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Corporate & Financial Regulation
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Pennsylvania
Insurance Department

VIA HAND DELIVERY

Mr. Steven L. Yerger
Pennsylvania Insurance Department
Bureau of Company Licensing
and Financial Analysis
1345 Strawberry Square
Harrisburg, Pennsylvania 17120

Re: Application for Approval to Acquire Control of OneBeacon Insurance Company and Potomac Insurance Company
43 Pa. Bull. 1157 (Feb. 23, 2013)
<u>Response to Petition to Intervene filed by Olin Corporation</u>

Dear Mr. Yerger:

OneBeacon Insurance Group, Ltd. ("OBIG") and Armour Group Holdings Limited ("Armour") (collectively, the "Companies") hereby respond to the "Petition to Intervene" (the "Petition") filed by Olin Corporation ("Olin") on April 11, 2014.

More than a year after the Department published notice of Armour's Form A filing, inviting interested persons to submit comments within 60 days[1]; one year after the Department received timely responses, in the form of petitions to intervene, from fourteen other policyholders or their representatives[2]; and one month after the Pennsylvania Office of Open Records (the "OOR") generally upheld the Department's position on the confidentiality of the

[1] 43 Pa. Bull. 1157 (Feb. 23, 2013).

[2] *See* Petition to Intervene filed by Colgate-Palmolive Company ("Colgate") on April 24, 2013 (the "Colgate Petition") and Petition to Intervene filed by the Pennsylvania Manufacturers' Association, Associated Industries of Massachusetts, Belden, Inc., Crosby Valve, LLC, Invensys Inc., ITT Corporation, Meritor, Inc., PolyOne Corporation, The Proctor & Gamble Company, Rockwell Automation, Inc., 3M Company, United Technologies Corporation and the Powell Company (the "PMA Group") on April 24, 2013 (the "PMA Group Petition").

03

records that the Companies have submitted in connection with the application[3]; Olin asserts for the first time that it should be "permit[ted] … to participate in all aspects of this proceeding" and "grant[ed] … access to all materials filed in connection with the Proposed Transaction (including those designated as confidential)." (Petition, ¶ 8.) In support of this demand, Olin claims it can provide "additional information" about the application, based on its allegedly "unique" relationship to the proposed transaction (*id.*, ¶ 24), and, furthermore, that Olin's interests in this matter "are not adequately represented" by the Department (*id.*, ¶ 7).

In reality, Olin does not even purport to offer any information about Armour's proposed acquisition that has not already been presented to the Department, either in the Colgate Petition, the PMA Petition or in the Companies' own public disclosures (including disclosures to the Department that were prepared in connection with the Form A application). Nor does Olin offer any legal argument regarding its purported right to intervene that was not fully set forth in the earlier petitions, and fully addressed in the Companies' responses to those petitions.[4] Thus, while the Companies do not object to Olin's providing public comment on the Form A application, Olin does not have a right to "participate in all aspects of this proceeding." For these reasons, and for the additional reasons set forth below, the Petition should be denied.

Olin Has No Right to Intervene

Olin tries to establish a legal right to intervene in two different ways. First, it claims its position as a policyholder with a recent verdict against One Beacon Insurance Company ("OBIC") makes it "[u]nlike [the] other policyholders" who have previously sought to intervene (Petition, ¶ 4), and that the verdict supposedly makes Olin able to "provide the Department with important information and analysis …, including the proper reserving of such claims … ." (*Id.*, ¶ 58.) There are two different ways in which this first claim is defective: Olin's litigation against OBIC does not make either its interests or its insights different in any material way from those of any other policyholder, and Olin's experience certainly does not confer any special expertise in evaluating insurance reserves.

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[3] *See In re Colgate-Palmolive Co. v. Pennsylvania Insurance Department*, Docket No. AP 2013-1631 (Pennsylvania Office of Open Records), Final Determination, March 7, 2014.

[4] *See* "Response to Confidential Comment filed by Colgate-Palmolive Company," filed May 3, 2013 ("Response to Colgate"); Response to Comment filed by the PMA Group Petitioners," filed May 3, 2013 ("Response to PMA"); "Response to Confidential Comment filed by Colgate-Palmolive Company," filed June 11, 2013 ("Supp. Colgate Response"); and Letter responding to May 18, 2013 letter from the PMA Group Petitioners, filed June 11, 2013 ("Supp. PMA Response").

Olin has prevailed against OBIC in the liability phase of a coverage suit—a result that is still subject to appeal. (Petition, ¶ 12.) Olin calls this a "substantial verdict" (*id.*, ¶ 7), even though *no damages at all* have been awarded at this point. (*Id.*, ¶ 12.) Olin has also asserted claims under the Massachusetts unfair trade practices statute, in a separate suit that is not even scheduled to be tried before December 2014. (*Id.*, ¶ 16.) Yet Olin claims the Department should treat its *allegations* in that case as "well-substantiated" (*id.*, ¶ 40) and "show[n]" by "evidence" (*id.*, ¶ 39)—"evidence" that is not so much as described in the Petition. (*See id.*) However inflated in Olin's perception, this litigation experience does *not* give Olin an interest in this matter that is different from that of any other policyholder. For example, Colgate, which filed timely comments a year ago, has also brought a coverage suit against OBIC in New York.

Furthermore, the only "important information" Olin claims it can provide relates to "its substantial verdict [sic] and other claims against OBIC." (*Id.*, ¶ 7.) Olin is *already* free to provide that information to the Department. The Petition does not even try to explain why Olin considers itself more qualified than the Department's professional staff and independent advisors to *apply* that information to determining the adequacy of OBIC's reserves.

Olin's second legal argument simply (and explicitly) repeats the claims that were previously made by the other objecting policyholders. Olin claims its right to intervene is created by one of the implementing regulations of the Administrative Agency Law ("AAL"), 1 Pa. Code § 35.28. (Petition, ¶ 60.) That argument is refuted by *Lafarge Corp. v. Commonwealth of Pennsylvania Insurance Department*, 557 Pa. 544, 735 A.2d 74 (1999).

Lafarge arose out of a proposed restructuring of CIGNA, which the Department examined under three different statutes.[5] One of them, the Insurance Companies Holding Act (the "IHCA") is at issue in Armour's' Form A filing; the IHCA expressly vests the Department with "discretion" over whether to conduct a public hearing (except where the hearing has been requested by one of the parties to the transaction), and it specifies procedures that govern any such hearing. 40 P.S. § 991.1402(f)(2). A second statute, the GAA Amendments Act (which is not applicable here), calls for a hearing in all cases, and, like the IHCA, includes only limited requirements for public participation in such hearings. *Compare* 40 P.S. § 991.1402 *with* 15 P.S. § 21207.

The plaintiff policyholders in *Lafarge* argued that the AAL required additional hearing procedures, including sworn testimony, cross-examination and briefing by interested parties. 557 Pa. at 548, 735 A.2d at 76. The Supreme Court rejected that argument, finding that application of those additional hearing procedures to proceedings under the GAA Act would

[5] *See* February 7, 1996, Decision and Order of Commissioner Kaiser (the "Kaiser Decision"), at p. 1. (A copy of the Kaiser Decision is attached to the Supp. PMA Response.)

(among other things) violate the plain meaning of the GAA Act. 557 Pa. at 549, 550, 735 A.2d at 76, 77. The same reasoning applies here.

Like the other policyholders, Olin therefore argues that *Lafarge* "did not address the right of policyholders ... in proceedings under the IHCA." (Petition, ¶ 61, *citing* letters from Colgate and the PMA Group.) But, in *Lafarge*, the Supreme Court held expressly that the procedures the Department had followed to approve CIGNA's restructuring *under the IHCA* had "fulfilled the requirements of administrative due process." 557 Pa. at 554, 735 A.2d at 79. It explained that "[t]he imposition of additional procedures ... would entail extensive delay ... [and] would not materially enhance the interests of [the policyholders] ... ." *Id.*

Olin now claims that holding was based on the policyholders' having been granted "robust participation rights." (Petition, ¶ 61.) In fact, while the policyholders in Lafarge were permitted to make written submissions, they were *not* allowed to make oral presentations at public hearings, to cross-examine witnesses or to examine confidential documents. (Kaiser Decision at pp. 16-26.) (As we stated above, the Companies do not object to Olin's submitting comments to the Department during the Form A process.)

Olin's Allegations about the Proposed Transaction are Without Merit

Although Olin claims its belated imitation of the other objecting policyholders is based on "additional information" those other policyholders could not provide (Petition, ¶ 24), its account of the "concerns" that are allegedly raised by the proposed transactions relies almost entirely on citations to the Colgate Petition and the PMA Group Petition. (*See id.*, ¶¶ 24, 27-29 35-36.) For a response to those purported "concerns," the Companies respectfully refer the Department to their "Response to Substantive Comments in Confidential Filing of Colgate-Palmolive Company," filed on June 21, 2013 (the "Colgate Substantive Response"), and their "Response to Substantive Comments," filed on June 21, 2013 (the "PMA Substantive Response"). A copy of the PMA Substantive Response is attached hereto as Exhibit A. (Because Colgate designated the Colgate Petition as confidential, the Colgate Substantive Response was filed as a non-public document.) Both documents are incorporated herein by reference.

Certain points in the Petition merit special mention. Like the other would-be intervenors, Olin claims the mere fact that certain sensitive and proprietary records have been submitted to the Department in confidence creates "serious doubt as to whether OBIC's proposed ... capitalization will" be sufficient. (Petition, ¶ 17. *See also id.*, ¶¶ 22, 43.) This was a bad argument when it was made last year; it is even worse now, after the OOR has generally sustained the joint position of the Companies and the Department on the confidentiality issue. As the OOR recognized, the Department routinely receives highly sensitive, proprietary records, precisely *because* it is responsible for protecting the interests of policyholders. The Department has exercised that responsibility by requiring extensive testing of the proposed capitalization. There is no defensible basis for the suggestion that there is a cloud over the Department's process.

Olin similarly repeats the other policyholders' erroneous claim that the companies to be acquired in the proposed transaction (the "Acquired Companies") have only \$200 million of reinsurance coverage available for claims that have not yet been paid. (Petition, ¶ 35. *See also* PMA Group Petition, ¶ 15.c; Colgate Petition, ¶ 31.) Olin's assertion is based on language in OBIG's Statement on Form 10-K for 2013, acknowledging that approximately \$2.3 billion of the \$2.5 billion NICO reinsurance cover is currently projected to have been exhausted. (*Id.*) However, as the Companies explained in a public filing with the Department *last June*, that \$2.3 billion consists of (i) \$1.5 billion that has already been paid, and (ii) approximately \$800 million that has been incurred but not yet paid —including both case reserves and IBNR (including IBNR associated with policyholders who have petitioned for leave to intervene). (*See* PMA Substantive Response (Exhibit A hereto) at pp. 23-24.)

Thus, the \$198.3 million that OBIG identified as "remaining" under the NICO cover is *not* (as Olin suggests) the only amount that remains available to pay projected liabilities. Rather, it is the additional amount that will remain available from NICO, *after* all *currently estimated* liabilities that are subject to the NICO cover *have been paid*. (*See id.* at p. 24.)[6] The Acquired Companies will have more than adequate reserves and reinsurance to satisfy future claims, *even if* Olin should be awarded the damages it seeks, the basis and amount of which remain subject to a number of strongly contested legal issues. As OBIG and Armour have previously demonstrated at length, the data shows that the Acquired Companies will have more than adequate reserves and reinsurance to satisfy future claims. (*See, e.g.*, PMA Substantive Response (Exhibit A hereto) at 23-29.)

Olin also claims it has special knowledge about how claims might be handled after the proposed transaction, because they will be handled by the same entities that are the subject of Olin's Massachusetts suit for alleged unfair trade practices. (Petition, ¶¶ 37-40.) Olin's argument on this point makes no sense: it is based on an acknowledgement that the same entities will be handling Olin's future claims, *regardless* of whether the Form A filing is approved. Furthermore, it turns out (once again) that there is nothing special or unique about Olin's "knowledge": the entities handling Olin's claims are also responsible for handling the claims of many of the other policyholders.

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[6] When considering what remains under the NICO cover, it is important to keep in mind that the gross amount of any judgment does not equate to its impact on the available cover, since the cover only declines net of any other available third-party reinsurance.

Finally, Olin claims its participation is essential to these proceedings, and that the Companies are not to be trusted, because the independent actuarial assessment that the Department required OBIG to commission produced a range of total statutory net loss and LAE reserves that was higher than the reserves OBIG had previously recorded. (Petition, ¶¶ 30, 34.)

This argument, too, is self-refuting. The information Olin purports to have unearthed was (1) generated at the request of the Department, and (2) publicly disclosed in (among other places) OBIG's filings with the Pennsylvania Insurance Department and the Securities Exchange Commission. The Department is reviewing and evaluating that information as part of its consideration of the Form A filing. Thus, while Olin's Petition repeatedly asserts as "plain fact that Olin's interests are not adequately represented" by the Department (*id.*, ¶ 7; *see also id.*, ¶ 51), Olin's own arguments demonstrate that the Form A process is working exactly as it should: the Department's decision on the filing will be based on its searching and exhaustive analysis, including its consideration of comments from interested policyholders.

For these additional reasons, the Petition should be denied.

A copy of this response has been sent to counsel for Olin as identified in the Petition.

Respectfully submitted,

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Enclosure

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EXHIBIT A

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Corporate & Financial Regulation

JUN 2 1 2013

Pennsylvania
Insurance Department

RESPONSE TO SUBSTANTIVE COMMENTS

I. Preliminary Statement

As previously described in the Form A Statement Regarding the Acquisition of Control of a Domestic Insurer (the "Form A"), Armour Group Holdings Limited, through its subsidiary, Trebuchet US Holdings, Inc. ("Armour"), seeks the approval of the Pennsylvania Insurance Department (the "Department") of its acquisition of OneBeacon Insurance Company ("OBIC") and Potomac Insurance Company ("Potomac"), which are currently wholly owned subsidiaries of OneBeacon Insurance Group LLC ("OBIG") (the "Transaction").

OneBeacon America Insurance Company ("OneBeacon America") and The Employers' Fire Insurance Company ("Employers") are Massachusetts domiciled insurance companies and wholly owned subsidiaries of OBIC. In connection with the restructuring of OBIG that is discussed below, they are being redomesticated from Massachusetts to Pennsylvania. Once this redomestication is approved, the Form A will be amended to include those two companies in the Transaction. For ease of reference, OBIC, Potomac, OneBeacon America and Employers are collectively referred to as the "Runoff Companies."

In response to the Form A, the Pennsylvania Manufacturers' Association, Associated Industries of Massachusetts, Belden, Inc., Crosby Valve, LLC, Invenys Inc., ITT Corporation, Meritor, Inc., PolyOne Corporation, The Procter and Gamble Company, Rockwell Automation, Inc., 3M Company, United Technologies Corporation and the William Powell Company (collectively, the "Commenting Policyholders") have filed a Petition to Intervene (the "Petition"). The Commenting Policyholders state that they are the holders of certain policies of insurance issued by one or more predecessors of the Runoff Companies. They further state that they have received claims arising out of alleged exposure to asbestos, as well as other environmental, toxic-tort and other "long-tail" claims seeking recovery for latent bodily injury and property damage, and that they expect to receive more claims in the future. They express concern that, if the Transaction is approved, their interests might be adversely affected.

On May 3, 2013, Armour and OBIG filed a joint submission with the Department, which explained that the Commenting Policyholders do not have a statutory right to "intervene." Specifically, the submission explained that Section 1402 of the Insurance Holding Companies Act (the "Act") expressly limits the persons or entities who may demand a public hearing with respect to a Form A filing to the acquirer, the acquiree and/or a stockholder of the acquiree, and it otherwise invests the Department with sole "discretion" over whether a hearing is required. 40 P.S. § 991.1402(f)(2). The submission further explained that, under the Pennsylvania Supreme Court's decisions in LaFarge Corp. v. Commonwealth of Pennsylvania Insurance Department, 557 Pa. 544, 554, 735 A.2d 74, 79 (1999), and Pa. Coal Mining Assoc. v. Insurance Department, 471 Pa. 437, 454, 370 A.2d 685, 693 (1977), due process does not require that the statutory procedures of the Act be supplemented by procedures under the Administrative Agency Law. Accordingly, the Commenting Policyholders have no right to intervene as parties—although they clearly *are* entitled to submit written comments regarding the Transaction, as they have done in their Petition, and to participate in any public hearing.

This submission is intended to address the substantive issues that are raised in the Petition. The Petition asserts that OBIG is trying to leave the Runoff Companies without the resources they will need to satisfy their obligations to the Commenting Policyholders, and that Armour intends to "profit" from that arrangement by knowingly acquiring underfunded companies, by underpaying claims, and then by putting the companies into liquidation. As we explain below, these accusations have no basis. The details of the Transaction that the Petition portrays as cause for concern are actually standard procedures for managing runoff business. Armour is an experienced runoff specialist that is well qualified to manage the Runoff Companies, and the parties have made specific arrangements to provide continuity in the handling of claims.

Equally important, the Transaction has been structured to provide adequate resources for the Runoff Companies. OBIG is confident it has determined those Companies' liabilities through sophisticated and ongoing actuarial reviews. Before the Transaction is approved, the liabilities will *also* have been subjected to an independent actuarial review, conducted by a leading independent risk specialist that was retained in consultation with the Department. (A summary of that review will be made public.)

Contrary to the suggestions in the Petition, the bulk of the Runoff Companies' estimated liabilities will continue to be subject, after the Transaction has closed, to reinsurance protection from highly rated carriers. Net reserves of the Runoff Companies will be secured by assets backing those reserves, together with the assets backing the companies' surplus, and the Stock Purchase Agreement between Armour and OBIG (the "SPA") provides that the assets will be in direct relation to those reserves. Under the SPA, that is, the aggregate purchase price to be paid at closing will be calculated under a formula designed to ensure that the Runoff Companies retain an adequate level of capital (the "Target Statutory Capital"), based on the information in their balance sheets at that time. If, after that price has been determined, the Department concludes that additional capital is needed, the SPA expressly provides that such capital will be provided at closing, in the form of surplus notes. Although the Commenting Policyholders' Petition specifically refers to some of these provisions of the SPA, it does not make a single argument purporting to show that this approach to capitalization is inadequate to protect policyholders.

In short, the terms of the Transaction are transparent, fair and reasonable, and the Transaction will not prejudice the interests of the Commenting Policyholders.

II. Introduction: Background and Nature of the Form A Review

OBIG's current business structure originates from 2001, when White Mountains Insurance Group, Ltd., acquired a group of insurance companies that sold personal lines and traditional commercial lines insurance products, and which also conducted a limited specialty business. Over the past decade, OBIG has pursued a business strategy of repositioning its focus exclusively on specialty insurance business. The non-specialty business, including the policies held by the Commenting Policyholders, now constitutes "runoff" business.

For most of the period from 2001 until 2009, OBIG did not segregate its ongoing specialty business from its runoff business. The two types of business were not conducted by separate groups of companies, and the liabilities of OBIG's subsidiaries were pooled under inter-company reinsurance arrangements, without regard for whether they were associated with runoff or specialty business. Thus, the OBIG subsidiaries that wrote new business remained liable for claims against legacy policies, and, conversely, there was no pool of assets dedicated solely to the runoff business.

A. The Restructuring and the Transaction

About three years ago, to address the inefficiencies inherent in the combination of runoff and active business, OBIG began a multi-step process (the "Restructuring") to separate the active and runoff businesses into discrete corporate organizations, subject to separate financial reporting and management. As part of the Restructuring, ownership of certain indirect subsidiaries of OBIG has been changed, so that the specialty business is conducted by one, distinct set of corporations, and the runoff business by another. The inter-company pooling and reinsurance arrangements were unwound, and new reinsurance arrangements were put in place, so that the Runoff Companies no longer have net liability for the specialty lines policies of the active writing subsidiaries of OBIG. Capital has been re-allocated within the OBIG organization in accordance with this new business structure.

B. The Petition

OBIG's strategic business decision to concentrate on specialty risks is not at issue here; nor are the elements of the Restructuring that have just been described. The purpose of this Form A review is to determine whether the Department should approve only one transaction—the acquisition of the Runoff Companies by a professional runoff manager, Armour. Under the Act, the Department may disapprove the acquisition, *if* it makes certain statutory findings—such as a finding that Armour's financial condition will be "such as might jeopardize the financial stability" of the Runoff Companies or "prejudice the interest of [their] policyholders"; or that Armour's plans to make any material change in the business, corporate structure or management of the Runoff Companies are otherwise "unfair and unreasonable and fail to confer benefit on policyholders . . . and are not in the public interest." 40 P.S. §§ 991.1402(f)(iii) and (iv).

In the Petition, the Commenting Policyholders contend that certain aspects of the Transaction are cause for a heightened level of "concern" that these disqualifying conditions might be present. They assert that they have special grounds for believing (1) that the Runoff Companies will have insufficient reinsurance, capital and reserves to satisfy claims under outstanding policies; (2) that Armour is likely to "slow-pay, or refuse to pay, valid claims"; and

(3) that the interests of the Commenting Policyholders in avoiding these outcomes "are not adequately represented" before the Department. These concerns are not well-founded.

The Petition expresses "concern" that OBIG has underestimated its liability for asbestos and environmental losses. As we explain below, OBIG has a sophisticated and ongoing actuarial review process, and its own internal analyses have consistently tested the adequacy of the reserves for the Runoff Companies. In consultation with the Department, OBIG has also retained Towers Watson, a leading risk specialist in the insurance industry, to conduct an independent and comprehensive actuarial evaluation of the reserves in question. When that evaluation is completed, it will be provided to the Department for consideration in its review of the Transaction, and a summary will be made public.

OBIG currently estimates that, as of March 31, 2013, approximately $2.1 billion of gross unpaid loss and loss adjustment expense reserves will remain in the Runoff Companies after the Transaction. As of March 31, 2013, most of that amount—approximately $1.9 billion—is covered by reinsurance that is currently available to the Runoff Companies, and that will continue to be available to them following the completion of the Transaction.[1] The Commenting Policyholders express "concern" that OBIG has "overstated" its reinsurance; they contend that the reinsurance cover is "plainly insufficient." As we explain below, however, this "concern" is based on a misreading and misunderstanding of public statements about how much reinsurance remains available under one of the Runoff Companies' reinsurance agreements—on an *incurred* basis, including IBNR. In fact, the Commenting Policyholders have underestimated the amount of reinsurance that remains available to the Runoff Companies by many hundreds of millions of dollars.

[1] Unless otherwise specified, the calculations in this Response are based on statutory accounting principles ("SAP"), which are the basis for financial statements filed with state insurance regulators.

The reserves that will exist in the Runoff Companies when the Transaction closes, and which are over and above this reinsurance, will be funded by the other assets of the Runoff Companies—primarily cash and investments. Observing that certain elements of the Restructuring have had the effect of reducing the available surplus of those Companies, the Commenting Policyholders accuse OBIG of having "treated itself" to their assets and leaving them "inadequately capitalized." The basis of these assertions is not entirely clear, but the assertions themselves are clearly mistaken, and they are wrong in two different ways.

First, the Commenting Policyholders erroneously portray ordinary transactions that are incidental to the strategic goal of separating the ongoing and runoff businesses as some kind of corporate looting. Some of what the Petition appears to refer to as "dividends," to which OBIG allegedly "treated itself," are actually asset transfers associated with corporate reorganization. For example: OBIC was the parent of certain subsidiaries that sold specialty risk policies, and, as part of the Restructuring, it contributed the stock of those companies to a *different* OBIG company that *also* sells specialty risk policies. That contribution will ultimately have the effect of reducing OBIC's surplus, but it was not made for any impermissible or inappropriate purpose, and it was reviewed and approved by the appropriate insurance regulators as part of OBIG's Restructuring.

Similarly, because of intercompany reinsurance arrangements, a single pool of assets was previously exposed to risks associated with *all* of the policies issued by OBIG's writing subsidiaries—both runoff policies and policies associated with OBIG's active, specialty business. As a result of OBIG's unwinding of those reinsurance arrangements, and the implementation of new ones, there are now two separate pools of assets and liabilities, one of which is dedicated exclusively to the Runoff Companies. The Petition asserts that these steps were taken to "insulate" certain assets that previously secured liabilities of the Runoff Companies from claims against legacy policies; but the same transactions *also* "insulated" the assets that *remain* in those Companies—from the risks associated with OBIG's ongoing specialty business. The *only* way to create a pool of capital that is dedicated solely to the exposures of the Runoff Companies was to divide the original pool among the different companies that had claims against it.

Contrary to the Commenting Policyholders' claims that the surplus of the Runoff Companies has been wrongfully "stripped out . . . wiped off their books, and handed over to OBIG," all of these transactions were fully disclosed to the appropriate state regulators and, where approval was required, received those regulators' approval.

The Commenting Policyholders' claims about capital are also mistaken in a different way: They ignore the way the Transaction has been structured to provide the Runoff Companies with adequate assets to fund whatever portion of the Companies' reserves is not covered by reinsurance, with a substantial margin for conservatism. As the Petition expressly acknowledges, the SPA provides that the aggregate purchase price to be paid for the Runoff Companies will be calculated under a formula that will leave them with Target Statutory Capital, based on the balance sheet at closing. In addition, if the Department deems it necessary, the SPA provides a mechanism for additional capital to be provided at closing through surplus notes.

Thus, the Petition's dramatic depiction of the steps by which OBIG has rationalized its capital structure in anticipation of the Transaction turns out to be a red herring. What is important is whether the approach to capitalization that is mandated by the SPA is adequate to protect the interests of the Commenting Policyholders. As noted above, the Petition does not even try to argue that this approach will not fully protect those interests.

Finally, the Commenting Policyholders express concern that the acquisition of the Runoff Companies by a professional runoff manager might somehow create unusual "incentives" for Armour to delay or refuse the payment of valid claims. Yet the only "incentive" they identify is the prospect that Armour could save money by paying less—a possibility that is inherent in every insurance claim-handling structure, and which creates an "incentive" only for those who do not take seriously the laws and regulations governing insurance contracts and the good faith handling of claims. The Commenting Policyholders do not explain why they think those laws would not control the conduct of a runoff specialist; there is no reason to believe they are not equally effective in a runoff context.

In fact, most of the Runoff Companies' asbestos and environmental claims (which account for a majority of the claims of the Commenting Policyholders) are subject to an agreement, under which a company called Resolute Management has handled the claims since 2006, and will continue to do so, even after the Transaction has been completed. As we explain below, the agreement requires (among other things) that Resolute Management exercise independent judgment and abide by all applicable laws—requirements on which the Transaction will have no effect at all.

Moreover, the arguments in the Petition ignore entirely the value that a runoff specialist like Armour *adds* to the claims process, including expertise in handling the specific lines to be managed, advantages in recruiting and retaining specialized personnel and an ability to bring scale across its organization. These advantages all benefit policyholders. The Commenting Policyholders also overlook Armour's own interest in acquiring companies that are adequately capitalized and reserved. The Commenting Policyholders casually assert that Armour will simply collect management fees until the Runoff Companies become insolvent. Such an accusation is a totally inappropriate and illogical attack on a professional company whose long-term prospects are tied to the successful runoff of long-tail claims.

C. Examining the Form A Filing

None of our arguments is intended to suggest either that the Department should not continue to examine thoroughly the capital, reserves and reinsurance of the Runoff Companies, together with Armour's plans to manage them, or that OBIG and Armour will not cooperate fully in that examination. We demonstrate below that the Runoff Companies will be appropriately capitalized, fully reserved and protected by extensive reinsurance; that the Transaction has been structured in a way that preserves continuity in the claims process; and that Armour is an experienced runoff manager that is fully qualified to oversee the runoff claims. OBIG has also retained Towers Watson, in consultation with the Department, to conduct an independent evaluation of the reserves of the Runoff Companies. When it is completed, the full Towers Watson report will be filed with the Department, and a summary of its findings will be made public.

Indeed, the Commenting Policyholders make a fundamental error by ignoring the very thorough and in-depth review that the Department is conducting, and by suggesting that their interests "are not adequately represented," because the resources of the Runoff Companies might somehow escape "searching independent review." The Commenting Policyholders find grounds for suspicion in the fact that certain business records of OBIG and Armour have not been publicly disclosed, but they *do not* claim that either OBIG or Armour has withheld any relevant information from the Department.

Contrary to the arguments of the Commenting Policyholders, the fact that OBIG selected a method for managing runoff that requires both OBIG and Armour to submit detailed, proprietary information to the Department, and the fact that these companies have provided all the information that has been requested by an independent staff of professional regulators, only confirm that the Transaction is *not* unusual or problematic in any way. Every Form A filing includes confidential documents that are reviewed only by the Department. The fact that the Department has access to confidential information that could not be shared with members of the general public (especially those who, like some of the Commenting Policyholders, are plaintiffs in pending coverage litigation against OBIG companies) is a critical component of an effective regulatory review process.

III. The Background of the Transaction

A. OBIG's Strategic Direction

In June 2001, White Mountains Insurance Group, Ltd., acquired the United States property and casualty insurance subsidiaries of CGU Insurance Limited, and it renamed the business "OneBeacon."[2] Over the course of the last decade, OBIG has pursued a business strategy that focuses exclusively on specialty insurance business. The process began with two CGU businesses that sold ocean marine and tuition refund insurance. OBIG began forming additional specialty segments in 2002, and it has pursued a goal of full specialization since 2006. OBIG now features eleven diverse specialty units, including units that concentrate on professional liability, inland marine, entertainment, sports and leisure, public entities and technology.

As part of this business strategy, OBIG's writing subsidiaries stopped issuing commercial lines policies to general commercial lines customers. Once the strategy had been implemented, maintaining these legacy lines within OBIG's operations created a number of management

[2] The companies that were acquired included insurers (collectively, the "Predecessor Companies") that had issued liability policies to the Commenting Policyholders.

challenges and inefficiencies that are typical in runoff situations. It created an inefficient capital structure. It complicated corporate accounting and reporting—among other reasons, because the liabilities of both specialty and runoff businesses were pooled under inter-company reinsurance arrangements. It required expertise in areas that are increasingly divergent from the core of OBIG's ongoing business. It also created difficulties in recruiting and retaining employees who possessed the relevant expertise.

OBIG responded to these challenges by undertaking the Restructuring, which is a multi-step process of segregating its runoff and ongoing businesses. Elements of this process have included (or will include) transfers of ownership of certain OBIG entities, consolidation of runoff risk in the Runoff Companies, unwinding the inter-company reinsurance agreements, implementing new reinsurance agreements and re-allocating capital within the OBIG organization.

Regulators from Pennsylvania, Massachusetts and other impacted states have been consulted about, and kept fully abreast of, every element and stage of the Restructuring, including the transfers of ownership, the unwinding of reinsurance arrangements and the re-allocation of capital, through cash dividends and otherwise. All Restructuring transactions that have been completed to date, and which required regulatory approval, have been disclosed to, and approved by, the relevant authority or authorities.

These elements of the Restructuring were initiated independently from the Transaction, and they are not at issue in the Department's review of the Form A. The sole object of that review is the Transaction.

B. Outline of the Restructuring

Each of the Runoff Companies (OBIC, Potomac and OBIC's two Massachusetts subsidiaries, OneBeacon America and Employers) holds a portion of OBIG's legacy runoff business.[3]

Additional runoff policies are held by direct and indirect subsidiaries of the Runoff Companies: (1) Northern Assurance Company of America ("Northern Assurance"), which is now a subsidiary of OneBeacon America; (2) OneBeacon Midwest Insurance Company ("Midwest"), which is a subsidiary of Northern Assurance; and (3) three OBIC subsidiaries (Camden Fire Insurance Association; Traders & General Insurance Company; Houston General Insurance Company) that are domiciled in New Jersey and Texas. To capture efficiencies by reducing the number of legal entities that contain the runoff business, OBIG is currently in the process of (1) merging Northern Assurance and Midwest into OneBeacon America and (2) merging the three OBIC subsidiaries from New Jersey and Texas into OBIC. OBIG expects the mergers to be completed before the Transaction is concluded. When these mergers have been completed, all of OBIG's runoff business will be held by the Runoff Companies.

Two other subsidiaries of OBIC—Atlantic Specialty Insurance Company ("ASIC") and Homeland Insurance Company of New York ("HONY")—are engaged in OBIG's ongoing, specialty business. Between October and December of 2012, OBIC conveyed ownership of several other companies that were associated with the ongoing specialty business to ASIC and HONY. Two subsidiaries, OBI National Insurance Company and Homeland Insurance Company of Delaware, currently write specialty business; OBIC conveyed ownership of those

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[3] OneBeacon America and Employers are Massachusetts domiciled insurers. As noted above, they are being redomesticated to Pennsylvania in connection with the Restructuring. Once this redomestication is approved, the Form A will be amended to include those two companies. These steps will enable the Department to analyze and make determinations regarding all of the companies that will be included in the Transaction—both in the context of the Form A filing and with respect to ongoing regulatory oversight over the Runoff Companies. They will also permit OBIG to avoid duplicative regulatory proceedings and, in the future, will promote efficiency and uniformity of regulation (with associated cost savings) for the Runoff Companies.

companies to ASIC through a capital contribution. Two other subsidiaries—OneBeacon Specialty Insurance Company ("OBSIC") and OneBeacon Select Insurance Company ("OBSEL")—do not yet issue policies, but are fully capitalized. OBIC conveyed ownership of OBSIC to ASIC through a capital contribution, and it sold OBSEL to HONY.

As a result of these Restructuring transactions, all of OBIG's ongoing, specialty business will be conducted by ASIC, HONY and their subsidiaries (collectively, the "Ongoing Companies"). Before the Transaction is completed and the Runoff Companies are acquired by Armour, OBIC, in a final move to separate the runoff and specialty business, intends to divest itself of ASIC and HONY.

Before October 2012, OBIC and all of its subsidiaries participated in inter-company reinsurance arrangements with the entities that conduct OBIG's ongoing, specialty business. (Potomac participated in a separate reinsurance arrangement.) In October 2012, those reinsurance arrangements were unwound, and new reinsurance arrangements were implemented. OBIC, Potomac and the OBIC subsidiaries that conduct runoff business are no longer exposed on a net basis to risks associated with OBIG's ongoing specialty business, and the Ongoing Companies are no longer exposed on a net basis to risks associated with runoff policies.

Through cash dividends and otherwise, OBIG has re-allocated capital within the organization to reflect its new business structure and pooling arrangements.

C. The Nature of the Transaction

The Commenting Policyholders characterize both the Restructuring and the Transaction as attempts by OBIG "to walk away from [its] legacy liabilities." In this respect (as in others), the Commenting Policyholders fundamentally misunderstand the nature of the Restructuring and the nature of the Transaction.

By segregating its ongoing and runoff businesses through the Restructuring, OBIG did not in any way disavow its obligations to legacy policyholders. It simply rationalized the organization and management of OBIG's business, making them reflect its change of strategic focus, and permitting separate management and accounting for different types of operations. That process also involved an appropriate realignment of capital with the ongoing and runoff risks. Although the Petition contends that this realignment was effected to "sever" the Runoff Companies from access to other assets of OBIG, it also (as we pointed out earlier) "severed" the assets of the Runoff Companies from exposure to the risks associated with the ongoing business.

The sale of the Runoff Companies in the Transaction also has nothing to do with "walking away from" liabilities. It is the final step of a multi-step process, as a result of which legacy claims will (1) continue to be subject to the same reinsurance protection they enjoy today; (2) continue to be handled (for the most part, if they are asbestos or environmental claims, like those of the Commenting Policyholders) by the same independent Administrator that currently handles those claims, and which will continue to employ the same claims personnel; and (3) be administered by a professional runoff manager, with expertise in overseeing portfolios of this type. The terms of the Transaction specify that the Runoff Companies' net reserves will be secured by assets at a level that the Department will have determined to be adequate.

It is common for insurance companies to possess discontinued operations, because they have exited a line of business for strategic or financial reasons, or because they "inherited" existing, discontinued operations from prior transactions. In fact, possession of runoff business is a natural part of the insurance business cycle, and insurers have a number of good business reasons to separate such operations from ongoing business—reasons that have nothing to do with "walking away" from liabilities. As many other insurers have learned, discontinued operations can draw resources and management attention away from ongoing, core business. It can also be difficult to attract and retain employees and managers to service discontinued operations within an ongoing group, because employees prefer to be associated with a company's core business operations, and because the discontinued operations often contract over time, as liabilities run off.

This does not mean, however, that OBIG is conducting a "fire sale," as the Petition suggests. That is not an accurate way to describe a transfer of runoff business, on economically reasonable terms, to a company that specializes in managing runoff portfolios. The Commenting Policyholders observe that the SPA provides for a purchase price that "may be a negative number," because the purchase price as of December 31, 2011, will be rolled forward to the closing date; but this provision just reflects the fact that the ultimate purchase price will be affected by any decrease, from December 31, 2011, to the closing date, in (1) net liabilities (as the reserves run off) and (2) the associated surplus. It does *not* mean OBIG is selling the Runoff Companies in an irresponsible way.

Finally, the Petition is wrong to suggest that runoff specialists like Armour are in the business of underpaying policyholders who have been "shunted over" to runoff. Runoff specialists are subject to the same regime of claims-handling laws and regulations that govern all insurers. There are several experienced specialists in managing the runoff of discontinued insurance operations. One of the first specialists, The Resolution Group (a subsidiary of Fairfax Financial Holdings Limited), was formed in 1992 to manage the discontinued business of the Xerox Group; it later oversaw the successful runoff of TIG Insurance and Sphere Drake Insurance Company, among others. Other well-known run-off specialists and participants include divisions of Berkshire Hathaway and Swiss Re, as well as Armour, Catalina, Enstar and Randall & Quilter, each of whose runoff acquisitions and successes have built upon the last.

Runoff firms have expertise that allows them to develop an appropriate runoff strategy to resolve liabilities and collect assets in a timely and cost-effective manner, by effectively managing operating expenses, proactively managing claims and reinsurance and other third party recoverables, and achieving claim finality. The management and employees in these firms are devoted to their core business: efficient and cost-effective management and resolution of claims and collection of third party recoverables. They employ staff dedicated to these primary objectives, who see this as a business with a future. They often implement staff retention and incentive programs aligned with key runoff objectives.

The separation of the discontinued operations from new business operations therefore has several advantages over other available strategies for managing runoff business. Each of the distinct operations (runoff and new business) can be managed with singular focus, and without potentially conflicting goals. When the discontinued operations are managed by a runoff specialist, employees will often have a longer-term employment opportunity, as additional books of business are added to the portfolio being managed by the specialist. Heightened job security leads to lower turnover and cost and better employee morale and service levels. Moreover, employees and management of the runoff entity will not face actual or perceived pressure for preferential treatment of claims from existing clients of the ongoing operations. The net results include lower expenses, more consistent and efficient claims management and improved reinsurance, third party liability and subrogation collections.

A.M. Best Company recently devised ratings criteria specifically for runoff specialists, and, in doing so, confirmed the advantages of acquisitions like the Transaction over the alternative of using an insurer's existing claims organization to handle claims under policies that the company no longer writes:

> A run-off specialist that is managing the run-off insurer may handle claims more efficiently, given its specialization. In addition, a runoff specialist's financial projections may have more credibility if management has a successful track record of executing its run-off strategy. The run-off insurer owned by a run-off specialist also may have fewer operational risks than if it were owned by a traditional insurance group (e.g., systems issues, lost personnel and employee agency problems). Furthermore, capital at an entity owned by a run-off specialist may experience less pressure to be reallocated to other areas than within an active insurance group. . . .
>
> A run-off specialist seeks to use its experience managing complex claims, its specialized focus and its economies of scale to profitably manage the run-off of the loss reserves. A run-off specialist will be motivated to effectively run off acquired entities and thereby ease future regulatory approval of additional acquisitions.[4]

In short, contrary to the suggestions of the Commenting Policyholders, the result of the Transaction will be that all of the insureds of the Runoff Companies will continue to receive expert, professional claims handling, that the portfolio of the Runoff Companies will be managed efficiently and responsively, and that holders of runoff policies will suffer no prejudice from OBIG's current focus on different lines of business.

[4] http://www3.ambest.com/ambv/ratingmethodology/OpenPDF.aspx?rc=209765.

D. Representing the Policyholders

There is another important feature of the method that OBIG has selected for handling its runoff claims, and which the Commenting Policyholders have disparaged: it is subject to approval by the Department. If, as the Commenting Policyholders have suggested, OBIG actually wanted to pursue a strategy of avoiding meaningful scrutiny of its business, it would never have turned down this road.

Contrary to the Commenting Policyholders' suggestion that their interests "are not adequately represented" in connection with the Form A, OBIG and Armour, by agreeing to the Transaction, have initiated a process in which the Department's professional staff is required to *disapprove* the Transaction, if it finds that (in addition to the presence of certain other circumstances) the financial condition of Armour might "prejudice the interest of [the] policyholders" of the Runoff Companies, or if Armour's plans or proposals for those Companies "are unfair and unreasonable and fail to confer benefit on [those] policyholders . . . and are not in the public interest." 40 P.S. §§ 991.1402(f)(1)(iii) and (iv). The Transaction represents a business opportunity for OBIG and Armour—OBIG will be permitted to focus fully on its ongoing, specialty business, while Armour will exercise its expertise in managing long-tail runoff claims—but the Department's examination will focus on the statutory standards of the Act, including the protection of *policyholders*.

In conducting that examination, the Department will have the benefit of *every* document whose designation as "confidential" has aroused the suspicion of the Commenting Policyholders. These include all the documents required under Section 991.1402(b) of the Act, as well as all the information that the Department has determined to be " necessary or appropriate for the protection of policyholders." (*Id.*)

The Department will *also* have the benefit of an independent and comprehensive actuarial evaluation of the reserves of the Runoff Companies, which is currently being conducted by a leading insurance industry risk specialist, Towers Watson. OBIG retained Towers Watson in consultation with the Department, and with the Department's approval. When it is completed, the full Towers Watson report will be filed with the Department, and it will provide an independent analysis of the sufficiency of the Runoff Companies' reserves. The full report will not be disclosed publicly, because it will contain confidential and proprietary business information, but Towers Watson has been asked (again, in consultation with the Department) to prepare a public summary of the report from which confidential information will be omitted.

Finally, the Commenting Policyholders will have substantial rights to participate in this process. They have already identified the substantive areas on which they believe the Department's examination should concentrate. As a result of the Department's extension of the comment period, they will now have an opportunity to make additional comments. As noted above, they will have a chance to review the summary of the Towers Watson report that will be made publicly available. Finally, they also will be permitted to participate in any public hearing that the Department might choose to conduct.

In short, the runoff solution that OBIG has selected provides both substantive and procedural safeguards to the policyholders of the Runoff Companies.

IV. The Commenting Policyholders' Specific Concerns

The Transaction has been structured in a way that directly addresses the concerns expressed in the Petition.

First, the Runoff Companies will have adequate reinsurance, capital and reserves to satisfy claims under outstanding policies. OBIG estimates, as of March 31, 2013, that the gross unpaid loss and loss adjustment expense reserves of the Runoff Companies, at the time they are acquired by Armour, will total approximately $2.1 billion. That estimate has been established by rigorous internal and external reviews, and it is currently being evaluated independently by Towers Watson. The reinsurance available to the Runoff Companies as of March 31, 2013, as outlined below, would cover approximately $1.9 billion of those reserves. All of that reinsurance will still be available to the Runoff Companies after the Transaction is completed. The net reserves of the Runoff Companies will be funded by other assets of those companies (primarily cash and investments). The SPA expressly provides mechanisms to ensure that those assets are equal to the Target Statutory Capital, based on the balance sheets at closing, and it also provides for the possibility of additional capital, through potential surplus notes.

Second, claims against the runoff policies will continue to be processed in a professional and expeditious manner. In fact, because of the claim handling agreements and protocols already in place, the claims of a substantial number of policyholders, including the Commenting Policyholders, will continue to be handled by the same entity (National Indemnity Insurance Company ("NICO"), and its runoff claims affiliate, Resolute Management, Inc. ("Resolute")) and many of the same individuals that handle those claims today. NICO has been involved in OBIG's runoff business continuously since 2001, and its affiliate, Resolute, has been handling OBIG's runoff claims since January 2007. (For about six years before that date, the runoff claims were handled by a different claims servicing contractor that employed many of the same individuals who now work for Resolute.) As we explain below, after the Transaction has been completed, Resolute would continue to handle claims that are subject to NICO's reinsurance cover, including most of the claims of the Commenting Policyholders.

A. The Runoff Companies Have Extensive Reinsurance Protections

Any analysis of the capital adequacy of the Runoff Companies must take into consideration the extensive reinsurance protections those companies have in place. The Runoff Companies are the beneficiaries of various forms of reinsurance protection. While the Commenting Policyholders acknowledge as much, their Petition nevertheless reveals a fundamental misunderstanding of that reinsurance protection.

For example, the Petition asserts that "there is less than $200 million in reinsurance remaining under the 2001 loss portfolio transfer agreements" between OBIG and NICO. In fact, there is approximately *$1 billion* in available reinsurance remaining in the NICO treaty, and that coverage is net of approximately $0.4 billion remaining under reinsurance treaties with highly-rated third party reinsurers. The Runoff Companies are *further* protected by available reinsurance under treaties with General Reinsurance Corporation ("Gen Re") and additional third party reinsurers.

OBIG's reinsurance treaties with NICO and Gen Re were both put into place in 2001, and both would continue to be available to the Runoff Companies following the consummation of the Transaction. Both NICO and Gen Re are rated A++ (Superior, the highest of sixteen financial strength ratings) by A.M. Best and AA+ (Very Strong, the second highest of twenty one financial strength ratings) by Standard & Poor's.

NICO's liability under the NICO Agreement is net of reinsurance recoverables from third party reinsurers. These third party recoverables thus provide additional protection to the Runoff Companies. For example, of claim payments from 2000 through 2012, approximately 47% of asbestos and environmental losses were recovered under this third party reinsurance, thereby preserving reinsurance coverage amounts available to the Runoff Companies within the NICO reinsurance agreement.

1. The NICO Cover

Under an Aggregate Loss Portfolio Reinsurance Agreement put into place in 2001 (the "NICO Agreement"), NICO agreed to provide $2.5 billion of reinsurance for the "business covered" by the NICO Agreement, which is defined to include:

> (i) all losses from perils on policies or contracts of insurance or reinsurance that terminated on or before December 31, 1987;
>
> (ii) for policies or contracts of insurance or reinsurance issued on or before January 1, 1987 and that terminated after December 31, 1987, for all losses from all perils incurred before January 1, 1988;
>
> (iii) all asbestos related losses covered by policies or contracts of insurance or reinsurance that terminated on or before December 31, 1992;
>
> (iv) for policies or contracts of insurance or reinsurance issued on or before January 1, 1992 that terminated after December 31, 1992, all asbestos related losses covered by those policies that were incurred before January 1, 1993;
>
> (v) all lead related losses on policies or contracts of insurance or reinsurance that terminated on or before December 31, 1995;
>
> (vi) for policies or contracts of insurance or reinsurance issued on or before January 1, 1995 that terminated after December 31, 1995, all lead related losses incurred before January 1, 1996; and
>
> (vii) all losses arising from certain pools and associations listed on the schedule attached to the NICO Agreement.[5]

As of March 31, 2013, approximately $1.5 billion of the NICO cover has been paid, leaving approximately $1 billion remaining available to the Runoff Companies. Of that amount, OBIG estimates that approximately $0.8 billion has been incurred, including both case reserves and IBNR, including the IBNR associated with the Commenting Policyholders. In other words, the NICO Agreement will provide coverage for approximately $800 million of the total reserves of the Runoff Companies, after they have been acquired by Armour. If the case reserves and/or

[5] Workers compensation claims are carved out of the coverage under the NICO Agreement, except for those asbestos workers compensation claims that would fall within the coverage of (iii) and (iv).

IBNR subject to the NICO cover should suffer future adverse development, resulting in additional liabilities for the Runoff Companies, the Runoff Companies will also have additional coverage available, because the total amount still available under the NICO cover exceeds that amount.

In the Petition, the Commenting Policyholders mistakenly assert that only $200 million of the NICO cover remains available, based on a statement in Best's Insurance Reports. What the report apparently did not make clear is that, while $2.3 billion of the NICO cover is projected to have been exhausted, that figure is calculated on an incurred basis, which, as noted above, includes IBNR. The $200 million, therefore, is *not* the amount of the NICO cover that remains available to pay the Runoff Companies' projected liabilities. Rather, it is the amount of the cover that is projected to remain available, *after* all the liabilities that are subject to the NICO cover *have been paid*. OBIG estimates that, in order to exhaust this $200 million reserve buffer, the book of runoff business would have to experience a 25% adverse loss development over current case and IBNR reserves, an event that it views as highly unlikely.

2. **Third Party Reinsurance**

As noted above, recovery under the NICO Agreement is net of reinsurance recoverables from the third party, highly-rated reinsurers that are listed under Schedule F – Part 3 of OBIG's 2012 Annual Statement (listing remaining net recoverables of all unaffiliated authorized reinsurers) (the "Schedule F"). OBIG currently estimates that $ 0.4 billion remains available under these contracts. Another $ 0.3 billion remains available under separate third party reinsurance contracts, as also set forth in the Schedule F, for a total of approximately $ 0.7 billion.

Most of these third party reinsurance treaties are not subject to an aggregate limit. Thus, as is the case with the NICO cover, these treaties also provide additional protection against any adverse development of the gross estimated liabilities.

3. The Gen Re Cover

Pursuant to an Adverse Development Agreement of Reinsurance, Gen Re provides reinsurance for up to approximately $0.6 billion of additional losses for certain types of claims arising from accident years 2000 and earlier. Payments received under that cover total approximately $ 0.2 billion as of March 31, 2013. On an incurred basis, as of March 31, 2013, OBIG has ceded to Gen Re approximately $ 0.6 billion of losses, and OBIG projects that, on an incurred basis, the cover is fully utilized. Accordingly, as payments are made in the future, the Runoff Companies will receive the remaining $ 0.4 billion in limits under the Gen Re cover. All losses in excess of the Gen Re cover have been fully reserved; they are part of the net reserves, discussed below, that will be paid out of the Runoff Companies' other assets.

4. Reinsurance Summary

The $0.4 billion recoverable under the Gen Re cover, the $0.7 billion remaining under third party reinsurance contracts, and the $0.8 billion available under the NICO cover for projected and incurred claims bring the total reinsurance recoverable for the Runoff Companies to approximately $1.9 billion as of March 31, 2013. Furthermore, as noted above, this total does not include additional coverage that remains available for adverse developments under the NICO cover and the third party reinsurance.

B. The Runoff Companies Are Appropriately Capitalized

OBIG estimates, as of March 31, 2013, that the Runoff Companies would have, at the time of closing under the terms of the Transaction, (1) about $2.1 billion in gross unpaid loss and loss adjustment expense reserves (discussed in detail below) and (2) approximately $1.9 billion in reinsurance recoverables. Given this level of reinsurance coverage, the net reserves of the Runoff Companies are likely to be a relatively small part of their total liabilities. Those reserves will be funded by other assets of the Runoff Companies.

1. Capitalization of the Runoff Companies

The SPA provides that the aggregate purchase price to be paid for the Runoff Companies at the closing of the Transaction will be calculated under a formula to provide those Companies with Target Statutory Capital, based on the balance sheets at closing. It also provides for the possibility of *additional* capital, if the Department should determine it to be appropriate.

Sections 2.1(c)(iii) and 5.18 of the SPA provide that the aggregate purchase price for the Runoff Companies will be calculated reflecting changes to the pro forma balance sheet of the Runoff Companies, from December 31, 2011, to the date of closing. Section 2.1(c)(iii) provides that the price will be calculated to maintain Target Statutory Capital. Section 5.18 of the SPA provides for the contribution to OBIC, prior to closing, of the absolute value of a negative purchase price calculated in accordance with Section 2.1(c)(iii) of the SPA.

Moreover, Section 5.19 of the SPA provides for additional contributions of capital by OBIG, in the event that the Department should determine that the Runoff Companies require additional capitalization. OBIG would receive surplus notes in consideration of such contributions, but no payment could be made on those notes without the Department's approval. In no event, therefore, will the Transaction be closed without the Runoff Companies' having available surplus in an amount the Department has determined to be adequate to protect policyholders.

2. The Petition Does Not Address Capital Adequacy

As we observed earlier, the Petition does not contain *any* argument purporting to show that the approach to capitalization that is mandated by the SPA will not fully protect the interests of the Commenting Policyholders. Instead, the Petition tries to mischaracterize some elements of the Restructuring (transactions that are *not* at issue in this Form A review) that had the net effect of reducing the surplus of the Runoff Companies. (As noted earlier, this reduction in surplus accompanied a reduction of the *net liability* to which the remaining assets were exposed). The Commenting Policyholders accuse OBIG of having "treated itself" to assets that were "stripped out" of runoff entities.

As we also discussed above, these accusations appear to refer to transactions that were incidental to the goal of segregating OBIG's runoff operations from its ongoing, specialty risk business. As part of the Restructuring, OBIC contributed the stock of several specialty risk subsidiaries to ASIC, and it sold another subsidiary to HONY. OBIC also plans to divest itself of ASIC and HONY before the Transaction closes. When they have all been completed, these transactions will have changed OBIG's capital structure, but they will also have had nothing to do with "stripping out" assets.

As part of the Restructuring, OBIG also unwound the inter-company reinsurance arrangements, under which the capital of the Runoff Companies was exposed to risks associated with OBIG's ongoing, specialty business, and it re-allocated certain capital as appropriate for the type and amount of risk faced by each company within the enterprise. There is nothing inappropriate, sinister or suspicious about those transactions. Because they are still actively writing new business, subject to all the costs and liabilities associated with ongoing operations, the Ongoing Companies require a different capitalization structure from the Runoff Companies. For example, the Ongoing Companies must have capital to support both old and new business, and they must meet both Risk Based Capital and Rating Agency capital criteria. In contrast, the Runoff Companies need capital sufficient only to ensure the payment of runoff claims.[6] Thus, while OBIG intends to convey the Runoff Companies to Armour, it would have undertaken the Restructuring, including the capital realignment, even if it had selected a different solution for managing its runoff policies.

Furthermore, before the Restructuring, OBIG met and conferred with various regulators, including the Department (collectively, the "Regulators"). As part of this process, OBIG reviewed with the Regulators each aspect of the Restructuring, including the conveyance of various OBIG subsidiaries from one company to another, the unwinding of the pooling arrangement, the details of the new policy management, and the capital realignment. As OBIG implemented the Restructuring, all transactions subject to regulatory approval, including dividends, were filed with and approved by the appropriate Regulators.

In sum, the Runoff Companies will be sufficiently capitalized and reinsured, and their transfer to Armour will not prejudice the interests of their policyholders.

C. The Runoff Companies Are Fully Reserved

As a hedge for their other arguments, the Commenting Policyholders also try to suggest that the Runoff Companies will require more capital, because their liabilities actually exceed the levels that are cited in the Petition. The Commenting Policyholders assert (without explanation) that OBIG has been "chronically under-reserved" for asbestos, environmental and other long-tail claims, and they say they are "concerned" that current loss projections are "unrealistic." OBIG respectfully disagrees with these assertions. OBIG has a sophisticated and ongoing actuarial

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[6] This is the reason it is commonplace for ratings agencies to downgrade insurers when they become free-standing runoff entities. As the Commenting Policyholders observe, Fitch has threatened a possible downgrade of the Runoff Companies. But such a decision by a ratings agency does *not* purport to be a determination of the issues that the Department must resolve under 40 P.S. § 991.1402.

review process, and its internal analyses have consistently tested the adequacy of the reserves for the Runoff Companies.

The OBIG companies' reserves are subject to continual and thorough internal and external reviews. Each quarter, OBIG's Corporate Actuarial Department analyzes the aggregate reserves associated with both its ongoing and runoff business, including the reserves of the Runoff Companies. The results of this quarterly review are reported to and reviewed by OBIG management, including its Chief Executive Officer, Chief Financial Officer and Chief Actuary, and adjustments are made as appropriate.

In addition to the quarterly reviews, every three years, OBIG, with the assistance of Resolute and outside consultants, performs a review of the aggregate reserves on business that is the subject of its reinsurance treaty with NICO. As described more fully above, this treaty protects against, among other things, losses arising from legacy policies and asbestos and environmental liabilities. This additional reserve analysis models the exposures relating to both direct and assumed liabilities.

Furthermore, the Department will not just have the benefit of analyses by OBIG and Resolute: OBIG has also retained Towers Watson (in consultation with the Department) to provide an independent and comprehensive actuarial evaluation of the reserves that are supporting the liabilities of the Runoff Companies. When completed, the full Towers Watson report will be filed with the Department for its review and analysis. In addition, a public summary of the Towers Watson actuarial report will be made available. After the completion of the report, OBIG will submit additional comments addressing the findings of that report, as appropriate.

D. Continuity of Claims Handling After Transaction

Apart from issues relating to the resources of the Runoff Companies, the Petition expresses "concern" that Armour might handle claims under runoff policies in an improper manner. Those concerns are misplaced: claims handling will be conducted under the ultimate supervision of Armour, and, as we discuss below, Armour is an experienced and qualified runoff specialist. Additionally, the Petition entirely ignores the fact that agreements already in place ensure continuity in the way the claims of the Commenting Policyholders will be resolved.

Resolute is part of Berkshire Hathaway, and it currently handles claims that are subject to the NICO cover. The NICO policy specifically covers claims under the types of legacy policies held by the Commenting Policyholders: "'Business Covered' means . . . [1] all losses from all perils on policies or contracts of insurance or reinsurance issued by the Reinsured or any [Predecessor Company]. . . which terminated on or before December 31, 1987 and. . . [2] all asbestos related losses covered by policies or contracts of insurance or reinsurance issued by the Reinsured or any[Predecessor Company] . . . which terminated on or before December 31, 1992. . . ."

The NICO policy also incorporates an administrative services agreement (the "ASA"), by which the parties agreed to delegate certain claims functions to Resolute, as designated Administrator. The ASA provides that the Administrator "shall carry out its functions as appropriate in its independent judgment." The agreement further provides that these claims functions "shall be performed by the Administrator in accordance with (i) applicable law, (ii) the Reinsured Contracts and (iii) Administrator's own standards in providing services with respect to similar insurance contracts. . . ." According to the terms of the NICO Agreement, the administrative services are to be provided "until the date of termination of this agreement."

Thus, following the Transaction, Resolute will continue to handle claims subject to the NICO cover, according to the same ASA, and with its own continued "independent judgment" and standards. Given the remaining limits of that cover, that means there will be no change in the claims handling for those claims following the Transaction.

In addition, as part of the Transaction, it is anticipated that a majority of the claims personnel currently employed by the Runoff Companies will follow the runoff business to Armour, and become Armour employees. Thus, after the Transaction, claims that were previously handled directly by the Runoff Companies will be handled by the same entity, by essentially the same personnel, and in the same manner as they are today.

E. The Transaction Contemplates a Number of Ancillary Agreements

Noting that they have not had access to certain of the documents relating to the Transaction, the Commenting Policyholders have raised a question regarding the purpose behind and operation of a number of those documents.[7] Specifically, they express an interest in two reinsurance agreements between OBIC and ASIC, the Administrative Services Agreements between those companies, and the Transition Services Agreement. Each will be discussed below.

There are two "Amended and Restated 100% Quota Share Reinsurance Agreements" between ASIC and OBIC. Pursuant to one, the parties have agreed that, until such time as ASIC or another of the Ongoing Companies obtains all policy-issuing approvals needed to write new business, OBIC (or another Runoff Company) will write such business on a "fronted" basis, with ASIC providing 100% reinsurance for that business (the "Retained Business"). Pursuant to the other reinsurance agreement between OBIC and ASIC, they have further agreed that, in

[7] The Commenting Policyholders express "concern" that the Department will consider certain business records of OBIG and the Runoff Companies that have not been publicly disclosed. In this connection, it is worth noting that several of the Commenting Policyholders are parties to pending coverage litigation against one or more of the Runoff Companies. The Department's ability to conduct an effective review of transactions such as the one at issue here would be severely undermined if litigating policyholders could use Form A filings to obtain discovery that is unavailable in court. The legitimate business interests of insurers would also be prejudiced.

exchange for ongoing premium payments and "cash or other assets", OBIC will provide 100% reinsurance to ASIC for certain runoff business (the "Post-Closing Runoff Business"). OBIC's liabilities under this latter agreement is included in the total amount of runoff liabilities that are being placed in OBIC as part of the Restructuring.

There are also two Administrative Services Agreements that relate to these reinsurance agreements. Under the Retained Business Administrative Services Agreement between OBIC and ASIC, the parties agreed that ASIC will perform certain administrative services with respect to the Retained Business, including claims handling, billing and collection. Under the Runoff Business Administrative Services Agreement, the parties agreed that OBIC will perform similar administrative services with respect to the Post-Closing Runoff Business.

Finally, in a further effort to protect policyholders and to ensure an orderly and smooth transition of the Runoff Companies, the Transaction includes a Transition Services Agreement, pursuant to which OBIG will provide certain information technology and other services relating to the business of the Runoff Companies. Because they address administrative issues and not liabilities or reserves, neither the Administrative Services Agreement nor the Transition Services Agreement significantly impacts the central question at issue here—whether the Runoff Companies have sufficient assets to pay policyholder claims.

V. <u>Armour Is An Experienced Runoff Manager</u>

Armour's ownership and management have extensive experience in the insurance and reinsurance industries, including in the management of other runoff portfolios. This experience is described, in part, in the Form A. Armour's senior management has, in the aggregate, more than 100 years of experience in managing discontinued operations and reinsurance involving aggregate runoff insurance reserves in excess of $7 billion. Armour provides its services through 70 employees in offices in the United States, Bermuda and the United Kingdom.

Armour's business focuses on claims management of insurance and reinsurance books of liabilities in runoff (primarily involving asbestos, pollution and health hazard "APH" exposures). As part of that management, Armour frequently develops and implements strategies for managing claims and other liabilities, debt collection and asset management. Armour also applies professional management to the attorney relationship, ensuring cost containment and timely resolution of liabilities where applicable. As a growing and dynamic organization, Armour can provide staff with security and career opportunities in a motivated environment.

In the Petition, the Commenting Policyholders suggest that the Transaction somehow creates unusual "incentives" for Armour to delay or refuse the payment of valid claims. Like any business, Armour hopes to realize a positive return from the Transaction. There is nothing secret or dangerous about this fact. But Armour's incentives are the same as those of any claims organization. In particular—and contrary to the suggestion in the Petition—Armour cares deeply about its reputation and can successfully operate its business only if that reputation is protected through professional and compliant management practices. The fact that Armour does not market insurance to new customers does not diminish the importance of reputation to Armour's future success.

Furthermore, the Commenting Policyholders suggest that Armour's "incentives" would cause it "to maximize its own profits, presumably until" the Runoff Companies "are forced into liquidation." Armour's incentive in this transaction is to ensure that the Runoff Companies have sufficient capital to satisfy all obligations under legacy policies, and to make a profit by using its expertise to manage the companies efficiently. Liquidation would eliminate Armour's ability to make a profit.

This is not to suggest that, after the Transaction, there will never be any disputes between the Runoff Companies and any policyholder over the interpretation of policy terms or the availability of coverage for specific claims. Such disputes have already arisen, and they will continue to be resolved through standard venues and mechanisms. If the Transaction is approved, the Runoff Companies will be subject to the same laws and regulations regarding the good-faith handling of claims that currently govern them. If, in the future, an insured believes that one of the Runoff Companies did not handle a claim appropriately, it can seek appropriate relief at that time.

Finally, the Commenting Policyholders purport to make specific claims about some of Armour's principals. They state that "the actual results generated by the runoffs in which [Armour's] principals have previously been involved were highly detrimental to the interests of policyholders." Upon closer examination, these claims turn out to have no support:

- The Petition states that Centre Reinsurance Group Limited, a former employer of one of Armour Group's principals, Mr. Huntington,[8] and a subsidiary of Zurich Financial Services Group, was involved in a series of reinsurance transactions involving Home Insurance Company, before that company was placed into liquidation. The Petition does not assert that Mr. Huntington had any involvement with these transactions, or that the transactions contributed to Home Insurance Company's eventual liquidation, or that they involved improper claim handling practices.

  The Petition further states that, "[a]lthough actuaries assured state regulators that Home's existing reserves and reinsurance recoverables from Centre Re and others would last 30 years, it was placed into liquidation only five years later." Armour does not possess any information that would enable it to respond to this claim about assurances being made by actuaries to state regulators. Indeed, Mr. Huntington had no material role or knowledge in the negotiation or structuring of the Home transaction, the structuring of any of the reinsurance transactions referred to by the Petition, Home's runoff business, its reserving

[8] Mr. Huntington was employed by, and an executive of, Centre Reinsurance Group Limited from 1993 to 1997.

or any representations made to state regulators or other third parties that related to the Home transaction.

- The Petition states that Castlewood Limited, a former employer of Mr. Williams,[9] has a U.S. affiliate that has managed the runoff of Seaton Insurance Company and Stonewall Insurance Company. Seaton and Stonewall were acquired by Castlewood Holdings, the successor company to Castlewood Limited, some eight years after Mr. Williams had left Castlewood Limited. The Petition further states that those runoffs have been "marked by lengthy delays in the recognition and payment of valid claims." The Petition does not assert that Mr. Williams had any involvement with Stonewall or Seaton, or that his association with Castlewood Limited overlapped with the management of Stonewall or Seaton by one of Castlewood's affiliates. Further, the Commenting Policyholders' conclusory assertion does not establish in any way that either Stonewall or Seaton failed to handle claims in an appropriate, professional manner. In particular, the Petition fails to allege that either company's claims practices led to any bad-faith judgments or regulatory action outside the norms for the insurance industry.

- The Petition states that another Armour Group executive, Mr. Ryland, is a former executive of PRO Insurance Solutions Limited, and the Petition describes PRO as a "principal servicing agent of the solvent scheme 'mill' in the London Market." The Petition goes on to offer criticisms of the "solvent scheme" process. Absent from this comment is any assertion that the solvent scheme process in the U.K. is detrimental to policyholders or involves any illegal or improper practices, or that Mr. Ryland has participated in any such activities. During Mr. Ryland's tenure with PRO, which ended in 2009, he was involved in managing up to $4 billion of legacy liabilities on behalf of 30 different legacy portfolios in multiple jurisdictions all over the world.

[9] Mr. Williams was employed by, and an executive of, Castlewood Limited from 1993-1999.

VI. Conclusion

The Transaction is the final step of a multi-step corporate reorganization. The Petition tries to cast suspicion on the earlier steps, but they were ordinary corporate transactions that were disclosed to and (where required) approved by state insurance regulators—including the regulators of the Department. They are not subject to review in connection with the Form A. These steps segregated OBIG's runoff business in a discrete group of corporations, with their own management and financial reporting, and secured the net liabilities of that business with assets that are not also subject to claims against OBIG's ongoing, specialty risk business.

The Form A filing concerns Armour's acquisition of the Runoff Companies. If the Transaction is completed, the Runoff Companies will have adequate resources with which to pay outstanding claims. They will be protected by approximately $1.9 billion in reinsurance, and their net reserves will be secured by their other assets. Under the express terms of the Transaction, those assets will be at a level the Department will have determined to be adequate, and the Department's determination will be informed by the independent actuarial review of Towers Watson.

If the Transaction is completed, the Runoff Companies will be managed by an experienced runoff manager, with expertise in overseeing portfolios of this kind. The claims of the Commenting Policyholders will be handled, for the most part, by the same Administrator, using the same personnel, that handles those claims today—under an agreement that requires the Administrator to comply with applicable laws and regulations and to exercise its independent judgment.

For these reasons, and for the additional reasons that are discussed above, the substantive concerns set forth in the Petition are not well-founded.

A copy of this Response has been sent to counsel for Commenting Policyholders, as identified in the Petition.

Respectfully submitted,

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