge also signed certifications under Section 1350 which stated, *inter alia*, "Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code), the undersigned officer of Fairfax Financial Holdings Limited (the 'Company'), hereby certifies, to such officer's knowledge, that: The Annual Report on Form 40-F for the year ended December 31, 2004 (the 'Report') of the Company fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company."

400. The 2004 40-F included a signed consent from PWC permitting the Company to use the clean audit letter appearing in the Company's 2004 Annual Report.

401. Defendants knew, or recklessly disregarded, that the statements in the 2004 40-F Report were materially false and misleading for the reasons stated in ¶¶371-77, 386-99. Moreover, statements concerning the adequacy of Fairfax's internal controls were made by Fairfax, Watsa and Ambridge either knowingly or with reckless disregard for the truthfulness of such statements. As admitted by the Company and PWC, Fairfax did not maintain appropriate controls between 2001 and 2005. The deficient controls led to Fairfax restating its financial results for the period covered by the 2004 40-F.

The First Quarter 2005 Press Release and Interim Report

402. On April 28, 2005, Fairfax issued a press release announcing its financial results for the first quarter of 2005. The April 28, 2005, press release and the first interim report for the three months ended March 31, 2005 (the "First Quarter 2005 Report") were filed as exhibits to Form 6-K on April 29, 2005. In the April 28, 2005 press release, Fairfax reported total revenue for three months ended March 31, 2005, as $1,474.3 million, EBIT and non-controlling interests

as $104.3 million, net earnings as $35.2 million and net earnings per share as $2.03. In the April 28, 2005 press release, Fairfax stated:

> • Total common shareholders' equity remained at $3.0 billion at March 31, 2005 while common shareholders' equity per basic share increased slightly to $185.00 at March 31, 2005 from $184.86 at the end of 2004.

403. Defendants knew, or recklessly disregarded, that the statements from the April 28, 2005 press release concerning shareholders' equity was materially false and misleading because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated shareholders' equity. Moreover, the Company's restatement also revealed that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated in the April 28, 2005 press release.

404. The First Quarter 2005 Report, repeated the financial figures from the April 28, 2005 press release and also reported assets as $26,345.4 million and liabilities as $19,634.6 million. Under U.S. GAAP, Fairfax reported total assets as $26,877.9 million and shareholders' equity as $2,800.6 million.

405. In commenting on Fairfax's investments the First Quarter 2005 Report stated, "At March 31, 2005 the investment portfolio had a pre-tax unrealized gain of $285.9 (consisting principally of unrealized losses on bonds of $99.3 and unrealized gains on equities of $381.0), a decrease of $142.4 from the unrealized gain of $428.3 at December 31, 2004."

406. Defendants knew, or recklessly disregarded, that the statements from the April 28, 2005 press release and the First Quarter 2005 Report concerning shareholders' equity was materially false and misleading because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated shareholders' equity. The Company's restatement also revealed that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated in the First Quarter 2005 Report. Moreover, Defendants knew, or

recklessly disregarded, that the statements from the First Quarter 2005 Report concerning the Company's assets were materially false and misleading because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported assets. Additionally, the Company's liabilities were understated because the Company deceptively accounted for certain reinsurance contracts under the reinsurance accounting method rather than deposit accounting method. Under the proper accounting method, reinsurance contracts which did not involve a sufficient transfer of risk should have been accounted for as financing rather than reinsurance thereby increasing liabilities. Further, net earnings, revenue and earnings per share were overstated because Fairfax inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions.

The May 13, 2005 Conference Call

407. On May 13, 2005, Fairfax held a conference call with analysts to discuss the Company's results for the first quarter of 2005 (the "May 13, 2005 Conference Call"). During the May 13, 2005 Conference Call, in response to a question from an analyst regarding Fairfax's insurance covers and whether they involved a legitimate transfers of risk, Watsa stated:

> these covers, which we've talked-- we talked about these aggregate stop-loss covers, and we made the point, and these covers can, you know, "finite" has got so many different connotations these days, we just said we consider these to be aggregate stop-loss treaties. We've made the point that for these treaties, the way we've considered them to be legitimate, is the fact that one, they've had risk transfer, risk transfer that our auditors have looked at, risk transfer that the regulators have looked at, and many, many different parties have looked at. They've been fully disclosed in our annual reports over time, so you and other analysts can look at it, anyone who deals with that can look at it. And finally, the- an important point that has come out more recently, is there's no side agreements. So those are three key requirements that, from our standpoint, make any aggregate stop-loss reinsurance treaty legitimate, in your language, and so we feel comfortable with what we have. We look back on our big one, Tom, the CAN $1 billion reinsurance protection that we had, balance sheet protection that we

> bought, and we bought it in 1999 and we continue to-- and I said at the annual meeting that-- and in the annual report that now, with hindsight, we are happy that we bought it, because remember, we're trying to protect our balance sheet in '99, and I don't know how we could have protected it other than buying this cover that we did, well-disclosed, the reinsurance stop-loss treaty that we did, with [inaudible] CAN $1 billion that covered all our reserves for '98 and prior, recognizing that the future was unpredictable. And so we bought the cover for reserve development as well as reinsurance recoverable bad debt. And so when we look at that, Tom, we feel quite comfortable in all of those treaties that we've acquired. ***They've met the test of risk transfer, they've met the test of being fully disclosed, and there's no side agreements***.

(Emphasis added.)

408. Defendants knew, or recklessly disregarded, that the statements from the May 13, 2005 Conference Call were materially false and misleading, because Watsa knew that the Company did not have adequate controls in place to assess whether agreements adequately transferred risk. As one confidential source reported, OdysseyRe did not have any risk transfer tests in place to determine whether reinsurance contracts transferred risks.

The Second Quarter 2005 Press Release and Interim Report

409. On July 28, 2005, Fairfax issued a press release announcing its financial results for the second quarter of 2005. The July 28, 2005 press release and the second interim report for the six months ended June 30, 2005, were filed as exhibits to Form 6-K on July 29, 2005 (the "Second Quarter 2005 Report"). In the July 28, 2005 press release, Fairfax reported total revenue for three months ended June 30, 2005, as $1,500.8 million, EBIT and non-controlling interests as $68.3 million, net earnings as $5.0 million and net earnings per share as $0.17. The Company also stated in the July 28, 2005, press release that "[t]otal common shareholders' equity remained at $3.0 billion ($184.46 per basic share) at June 30, 2005."

410. The Second Quarter 2005 Report, repeated the financial figures from the July 28, 2005 press release and also reported assets as $26,058.8 million and liabilities as $19,457.4 million. Under U.S. GAAP, Fairfax reported total assets as $26,690.2 million and shareholders' equity as $3,087.1 million.

411. Defendants knew, or recklessly disregarded, that the statements from the July 28, 2005 press release and the Second Quarter 2005 Report concerning the Company's assets and shareholder equity were materially false and misleading because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported assets and shareholder equity. Moreover, the Company's restatement also revealed that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated in the periods covered by the July 28, 2005 press release and the Second Quarter 2005 Report. Additionally, the Company's assets were overstated and its liabilities were understated because the Company deceptively accounted for certain reinsurance contracts under the reinsurance accounting method rather than deposit accounting method. Under the proper accounting method, reinsurance contracts which did not involve a sufficient transfer of risk should have been accounted for as financing rather than reinsurance. Further, net earnings, revenue and investment income were overstated because Fairfax inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions.

The July 29, 2005 Conference Call

412. On July 29, 2005, Fairfax held a conference call with analysts to discuss the Company's results for the second quarter of 2005 (the "July 29, 2005 Conference Call"). During the call Taylor stated:

> Operating income for the quarter was $165.4 million, which is up almost 30% from the second quarter results for 2004. Now, driving this increase were two things, and the first was excellent underwriting performance by our operating companies, as Prem has motioned. Underwriting profit was $65.7 million, which is up almost 20% year-over-year. Our consolidated combined ratio was 94.1% versus 94.9%; almost a full percentage point increase in our combined ratio on our $1.2 billion almost in earned premium during the quarter.

*   *   *

> The sum total of all this, all these things that I've talked about financial position wise, it's fair to say that our financial position has improved significantly over the past six months. And the rating agencies concur. Out there in the past quarter, we had Amvest recognizing the improvement in our financial strength. Our U.S. insurance companies, the outlook for them was raised to A-, stable outlook. Our Canadian insurance companies, the outlook for those was raised to A-, positive outlook. So, very positive recognition by the rating agencies of our improvements in financial strength.

413. Taylor knew, or recklessly disregarded, that the statements from the July 29, 2005 Conference Call were materially false and misleading, because Fairfax inappropriately used finite reinsurance contracts that did not transfer risk to mask the Company's financial condition.

The September 26, 2005 Investor Conference

414. On September 26, 2005, Fairfax held an investor conference (the "September 26, 2005 Investor Conference"). Among others, Watsa and Taylor spoke at the conference.

415. During the September 26, 2005 Investor Conference, Watsa stated:

> So why would Fairfax achieve 15% over the long term? We have got well-established operating companies. Our investment team has a proven track record. We have got a track record of creating wealth for shareholders but always I have said to you, our shareholders and people we deal with, the last two are the most important, we have got a track record of treating people fairly and not compromising our integrity and we have got a commitment to build the company over the long term.

416. Watsa knew, or recklessly disregarded, that the statements from the September 26, 2005 Investor Conference were materially false and misleading, because Fairfax inappropriately used finite reinsurance contracts that did not transfer risk to mask the Company's financial condition. Further, statements about Fairfax's "track record of creating wealth" were false and misleading because the Company's net earnings, revenue and investment income were overstated because Fairfax inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions.

417. Andy Bernard, President of OdysseyRe, was also given an opportunity to tout OdysseyRe during the September 26, 2005 Investor Conference. Bernard stated:

> Our combined ratio over this period of time from 2002 at 97.9% has allowed us to generate an underwriting profit. We have had to absorb catastrophe activity, most notably last year with the Florida hurricanes and we have also had to absorb some additional costs from the soft market years of the '97 to 2000 period, but notwithstanding the amount of adverse development that Odyssey has reflected. We have generated an underwriting profit. Our investment return, including unrealized gains, all-in 9.5% over this period. We have had a return on equity again on an all-in basis as a full taxpayer of 14.5% during this period of time. And once again, 19% has been the growth in book value since we have gone public.
>
> * * *
>
> So summing it up, OdysseyRe, we're not your conventional story. We to operate as part of the Fairfax group on a total return concept. We do believe industry fundamentals favor diversified companies. We will have more moderate returns in any given year than some of the monoline companies or the companies that focus more on the catastrophe risk. However we believe over the long-term that is the right approach for building consistently book value, asset leverage, investment track record. We have had over 500 million of net realized gains in this company over the last four years. Our 19% growth in book value since we went public four solid years, very strong performance and Odyssey's current stock price, which of course does not reflect a 19% growth in book value over the four years at 0.95 of book value we believe provides a very attractive entry point for investors in OdysseyRe.

418. Defendants knew, or recklessly disregarded, that the statements from the September 26, 2005 Investor Conference concerning OdysseyRe were materially false and misleading because, as the Company has now admitted (through OdysseyRe's restatement), OdysseyRe's reported financial results were misstated because they "[included] accounting errors associated with certain reinsurance contracts entered into by [OdysseyRe] . . . between 1998 and 2004." Moreover, as disclosed by Fairfax in the Company's restatement, OdysseyRe's restatement had the effect of reducing shareholder equity in 2004 and 2005.

The September 28, 2005 Supplemental Prospectus

419. On September 28, 2005, Fairfax filed a supplemental prospectus to the January 25, 2005 F-10 (the "September 28, 2005 Supplemental Prospectus"). The September 28, 2005

Supplemental Prospectus offered 1,843,318 subordinate voting shares. The September 28, 2005 Supplemental Prospectus incorporated by reference several documents including: the audited consolidated financial statements and the notes for the years ended December 31, 2004 and retained earnings statements for the six months ended June 30, 2005; management's discussion and analysis for the annual consolidated financial statements for the years ended December 31, 2004; and Fairfax's 2005 Proxy (the Company did not incorporate parts of the 2005 Proxy entitled, "Executive Compensation", "Performance Graph" and "Statement of Corporate Governance Practices").

420. The September 28, 2005 Supplemental Prospectus reported (as of June 30, 2005) total debt as $2,581.7 million ($2,641.1 million under U.S. GAAP) and shareholders' equity as $3,164.2 million ($3,087.1 million under U.S. GAAP).

421. Defendants knew, or recklessly disregarded, that the statements incorporated into the September 28, 2005 Supplemental Prospectus, including the incorporated portions of the 2004 Annual Report, the 2005 Proxy and the Second Quarter 2005 Report were materially false and misleading, for the reasons set forth in ¶¶386-99, 402-03, 416-18.

422. Defendants knew, or recklessly disregarded, that the statements from the September 28, 2005 Supplemental Prospectus regarding Fairfax's total debt and shareholders' equity were materially false and misleading, because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported shareholder equity and understated its reported debt. Moreover, the Company's restatement also revealed that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated. Additionally, the Company's reported debt was understated because the Company deceptively accounted for certain reinsurance contracts under the reinsurance accounting method rather than deposit accounting method. Under the proper accounting method, reinsurance

contracts which did not involve a sufficient transfer of risk should have been accounted for as financing rather than reinsurance thereby increasing Fairfax's reported debt. Further, net earnings, revenue and investment income were overstated because Fairfax inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions.

Fairfax Tries to Downplay the Justice Department's Interest in the Company

423. On October 10, 2005, in response to several articles stating that the Justice Department joined the SEC's investigation into Fairfax, the Company issued a press release stating, "Fairfax Financial Holdings Limited (TSX:FFH.SV) (NYSE:FFH) confirms, in response to various inquiries, that it has not received a subpoena or other information request from the U.S. Attorney's Office." The following day the Company retreated from its October 10, 2005 statement and issued a "clarification," stating:

> In response to certain published information incorrectly reporting Fairfax's release of October 10, 2005, Fairfax advises that it understands that the U.S. attorney's office for the Southern District of New York will review information that Fairfax provides to the SEC in response to SEC subpoenas, but that Fairfax has not been advised that it is the target of an investigation by that office. Fairfax confirms its October 10, 2005 release that it has not received a subpoena or other information request from the U.S. attorney's office. Fairfax continues to cooperate with the SEC's investigation.

424. Defendants knew, or recklessly disregarded, that the statements from the October 10, 2005 press release were materially false and misleading, because the Defendants knew that the Justice Department was reviewing the documents Fairfax submitted to the SEC.

The Third Quarter 2005 Press Release and Interim Report

425. On October 27, 2005, Fairfax issued a press release announcing its financial results for the third quarter of 2005. The October 27, 2005, press release and the third interim report for the nine months ended September 30, 2005 were filed as exhibits to Form 6-K on

October 28, 2005 (the "Third Quarter 2005 Report"). In the October 27, 2005 press release, Fairfax reported total revenue for three months ended September 30, 2005, as $1,542.1 million, EBIT and non-controlling interests as ($275.6) million, net earnings as ($220.0) million and net earnings per share as ($13.83). In the October 27, 2005 press release, Fairfax also stated:

> The strength of Fairfax's underlying underwriting results, coupled with increased investment income earned during the quarter, allowed the company, despite the hurricane losses, to maintain its strong financial position, subsequently further improved by the $300 million equity issue completed in October 2005. The hurricane losses have not adversely affected the capital adequacy of any of Fairfax's ongoing insurance and reinsurance companies.
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> * * *
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> • Net realized gains on investments totaled $154.7 million in 2005 (after being reduced by $92.5 million of non-trading losses resulting from mark-to-market valuation adjustments), compared to $94.4 million in 2004 (after being reduced by $7.6 million in non-trading losses).
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> * * *
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> • Reinsurance recoverables were $7.6 billion at September 30, 2005, compared to $7.3 billion at June 30, 2005 and $8.1 billion at December 31, 2004. Reinsurance recoverables at September 30, 2005 reflect an increase in the third quarter due to ceded hurricane losses, and a decrease in the second quarter due to a reinsurance commutation.
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> * * *
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> • Total common shareholders' equity decreased to $2.8 billion ($172.29 per basic share) at September 30, 2005 from $3.0 billion at June 30, 2005 ($184.46 per basic share) as a result of the losses from the third quarter hurricanes. Had the company's issue in October 2005 of additional subordinate voting shares, for net proceeds (after issue costs) of $299.8 million, occurred on September 30, 2005, common shareholders' equity at that date would have been $3.1 billion ($171.29 per basic share).

426. Defendants knew, or recklessly disregarded, that the statements from the October 27, 2005 press release concerning the Company's reinsurance receivables and shareholder equity were materially false and misleading because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported reinsurance receivables and shareholder equity. Moreover, the Company's restatement also revealed that

Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated in the periods covered by the statements. Further, statements about Fairfax's "strong financial position" were false and misleading because the Company's net earnings, revenue and investment income were overstated because Fairfax inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions.

427. The Third Quarter 2005 Report, repeated the financial figures from the October 27, 2005 press release and also reported assets as $27,070.9 million and liabilities as $20,460.5 million and shareholders' equity as $2,968.4 million. Under U.S. GAAP, Fairfax reported total assets as $27,527.5 million and shareholders' equity as $2,728.1 million.

428. Defendants knew, or recklessly disregarded, that the statements from the Third Quarter 2005 Report concerning the Company's assets and shareholder equity were materially false and misleading because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported assets and shareholder equity. Moreover, the Company's restatement also revealed that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated in the periods covered by the statements. Additionally, the Company's assets were overstated and its liabilities were understated because the Company deceptively accounted for certain reinsurance contracts under the reinsurance accounting method rather than deposit accounting method. Under the proper accounting method, reinsurance contracts which did not involve a sufficient transfer of risk should have been accounted for as financing rather than reinsurance.

429. With respect to OdysseyRe, the Third Quarter 2005 Report reported the following figures for the three months ended September 30, 2005: underwriting profit of ($267.0) million;

combined ratio of 145.0%; gross premiums written of $736.7 million; net premiums written of $634.3 million; net premiums earned of $593.1 million; operating income of ($231.0) million; realized gains of $93.4 million; and pre-tax income of ($137.6) million. In commenting on the results, the Company stated:

> OdysseyRe's gross premiums written decreased 2.3% in the third quarter of 2005 over the third quarter of 2004. This primarily reflects a decline of 12.2% in its worldwide reinsurance business (excluding reinstatement premiums) during the U.S. insurance business. This compares to an increase in total gross premiums written of 1.2% for the nine months ended September 30, 2005 over the same period in 2004. While there have been continued competitive pressures in the reinsurance market, the significant losses across the industry stemming from Hurricanes Katrina and Rita are expected to result in improved trading conditions across the reinsurance market. OdysseyRe, through its opportunistic underwriting approach, expects to benefit from these improved trading conditions.
>
> During the third quarter of 2005, OdysseyRe's combined ratio was 145.0%, reflecting total net catastrophe losses (before tax), net of reinstatement premiums, of $317.4, which represented 53.5 points of its combined ratio. The third quarter of 2005 includes net losses before tax, after applicable reinstatement premiums, of $225.0 from Hurricane Katrina and $50.0 from Hurricane Rita. The third quarter of 2005 also includes $33.3 in adverse development relating to casualty business, primarily for years 2001 and prior, which represented 5.6 points of OdysseyRe's combined ratio. This compares to a combined ratio of 107.7% during the third quarter of 2004, which reflects net losses of $86.3 from the 2004 third quarter hurricanes. Notwithstanding higher income on cash and bonds as average invested assets continued to expand during the third quarter of 2005, investment income decreased during the quarter, primarily as a result of OdysseyRe's share of Advent's hurricane-affected third quarter results.

430. Defendants knew, or recklessly disregarded, that the statements from the Third Quarter 2005 Report concerning OdysseyRe were materially false and misleading because, as the Company has now admitted (through OdysseyRe's restatement), OdysseyRe's reported financial results were misstated because they "[included] accounting errors associated with certain reinsurance contracts entered into by [OdysseyRe] . . . between 1998 and 2004." Moreover, as disclosed by Fairfax in the Company's restatement, OdysseyRe's restatement had the effect of reducing shareholder equity in 2004 and 2005.

The November 11, 2005 Conference Call

431. On November 11, 2005, Fairfax held a conference call with analysts to discuss the Company's results for the third quarter of 2005 (the "November 11, 2005 Conference Call"). During the November 11, 2005 Conference Call, Watsa stated:

> It is very encouraging to note that if the effect of the losses from Hurricane Katrina and Rita were removed, we would have produced excellent combined ratios and good earnings in the third quarter. We anticipate that these natural disasters will create an improved environment for the industry, and we expect to benefit from it.

432. Also, during the November 11, 2005 Conference Call, Taylor stated:

> Reinsurance recoverables. We are affected greatly by the storms. At June, if you recall, we were down about $800 million year to date, and that was principally in the runoff segment. Now, we are down year to date by about 500 million. So then that split is -- runoff for year to date were down about $875 million, not much change there, and operating companies though is up by 350. And this is a straight function of the hurricane losses incurred by us that we have ceded to reinsurers. You should note that the reinsurers that we have ceded these losses to our highly-rated, good-quality reinsurers. And these are short-tailed claims, so they will pay out in short order.
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> * * *
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> Shareholders' equity at September 30, you'll see on the statement is 2.97 billion prior to our 300 million equity offering. So today, shareholders' equity stands at 3.27 billion compared to 3.17 billion at year end. So a quick recap here of our financial position, which we believe is quite strong and much stronger than in recent years. We've got 600 million plus in cash at the holding Company level. We have no significant holding Company debt maturities until 2012. We have no bank debt outstanding. We have demonstrated again our ready access to capital markets with the recent common and preferred offerings by Fairfax and Odyssey.
>
> Our ratings are stronger. They are better today across all of our businesses than they were earlier this year. And we've got reduced principal balance sheet risks. We've addressed all kinds of things like reinsurance recoverables, investment portfolios. Our reserves are fairly stable. Debt and refinancing risk has been addressed as well.
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> * * *
>
> Again our strengths -- we are very well-positioned to compete for business in 2006; we've got strong operating company underwriting performance; we are very well-capitalized at the operating companies. Our ratings, not only do we head into 2006 with all of our ratings affirmed and in tact [sic], but they are in fact

> improved across the board from what they were earlier this year. And at the holding Company -- a large cash and liquidity position; low refinancing risk; and a stronger, lower-risk balance sheet than we have had in many years.

433. Watsa and Taylor knew, or recklessly disregarded, that the statements from the November 11, 2005 Conference Call concerning the Company's "good earnings," reinsurance receivables and shareholder equity were materially false and misleading because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported reinsurance receivables and shareholder equity. Moreover, the Company's restatement also revealed that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated in the periods covered by the statements. Further, net earnings, revenue and investment income were overstated because Fairfax inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions.

434. In commenting on the volatility of Fairfax's stock, short sellers, and subpoenas from the SEC, Watsa stated:

> in the past 3 years, a significant short position has developed in our Company after our listing on the New York Stock Exchange in December 2002. The last report from the New York Stock Exchange had the number around 2.2 million shares. The short sellers obviously have a financial incentive to cast the Company in a negative light.
>
> Given the fact that our shares are substantially held by a small number of long-term shareholders, we think it will be very difficult for the short sellers to cover their short positions in the market. That's the noise in the market.
>
> ***We have always believed in full and plain disclosure to you, and you can count on that***. Ultimately, results roll out, and that continues to be our focus.
>
> As far as subpoenas are concerned, you should know -- one, there have been approximately 30 insurance companies that have received SEC subpoenas and about 20 insurance companies that have received Department of Justice subpoenas. We have received SEC subpoenas but not Department of Justice subpoenas; although, we know that the Department of Justice is reviewing the information we provide to the SEC as is their right. If we get the Department of

> Justice subpoena, we will of course announce it. Two, we will deal with the SEC in the same way we have done with our insurance regulators and the rating agencies -- full and open disclosure. Finally, three, we will not respond to speculation on where the SEC or any other regulatory agency is in their inquiries. Although of course, we'll make appropriate disclosure of material facts on a timely basis.

(Emphasis added.)

435. In response to a question from an analyst about regulatory focus on finite reinsurance trading in a company's own securities, Watsa stated:

> On the trading subpoena that we had, we have nothing more to add on it other than the fact that the SEC is looking at it, and we are providing them with all the information that they need. We feel comfortable with our position in terms of any stock issues we might have done or buybacks that we might have done or any of those items. But they have asked us for more information, and we are giving them anything that they want.

436. Watsa knew, or recklessly disregarded, that the statements from the November 11, 2005 Conference Call were materially false and misleading, because Watsa knew that Fairfax's use of finite reinsurance contracts was not appropriate and would subject the Company to regulatory scrutiny. Moreover, Watsa knew, or recklessly disregarded, that the statements from the November 11, 2005 Conference Call concerning Fairfax's commitment to provide complete disclosures to investors were materially false and misleading because he knew, or was reckless in not knowing, that Fairfax and its subsidiaries used reinsurance contracts that did not involve a sufficient transfer of risk to manipulate Fairfax's financial results. Accordingly, investors were not, contrary to Fairfax's statements, provided "full and plain" disclosure by Fairfax.

Fairfax Announces Financial Results For 2005

437. On February 9, 2006, Fairfax issued its financial results for the three months and year ended December 31, 2005 (the "February 9, 2006 Press Release"). The February 9, 2006 Press Release was filed with the SEC on Form 6-K on February 10, 2006. In the February 9, 2006 Press Release, Fairfax reported, "that it had a net loss of $318.1 million in the fourth quarter of 2005 and $497.9 million for the 2005 year, after absorbing losses from Hurricanes

Katrina, Rita and Wilma during the fourth quarter and the 2005 year of $249.5 million and $715.5 million, respectively, and after recording pre-tax charges resulting from actions taken in runoff during the fourth quarter and the 2005 year aggregating $249.9 million and $465.5 million, respectively." In the February 9, 2006 Press Release, Fairfax also reported:

> Prem Watsa, Chairman and CEO, commented, "During 2005, the insurance industry experienced the largest catastrophe losses in its history, including from Hurricanes Katrina, Rita and Wilma. Our results were significantly affected by these losses, but our financial strength and the capital base of our insurance and reinsurance companies permitted us to absorb them. It is very encouraging to note that if the effect of the hurricane losses were removed, we would have produced excellent combined ratios in 2005. ***We enter 2006 with very sound operations at our ongoing insurance and reinsurance companies and with a good prospect of approaching breakeven at our runoff operation***."
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> Other highlights for 2005 were as follows:
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> * * *
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> • Total common shareholders' equity decreased to $2.7 billion ($151.52 per basic share) at December 31, 2005 from $3.0 billion ($184.86 per basic share) at December 31, 2004, principally as a result of the losses arising from the 2005 hurricanes and the charges resulting from actions taken in runoff.
>
> • Reinsurance recoverables decreased to $7.7 billion at December 31, 2005 from $8.1 billion at December 31, 2004, notwithstanding an increase in reinsurance recoverables in 2005 due to ceded losses from the 2005 hurricanes.

(Emphasis added.)

438. The Defendants knew, or recklessly disregarded, that the statements from the February 9, 2006 Press Release concerning the Company's reinsurance receivables and shareholder equity were materially false and misleading because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported reinsurance receivables and shareholder equity. Moreover, the Company's restatement also revealed that Fairfax's reported shareholder's equity under U.S. and Canadian GAAP was overstated in the periods covered by the statements. Further, net earnings, revenue and investment income were overstated because Fairfax inappropriately valued privately held

investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions.

439. For the year ended December 31, 2005, the February 9, 2006 Press Release reported Fairfax's total assets as $27,565.7 million and liabilities as $20,937.3 million.

440. Defendants knew, or recklessly disregarded, that the statements from the February 9, 2006 Press Release concerning the Company's assets were materially false and misleading because of Fairfax's use of finite reinsurance contracts, which did not involve a sufficient transfer of risk, overstated the Company's reported assets. Additionally, the Company's liabilities were understated because the Company deceptively accounted for certain reinsurance contracts under the reinsurance accounting method rather than deposit accounting method. Under the proper accounting method, reinsurance contracts which did not involve a sufficient transfer of risk should have been accounted for as financing rather than reinsurance.

441. Referring to OdysseyRe's performance the Company stated:

> OdysseyRe announced today that, as a result of its internal review of contracts with finite characteristics, it is restating its financial results for the years 2001 through 2004, as well as its results for the nine months ended September 30, 2005. The primary purpose of the restatement is to correct the accounting treatment (relating primarily to the timing of recognition of income) for certain contract features of seven ceded reinsurance contracts and the accounting treatment of ceding commissions relating to three ceded aggregate excess of loss contracts. Fairfax has assessed the individual and aggregate components of the restatements announced by OdysseyRe and has concluded that they are not individually or in the aggregate material at the consolidated Fairfax level and consequently that it will not be restating its financial results for any period.
>
> * * *
>
> In 2005, a year of unprecedented catastrophes, OdysseyRe's combined ratio was 117.2%, which included 19.0 combined ratio points ($436.0 of pre-tax losses, net of applicable reinstatement premiums and reinsurance) arising from Hurricanes Katrina, Rita and Wilma. This compares to a combined ratio of 98.1% in 2004, which included 4.2 points arising from the 2004 third quarter hurricanes. OdysseyRe's combined ratio in 2005 also included 8.2 combined ratio points ($189.0 of net pre-tax losses) in adverse loss development from prior period

> losses (7.4 combined ratio points in 2004). Gross premiums written were virtually unchanged in 2005, following an average annual increase of 34.0% from 2002 to 2004. For 2005, gross premiums written in the United States represented 55% of the total, with non-U.S. premiums representing 45%. In 2005, OdysseyRe produced a net loss of $107.4 as compared to net income of $160.1 in 2004, primarily driven by hurricane losses in 2005. OdysseyRe deploys an opportunistic underwriting approach designed to maximize underwriting margins and remains well positioned to benefit from a changing global reinsurance landscape, with a diversified U.S. business and a well established international franchise.

442. Defendants knew, or recklessly disregarded, that the statements from the Third Quarter 2005 Report concerning OdysseyRe were materially false and misleading because, as the Company has now admitted (through OdysseyRe's restatement), OdysseyRe's reported financial results were misstated because they "[included] accounting errors associated with certain reinsurance contracts entered into by [OdysseyRe] . . . between 1998 and 2004." Moreover, as disclosed by Fairfax in the Company's restatement, OdysseyRe's restatement had the effect of reducing shareholder equity in 2004 and 2005.

The February 10, 2006 Conference Call

443. On February 10, 2006, Fairfax held a conference call with analysts to discuss the Company's results for the year ended December 31, 2005 (the "February 10, 2006 Conference Call").

444. During the February 10, 2006 Conference Call, Watsa stated:

> We had a net loss of $497.9 million in 2005 after absorbing $715.5 million in losses from Hurricanes Katrina, Rita, and Wilma and after recording pretax charges resulting from actions taken in runoff during the fourth quarter and the whole year 2005 of 249.9 million and $465.5 million respectively.
>
> The good news is that the financial strength and capital base of our insurance and reinsurance companies permitted us to absorb these record hurricane losses. Most importantly, we entered 2006 with very sound operations at our ongoing insurance and reinsurance companies and with a good prospect of approaching breakeven at our runoff operations.

445. Watsa's statements regarding Fairfax's net loss and "financial strength" was materially false and misleading because Fairfax's net earnings, revenue and investment income

were overstated because Fairfax inappropriately valued privately held investments in foreign jurisdictions; while shareholders' equity was overstated because the Company failed to properly account for its investments in Zenith and other intercompany transactions.

446. Also during the February 10, 2006 Conference Call, and in response to a question from an analyst about Fairfax's internal review of the Company's finite reinsurance contracts, Watsa stated:

> We have of course with the focus on the industry on finite contracts, we have done a complete review of all our companies, all our contracts, and across Fairfax and its subsidiaries, across Fairfax and one or two of the -- a few contracts that we have had at the holding company. And I am happy to tell you that that's the OdysseyRe restatement were the only ones that did come up. Greg has given you a perspective on them and -- but we are happy to say that we have been a full review by us and by our independent auditors and those were the only ones that came up.

447. Defendants knew, or recklessly disregarded, that the statements from the February 10, 2006 Conference Call were materially false and misleading, because the Defendants have admitted "In the fall of 2005, Fairfax and its subsidiaries prepared and provided to the SEC a list intended to identify certain finite contracts and contracts with other non-traditional features of all Fairfax group companies." Moreover, the SEC sent a subpoena to Watsa "in connection with the answer to a question on the February 10, 2006 investor conference call concerning the review of the company's finite insurance contracts."

Fairfax Announces It Will Delay Filing Its Annual Report

448. On March 16, 2006, Fairfax issued a press release announcing that the Company's annual report would not be filed until OdysseyRe completes its restatement:

> Fairfax Financial Holdings Limited (TSX:FFH.SV) (NYSE:FFH) has been advised by its OdysseyRe Holdings Corp. subsidiary that it intends to file a notice with the Securities and Exchange Commission that it will delay the filing of its Annual Report on Form 10-K. In connection with OdysseyRe's previously announced restatement of its financial results for the years 2001 through 2004, and the nine months ended September 30, 2005, OdysseyRe requires additional time to complete the year-end process. OdysseyRe expects to file its 2005 Annual Report on Form 10-K in the next 30 days. The filing and mailing to shareholders

> of Fairfax's Annual Report will be delayed until the filing of OdysseyRe's Annual Report on Form 10-K. As a result of this delay, the date of Fairfax's annual general meeting of the shareholders will be moved to a date to be announced at the time of filing of Fairfax's Annual Report.

449. Defendants knew, or recklessly disregarded, that the statements from the March 16, 2006 press release were materially false and misleading, because the Defendants would also need to restate the Company's financial reports because of the Company's inappropriate use of finite reinsurance contracts, failing to properly account for intercompany transactions, and failing to properly account for Fairfax's investments.

XI. SCIENTER

A. The Officer Defendants' Conscious Misbehavior

450. Fairfax's improper accounting of finance reinsurance contracts and the absolute failure to install internal controls was directed by the Defendants Watsa, Ambridge, and, following Ambridge's departure from Fairfax, by Defendant Taylor.

451. These Officer Defendants were active, culpable, and primary participants in the fraud by virtue of (1) their knowledge of and approval of the use of finite reinsurance contracts that did not transfer risk in order to enhance Fairfax's financial appearance; (2) their actual issuance and control over Fairfax's materially false and misleading statements; (3) their supervision over employees and Fairfax's subsidiaries and actual direction of policies that encouraged the fraud detailed herein; and (4) the Officer Defendants' association with the Company which made them privy to confidential information concerning the Company.

452. The Officer Defendants knew or recklessly disregarded the materially false and misleading nature of the information they caused to be disseminated to the investing public. The Officer Defendants also knew or recklessly disregarded that the Company's (and the Company's subsidiaries') use of finite reinsurance contracts that did not transfer risk caused Fairfax's financial statements to be materially false and misleading, would adversely affect the integrity of

the market for the Company's common stock and would cause the price of the Company's common stock to be artificially inflated. The Officer Defendants acted knowingly or in such a reckless manner as to constitute fraud and deceit upon Plaintiff and the Class.

453. The Officer Defendants also repeatedly assured investors that Fairfax and its subsidiaries maintained adequate reporting controls throughout the Class Period. The Company's restatement admits that the Company and the Officer Defendants misrepresented the Company's financial health during the Class Period as well as the adequacy of the Company's controls. As further admitted by the Company, Fairfax's deficient controls "resulted in the restatement of the company's consolidated financial statements for the years ended December 31, 2001 through 2005 and related disclosures." By failing to install proper controls and hire the appropriate people to audit Fairfax's financials, the Officer Defendants were able to conceal Fairfax's fraudulent accounting practices.

454. The Officer Defendants directed, knew about or recklessly disregarded the fraudulent practices implemented under their watch. As officers of the Company, the Officer Defendants each knew, through direct knowledge or knowledge learned through the supervisory nature of their positions or recklessly disregarded and failed to disclose, material adverse information; were involved in the decisions concerning the use of finite reinsurance contracts made at the Company and its subsidiaries and the deficient controls; and, made false and misleading statements of material fact.

455. Indeed as confirmed by confidential witnesses, several of the Officer Defendants, including Watsa, had knowledge of the lack of disclosure of material adverse information concerning the Company's (and its subsidiaries') use of finite reinsurance contracts and the deficient controls.

1. V. Prem Watsa

456. As the founder, CEO, chairman and controlling shareholder of Fairfax, Watsa wields absolute control over Fairfax and its subsidiaries.

457. Watsa's unique role as the architect and controlling shareholder of Fairfax gives him unparallel access to every critical decision made by Fairfax and its subsidiaries.

458. Watsa's domination of Fairfax's and its subsidiaries is well known with the industry. For example, as stated in an article published in *The New York Post* on August 8, 2006, "[a]ll of OdysseyRe's investment decisions are cleared through [Watsa]. . . ."

459. *The New York Post*'s account of Watsa's domination over its subsidiaries was corroborated by various confidential sources. According to CW9, OdysseyRe's predecessor abandoned the use of finite reinsurance contracts because they proved to be "risky and tricky." It was only after OdysseyRe's public offering that Watsa decided to reintroduce finite reinsurance contracts into OdysseyRe's portfolio. CW9 stated that the high margins available to companies from using finite reinsurance contracts is what motivated Watsa to use them at OdysseyRe. According to CW9, because the use of finite reinsurance contracts were in their infancy, they were handled solely "at the most senior levels" of the Company.

460. With respect to Fairfax's controls, CW4 and CW5 reported that they personally provided reports that were reviewed by top management, including Watsa, which highlighted inconsistencies with Fairfax's internal figures (CW4) and Fairfax's deficient internal controls (CW5). In addition to directly providing Watsa with information about Fairfax's internal controls, Watsa knew or was reckless in not knowing that Fairfax and its subsidiaries did not maintain adequate internal controls. Indeed several of the confidential witnesses that provided information about Fairfax's scheme provided corroborating evidence (which was also

corroborated by Fairfax's restatement) that Watsa, Fairfax and its subsidiaries simply did not maintain adequate controls and/or actually knew of improper activity. Specifically:

(a) CW1 stated he/she was not aware of any internal controls at OdysseyRe;

(b) CW2 stated that OdysseyRe's runoff operations were a "real mess" and the documents relating to the runoff operation's claims were in "very sloppy shape;"

(c) CW3 stated that he/she "hated" Fairfax because it had an unorganized management;

(d) CW4 stated that he/she was instructed to ignore figures that could not be reconciled. CW4 also made clear that the problem with Fairfax was that there were "no controls;"

(e) CW5 reported that he/she provided Fairfax's managers, including Watsa, an audit report that rated OdysseyRe as a "fail." This witness also described the state of OdysseyRe's internal controls as "scary;"

(f) CW6 stated that Hudson was "not organized," relied on calculating reports (which were sent to OdysseyRe) by hand, could not reconcile figures relating to the collection of insurance premiums, and "sort of just lived with the problems;"

(g) CW7 reported that Watsa had an office in OdysseyRe's headquarters and was "very visible at Odyssey;"

(h) CW8 stated that Watsa directed MFX to use a London based company called "MI2G" for IT consulting work. CW8 reported that he/she felt "certain" that Watsa was using MI2G, which he/she decried as "grossly over billing" Fairfax to "funnel" money elsewhere; and

(i) CW9 stated that it was Watsa's decision to reintroduce finite reinsurance contracts into OdysseyRe's portfolio and that despite the complexity in accounting for these contracts OdysseyRe did not have risk transfer tests to analyze risks associated finite reinsurance contracts.

461. Moreover, given the ongoing industry probe into the use of finite reinsurance contracts and federal regulators were seeking information about Fairfax's finite reinsurance exposure, Watsa was well aware of the accounting problems created by finite reinsurance contracts from at the very latest, June 2005; however, confidential witnesses provided information that Watsa instructed OdysseyRe to employ finite reinsurance contracts shortly after its IPO in June 2001 *See* ¶466.

462. Despite being fully aware of the dubious nature of finite reinsurance contracts, Watsa misrepresented Fairfax's financial health to investors throughout the Class Period and blatantly lied to (or was extremely reckless) in providing information about the Company's use of finite reinsurance contracts in responding to a question from an analyst during the Company's February 2006 conference call. Specifically, Watsa stated:

> We have of course with the focus on the industry on finite contracts, we have done a complete review of all our companies, all our contracts, and across Fairfax and its subsidiaries, across Fairfax and one or two of the -- a few contracts that we have had at the holding company. And I am happy to tell you that that's the OdysseyRe restatement were the only ones that did come up. Greg has given you a perspective on them and -- but we are happy to say that we have been a full review by us and by our independent auditors and those were the only ones that came up.

463. Despite Watsa's statements seeking to assure investors that use of finite reinsurance contracts was limited to a "few" at OdysseyRe, according to the Company, "in the fall of 2005, Fairfax and its subsidiaries prepared and provided to the SEC a list intended to identify certain finite contracts and contracts with other non-traditional features of all Fairfax group companies."

464. Shortly after Watsa's February 10, 2006 statement, he received a subpoena from the SEC inquiring about his response concerning the "review of the Company's finite insurance contracts."

465. Specifically, in December 2004 an analyst sent a letter addressed to Ambridge, which also copied Watsa and Kevin Dancey (a senior partner at PWC), wherein the writer asked Ambridge to explain the $1 billion in financial assets from Fairfax's financial reports.

466. Ambridge responded to the letter on December 14, 2004, and denied any wrongdoing related to the missing assets. Accordingly, Watsa was aware after receiving the letter that Fairfax may have manipulated their financials. Despite being put on notice of accounting irregularities in December 2004, Fairfax continued to issue false and misleading statements until it was forced to file a restatement on the heels of inquiries by the SEC and Department of Justice.

2. Trevor Ambridge

467. Ambridge served as Fairfax's CFO from the start of the Class Period until his dismissal as CFO on May 13, 2005.

468. During the Class Period, Ambridge knowing or with extreme recklessness issued statements about Fairfax's financial health and certified that Fairfax's controls were effective.

469. An undated letter was received by Ambridge on December 9, 2004 from a hedge fund analyst expressing concern over the author's inability to reconcile the stock and bond holdings on the 2003 consolidated annual report of Fairfax to the total holdings from the individual insurance subsidiaries public or annual statutory filings. Attached were 11 pages of detailed calculations and assumptions supporting the author's contention that the total discrepancy between Fairfax's consolidated stock and bond holdings and the aggregate total of those amounts on the subsidiary or statutory reports was approximately $1 billion. The author

copied Kevin Dancey, CEO, Canadian Senior Partner at PWC and The United States SEC on the letter.

470. On December 14, 2004, Ambridge responded to the letter that the analyst's concerns were unwarranted and assured the analyst of the soundness of Fairfax's reporting.

471. Ambridge's departure from Fairfax did not end the government's interest in him. According to the *New York Post*, a deputized FBI agent approached Ambridge in the Summer of 2006 as part of the government's investigation. The paper also reported that the deputized agent "extensively" emailed Ambridge during the summer to meet Ambridge in order to bring him "into the government's fold."

472. According to the *New York Post*, Ambridge, who became the CFO of a Fairfax subsidiary based in London after leaving Fairfax, declined to help the government.

473. Accordingly, not only did Ambridge help deceive investors during the Class Period, he fled to London, and refused to help investigators looking into the Company's transactions.

B. The Officer Defendants Had Motive and Opportunity to Falsify Fairfax's Financial Performance

474. The compensation structure for Fairfax's employees motivated employees to engage in the fraudulent conduct described here. As Watsa himself stated during the November 8, 2004 Investor Conference:

> So if I move onto the next slide, we just give you our structure. And the structure just highlights for you the fact that we're decentralized, except for holding company functions -- complete and open communication between our Fairfax and its subsidiaries. ***Share ownership and large incentives are encouraged in the Group***. And the reason -- because of that, in the past, we've been able to attract very good people. And we've been able to keep them. In the main, we haven't lost anyone we have wanted to keep who has been running our companies. And you will see a consistency or a constancy when you see each of our company management, starting with Northbridge.
>
> The incentives are not based on premium growth, on volume; ***the incentives are based very simply on underwriting profit in the operating company area***.

(Emphasis added.)

475. Additionally, as the founder, CEO, chairman and controlling shareholder of Fairfax, Watsa had both the motive and opportunity to orchestrate and implement the fraudulent scheme described herein.

476. According to Fairfax's Management Proxy Circular (dated March 31, 2006), Watsa holds slightly less than a majority of Fairfax's voting shares:

> The Sixty Two Investment Company Limited (''Sixty Two'') owns 50,620 subordinate voting shares and 1,548,000 multiple voting shares, representing 47.6% of the total votes attached to all classes of our shares (100% of the total votes attached to the multiple voting shares and 0.3% of the total votes attached to the subordinate voting shares). V. Prem Watsa, our Chairman and a director, controls Sixty Two and himself beneficially owns an additional 255,552 subordinate voting shares and exercises control or direction over an additional 2,100 subordinate voting shares. These shares, together with the shares owned directly by Sixty Two, represent 48.4% of the total votes attached to all classes of our shares (100% of the total votes attached to the multiple voting shares and 1.8% of the total votes attached to the subordinate voting shares). To the knowledge of our directors and officers, there are no other persons who beneficially own (directly or indirectly) or exercise control or direction over more than 10% of the votes attached to any class of our shares. . . .

477. Collectively, Watsa owns and/or controls 308,242 subordinate voting shares. At $200 per share Watsa's personal interest in Fairfax (based on the subordinate voting shares alone) exceeds $50 million.

478. The value of Fairfax's securities are critical to Watsa's financial health. According to the Company's 2006 Proxy, Watsa's only form of compensation from Fairfax is an annual salary of $600,000. Thus, if the price of Fairfax's securities collapses, Watsa's Fairfax related fortune would dwindle to nothing.

C. OdysseyRe's Scienter

479. Chief among subsidiaries that abused finite reinsurance contracts to bolster Fairfax's appearance was OdysseyRe.

480. OdysseyRe has admitted in a press release dated March 31, 2006, "[i]n connection with the restatement, management has determined that the Company did not maintain effective internal controls over the accounting for complex reinsurance transactions, which constitutes a material weakness"

481. However, while OdysseyRe blamed the need to restate on ineffective controls, in reality OdysseyRe deliberately obscured the true substance of reinsurance contracts in order to enhance OdysseyRe's and thereby Fairfax's financial appearance.

482. As CW9 reported, OdysseyRe did not have any risk transfer tests. CW9 reported this behavior as "odd" given that the "senior most level" of OdysseyRe handled finite reinsurance contracts and "should have known better."

483. According to CW9 the "senior most level" of OdysseyRe included: Charles Trioano, OdysseyRe's CFO, Andrew Barnard, OdysseyRe's CEO, Michael G. Wasek, OdysseyRe's Chief Executive Officer of the Americas Division, Bob Bennett, OdysseyRe's Chief Actuary, Don Smith, OdysseyRe's General Counsel, Anthony Narcisco, OdysseyRe's Controller and Steven Vandergraff.

484. Moreover, OdysseyRe's scienter is evident from its efforts to mislead Fairfax's investors as news of the subsidiary's restatement began to surface.

485. Specifically, on February 10, 2006, OdysseyRe held an earnings conference call to discuss the company's 2005 results.

486. During the call, OdysseyRe's then CFO, Robert Giammarco ("Giammarco"), blatantly lied to investors about Fairfax's use of intracompany transactions. As reported by the *New York Post*:

> On the call in question, CFO Robert Giammarco . . . repeatedly insisted that reinsurance contracts Odyssey was forced to restate were not done with any of Fairfax's almost 240 separate operating subsidiaries.

> According to a transcript of the call, Odyssey's Giammarco answered the first question on the matter from Rob Bobman of Capital Returns about the identity of the counterparties in the restated contracts.
>
> "We don't disclose the counterparties, but there were different counterparties to each of these contracts," he said.
>
> Banc of America Securities analyst Brian Meredith asked if any of the deals were with other Fairfax units, referring to them as "inter-company."
>
> Giammarco strongly denied it, stating again, "***No intercompany, no Fairfax***."
>
> On March 31, OdysseyRe's form 10-K filed with the Securities and Exchange Commission discusses how it restated one of its reinsurance contracts with a company named nSpire Re, a wholly owned subsidairy [sic] of Fairfax.

(Emphasis added.)

487. Giammarco abruptly resigned from OdysseyRe in July of 2006, citing a desire to "pursue other interests."

488. Accordingly, the fact that senior OdysseyRe employees were deliberately ignoring basic tests used to ensure sufficient transfer of risk and OdysseyRe deliberately (or with extreme recklessness) mislead Fairfax's investors regarding the use of intracompany agreements evidences OdysseyRe's scienter.

D. The SEC "No Action" Letter Does Not Mean That Defendants Acted Without Scienter

489. The SEC's announcement, stated in its June 25, 2009 "no action" letter to Fairfax's counsel, that its investigation into Fairfax had been completed does not mean that Defendants acted without scienter when they made the false and misleading statements discussed above. The letter unequivocally states that the SEC's decision to conclude its investigation does not mean that Fairfax had been exonerated, and may have been based "upon various reasons, some of which, such as workload considerations, are clearly irrelevant to the merits of any subsequent action," such as this putative class action. *See*, *supra*, Securities Act Release No. 5310 (quoted at ¶220). Use of the "no action" letter as a defense to any elements of the claims

alleged herein "would be clearly inappropriate and improper," in the SEC's words. *See id*. Moreover, even if any inference could be drawn from the SEC letter, which none can be, the SEC's letter specifically applies solely to Fairfax Financial Holdings, Ltd., and has no application to OdysseyRe, PWC or the eight Individual Defendants sued in this action.

E. PWC's Scienter

490. PWC is a worldwide firm of certified public accountants, auditors and consultants, which provides a variety of accounting, auditing, tax and consulting services. PWC served as Fairfax's independent auditor and principal accounting firm prior to, and during, the Class Period. PWC acted in these capacities pursuant to the terms of contracts it had with Fairfax that, among other things, required PWC to audit Fairfax's financial statements in accordance with Canadian Generally Accepted Auditing Standards ("GAAS"), and beginning in 2004, to audit management's assessment of the effectiveness of internal control over financial reporting as mandated by Section 404 of the Sarbanes-Oxley Act of 2002 and to report the results of those audits (and quarterly reviews) to Fairfax, its Board of Directors, its Audit Committee, and the members of the investing public, including Plaintiff and the members of the Class.

491. PWC was engaged by Fairfax to provide independent accounting, business consulting and auditing services to Fairfax and gave Fairfax accounting advice and consultation regarding Fairfax's annual and quarterly reports, which were filed with the SEC and publicly distributed. Defendant PWC, by virtue of its position as independent accountant and auditor of Fairfax, had access to the files and key employees of the Company at all relevant times. As a result of the auditing and other services it provided to Fairfax, PWC personnel were frequently present at Fairfax's corporate headquarters throughout each year, and had continual access to and knowledge of Fairfax's confidential internal corporate, financial, operating, and business

information, and had the opportunity to observe and review the Company's business and accounting practices, and to test the Company's internal accounting information and publicly reported financial statements as well as the Company's internal controls and structures.

492. For these services to Fairfax, and for numerous other non-audit services, PWC was highly compensated. PWC earned CDN$26.0 million in auditing fees from Fairfax for 2005, CDN$14.6 million in auditing fees 2004 and CDN$10.3 million in auditing fees for 2003. Thus, from 2003 through 2005, PWC was paid CDN$50.9 million in auditing fees alone. In addition to these auditing fees, PWC also collected CDN$8.0 million from non-auditing fees, from fiscal year 2003 to 2005. PWC's fees were unusually large when compared with the average audit fee paid to auditors by S&P 500 companies. According to an annual survey conducted by the law firm of Foley and Lardner, the average audit fees paid by S&P 500 companies for fiscal years 2003, 2004 and 2005 were $6.82 million, $9.50 million and $9.60 million, respectively. Thomas Hartman, *The Cost of Being Public In the Era of Sarbanes-Oxley*, (June 15, 2006).

493. PWC was required to perform its audits in accordance with GAAS. PWC signed Auditors' Reports for each of the audits of Fairfax in the Class Period and stated that they conducted the audits of the Company's financial statements in accordance with GAAS.

494. The Board of Directors of the Canadian Institute of Chartered Accountants ("CICA") granted the Auditing and Assurance Board[7] authority to publish reports on its own authority. Under this authority, the Board issues Recommendations setting out certain standards for performance and reporting, such as:

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[7] On October 1, 1991, the Auditing Standards Committee was renamed the Auditing Standards Board. On October 1, 1998, the Auditing Standards Board was renamed the Assurance Standards Board. On September 1, 2003, the Assurance Standards Board was renamed the Auditing and Assurance Standards Board.

(a) The Recommendations in STANDARDS FOR ASSURANCE ENGAGEMENTS, CICA Section 5025, constitute the basic professional standards with which the practitioner should comply when performing an assurance engagement; and

(b) The Recommendations in GENERALLY ACCEPTED AUDITING STANDARDS, CICA Section 5100, represent the basic professional standards with which an auditor should comply when auditing financial statements.

495. The Auditing and Assurance Board has established in CICA section 5090 with respect to audits of financial statements relating to periods on or after December 15, 2004, that:

> The objective of an audit of financial statements is to express an opinion on whether the financial statements present fairly, in all material respects, the financial position, results of operations, and its cash flows in accordance with generally accepted accounting principles, except in the circumstances referred to in reporting standard (iv) in GAAS, paragraph 5100.02.

496. When performing an audit of a company's financial statements, "The auditor's objective is to assess whether the financial statements are misstated by a material amount." (CICA Section 5142.14) "The auditor should aggregate misstatements in such a way that he or she can ascertain whether, in relation to individual amounts, subtotals or totals in the financial statements, they materially misstate the financial statements as a whole." (CICA Section 5142.19)

497. Despite the numerous GAAP violations evident in Fairfax's financial statements during the Class Period, PWC issued unqualified opinions, representing that Fairfax's financial statements were presented fairly, in all material respects, and in accordance with Canadian GAAP for each of the years ended December 31, 2003 to December 31, 2004.

498. PWC's audit report dated February 5, 2004 reporting on Fairfax's Financial Statements as of and for the year ending December 31, 2003, was filed with the SEC on May 18, 2004. In its audit report regarding Fairfax's 2003 financial statements, PWC stated:

> We have audited the consolidated balance sheets of Fairfax Financial Holdings Limited as at December 31, 2003 and 2002, and the consolidated statements of earnings, retained earnings and cash flows for each of the years in the three year period ended December 31, 2003. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.
>
> We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.
>
> In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2003 in accordance with Canadian generally accepted accounting principles.

499. In addition, PWC included the following explanatory paragraph regarding Canadian versus US reporting differences:

> In the United States, reporting standards for auditors require the addition of an explanatory paragraph (following the opinion paragraph) when there is a change in accounting principles that has a material effect on the comparability of the company's financial statements, such as the change described in note 3 to the financial statements relating to goodwill. Our report to the shareholders dated February 5, 2004 is expressed in accordance with Canadian reporting standards which do not require a reference to such a change in accounting principles in the auditors' report when the change is properly accounted for and adequately disclosed in the financial statements.

500. PWC's audit report dated March 4, 2005, reporting on Fairfax's financial statements as of and for the years ending December 31, 2004 and December 31, 2003, was filed with the SEC on March 31, 2005. In its audit report regarding Fairfax's 2004 financials, PWC stated:

> We have audited the accompanying consolidated balance sheets of Fairfax Financial Holdings Limited (the Company) as at December 31, 2004 and 2003 and the related consolidated statements of earnings, retained earnings and cash flows for each of the years in the three-year period ended December 31, 2004. We have also audited the effectiveness of the Company's internal control over financial reporting as at December 31, 2004 based on the criteria established in

Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and management's assessment thereof included in Management's Report on Internal Control over Financial Reporting. The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on these consolidated financial statements, an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audits.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

We conducted our audits of the Company's consolidated financial statements in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. A financial statement audit also includes assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We conducted our audit of the effectiveness of the Company's internal control over financial reporting and management's assessment thereof in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control and performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as at

> December 31, 2004 and 2003 and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2004 in accordance with Canadian generally accepted accounting principles. Also, in our opinion, management's assessment that the Company maintained effective internal control over financial reporting as at December 31, 2004 is fairly stated, in all material respects, based on criteria established in Internal Control — Integrated Framework issued by the COSO. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as at December 31, 2004 based on criteria established in Internal Control — Integrated Framework issued by the COSO. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

1. Numerous "Red Flags" Should Have Alerted PWC to Fairfax's Materially False and Misleading Financial Statements

501. Had PWC conducted its audits in accordance with GAAS, it would have discovered that Fairfax's financial statements were materially false and misleading and failed to comply with GAAP.

502. CICA Section 5135 requires auditors to plan and perform audits to obtain reasonable assurance that the financial statements are free of material misstatement whether caused by error or fraud. The auditor's consideration of fraudulent acts under this section establishes that for those fraudulent acts that have a direct and material effect on the determination of financial statement amounts, the auditor's responsibility to detect misstatement resulting from such fraudulent acts is the same as that for errors.

503. Appendix A. to CICA Section 5135 identifies various examples of "red flags" that auditors need to consider in determining audit risk relating to misstatements arising from fraudulent financial reporting and emphasizes the need for increased auditor professional skepticism and professional judgment in assessing the risks of fraud or misstatement. Numerous red flags enumerated in CICA Section 5135 were present at Fairfax and should have alerted PWC to the potential of irregularities in Fairfax's accounting. These include:

(a) A known history of securities law violations or claims against the entity or its senior management alleging fraud or violations or securities laws. Here, shortly after Fairfax was listed on the NYSE, analysts questioned the adequacy of the Company's reserves. Moreover, the SEC issued three subpoenas to Fairfax and/or its subsidiaries between June and September 2005. Specifically, on June 24, 2005, the Company announced that Fairmont received a subpoena from the SEC requesting documents regarding any non-traditional insurance product transactions entered into by Fairmont with General Re Corporation or affiliates thereof. In September 2005 the Company announced that the SEC issued two subpoenas regarding non-traditional insurance/reinsurance products and loss mitigation products entered into by Fairfax and/or its subsidiaries. In March 2006 the Company disclosed that in the fall of 2005, Fairfax and its subsidiaries prepared and provided to the SEC a list identifying finite contracts. Further, PWC's Kevin Dancey, was copied on a December 2004 letter addressed to Ambridge which expressed concern over the author's inability to reconcile Fairfax's stock and bond holdings on the Company's 2003 consolidated annual report. Despite knowing that analysts openly questioned the adequacy of the Company's reserves, concerns over disclosures in Fairfax's 2003 Annual Report (which were expressed directly to PWC's top managers) and that the SEC was investigating Fairfax and its subsidiaries for their use of finite reinsurance as well as other contracts, PWC issued and/or permitted Fairfax to use its "clean audit" opinions throughout the Class Period;

(b) Intentional misapplication of accounting principles. Confidential witnesses reported that Fairfax did not have any risk transfer protocols in place to determine whether sufficient risk was transferred with its finite reinsurance contracts. *See* ¶¶49, 120. Despite the lack of adequate risk transfer tests, Fairfax inappropriately accounted for reinsurance contracts under the reinsurance method of accounting and ultimately restated its financial results based on the erroneous accounting treatment assigned to its reinsurance contracts. Fairfax's restatement also admits that the Company failed to properly account for its investment in Zenith which led to decreases in shareholders' equity by $11.6 million and $16.8 million as of December 31, 2005 and December 31, 2004, respectively. Despite knowing that Fairfax used reinsurance contracts without adequate risk transfer tests and that the Company failed to properly account for its investment in Zenith, both of which amounted to misapplication of accounting principles, PWC issued and/or permitted Fairfax to use its "clean audit" opinions throughout the Class Period;

(c) Alteration of supporting documents for amounts in the financial statements. Confidential witnesses reported that Fairfax did not have any risk transfer protocols in place to determine whether sufficient risk was transferred with its finite reinsurance contracts to justify according them reinsurance accounting treatment. *See* ¶¶49, 102. Despite the lack of adequate risk transfer tests, Fairfax inappropriately accounted for reinsurance contracts under the reinsurance method of accounting and ultimately restated its financial results based on the erroneous accounting treatment assigned to its reinsurance contracts. Accordingly, any supporting documents associated with reinsurance contracts to which Fairfax inappropriately accounted for under the reinsurance accounting method failed to justify this type of accounting treatment. Fairfax's restatement also admits that the Company failed to properly account for its investment in Zenith which led to decreases in shareholders' equity by $11.6 million and $16.8 million as of December 31, 2005 and December 31, 2004, respectively. Thus, any documents purporting to support accounting for Fairfax's investment in Zenith under the cost basis method were inadequate. Despite knowing that Fairfax used reinsurance contracts without adequate risk transfer tests and that the Company failed to properly account for its investment in Zenith, PWC issued and/or permitted Fairfax to use its "clean audit" opinions throughout the Class Period;

(d) Significant intercompany or related party transactions. As admitted in the Company's restatement, Fairfax restated its financial figures to, *inter alia*, take into account "[b]ookkeeping errors in the accounting for various intercompany transactions including incorrect eliminations of gains and losses on intercompany purchases and sales of portfolio investments, write-offs of unreconciled intercompany balances, incorrect elimination of intercompany advances, and related foreign currency accounting." (Emphasis added.) Thus, by Fairfax's own admission the Company engaged in several intercompany transactions during the Class Period. Despite knowing that Fairfax engaged in intercompany transactions PWC issued and/or permitted Fairfax to use its "clean audit" opinions throughout the Class Period;

(e) Management continuing to employ an inexperienced and ineffective accounting staff. According to CW4, her superior, who reported directly to Williamson, had not passed the exam to become a Chartered Accountant in Canada and had a difficult time executing "101" accounting procedures such as drawing T-charts for transactions. Corroborating CW4's account of incompetent managers, in the Company's report on internal controls (which was included in the Company's restatement), Fairfax admitted that one of its control deficiencies was based upon "not maintain[ing] personnel with an appropriate level of accounting knowledge." According, Fairfax employed inexperienced and ineffective accounting personnel throughout the Class Period. Despite knowing that Fairfax employed inexperienced and ineffective accounting personnel, PWC issued and/or permitted Fairfax to use its "clean audit" opinions throughout the Class Period;

(f) Management is dominated by a select group. Fairfax and its subsidiaries are completely dominated by Watsa. Watsa is Fairfax's founder, CEO, Chairman and controlling shareholder. Moreover, Fairfax's subsidiaries are also dominated by Watsa. As reported in *The New York Post* on August 8, 2006, "[a]ll of OdysseyRe's investment decisions are cleared through [Watsa]. . . ." Watsa also sits as the chairman of several Fairfax subsidiaries including OdysseyRe and C&F. According to CW9, Watsa was the one who demanded that OdysseyRe use finite reinsurance contracts. Additionally, as stated in Fairfax's 2004 Proxy, Watsa has intentionally designed Fairfax's board to be a small group. The 2004 Proxy states, "In considering the characteristics of directors who will be proposed to constitute the board, the board and Fairfax's controlling shareholder, Prem Watsa, have considered it important that the number of directors be kept reasonably small, preferably between four and seven. . . ." Despite knowing that Fairfax was dominated by Watsa, PWC issued and/or permitted Fairfax to use its "clean audit" opinions throughout the Class Period;

(g) Complex transactions that pose "substance over form" questions. The accounting for finite reinsurance contracts is governed by SFAS No. 113. Under this provision, in order for contracts to receive reinsurance accounting treatment both of the following elements must be met: (a) the reinsurer must assume significant insurance risk, and (b) it must be reasonably possible that the reinsurer may realize a significant loss from the transaction or the reinsurer assumes substantially all of the insurance risk relating to the reinsured portions of the underlying contracts. Thus, a staple of Fairfax's business model – finite reinsurance contracts – relied on assessing whether significant risk was transferred to the to the entity reinsuring Fairfax. If sufficient risk had not passed from Fairfax, its reinsurance contracts could not receive reinsurance accounting treatment – irrespective of the terms or form of the reinsurance agreement. Here, the accounting for reinsurance contracts is a substance over form issue. Despite knowing that the appropriate accounting for reinsurance contracts hinged on whether a significant amount of risk was transferred to the reinsuring entity – a question of substance – PWC issued and/or permitted Fairfax to use its "clean audit" opinions throughout the Class Period;

(h) Management setting aggressive financial goals. Fairfax has openly boasted about achieving a fifteen percent return on shareholder equity ("ROE"). As stated by Watsa during a conference call on November 8, 2004, "The first, very simply is that we're focused on making a return for shareholders. That's our objective. I think the objective of any public company is to make a return to shareholders. Ours is over time to make a 15 percent return on shareholder' equity -- over time and not in any single year. . . ." Watsa's emphasis on Fairfax earning a fifteen percent ROE was reiterated during a February 11, 2005 conference call, in which Watsa stated, "our objectives in 2005 continue to be one, to achieve our targeted return on equity of 15 percent. . . ." Accordingly, PWC knew that Fairfax set aggressive financial goals by openly and repeatedly setting an objective to earn a 15 percent ROE; and

(i) Management fails to correct known significant weaknesses in internal control on a timely basis. Fairfax's internal control deficiencies infected every level of the Company. *See* ¶¶130-52. Moreover, the Company admitted to maintaining ineffective controls throughout the Class Period. Despite knowing that Fairfax maintained ineffective controls, PWC issued and/or permitted Fairfax to use its "clean audit" opinions throughout the Class Period. PWC's "clean audit" opinions also attested to the effectiveness of Fairfax's controls. *See* ¶¶246-48, 288-89, 398-99.

504. Many of the following red flags should have alerted PWC to Fairfax's fraudulent accounting practices, which were rampant at Fairfax and endemic to Watsa's business strategy and Fairfax's corporate culture. For example:

(a) Fairfax's inability to reconcile intercompany balances and transactions;

(b) Fairfax's inability to properly prepare a consolidation of all Fairfax operations;

(c) Fairfax's extensive use of finite reinsurance, a highly publicized product used to improve short-term results, enhance capital, or to smooth earnings from quarter to quarter, rather than to transfer risk should have been subject to intense scrutiny by PWC;

(d) New York Attorney General Eliot Spitzer began a high profile investigation into the misuse of finite reinsurance contracts in November 2004. Initial investigations reviewed the use of such products by American International Group, Inc. (AIG) and other industry heavyweights pursuing suspicions that AIG and others engaged in finite reinsurance transactions as a means to inflate their balance sheets or smooth out their income statements, with little intended or actual risk transfer taking place. To the extent AIG and others utilized reinsurance accounting for such transactions; Spitzer claimed they misrepresented their financial condition in their publicly filed and/or available financial statements. In the case of AIG, these claims led to the retirement of AIG's chairman and multiple restatements of AIG's 2004 financials involving hundreds of millions of dollars in reserve increases. AIG's long time auditors are PWC. If any accounting firm should have been sensitized to the misuses of finite reinsurance, it certainly should have been PWC;

(e) The SEC also aggressively began investigating the finite reinsurance market. The SEC subpoenaed many insurance companies over their use of finite reinsurance contracts. In fact, on June 24, 2005, the Company received a subpoena from the SEC requesting documents regarding any "non-traditional" insurance product transactions between its Fairmont subsidiary and General Re. On September 7, 2005, Fairfax received a subpoena from the SEC requesting documents on any 'non-traditional" insurance or reinsurance products offered by any of the Fairfax owned companies. Then on September 26, 2005, the Company received a further subpoena from the SEC as part of their investigation;

(f) An undated letter was received by Fairfax CFO, Ambridge on December 9, 2004 from a hedge fund analyst expressing concern over the author's inability to reconcile the stock and bond holdings on the 2003 consolidated annual report of Fairfax to the total holdings from the individual insurance subsidiaries public or annual statutory filings. Attached were 11 pages of detailed calculations and assumptions supporting the author's contention that the total discrepancy between Fairfax's consolidated stock and bond holdings and the aggregate total of those amounts on the subsidiary or statutory reports was approximately $1 billion. The author copied Kevin Dancey, CEO, Canadian Senior Partner at PWC and The United States SEC on the letter;

(g) One of the prominent ratings agencies, FitchRatings, in a Rating Report dated March 2, 2005 that gave Fairfax a 'B+' senior debt rating and placed them on Negative Rating Watch status questioned management's strategy and raised concerns over the existence of fraud at Fairfax. This analyst report stated:

> Furthermore, Fitch believes a number of management actions, while providing short-term benefits, have further limited future financial flexibility. The very need to take these actions is a reflection of the challenges management faces in maintaining organizational viability. These include the transfer of a support agreement related to a run-off operation's obligation from Fairfax to a partially owned subsidiary; changes in the structure of the organization's letters of credit, which Fitch believes may provide inferior claims-paying capacity and raises concerns regarding the potential for "double-pledging" of the assets securing the facility; the extensive utilization of internal and external income smoothing/ capital-enhancing financial reinsurance, which has negatively affected investment income; and sales of minority stakes in profitable operating segments, which has decreased available operating cash flow.

(h) A well-known industry analyst, John Gwynn with Morgan Keegan, in his January 30, 2003 analyst report opined that using loss triangles, he estimated Fairfax is approximately $1.04 billion under-reserved excluding asbestos, which he also believed to be under reserved. Gwynn specifically attributed those reserve shortfalls to claims losses at TIG.

The projected reserve shortfall of $1.04 billion was approximately 5% of the balance of the provision for claims on Fairfax's balance sheet at December 31, 2002.

2. PWC either Deliberately Ignored or Was Reckless in Ignoring Red Flags Because Its Audits Were Not Performed In Accordance With GAAS

505. PWC either deliberately ignored or was reckless in ignoring red flags resulting in its audits not being prepared in accordance with GAAS. In issuing unqualified audit opinions on Fairfax's financial statements despite Fairfax's violations of GAAP, and in failing to heed the numerous red flags that should have alerted it to Fairfax's accounting violations, PWC either acted knowingly, or was reckless, in failing to comply with the professional standards dictated by GAAS including:

(a) Multiple General Standards (5025.27 and 5025.30) were violated, which require that the audit be performed by a person or persons having adequate technical training and proficiency as an auditor;

(b) A General Standard (5025.24) was violated, which standard requires that due care is to be exercised in the performance of the audit and in the preparation of the report;

(c) An Examination Standard (5100.02), which requires that the auditor's work be adequately planned and assistants, if any, are to be properly supervised;

(d) An Examination Standard (5100.02), which requires that an auditor gain sufficient understanding of a company's internal control to plan the audit and to determine the nature, timing, and extent of tests to be performed;

(e) An Examination Standard (5100.02), which requires that the auditor obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion on the financial statements under examination; and

(f) A Reporting Standard (5100.02), which requires that an auditor's report state whether the financial statements are presented in accordance with generally accepted accounting principles.

506. As set forth above, Fairfax's financial statements during the Class Period failed to comply with both Canadian and US GAAP and applicable SEC regulations. Pursuant to GAAS, PWC was required to qualify its opinions—as opposed to issuing unqualified opinions—on Fairfax's financial statements (CICA Section 5510) and thereby disclose to the investing public the nature and extent of the Company's non-GAAP accounting and to provide the disclosures that the Company's financial statements omitted.

507. However, PWC violated GAAS by issuing unqualified opinions on the Company's financial statements during the Class Period and by failing to provide the necessary disclosures.

3. PWC Failed to Adequately Plan Its Audit

508. Under GAAS, it is inherent in the planning process (CICA Section 5141) to have sufficient knowledge of the Company, the industry, the environment, areas of audit exposure, weaknesses in internal control and various other important matters in order to properly plan the audit. GAAS (CICA Section 5141) states that:

> Obtaining an understanding of the entity and its environment is an essential aspect of performing an audit in accordance with generally accepted auditing standards. In particular, that understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgment about assessing risks of material misstatement of the financial statements and responding to those risks throughout the audit, for example when:
>
> a. Establishing materiality and evaluating whether the judgment about materiality remains appropriate as the audit progresses;
>
> b. Considering the appropriateness of the selection and application of accounting policies, and the adequacy of financial statement disclosures;
>
> c. Identifying areas where special audit consideration may be necessary (*e.g.*, related party transactions, conditions and events that cast doubt on the entity's

ability to continue as a going concern or considering the business purpose of transactions);

d. Developing expectations for use when performing analytical procedures;

e. Designing and performing further audit procedures to reduce audit risk to an acceptably low level; and

f. Evaluating the sufficiency and appropriateness of audit evidence obtained, such as the appropriateness of assumptions and of management's oral and written representations.

509. Moreover, the auditor is required to design the audit with professional skepticism (CICA 5135.023-.025) in order to provide reasonable assurance of detecting errors, material misstatements or fraud. Although PWC had a long history with Fairfax, GAAS requires that when making inquiries and performing audit procedures, the auditor should exercise professional skepticism and not be satisfied with less-than-persuasive audit evidence.

510. PWC failed to comply with GAAS as it failed to design its audit plan to provide reasonable assurance of detecting material errors as required by CICA Section 5141. PWC was required under GAAS to obtain knowledge of the Company's business and environment, including its internal control, apply analytical procedures and assess the risk of material misstatement in planning for its audit.

511. PWC failed to consider or overlooked the existence of the red flags identified herein, and other risk factors, or failed to properly design or modify its planned audit procedures to mitigate those risks. Despite these obvious issues, PWC failed to develop an adequate strategy for the conduct and scope of the audit of the Company's finite reinsurance and the related reserves and reinsurance recoverables, intercompany transactions, consolidation, investments and tax accounting.

512. PWC audited Fairfax's financial statements and provided tax, actuarial, and other services prior to and during the Class Period, and had a thorough knowledge of the Company's financial history, accounting practices, internal controls, and business operations. Despite this

intimate familiarity with Fairfax's business practices, in auditing Fairfax's financial statements, PWC either knowingly or recklessly failed to:

(a) Identify areas that needed special consideration (such as finite reinsurance contracts, intercompany transactions, hedging, off-shore subsidiaries and consolidation) or identified such areas and audited them in a manner which was so deficient that it amounted to no audit at all, while making audit judgments that no reasonable auditor would have made if confronted with the same facts;

(b) Assess the conditions under which accounting data (such as for "finite reinsurance contracts") was produced, processed, reviewed, and accumulated within the organization or assessed such conditions and made audit judgments based upon said assessment that no reasonable auditor would have made if confronted with the same facts;

(c) Evaluate the reasonableness of estimates and management's representations (such as its estimates of claim loss reserves and its representations regarding the evaluations of the transfer of risk in the Company's finite reinsurance contracts, its offshore reinsurance operations and intercompany transactions, and its significant risks and uncertainties) or evaluated them in a manner which was so deficient that it amounted to no evaluation at all; and

(d) Judge the appropriateness of the accounting principles applied (such as the principle that the finite reinsurance contracts transferred risk to the reinsurer (as required under US GAAP SFAS No. 113) and the adequacy of disclosures in the Company's financial statements (such as those required by US GAAP SFAS No. 60), or did so and arrived at judgments that no reasonable auditor would have arrived at if confronted with the same facts.

513. GAAS (CICA Section 5150) states that audit planning involves developing an overall strategy for the expected conduct and scope of the audit. Accordingly, GAAS recognizes

that the nature, extent, and timing of audit planning may vary with the size and complexity of the company, the level of experience of the audit team, experience with the company, and knowledge of the company's business. In this regard, GAAS provides that in planning the audit, the auditor should prepare a written audit program (or set of written audit programs) for every audit and that this audit program should set forth in reasonable detail the audit procedures that the auditor believes are necessary to accomplish the objectives of the audit. GAAS further states that, in developing the program, the auditor should be guided by the results of the planning considerations and procedures and, as the audit progresses, it may be necessary to modify the audit plan.

514. Matters that the auditor needs to consider when planning the audit include (CICA Section 5150):

(a) The terms of the engagement and the expected date of his or her report;

(b) The nature of the client's business including applicable statutory and contractual requirements;

(c) The experience gained during previous audit engagements;

(d) The accounting policies;

(e) The degree of complexity of the entity's control environment and control systems;

(f) The level of materiality and the components of audit risk;

(g) Any involvement of other auditors;

(h) Any involvement of internal auditors and persons having special expertise;

(i) The intended audit approach;

(j) The level of experience and number of any assistants to be assigned to the engagements; and

(k) The date the auditing procedures are to be performed taking into account the availability of audit evidence to be obtained and the effectiveness of performing such procedures at that date.

515. PWC failed to comply with the foregoing provisions of GAAS in that PWC knew or was reckless in not knowing that Fairfax's finite reinsurance transactions and the internal control weaknesses present at Fairfax were a material part of the Company's business operations, and PWC failed to utilize this information in planning and performing its audit or utilized this information in a manner that no reasonable auditor would have used if confronted with the same facts. Given that PWC had unrestricted access to all of the Company's books and records, counseled the Company on a wide variety of tax, accounting, actuarial and other business matters, and attended meetings of the Audit Committee of the Company's Board of Directors to discuss the planning and staffing of its audit, the Company's internal controls, and the management letters which PWC issued on a regular basis, it is apparent that PWC was thoroughly familiar with all aspects of the Company's financial history, accounting practices, system of internal controls, and business operations.

516. GAAS mandates (CICA Section 5025.24) that: "The assurance engagement should be performed with due care and an objective state of mind." Due care imposes a responsibility on each person performing the assurance engagement to comply with each of the Standards for Assurance Engagements in the context of his or her responsibilities. All persons performing the assurance engagement should maintain an objective state of mind in order to remain unbiased in carrying out their responsibilities and in forming their conclusions.

517. Given the materiality and high level of assessed risk associated with the Company's finite reinsurance contracts and the significant reductions in net claims reserves and the on-going consolidation and intercompany issues, PWC should have significantly expanded

the scope of its audits and the nature of its procedures in observance of GAAS (CICA Section 5143.07) which states that: "The auditor should design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement at the assertion level." PWC failed to do so, violating GAAS.

518. On November 16, 2004, Attorney General for the State of New York, Eliot Spitzer testified before U.S. Congress to "Widespread Corruption and Illegal Practices in the Insurance Industry," characterizing his investigations' findings to that of a "Pandora's Box of Unethical Conduct." He soon thereafter led an investigation into finite reinsurance transactions at AIG that eventually led to the Chairman's dismissal and hundreds of millions of dollars in restatements.

519. Given the highly publicized nature of Spitzer's activities and the AIG investigations, PWC was well aware that finite reinsurance transactions and whether they provided an appropriate risk transfer were under the microscope. The investigations had also brought to light the existence of side-agreements between many parties to finite reinsurance transactions. PWC was required by GAAS (CICA Section 5090.05) to exercise professional skepticism in evaluating finite reinsurance transactions at Fairfax. Moreover, PWC was required by GAAS (CICA Sections 5090.023, 5100.02 and 5600.13) to assess whether the true nature of Fairfax's finite reinsurance transactions were properly disclosed in compliance with GAAP and the rules and regulations of the SEC (Item 404 of Regulation S K).

520. Pursuant to GAAS (CICA Sections 5141), PWC was required to understand whether there was a real commercial business reason behind Fairfax's finite reinsurance transactions or whether they were entered into simply to improve short-term results, enhance the appearance of the Company's financial condition, or to smooth earnings from quarter to quarter:

> Assessing the risks of material misstatement requires the auditor to identify and assess the risks of material misstatem5ent at the financial statement and assertion

> levels. The auditor" identifies risks by considering the entity and its environment, including relevant controls, and by considering the classes of transactions, account balances and disclosures in the financial statements.

521. PWC either complied with the foregoing GAAS and understood the business sense of Fairfax's finite reinsurance transactions--and thus the true nature of Fairfax's reinsurance transactions with reinsurers--or recklessly failed to comply with GAAS and, thus, failed to know, thereby violating GAAS.

522. In addition, under the GAAS (CICA Section 5025) Performance Standards, the audit should be adequately planned and auditors should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability so that they can evaluate the sufficiency and appropriateness of the audit evidence they are examining.

523. PWC either possessed the requisite level of knowledge to understand and evaluate the effects of finite reinsurance transactions and knew and ignored that the high profile transactions were riskless arrangements under US GAAP SFAS No. 113, and that required GAAP disclosures were not made, or PWC failed to possess the requisite level of knowledge and understanding and failed to know these facts.

524. PWC failed to comply with the provisions of GAAS (CICA Section 6010), which requires the auditor be aware of the possible existence of material related-party transactions that could affect the financial statements. Certain restatement adjustments were made to correct for unreconciled intercompany balances and to record the effects of an intercompany dispute. Compliance with this GAAS mandate, alone, should have caused PWC to identify these issues in the periods in which they first arose and not allowed them to continue uncorrected for years.

4. PWC Failed to Obtain Sufficient Competent Evidential Matter

525. GAAS provides that accounting data alone is insufficient to support an opinion on financial statements. Before rendering an opinion on financial statements, the auditor must obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which

to base the audit opinion. Audit evidence consists of the underlying accounting data and all corroborating information available to the auditor. (CICA Section 5300). Sufficient appropriate audit evidence includes both documentation obtained during the field work (*e.g.*, checks, invoices, contracts, and independent confirmations) and information obtained from inquiry, observation, inspection and physical examination. (CICA Section 5300).

526. Management inquiry alone ordinarily does not provide sufficient audit evidence to detect a material misstatement at the assertion level or to test the operating effectiveness of controls. Management representations are not a valid substitute for the application of audit procedures to form a reasonable basis for an auditor's opinion of financial statements (CICA Section 5300). Appropriate audit evidence that can be obtained from independent sources outside an entity provides greater assurance of reliability than any internally developed. Confirmation of accounts receivable is an acceptable form of appropriate audit evidence under GAAS. (CICA Section 5303). Confirmations are to be used to obtain evidence from third parties about financial statement assertions made by management, such as rights and obligations under reinsurance contracts. PWC either complied with GAAS and sent appropriate confirmations and knew and ignored that Fairfax's financial statement assertions were materially false and misleading, or it failed to comply with GAAS (CICA Section 5303) and failed to know.

527. In the course of auditing Fairfax's financial statements during the relevant time period, PWC either knew or recklessly disregarded facts that indicated that it had failed to obtain sufficient appropriate audit evidence to afford a reasonable basis for expressing unqualified opinions on Fairfax's financial statements. PWC's staff was frequently present at Fairfax's offices and had access to Fairfax's internal corporate books and records particularly during its annual audits. In addition, PWC's staff had access to Fairfax's private and confidential financial and business information. Given the availability of such records and information, PWC either

obtained, through inspection, observations, inquiries, and other audit procedures, sufficient appropriate audit evidence to compel it to issue qualified or adverse opinions on Fairfax's financial statements, or it recklessly failed to utilize the available records and information in the performance of its audits and recklessly failed to issue qualified or adverse opinions on Fairfax's financial statements.

528. GAAS (CICA Section 5300) notes that underlying accounting data and all corroborating information available to the auditor (including books of original entry, the general and subsidiary ledgers, related accounting manuals, and records such as work sheets and spreadsheets supporting cost allocations, computations, checks, purchase orders, bills of lading, invoices, records of electronic fund transfers, invoices, contracts, minutes of meetings, and reconciliations) constitute evidence that should be subjected to inquiry, observation, inspection, confirmation, and physical examination during an audit. It is inconceivable that PWC could have inquired about, observed, inspected, confirmed and physically examined the available documentation and failed to detect the fraudulent activities of the Company. Accordingly, PWC either performed audits which were so deficient that they amounted to no audits at all, or it identified and ignored, or recklessly failed to investigate extremely questionable transactions and documents, and made audit judgments that no reasonable auditor would have made if confronted with the same facts.

529. PWC was also required to have significantly expanded the scope of its audits and the nature of its procedures in observance of GAAS (CICA Section 5143.11) which states that "The auditor's selection of audit procedures is based on the assessment of risk. The higher the auditor's assessment of risk, the more reliable and relevant is the audit evidence sought by the auditor from substantive procedures." Based on the high risk nature of the finite reinsurance,

intercompany, and consolidation issues, PWC should have sought a higher level of sufficient appropriate audit evidence.

5. PWC Improperly Issued Unqualified Audit Reports

530. The Reporting Standards under GAAS, provide the following: (i) the report should identify the financial statements and distinguish between the responsibilities of management and responsibilities of the auditor; (ii) the report should describe the scope of the auditor's examination; (iii) the report should contain either an expression of opinion on the financial statements or an assertion that an opinion cannot be expressed; in the later case, the reasons therefore should be stated; and (iv) where an opinion is expressed, it should indicate whether the financial statements present fairly, in all material respects, the financial position, results of operations and cash flows in accordance with Canadian generally accepted accounting principles, except when the financial statements are prepared using a basis of accounting other than generally accepted accounting principles or are financial statements of a federal, provincial, territorial or local government. (CICA Section 5100).

531. PWC issued unqualified audit opinions on the Company's annual financial statements for each of the years ended December 31, 2003 to 2004, falsely stating that those financial statements had been prepared in accordance with Canadian GAAP.

532. PWC failed to comply with GAAS in that PWC's opinions failed to state that the disclosures in Fairfax's financial statements on the nature of the finite reinsurance transactions were not reasonably adequate.

533. PWC, when confronted with financial statements that ignored the inappropriate use of reinsurance accounting and included the misstatement effects of serious material weaknesses in internal control, failed to express a qualified or adverse opinion and provide the information in its reports as required by GAAS. Instead, PWC stated, in each and every audit

opinion which it issued during the Class Period, that it examined "evidence supporting the amounts and disclosures in the financial statements" and assessed the "accounting principles used . . . as well as . . . the overall financial statement presentation" and determined that Fairfax's financial statements were presented "fairly, in all material respects."

534. PWC should have insisted that Fairfax adjust its financial statements prior to issuing its unqualified audit opinions. If Fairfax had refused to make the corrections, then PWC should have decided what type of reservation was appropriate. In accordance with the GAAS provisions of CICA Section 5510, *Reservations in the Auditor's Report*, "when there is a departure from GAAP or a scope limitation, the auditor must decide what type of reservation is necessary." This involves evaluation of materiality, the degree to which the matter impairs the usefulness of the financial statements, the extent to which the effects on the financial statements can be determined and whether they are misleading. PWC should have decided whether an adverse or qualified opinion should have been issued stating that Fairfax's financial statements did not comply with GAAP and were not presented fairly or qualified opinions. These types of opinions should have disclosed the reasons PWC was departing from the standard unqualified audit opinion. If such audit reports had been issued by PWC, then investors would have been notified of the substantial risk they were shouldering by investing in and lending to Fairfax. Instead, PWC became a primary violator of the securities laws by issuing 'clean' audit opinions which greatly facilitated and prolonged the fraud. Without these materially false and misleading unqualified audit opinion reports, the fraud could not have been perpetuated.

6. PWC Improperly Issued an Unqualified Audit on the Effectiveness of the Company's Internal Controls over Financial Reporting

535. PWC violated Public Company Accounting Oversight Board Auditing ("PCAOB") Standard No. 2: *An Audit of Internal Control Over Financial Reporting Performed*

in Conjunction With an Audit of Financial Statements. Under Section 404(b) of the Sarbanes-Oxley Act of 2002, PWC, as the financial statement auditor, was to opine on management's assessment of the effectiveness of internal control over financial reporting beginning with the 2004 audit.

536. This standard defines internal control over financial reporting as a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

537. The concept of reasonable assurance is built into the definition of internal control over financial reporting and also is integral to the auditor's opinion. Reasonable assurance includes the understanding that there is a remote likelihood that material misstatements will not be prevented or detected on a timely basis. Although not absolute assurance, reasonable assurance is, nevertheless, a high level of assurance.

538. PCAOB acknowledges how important this audit of internal control over financial reporting is to investors. PCAOB Auditing Standard No. 2 states:

> The auditor should be aware that persons who rely on the information concerning internal control over financial reporting include investors, creditors, the board of directors and audit committee, and regulators in specialized industries, such as banking or insurance. The auditor should be aware that external users of financial statements are interested in information on internal control over financial reporting because it enhances the quality of financial reporting and increases their confidence in financial information, including financial information issued between annual reports, such as quarterly information. Information on internal control over financial reporting is also intended to provide an early warning to those inside and outside the company who are in a position to insist on improvements in internal control over financial reporting, such as the audit committee and regulators in specialized industries.

539. In Fairfax's restated Form 40-F/A for the year ended December 31, 2005 filed on September 11, 2006, it was disclosed in the restated "Management's Evaluation of Disclosure Controls and Procedures" that Watsa and Ambridge concluded that the disclosure controls and procedures were not effective as of December 31, 2005 because of the material weaknesses discovered. A material weakness is defined under the PCAOB standards as "a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected."

540. To obtain reasonable assurance, the auditor is required to evaluate the assessment performed by management and obtain and evaluate evidence about whether the internal control over financial reporting was designed and operated effectively.

541. In Fairfax's restatement of Form 40-F for the year ended December 31, 2005, the following material weaknesses were disclosed by Fairfax:

(a) Fairfax failed to maintain an appropriate accounting and financial reporting organizational structure, including insufficient staffing and not maintaining the appropriate level of accounting knowledge, experience and training;

(b) Fairfax failed to maintain effective controls over the completeness and accuracy of period-ending financial reporting and close processes, including lack of monitoring and documentation over intercompany eliminations and reconciliation, translation of foreign currency transactions and recording of journal entries;

(c) Fairfax failed to maintain controls over accounting for derivatives in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities; and

(d) Fairfax failed to maintain effective controls over the completeness and accuracy of the income tax calculations and responsibilities.

542. PWC in turn restated its audit report on the December 31, 2005 financial statements due to the material weaknesses noted above, and opined that Fairfax has not maintained effective internal control over financial reporting as of December 31, 2005.

543. As much as PWC's restated opinion only refers to December 31, 2005, the nature of the material weaknesses disclosed and the related restatement adjustments made by the Company are clearly reflective of material weaknesses that have existed at Fairfax since prior to the beginning of the class period, but were never disclosed by the Company or revealed by PWC. The restatement adjustments pertaining to intercompany errors, unreconciled intercompany balances and consolidation errors had an effect on net earnings in years going back to 2000 and prior. Foreign currency translation errors and errors in the calculation of income tax provisions had an effect on net earnings in years dating back to 2001.

544. PWC's failure to identify the material internal control weaknesses in the years of the class period are not simply a violation of PCAOB Auditing Standard No. 2. In an audit of internal control over financial reporting, the auditor's evaluation of controls is interrelated with the auditor's evaluation of controls in a financial statement audit, as required by AU Sec. 316, *Consideration of Fraud in a Financial Statement Audit*. Controls identified and evaluated by the auditor during the audit of internal control over financial reporting also address or mitigate fraud risks, which the auditor is required to consider in a financial statement audit. PWC failed to adequately test and identify, or respond to, deficiencies in controls designed to prevent and detect fraud during the audit of internal control over financial reporting. Under AU Sec. 316, PWC should have additionally altered the nature, timing, or extent of procedures to be performed during the financial statement audit in consideration of these deficiencies.

545. PWC violated PCAOB Auditing Standard No. 2, which requires that the auditor obtain sufficient competent evidence about the design and operating effectiveness of controls over all relevant financial statement assertions related to all significant accounts and disclosures in the financial statements. The auditor must plan and perform the audit to obtain reasonable assurance that deficiencies that, individually or in the aggregate, would represent material weaknesses are identified. Based on the material weaknesses identified in the restatement and the related restatement adjustments and the periods effected, it is clear PWC failed to obtain sufficient competent evidential matter on the design and effectiveness of the internal controls since the beginning of the Sarbanes-Oxley requirements for Fairfax in 2004. Corroborating evidential matter under GAAS includes both documentation obtained during the field work (*e.g.*, invoices, contracts, and independent confirmations) and information obtained from inquiry, observation, inspection and physical examination.

546. The same GAAS general standards of fieldwork and reporting as required in the auditing of the financial statements are required by PCAOB. As such, PWC's violations of the general and fieldwork standards, as outlined above, also pertain to its performance of the audit of internal control over financial reporting. PWC violated additional provisions of PCAOB Auditing Standard No. 2. Had PWC properly understood and evaluated management's process and its inherent shortfalls, and performed the basic audit procedures, it would have identified the material weaknesses that lead to the restatements. These additional violations are as follows:

(a) PWC violated ¶129 of Auditing Standard 2, which states that an auditor may issue an unqualified opinion only when there are no identified material weaknesses. PWC's audit either failed to acknowledge, or report these weaknesses that had been in existence since prior to the beginning of the class period, and were identified in the restated Form 40-F/A filed on September 11, 2006;

(b) PWC violated ¶40 of Auditing Standard 2, which requires the auditor obtain an understanding of, and evaluate, management's process for assessing the effectiveness of the company's internal control over financial reporting; and

(c) PWC violated ¶47 of Auditing Standard 2, which requires the auditor obtain an understanding of the design of specific controls by applying procedures that included making inquiries of appropriate management, supervisory, and staff personnel, inspecting company documents, observing the application of specific controls; and tracing transactions through the information system relevant to financial reporting.

XII. APPLICABILITY OF PRESUMPTION OF RELIANCE: FRAUD ON THE MARKET

547. Plaintiff will rely upon the presumption of reliance established by the fraud-on-the-market doctrine in that, among other things:

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

(b) The omissions and misrepresentations were material;

(c) The Company's shares traded in efficient markets;

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

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

548. At all relevant times, the markets for Fairfax's publicly-traded securities were efficient for the following reasons, among others:

(a) As a regulated issuer, Fairfax filed periodic public reports with the SEC and Canadian securities regulators;

(b) Fairfax regularly communicated with public investors via established market communication mechanisms, including through regular dissemination of press releases on the major news wire services and through other wide-ranging public disclosures, such as communications with the financial press, securities analysts and other similar reporting services; and

(c) Fairfax's publicly-traded securities were actively traded in efficient markets.

XIII. LOSS CAUSATION ALLEGATIONS

549. Throughout the Class Period, the price of Fairfax's securities was massively inflated as the result of the Defendants' manipulation of Fairfax's financial results. But for the Defendants' misrepresentations, which had the effect of overstating shareholders' equity, assets and investment income, while understating liabilities, Plaintiff would not have purchased Fairfax's securities at the artificially inflated prices at which they were offered.

550. As a direct result of the Defendants' scheme, misrepresentations and omissions of material facts the price of Fairfax's subordinate voting shares (or common stock) was artificially inflated throughout the Class Period. Because of the Defendants' false and misleading statements, Fairfax's common stock closed at an average price of $154.86 during the Class Period, reaching a Class Period high of $187.20 on February 3, 2004.

551. The Defendants' schemes slowly began to reveal themselves to the market in June 2005 four months after Fairfax's common stock peaked at its Class Period high. Each individual disclosure partially corrected misstatements relating to the Defendants' scheme to present

Fairfax as a successful business and slowly corrected the inflation caused by the Defendants' conduct.

552. The declines in the Company's stock price between June 2005 and March 2006, including but limited to, the declines summarized below, are directly attributable to the market's absorption of information correcting misrepresentations relating to the Defendants' scheme to present Fairfax as a successful business.

553. On June 24, 2005, Fairfax issued a press release stating that, "Fairmont Specialty Group, has received a subpoena from the Securities and Exchange Commission requesting documents regarding any non-traditional insurance product transactions entered into by Fairmont with General Re Corporation." The June 24, 2005 press release, partially corrected the Defendants' misrepresentations that Fairfax was based on a sound business model, which did not include improper use of finite reinsurance contracts, and partially disclosed that the improperly used finite reinsurance contracts to mask the Company's liquidity problems. As the market absorbed the information contained in the June 24, 2005 press release, Fairfax's shares declined in value, falling from $164.50 on June 23, 2005, to close at $161.91 on June 24, 2005, a decline of 1.6%.

554. On September 7, 2005, Fairfax issued a press release stating that, "the Fairfax group has received a subpoena from the Securities and Exchange Commission requesting documents regarding any non-traditional insurance/reinsurance product transactions entered into by the entities in that group and any non-traditional insurance/reinsurance products offered by the entities in that group." The September 7, 2005 press release, partially corrected the Defendants' misrepresentations that Fairfax was based on a sound business model, which did not include improper use of finite reinsurance contracts, and partially disclosed that the improperly used finite reinsurance contracts to mask the Company's liquidity problems. As the market

absorbed the information contained in the September 7, 2005 press release, Fairfax's shares continued to lose value. Fairfax's shares fell from $166.15 on September 6, 2005, to close at $159.51 on September 16, 2005, a decline of 4%.

555. On October 10, 2005, several news articles reported that the Justice Department joined the SEC's investigation of Fairfax. The October 10, 2005, articles partially corrected the Defendants' misrepresentations, despite Fairfax's statement that day "that it has not received a subpoena or other information request from the U.S. Attorney's Office," that Fairfax was based on a sound business model, which did not include improper use of finite reinsurance contracts, and partially disclosed that the improperly used finite reinsurance contracts to mask the Company's liquidity problems. As the market absorbed the information contained in the October 10, 2005 articles, Fairfax's shares continued to lose value. Fairfax's shares fell from $168.17 on October 7, 2005, to close at $149.00 on the following trading day (October 10, 2005), a decline of 11.4%.

556. On October 11, 2005, Fairfax issued a "clarification" of its statements concerning the Justice Department's interest in the Company. The October 11, 2005 press release stated:

> In response to certain published information incorrectly reporting Fairfax's release of October 10, 2005, Fairfax advises that it understands that the U.S. attorney's office for the Southern District of New York will review information that Fairfax provides to the SEC in response to SEC subpoenas, but that Fairfax has not been advised that it is the target of an investigation by that office. Fairfax confirms its October 10, 2005 release that it has not received a subpoena or other information request from the U.S. attorney's office. Fairfax continues to cooperate with the SEC's investigation.

The October 11, 2005, press release partially corrected the Defendants' misrepresentations (notwithstanding Fairfax's statement the previous day "that it has not received a subpoena or other information request from the U.S. Attorney's Office") that Fairfax was based on a sound business model, which did not include improper use of finite reinsurance contracts, and partially disclosed that the improperly used finite reinsurance contracts to mask the Company's liquidity problems. As the market absorbed the information contained in the October 11, 2005 press release, Fairfax's shares continued to lose value. Fairfax's shares fell from $151.00 on October 11, 2005, to close at $143.71 on October 18, 2005, a decline of 4.8%.

557. On February 10, 2006, Fairfax held a conference call with analysts to discuss the Company's results for the year ended December 31, 2005. During the February 10, 2006 Conference Call, and in response to a question from an analyst about Fairfax's internal review of the Company's finite reinsurance contracts, Watsa stated:

> We have of course with the focus on the industry on finite contracts, we have done a complete review of all our companies, all our contracts, and across Fairfax and its subsidiaries, across Fairfax and one or two of the -- a few contracts that we have had at the holding company. And I am happy to tell you that that's the OdysseyRe restatement were the only ones that did come up. Greg has given you a perspective on them and -- but we are happy to say that we have been a full review by us and by our independent auditors and those were the only ones that came up.

558. The February 10, 2006 Conference Call partially corrected the Defendants' misrepresentations that Fairfax was based on a sound business model, which did not include improper use of finite reinsurance contracts, and partially disclosed that the Company was facing a liquidity crisis. As the market absorbed the information contained in the February 10, 2006 Conference Call, Fairfax's shares continued to lose value. Fairfax's shares fell from $147.00 on February 10, 2006, to close at $140.38 on February 17, 2006, a decline of 4.5%.

559. Shortly after Watsa declared that after a "complete review of all our companies, all our contracts, and across Fairfax and its subsidiaries . . . the OdysseyRe restatement were the only ones that did come up," on March 22, 2006, Fairfax issued press release titled, "Subpoena Update."

560. The March 22, 2006 press release, stated that SEC subpoenas had been issued to the Company and its affiliates and reiterated that the U.S. Attorney's Office for the Southern District of New York was reviewing documents produced to the SEC by the Company and was

participating in the investigation of the matters being probed by the SEC. The Company also announced that it had "prepared presentations and provided documents to the SEC and the U.S. Attorney's office" and that "its employees, including senior officers, have attended or have been requested to attend interviews conducted by the SEC and the U.S. Attorneys office."

561. At this same time, the Company noted that Fairfax and Watsa had both received subpoenas from the SEC in connection with Watsa's comments on the February 10, 2006 investor conference call concerning the internal review of the Company's finite insurance contracts. Following the Company's March 22, 2006 disclosure, Fairfax's stock suffered its biggest single day decline in approximately three years, falling from $130.90 to $113.93 per share, representing a decline in market capitalization of approximately $300 million, or approximately 13% of its value.

562. During the Class Period, unsuspecting investors priced Fairfax's securities based upon the Company's reported financial figures. The declines in the Company's stock price described above are directly attributable to disclosures that partially corrected misrepresentations relating to the Defendants' scheme to present Fairfax as a successful business that did not improperly rely on finite reinsurance contracts to manipulate its results and was not facing a liquidity crisis.

563. The Defendants' misrepresentations and fraudulent schemes, which were eventually revealed to the market, were the proximate and foreseeable cause of the Class's losses, as the value of investors' investments in Fairfax's securities declined in direct response to the revelations of the Defendants' fraud as alleged herein.

564. Although the corrective disclosures identified herein partially corrected misrepresentations relating to the Defendants' scheme to present Fairfax as a successful business, none of the disclosures revealed the magnitude of the Defendants' scheme. Only after

Fairfax filed its restatement, did investors learn of the Defendants' schemes to falsify Fairfax's financial statements and magnitude of the fraud perpetuated on the market by the Defendants.

XIV. CLAIMS FOR RELIEF

COUNT I

Violation of Section 10(b) of the Securities Exchange Act and, Rule 10b-5 Promulgated Thereunder, Against Fairfax, OdysseyRe, the Officer Defendants, and PWC (the "10(b) Defendants")

565. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

566. This Count is asserted against the 10(b) Defendants by Plaintiff on behalf of itself and all members of the Class for violations of Section 10(b) of the Exchange Act, 15 U.S.C. §78j(b), and Rule 10b-5, 17 C.F.R. §240.10b-5, promulgated thereunder.

567. During the Class Period, the 10(b) Defendants individually and in concert, directly and indirectly, by the use and means of instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct that intended to and did: (i) deceive the investing public, including Plaintiff and the Class; (ii) artificially inflate the earnings reported by the Company and included in the Company's financial statements filed with the SEC; (iii) artificially inflate and maintain the market price of the Company's securities; and (iv) cause Plaintiff and the Class to purchase or otherwise acquire the Company's securities.

568. The 10(b) Defendants: (a) employed devices, schemes, and artifices to defraud while in the possession of material, adverse non-public information; (b) made untrue and/or misleading statements of material fact and/or omitted to state material facts necessary in order to make the statements made not misleading; and (c) engaged in acts, practices and a course of business which operated as a fraud and deceit upon Plaintiff and the other members of the Class in an effort to artificially inflate the price of the Company's securities and maintain such

artificially inflated prices, in violation of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

569. In addition to the duties of full disclosure imposed on the 10(b) Defendants as a result of their making affirmative statements and reports, or participation in the making of affirmative statements and reports to the investing public, they had a duty to promptly disseminate truthful information that would be material to investors, in compliance with GAAP and the integrated disclosure provisions of the SEC as embodied in SEC Regulations S-X (17 C.F.R. §210.01, *et seq*.) and S-K (17 C.F.R. §229.10, *et seq*.) and other SEC regulations, including truthful, complete and accurate information with respect to the Company's operations and performance so that the market prices of the Company's publicly-traded securities would be based on truthful, complete and accurate information.

570. The 10(b) Defendants named in this count had access to the non-public information detailed above, by virtue of their receipt of periodic internal reports and other financial information. During the Class Period, Fairfax acted through the Officer Defendants, whom they portrayed and represented to the press and public as their authorized representatives. The willfulness, motive, knowledge, and/or recklessness of the Officer Defendants is therefore imputed to Fairfax which is liable for the securities law violations of the Officer Defendants while acting in their official capacity as Company representatives, or, in the alternative, which is liable for the acts of the Officer Defendants under the doctrine of *respondeat superior*.

571. Each of the 10(b) Defendants knew or recklessly disregarded the fact that the above acts and practices, misleading statements, and omissions would adversely affect the integrity of the market of Fairfax's securities. Had the adverse facts been properly disclosed, Fairfax's securities would not have sold at artificially inflated prices during the Class Period.

572. As alleged herein, each 10(b) Defendant acted with scienter during the Class Period, in that each had actual knowledge of the misrepresentations and/or omissions of material facts set forth herein, or acted with reckless disregard for the truth and failed to ascertain and disclose the true facts.

573. The facts, as alleged herein, compel a strong inference that the 10(b) Defendants made materially false and misleading statements to the investing public and acted with scienter in that they knew that the public documents and statements, issued or disseminated by or in the name of the Company were materially false and misleading; knew or recklessly disregarded that such statements or documents would be issued or disseminated to the investing public; and knowingly and substantially participated or acquiesced in the issuance or dissemination of such statements or documents as primary violators of the federal securities laws. Moreover, the 10(b) Defendants caused Fairfax to engage in improper accounting practices, and in turn caused Fairfax to report artificially inflated financial results.

574. The Officer Defendants were senior executives of Fairfax and responsible for all of its day-to-day operations during the Class Period. By virtue of their positions and control, the Officer Defendants were privy to information reflecting the true facts regarding Fairfax. The ongoing fraudulent scheme described in this complaint could not have been perpetrated over a substantial period of time, as has occurred, without the knowledge and complicity of the personnel at the highest level of the Company, including the Officer Defendants.

575. The Officer Defendants participated in the drafting, preparation, and/or approval of the various public reports and other communications complained of herein and knew of, or recklessly disregarded, the misstatements contained therein and omissions therefrom, and were aware of their materially false and misleading nature.

576. As a result of the dissemination of the materially false and misleading information and/or the 10(b) Defendants' failure to disclose material facts, as set forth herein, the market price of Fairfax securities was artificially inflated at all times during the Class Period. In ignorance of the fact that the market price of Fairfax's publicly-traded securities was artificially inflated, and relying directly or indirectly on the materially false and misleading statements made by the 10(b) Defendants, or upon the integrity of the market in which the securities trade, Plaintiff and the Class purchased or otherwise acquired for value Fairfax securities during the Class Period at artificially high prices and were damaged thereby.

577. At the time of such misstatements and omissions, Plaintiff and the Class were ignorant of their falsity, and believed them to be true. Had Plaintiff, the Class, and the marketplace known of the true financial condition of the Company, which was not disclosed by the 10(b) Defendants, Plaintiff and the Class would not have purchased or otherwise acquired Fairfax's securities during the Class Period, or, if they had purchased or otherwise acquired such shares during the Class Period, they would not have done so at artificially inflated prices.

578. The price of Fairfax securities declined materially upon public disclosure of the true facts that had been misrepresented or concealed, as alleged herein. Plaintiff and other members of the Class have suffered substantial damages as a result of the wrongs alleged herein.

579. The 10(b) Defendants are liable as direct participants in all of the wrongs complained of herein. Through their positions of control and authority, the Officer Defendants were in a position to and did control all of the Company's public filings and press releases as more particularly set forth above. In addition, certain of these false and misleading statements constitute "group published information," which the Officer Defendants were responsible for creating, reviewing and/or approving before they were disseminated to the investing public.

Fairfax is liable for each of the statements of the Officer Defendants through the principles of *respondeat superior*.

580. In addition, the Officer Defendants are liable for the specific false and misleading statements contained in ¶¶231-456.

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

COUNT II

Violation of Section 20(a) of the Exchange Act Against Fairfax and the Officer Defendants (the "20(a) Defendants")

582. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

583. This count is asserted against the 20(a) Defendants by Plaintiff on behalf of itself and all members of the Class for violation of Section 20(a) of the Exchange Act.

584. The 10(b) Defendants committed a primary violation of Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder, by making false and misleading statements of material fact, in connection with the purchase and sale of securities, which were relied upon by Plaintiff and all other members of the Class to their detriment (as described herein). At the time these false and misleading statements were made, the Company knew, or was reckless in not knowing, of their falsity.

585. The Officer Defendants had direct control and/or supervisory involvement in the operations of the Company and therefore had the power to control or influence the particular transactions giving rise to the securities violations as alleged herein, and exercised the same. Fairfax had the power to control or influence the Officer Defendants with respect to the particular transactions giving rise to the securities violations as alleged herein, and exercised the same.

586. By reason of their status as officers and members of management and/or as senior executives of Fairfax, or their ownership of substantial amounts of Fairfax's voting shares during the Class Period, the Officer Defendants are "controlling persons" of Fairfax within the meaning of Section 20(a) of the Exchange Act because they had the power and influence to cause Fairfax to engage in the unlawful conduct complained of herein. Because of their positions of control, the Officer Defendants were able to, and did, directly or indirectly, control the conduct of Fairfax's business, the information contained in its filings with the SEC, and public statements about its business.

587. Fairfax had direct control in the operations of Defendant OdysseyRe and therefore had the power to control or influence the particular transactions giving rise to the securities violations as alleged herein, and exercised the same. Fairfax had the power to control or influence OdysseyRe with respect to the particular transactions giving rise to the securities violations as alleged herein, and exercised the same.

588. Each of the 20(a) Defendants named in this Count were provided with or had access to copies of the Company's reports, press releases, public filings and other statements alleged by Plaintiff to be misleading prior to and/or shortly after these statements were issued and had the ability to prevent the issuance of the statements or cause the statements to be corrected.

589. As set forth above, each of the 20(a) Defendants controlled persons or entities who violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. By virtue of their positions as controlling persons, the 20(a) Defendants named in this count are liable pursuant to §20(a) of the Exchange Act. As a direct and proximate cause of the 20(a) Defendants' wrongful conduct, Plaintiff and other members of the Class suffered damages in connection with their purchases of the Company's securities during the Class Period.

COUNT III

Violation of Section 11 of the Securities Act Against Fairfax, PWC, Martin, Watsa, Ambridge, Williamson, Bennett, Griffiths, Hartog and Sweitzer in Connection with the October 2004 Offering of Subordinate Voting Shares (the "October 2004 Offering Section 11 Defendants")

590. Plaintiff repeats and realleges each and every allegation, except those alleging fraud, contained above as if fully set forth herein.

591. This count does not sound in fraud. All of the preceding allegations of fraud or fraudulent conduct and/or motive are specifically excluded from this count. For the provisions of this Count only, Plaintiff does not allege that the October 2004 Offering Section 11 Defendants had scienter or fraudulent intent, which is not an element of a Section 11 claim.

592. This count is asserted against the October 2004 Offering Section 11 Defendants for violations of Section 11 of the Securities Act, 15 U.S.C. §77k, on behalf of all members of the Class who purchased or otherwise acquired securities in connection with Fairfax's offering of 2,406,741 subordinate voting shares through the October 28, 2004 Supplemental Prospectus and accompanying registration statement (the "October 2004 Offering").

593. The supplemental prospectus relating to the October 2004 Offering, filed on October 28, 2004 and the registration statement on Form F-10 filed with the SEC on April 20, 2004 (collectively, the "October 2004 Offering Registration Statement/Prospectus"), were inaccurate and misleading, contained untrue statements of material fact and omitted other facts necessary to make the statements made not misleading, and failed to disclose material facts as described above.

594. The Company is the registrant for Fairfax's October 2004 Offering. As the issuer of the securities that were registered, the Company is strictly liable to Plaintiff and members of the Class who purchased or otherwise acquired securities through the October 2004 Offering in

connection with offering and pursuant to the October 2004 Offering Registration Statement/Prospectus for the misstatements and omissions contained therein.

595. Defendants Martin, Watsa, Ambridge, Williamson, Bennett, Griffiths, Hartog and Sweitzer were principal officers, directors and representatives of the Company who signed and/or were otherwise responsible for the contents and dissemination of the October 2004 Registration Statement/Prospectus. As such, these defendants issued, caused to be issued, and participated in the issuance of materially false and misleading written statements that were contained in the October 2004 Registration Statement/Prospectus, which misrepresented or failed to disclose, among other things, the facts set forth above. By reasons of the conduct alleged herein, each of these defendants violated, or controlled a person, who violated Section 11 of the Securities Act.

596. At the time the members of the Class acquired securities through the October 2004 Offering pursuant to the October 2004 Registration Statement/Prospectus, they did not know of the wrongful conduct alleged herein or of the facts concerning the untrue and misleading statements and omissions alleged herein, and could not have reasonably discovered such facts or wrongful conduct. This claim is filed within one year of untolled time since the time that Plaintiff discovered or reasonably could have discovered the facts upon which this claim is based. This claim is filed within three years of untolled time since the issuance of the October 2004 Offering.

597. The Class has sustained damages from their transactions in the October 2004 Offering.

598. By reason of the foregoing, the October 2004 Offering Section 11 Defendants are liable for violations of Section 11 of the Securities Act to Plaintiff and the other members of the Class who purchased or acquired securities through the October 2004 Offering.

COUNT IV

Violation of Section 15 of the Securities Act Against Martin, Watsa, Ambridge, Williamson, Bennett, Griffiths, Hartog and Sweitzer in Connection with the October 2004 Offering of Subordinate Voting Shares (the "October 2004 Offering Section 15 Defendants")

599. Plaintiff repeats and realleges each and every allegation, except those alleging fraud, contained above as if fully set forth herein.

600. This count does not sound in fraud. All of the preceding allegations of fraud or fraudulent conduct and/or motive are specifically excluded from this count.

601. This count is asserted against the Secondary Offering Section 15 Defendants for violations of Section 15 of the Securities Act, 15 U.S.C. §77o, on behalf of all members of the Class who purchased or otherwise acquired securities in connection with the October 2004 Offering pursuant to the October 2004 Registration Statement/Prospectus.

602. At all relevant times, each of the October 2004 Offering Section 15 Defendants were controlling persons of the Company within the meaning of Section 15 of the Securities Act. The October 2004 Offering Section 15 Defendants were controlling persons by virtue of their positions as directors and/or senior officers of the Company.

603. By reason of the aforementioned wrongful conduct, each of the October 2004 Offering Section 15 Defendants named in this count are liable under Section 15 of the Securities Act, jointly and severally with, and to the same extent as the Company, is liable under Section 11 of the Securities Act, to members of the Class who purchased securities in the October 2004 Offering. As a direct and proximate result of the wrongful conduct of each of the October 2004 Offering Section 15 Defendants named in this count, the Class suffered damages in connection with their purchase or acquisition of securities through the October 2004 Offering.

COUNT V

Violation of Section 11 of the Securities Act Against Fairfax, PWC, Martin, Watsa, Ambridge, Williamson, Bennett, Griffiths, Hartog and Sweitzer in Connection with the September 2005 Offering of Subordinate Voting Shares (the "September 2005 Offering Section 11 Defendants")

604. Plaintiff repeats and realleges each and every allegation, except those alleging fraud, contained above as if fully set forth herein.

605. This count does not sound in fraud. All of the preceding allegations of fraud or fraudulent conduct and/or motive are specifically excluded from this count. For the provisions of this Count only, Plaintiff does not allege that the September 2005 Offering Section 11 Defendants had scienter or fraudulent intent, which is not an element of a Section 11 claim.

606. This count is asserted against the September 2005 Offering Section 11 Defendants for violations of Section 11 of the Securities Act, 15 U.S.C. §77k, on behalf of all members of the Class who purchased or otherwise acquired securities in connection with Fairfax's offering of 1,843,318 subordinate voting shares through the September 28, 2005 Supplemental Prospectus and accompanying registration statement (the "September 2005 Offering").

607. The supplemental prospectus relating to the September 2005 Offering, filed on September 28, 2005 and the registration statement on Form F-10 filed with the SEC on January 25, 2005 (collectively, the "September 2005 Offering Registration Statement/Prospectus"), were inaccurate and misleading, contained untrue statements of material fact and omitted other facts necessary to make the statements made not misleading, and failed to disclose material facts as described above.

608. The Company is the registrant for Fairfax's September 2005 Offering. As the issuer of the securities that were registered, the Company is strictly liable to Plaintiff and members of the Class who purchased or otherwise acquired securities through the September

2005 Offering in connection with offering and pursuant to the September 2005 Offering Registration Statement/Prospectus for the misstatements and omissions contained therein.

609. Defendants Martin, Watsa, Ambridge, Williamson, Bennett, Griffiths, Hartog and Sweitzer were principal officers, directors and representatives of the Company who signed and/or were otherwise responsible for the contents and dissemination of the September 2005 Registration Statement/Prospectus. As such, these defendants issued, caused to be issued, and participated in the issuance of materially false and misleading written statements that were contained in the September 2005 Registration Statement/Prospectus, which misrepresented or failed to disclose, among other things, the facts set forth above. By reasons of the conduct alleged herein, each of these defendants violated, or controlled a person, who violated Section 11 of the Securities Act.

610. At the time the members of the Class acquired securities through the September 2005 Offering pursuant to the September 2005 Registration Statement/Prospectus, they did not know of the wrongful conduct alleged herein or of the facts concerning the untrue and misleading statements and omissions alleged herein, and could not have reasonably discovered such facts or wrongful conduct. This claim is filed within one year of untolled time since the time that Plaintiff discovered or reasonably could have discovered the facts upon which this claim is based. This claim is filed within three years of untolled time since the issuance of the September 2005 Offering.

611. The Class has sustained damages from their transactions in the September 2005 Offering.

612. By reason of the foregoing, the September 2005 Offering Section 11 Defendants are liable for violations of Section 11 of the Securities Act to Plaintiff and the other members of the Class who purchased or acquired securities through the September 2005 Offering.

COUNT VI

Violation of Section 15 of the Securities Act Against Martin, Watsa, Ambridge, Williamson, Bennett, Griffiths, Hartog and Sweitzer in Connection with the September 2005 Offering of Subordinate Voting Shares (the "September 2005 Offering Section 15 Defendants")

613. Plaintiff repeats and realleges each and every allegation, except those alleging fraud, contained above as if fully set forth herein.

614. This count does not sound in fraud. All of the preceding allegations of fraud or fraudulent conduct and/or motive are specifically excluded from this count.

615. This count is asserted against the Secondary Offering Section 15 Defendants for violations of Section 15 of the Securities Act, 15 U.S.C. §77o, on behalf of all members of the Class who purchased or otherwise acquired securities in connection with the September 2005 Offering pursuant to the September 2005 Registration Statement/Prospectus.

616. At all relevant times, each of the September 2005 Offering Section 15 Defendants were controlling persons of the Company within the meaning of Section 15 of the Securities Act. The September 2005 Offering Section 15 Defendants were controlling persons by virtue of their positions as directors and/or senior officers of the Company.

617. By reason of the aforementioned wrongful conduct, each of the September 2005 Offering Section 15 Defendants named in this count are liable under Section 15 of the Securities Act, jointly and severally with, and to the same extent as the Company, is liable under Section 11 of the Securities Act, to members of the Class who purchased securities in the September 2005 Offering. As a direct and proximate result of the wrongful conduct of each of the September 2005 Offering Section 15 Defendants named in this count, Plaintiff and the Class suffered damages in connection with their purchase or acquisition of securities through the September 2005 Offering.

PRAYER FOR RELIEF

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

A. Declaring this action to be a proper class action maintainable pursuant to Rule 23 of the Federal Rules of Civil Procedure;

B. Certifying the Pension Fund as Class Representatives and its counsel as Class Counsel;

C. Declaring and determining that Defendants violated the federal securities laws by reason of their conduct as alleged herein;

D. Awarding Plaintiff and the Class monetary damages, jointly and severally, for all losses and damages suffered as a result of Defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;

E. Awarding Plaintiff and the Class their costs and expenses for this litigation including reasonable attorneys' fees and other disbursements;

F. Compelling the Defendants to disgorge all proceeds and compensation awarded based on the fraudulent conduct described herein;

G. Granting restitution of Plaintiff's and the other Class member's monies of which they were defrauded;

H. Awarding extraordinary, equitable and/or injunctive relief as permitted by law; and

I. Granting such other and further relief as the Court deems to be just and proper.

JURY DEMAND

Plaintiff hereby demands a trial by jury.

DATED: July 25, 2011

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