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Pennsylvania
Insurance Department

July 18, 2014

Mr. Stephen Johnson
Pennsylvania Insurance Department
Bureau of Company Licensing and Financial Analysis
1345 Strawberry Square
Harrisburg, PA 17120

Re: Application for Approval to Acquire Control of OneBeacon Insurance Company and Potomac Insurance Company, 43 Pa. Bull. 1157 (Feb. 23, 2013) - Reply In Support of Petition to Intervene by Colgate-Palmolive Company

Dear Mr. Johnson:

In further support of its Petition to Intervene in the above-referenced proceeding, Colgate-Palmolive Company ("Colgate"), through its attorneys, submits this letter in response to the Towers Watson Stochastic Modeling Summary Report and the related Actuarial Reviews of the Towers Watson reports by Risk & Regulatory Consulting ("RRC") that the Department published on its web page with regard to the acquisition that OneBeacon Insurance Group LLC ("OBIG") and Armour Group Holdings, Ltd. ("Armour") (collectively the "Applicants") have proposed. As the Department is aware, the Applicants propose an acquisition of OneBeacon Insurance Company's ("OBIC"), OneBeacon America Insurance Company's ("OBA"), and Potomac Insurance Company's ("Potomac") run-off risks by Trebuchet US Holdings, Inc., a subsidiary of Bermuda-domiciled and Bermuda-incorporated Armour (the "Proposed Acquisition").

According to the Towers Watson report, the companies to be transferred to Armour (the "Run-Off Companies") are not adequately capitalized. Even assuming the information in the Towers Watson report is accurate, the Run-Off Companies require at least an additional \$200 million of capital in order to avoid falling below the capital threshold that triggers the Department to intervene. (See Exhibit 1 attached hereto at p. 3.)

In fact, based on the Towers Watson Report, Potomac Insurance Company ("Potomac") is the Run-Off Company that holds most of the asbestos and environmental coverage that will lead to significant claims and OneBeacon set Potomac's Authorized Control Level of capital at \$116 million. (Id.) That means that

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Potomac's Company Action Level is \$232 million, based on the NAIC Model Act. (Id.) But Towers Watson also reports that Potomac will be left only with approximately \$161,500,000 of capital. (Id.) This fact alone means that the Department will need to take regulatory action and intervene on "day one," because at least one of the Run-Off Companies will be underfunded.

Although Pennsylvania does not have a strict threshold for measuring adequate capitalization, the Department has stepped in as a regulator in cases where other insurance companies have similarly inadequate capital. For example, the Department has taken action with regard to Century Indemnity Company. Century's capital deficiencies are similar to those of Potomac's. (See Exhibit 1 at Attachment II attached hereto, a chart of the capital held by several insurance companies like Potomac and the Run-Off Companies.) The major difference between Potomac and Century is that Century has the benefit of substantial capital that it can obtain from its parent companies which are part of the ACE conglomerate. In contrast, the Proposed Acquisition is intended to decouple the Run-Off Companies from OneBeacon's financial resources. Notably, the Department has required Century to be guaranteed by ACE. Here, if the Proposed Acquisition is approved, Armour will not be able to guarantee Potomac's liabilities because, as explained below, Armour lacks the financial resources to do so and has explicitly represented that it will not be providing any financial backing to the Run-Off Companies. (See Exhibit 1.)

Turning back to the \$200 million needed to fix the inadequate capital, that figure is based on the assumptions made by Towers Watson. In other words, it assumes that everything relied upon in the Towers Watson report is accurate and complete. As Colgate has previously communicated to the Department, it is not at all clear that the Run-Off Companies have the reinsurance resources that they claim will resolve the lack of capital. Notably, the NICO and Gen Re reinsurance policies appear to be largely, if not completely, exhausted. Even assuming Towers Watson properly included these reinsurance assets at the levels OneBeacon claims they are available, Towers Watson's report leads to the conclusion that \$200 million of additional capital is needed. (Id. p. 3.)

In fact, Towers Watson's report reveals a 12% predicted rate of failure. (Exhibit 1, p. 1.) Given the number of assumptions Towers Watson has made (see Exhibit 1 at p. 5-6 and Attachment I), the inability to verify much of the information relied upon by Towers Watson and the fact that the limited amount of available information undermines Towers Watson's assumptions in many instances, the 12% rate of failure is, at best, a minimum rate and not a rate reached based on a conservative methodology. (Id. p. 2-3.) Even if accurate, Colgate respectfully submits that this failure rate is unacceptable and inconsistent with the Department's duty to protect policyholders from an unreasonable risk of the Run-Off Companies being unable to

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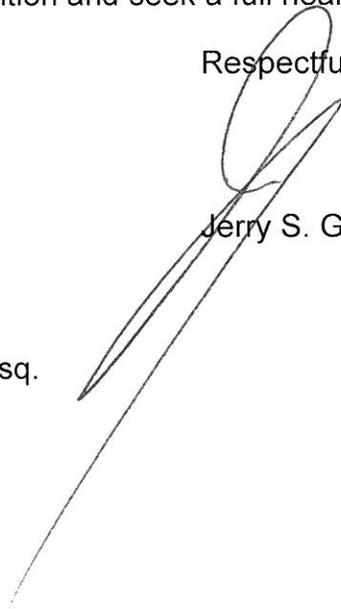
satisfy their obligations to policyholders after the Proposed Acquisition. (Exhibit 1 at p. 4.)

The Run-Off Companies' are undercapitalized to such an extent that Armour does not have the financial resources to cover the difference. Armour fought to keep its financial information confidential, up through the Right-to-Know Law appeal that Colgate needed to pursue to obtain those financials. They demonstrate that Armour, as suspected, does not have anywhere close to the type of capital needed to keep just Potomac, let alone the other Run-Off Companies, out of the Company Action Level. (See Exhibit 1.) To the contrary, Armour will be charging the Run-Off Companies fees for its services in administering claims and the run-off process. These fees, which remain undisclosed, will only further deplete the already under-capitalized companies.

To date, and as repeatedly pointed out by numerous other policyholders, the Applicants have failed to make available many of the key documents bearing on the Proposed Acquisition. Without these documents, it is difficult, if not impossible, for policyholders to understand fully the potential effects of the Proposed Acquisition. Nonetheless, even based on the limited available information, it is clear that the Proposed Acquisition will leave the Run-Off Companies insufficiently capitalized and likely subject to regulatory action on day one. Accordingly, Colgate respectfully submits that the Proposed Acquisition should be denied.

Colgate reserves the right to supplement and amend this submission. Colgate does not waive its rights, and expressly reserves its rights, including to intervene in the Proposed Acquisition and seek a full hearing of the matter.

Respectfully submitted,



Jerry S. Goldman

JSG/hs

cc: Alexander D. Hardiman, Esq.
Daniel J. Healy, Esq.

EXHIBIT 1



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July 18, 2014

FTI Consulting, Inc. (“FTI”) has performed a preliminary review of the 1) OneBeacon Insurance Group, LLC Stochastic Modeling of Run-Off Business Pro-forma Balance Sheet as of June 30, 2014, Summary Report, prepared by Towers Watson (“TW”), dated June 10, 2014 (“TW Modeling Report”), and 2) Report on Actuarial Review of “One Beacon Insurance Group, LLC Stochastic Modeling of Run-Off Business Pro-Forma Balance Sheet as of June 30, 2014,” as Prepared by Towers Watson, Summary Report, prepared by Risk & Regulatory Consulting (“RRC”), dated June 20, 2014 (“RRC Modeling Review”).

Based on FTI’s preliminary review of the TW Modeling Report and the RRC Modeling Review, FTI has observed that both the TW Modeling Report and RRC Modeling Review do not appear to provide the information needed by the Pennsylvania Insurance Department (the “Department”) to evaluate whether the acquisition of control of One Beacon Insurance Company, Potomac Insurance Company (“Potomac”), OneBeacon America Insurance Company and The Employers’ Fire Insurance Company (the “Run-off Companies”), by Armour Group Holdings Limited (“Armour”), through its subsidiary Trebuchet US Holdings, Inc., (the “Transaction”) will result in adequate confidence that the Run-off Companies will make claim or other payments on a timely basis.

Specifically, FTI observes:

- The TW Modeling Report and RRC Modeling Review do not assess technical insolvency or surplus adequacy. As such, even accepting all other features of the TW stochastic modeling:
 - The failure rate is higher than shown by TW.
 - Failures will be recognized and timely payment potentially interrupted much sooner than indicated in Table 1, Estimated Success Rate – Final Version, of the TW Modeling Report (“Table 1”).
- Even 12% is a high failure rate.
- The TW Modeling Report does not include sensitivity testing or reverse stress testing.
- TW prepares its analysis based on the actuarial central estimate of reserves, thus valuing the risk of the low and high estimate of reserves at zero.
- TW does not include the risk of ‘known unknowns.’

- The starting point for TW’s analysis of loss reserves is older than necessary.
- The pro forma balance sheet for the Run-off Companies as of June 30, 2014 presented by TW shares similarities with failing insurers in runoff.

Further, the TW Modeling Report selectively discloses information, thus entirely omitting the disclosure of important information necessary to understand key assumptions in TW’s work. Without further information, FTI cannot properly assess the potential impact of certain assumptions.

The remainder of this letter elaborates on FTI’s preliminary observations. This initial review by FTI does not constitute a complete review of TW’s or RRC’s work, particularly as both parties only provided summaries of their work. A full review of the TW and RRC work might produce very different observations, potentially contradicting the observations in this letter. Moreover, FTI is only providing preliminary observations related to our review of the TW Modeling Report and the RRC Modeling Review for purposes of the Transaction, and is not expressing any opinions related to OneBeacon Insurance Group, LLC (“OneBeacon”), Armour, TW, RRC, or the Department.

THE TW MODELING REPORT AND RRC MODELING REVIEW DO NOT ASSESS TECHNICAL INSOLVENCY OR SURPLUS ADEQUACY.

As outlined by RRC,¹ FTI understands that the Department needs to determine the extent to which all amounts due to policyholders and claimants are likely to be paid on a timely basis. However, “success,” as defined by TW,² is not sufficient to assure “timely payment.” The extent of timely payment requires the evaluation of other crucial criteria: technical insolvency and surplus adequacy.

Technical Insolvency:

An insurance company’s financial statements must show that assets are sufficient to cover its liabilities, and failure to do so is known as technical insolvency. If there is technical insolvency, a regulator might deem it necessary to step in to limit payments (and thus delay payments) to assure that remaining assets were distributed appropriately. The implications of not modeling technical insolvency include:

- First, Table 1 does not show, and does not explain, that a cash shortage in year 25 will likely be recognized as a technical insolvency years earlier, e.g., in years 1-10. A technical insolvency would trigger a default condition and a failure for timely payments far earlier than shown.

¹ RRC states, “The Department’s primary objective is to determine whether or not the Run-off Companies, at the time of and following the acquisition by Armour, contain sufficient assets, including expected investment income and sufficient liquidity to pay out on a timely basis all amounts due to policyholders and claimants” (emphasis added). RRC Modeling Review, p. 3.

² TW measures, and RRC uses, the following criteria: “Success” is any scenario in which the invested assets never fall below zero before the last claim is paid. “Failure” is any scenario in which the invested assets fall to zero before the last claim is paid. (i.e., invested assets are not sufficient to pay all claims.) TW Modeling Report, p. 4.

As such, the apparent high degree of success in early years in Table 1 is illusory. For example, the reported 12% failure rate after 30 years (i.e., the complement of the 88.28% success rate) may well be largely recognized within 15 years.

- Second, liability estimates are uncertain and this uncertainty affects the failure rate. In addition to the cash failures estimated by TW, there will be situations in which reserve estimates predict a cash failure, even though cash was ultimately sufficient. As such timely payment will be interrupted (“near misses”).

A near miss, while not a cash failure, can cause an interruption in timely claim payments if regulatory intervention is deemed necessary to assure the fair distribution of assets. Thus, each near miss is a failure.

For example, suppose there are 0.5 near misses for each cash failure.³ The chance that the Run-off Companies will fail to make timely payments is no longer 12%, i.e., 100% minus the 88.28% success rate in Table 1. Rather, the chance that the Run-off Companies will fail to make timely payments rises to 18%.

Surplus Adequacy:

The level of surplus must provide the regulator and management with confidence that payments can be made to all policyholders. If there is inadequate surplus, a regulator might deem it necessary need to step in to limit payments (and thus delay payments) to assure that remaining assets are distributed appropriately.

In order to avoid the potential for intervention by state regulators, and disruption of timely payments to claimants and others, insurance companies must maintain adjusted surplus above certain risk-based capital (“RBC”) thresholds. For example, if an insurer’s surplus falls below the Company Action Level RBC, the insurer must submit a report to the state regulator outlining how the company will cure its current financial condition and the implications if corrective action is not taken.⁴ The implications of not modeling surplus adequacy include:

- As of December 31, 2013 Potomac alone indicated that its Authorized Control Level RBC was \$116 million.⁵ Potomac’s Company Action Level RBC was twice that, or \$232 million.⁶ If the Run-off Companies were required to maintain surplus above the Company Action Level RBC, it might require over \$200 million⁷ of surplus in addition to the surplus reflected

³ The proportion of near misses depends on factors including the variability in the reserve estimation process, which would be high for asbestos and environmental liabilities, and the shape of the cash payout distribution, particularly in the region near the cash failures. The information to assess those parameters is not provided in the TW Modeling Report or RRC Modeling Review.

⁴ Risk-Based Capital (RBC) For Insurers Model Act, pp. 312-4 – 312-5.

⁵ Annual Statement of the Potomac Insurance Company, For The Year Ended December 31, 2013, Five-Year Historical Data, p. 17.

⁶ “‘Company Action Level RBC’ means, with respect to any insurer, the product of 2.0 and its Authorized Control Level RBC.” Risk-Based Capital (RBC) For Insurers Model Act, p. 312-2.

⁷ This amount is a rough estimate. The actual effect depends on issues such as how the NICO cover would be treated for measuring surplus adequacy, the investment income that would be earned on additional assets, how the regulator

on the June 30, 2014 pro forma opening balance sheet for the Run-off Companies of \$161.5 million⁸ to avoid an RBC event that might cause the failure to make timely payments. Said another way, TW measures “success” as any scenario in which surplus is greater than \$0. If “success” were redefined to equal the Company Action Level RBC (a better measure of surplus adequacy), the Run-off Companies’ beginning pro forma surplus would require an additional \$232 million in surplus to achieve a failure rate as low as 12%, or as low as 18% if assuming a 0.5 near miss rate for each cash failure.

EVEN 12% IS A HIGH FAILURE RATE.

TW reports that the failure rate under its model is 12%. While, for the reasons described in this letter, the true failure rate is above 12%, even 12% is a high failure rate.

For example, the National Association of Insurance Commissioners (“NAIC”) RBC underwriting risk factors are based on a probability of failure through reserve runoff of no more than 12.5% (87.5% success rate).⁹ With an 87.5% success rate a company would be at the Company Action Level RBC and would be required to provide a plan for improving its capital level.

Further, since a 12.5% failure rate in this example is the Company Action Level RBC, a 12% failure rate suggests that the Run-off Companies would not have adequate surplus “even when under considerable stress.”¹⁰ Most insurance companies maintain capital that is multiples of the Company Action Level RBC, and therefore have a failure rate that is much smaller than 12.5%.

THE TW MODELING REPORT DOES NOT INCLUDE SENSITIVITY TESTING OR REVERSE STRESS TESTING.

It appears that both the TW Modeling Report and the RRC Modeling Review do not include two techniques commonly used to examine the viability of an insurance enterprise: sensitivity testing¹¹ and reverse stress testing.

- Sensitivity testing: shows the effect of changes in parameters, such as changes in inflation.
- Reverse stress testing: shows the values of key parameters that are needed to “break” the system. This testing avoids the bias of only doing the sensitivity tests that prove the desired conclusion.

would be expected to treat RBC events, and the fact that high RBC would be indicated in adverse scenarios. Those issues could be reflected in stochastic modeling that included balance sheet and asset adequacy testing.

⁸ TW Modeling Report, p. 6.

⁹ AN UPDATE TO P/C RISK-BASED CAPITAL UNDERWRITING FACTORS: SEPTEMBER 2007 REPORT TO THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS P/C RISK-BASED CAPITAL WORKING GROUP, American Academy of Actuaries’ P/C Risk-Based Capital Committee, p. 6.

¹⁰ RRC concluded that “Overall, we [RRC] concur that the Run-off Companies are likely to meet their obligations even when under considerable stress.” RRC Modeling Review, p. 16.

¹¹ TW did use asset allocation sensitivity tests to explain their position that the proposed asset strategy is safer for policyholders than certain other asset allocation strategies.

The TW Modeling Report shows neither. Yet, the Enterprise Risk Management (“ERM”) Integrated Framework and the draft NAIC Own Risk Solvency Assessment (“ORSA”) Guidance Manual, both referenced by RRC for their use of stochastic modeling,¹² recommend using sensitivity and stress testing. For example:

1. In performing risk assessment as part of the ERM – Integrated Framework, The Committee of Sponsoring Organizations of the Treadway Commissions (“COSO”) have developed Application Techniques that include:
 - Sensitivity Analysis – “used to assess the impact of normal, or routine, changes in potential events. Due to the relative ease of calculation, sensitivity measures sometimes are used to complement a probabilistic approach.”¹³
 - Stress Testing – “assesses the impact of events having extreme impact.”¹⁴
2. A draft of the NAIC ORSA Guidance Manual includes “simple stress tests or more complex stochastic analyses. When evaluating a risk, the insurer should analyze the results under both normal and stressed environments.”¹⁵

The TW Modeling Report and RRC Modeling Review identify numerous issues, identified in the following two sections of this letter, that are not reflected in the stochastic model. Based on FTI’s review of TW’s and RRC’s summary reports, sensitivity and stress testing on those issues have not been performed.

TW PREPARES ITS ANALYSIS BASED ON THE ACTUARIAL CENTRAL ESTIMATE OF RESERVES, THUS VALUING THE RISK OF THE LOW AND HIGH ESTIMATE OF RESERVES AT ZERO.

TW has prepared low, central and high estimates of reserves. The TW stochastic results, however, are based only on the central estimates.

An unbiased assessment of all known risks would reflect the reserve range, and not just the central estimate, in modeling claim payment capacity. For example, this can be done using a single model that gives some weight, not zero weight, to the high and low estimates.

Alternatively, this could be done using sensitivity tests that show the failure rates from the low and high scenarios.¹⁶ Neither approach has been incorporated into TW’s stochastic modeling of the Run-off Companies.

¹² RRC Modeling Review, p. 8.

¹³ Enterprise Risk Management – Integrated Framework, Application Techniques, September 2004, COSO, p. 42.

¹⁴ *Ibid.*, p. 43.

¹⁵ NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual, As of March 2014, p. 7.

¹⁶ RRC notes that it used the stochastic model output to judge the reasonableness of the high end of the reserve range. (RRC Modeling Review, p. 16.) However, this analysis does not account for the difference between “reasonable range of reserves” and the range of likely outcomes. The stochastic model projects a range of outcomes based on the assumptions in the central estimate. The high reserve estimate is based on a different set of

TW DOES NOT INCLUDE THE RISK OF ‘KNOWN UNKNOWN.’

The TW and RRC reports contain many references to features of the stochastic model that understate risks (and therefore understate the failure rate). The issues relate to the modeling of variability, investment returns and inflation and are listed in *Attachment I*.

Neither the TW Modeling Report nor the RRC Modeling Review quantifies the effect of those features through sensitivity testing, stress testing or other methods. As such, TW values the above ‘known unknowns’ at zero in its analysis, that is, the ‘known unknowns’ are not included. Some or all of these ‘known unknowns’ should have been valued at something other than zero and included in the stochastic model.

THE STARTING POINT FOR TW’S ANALYSIS OF LOSS RESERVES IS OLDER THAN NECESSARY.

The loss reserve analysis relied on by TW in its work is as much as 18 months old. To make the loss reserve data ‘current,’ RRC noted that TW “performed a review of payments and other claim activity during the intervening months (from September 30, 2012 and December 31, 2012 to September 30, 2013), and increased their central estimate for pollution by \$10 million to reflect unexpected claim activity during the roll forward period.”¹⁷ TW does not specify its tolerance for variations in actual vs. expected roll forward results. The pollution example suggests a 10% variation is too high,¹⁸ but even a 5% variation upward of the pro forma gross nominal loss and loss adjustment expense (“LAE”) reserve of \$1,185 million¹⁹ is over \$50 million, which is material to the Run-off Companies.

According to RRC, OneBeacon reviews its reserves regularly.²⁰ As such, TW could have examined the OneBeacon analysis and the OneBeacon movement in reserves (a portion of which appears to be adjusted annually) as part of its assessment of the stochastic modeling starting point.²¹

assumptions, that must be valued on its own merits regardless of the extent to which, if at all, the range of outcomes overlaps.

¹⁷ RRC Modeling Review, p. 6. RRC is not specific about the affected reserve category, but FTI assumes that the \$10 million increase in TW’s central estimate relates to direct pollution net of reinsurance for which the December 31, 2012 reserve was \$99 million. (OneBeacon Insurance Group, LLC Analysis of Unpaid Loss and LAE as of September 30, 2012, December 31, 2012, and March 31, 2013 – Summary Report, prepared by Towers Watson, dated September 9, 2013, p. 12.)

¹⁸ Equal to the \$10 million increase in the central estimate for pollution divided by the December 31, 2012 reserve for direct pollution net of reinsurance of \$99 million.

¹⁹ TW Modeling Report, p. 6.

²⁰ RRC notes that “One Beacon itself performs actuarial reviews of its data each year and the data should be adequate for use in the stochastic modeling process.” RRC Modeling Review, p. 6.

²¹ FTI’s review of OneBeacon’s Form 10-K’s for the past number of years suggests that asbestos and environmental reserves (the main area of risk) are not adjusted annually. Nonetheless, OneBeacon does perform a regular review for other reserve categories, and using more current data may have altered the results of TW’s stochastic model.

THE PRO FORMA BALANCE SHEET FOR THE RUN-OFF COMPANIES AS OF JUNE 30, 2014 PRESENTED BY TW SHARES SIMILARITIES WITH FAILING INSURERS IN RUNOFF.

There is no evidence that TW or RRC considered other common industry ratios used to identify red flags that may signal solvency concerns, under-reserving, liquidity issues, etc. To illustrate the results of such an analysis, FTI has computed the following ratios for a sample of ten other active and runoff multiline property and casualty insurers:²²

- Gross losses²³ and LAE reserves / Invested assets
- Gross losses and LAE reserves / Surplus
- Gross losses and LAE reserves / [Total admitted assets + reinsurance recoverable on unpaid losses]

The results of these ratios have been presented in *Attachment II* and show that of the ten other insurers analyzed, only four exhibited results similar to that of the Run-off Companies. However, FTI observes that these four insurers fall into two categories:

1. Two insurers, Century Indemnity Company and Seaton Insurance Company, have triggered an RBC event (i.e., total adjusted capital is at least below the Authorized Control Level RBC).
2. The two remaining insurers, National Union Fire Insurance Company and Indemnity Insurance Company of North America, are active insurers that are party to intercompany pooling arrangements and are held by large insurance holding companies. Therefore, these entities reap the benefit of parental and affiliate support in the event they experience surplus strain. Upon execution of the stock purchase agreement with Armour, the Run-off Companies will neither have the benefit of such parental and affiliate support nor incoming cash flow from ongoing business.

In summary, using the pro forma balance sheet within the TW Modeling Report, the Run-off Companies appear to have unusually high levels of gross losses and LAE reserves akin to that of other runoff insurers that have triggered an RBC event.

²² FTI selected seven insurers in runoff and an additional three active insurers domiciled in Pennsylvania. FTI's selection of these ten insurers is not intended to be a comparative peer analysis. Instead, these insurers were selected as an illustration of how the Run-off Companies will differ from other active and runoff insurers using the pro forma balance sheet presented in the TW Modeling Report.

²³ FTI compares gross liabilities because with the Run-off Companies' finite reinsurance rearrangements comparison of net liabilities is not meaningful.

ATTACHMENT I

Risk Areas Identified but Not Assessed by TW or RRC

The TW and RRC reports contain many references to features of the stochastic model that understate risks (and therefore understate the failure rate). Neither the TW Modeling Report nor the RRC Modeling Review quantifies the effect of those features though sensitivity testing, stress testing or other methods.

The features, as described by RRC in its report, include the following:

Measuring Variability

- Regarding bootstrapping, a statistical technique, “Towers notes that part of the process is to exclude outliers in the age-to-age data being sampled. We [RRC] asked for further information on these outliers, and this was provided by Towers.”²⁴

The effect of this exclusion is not tested.

- “To the extent that there may be more uncertainty or more correlation between business lines in One Beacon’s book than has been modeled, the failure rate may actually be higher than 11.7% over the 70 year projection.”²⁵
- “There is also the potential uncertainty resulting from the possibility that the models used are not appropriate (model risk).”²⁶
- Regarding asbestos and environmental stochastic modeling, “The use of the lognormal distribution along with three industry benchmark payment patterns is a reasonable approach. We [RRC] caution that historical data may fall short in simulating future claim activity that is unprecedented and Towers modeling of the variability does not attempt to include this explicitly.”²⁷

Interest Rates and Equity Returns

- TW “made judgmental adjustments to the ESG [Economic Scenario Generator, a software tool that provides input to Igloo, TW’s tool that produces the stochastic results] regarding interest rates, equity returns, and BBB defaults, based on input from Towers’ investment consulting practice. We [RRC] concluded that the adjustments made by Towers to the economic scenario generator inputs are not unreasonable. However, we [RRC] view these adjustments, as adding somewhat to the riskiness of the model results.”²⁸

²⁴ RRC Modeling Review, p. 14.

²⁵ *Ibid.*, p. 5.

²⁶ *Ibid.*, p. 5.

²⁷ *Ibid.*, p. 13.

²⁸ *Ibid.*, p. 11.

ATTACHMENT I

Inflation

- TW may overlook “scenarios in which claims inflation significantly exceeds returns on assets.”²⁹
- “At the present time, inflation rates have been historically low for several years. We [RRC] do not know when inflation will rise above these low levels. However, over a thirty year period of time, it seems likely that this will occur. It appears to us that the resulting impact on claim inflation for these important lines may be low.”³⁰
- “Liability lines and Personal Injury Protection (PIP) also were projected using a ‘superimposed’ component that was separately modeled. For liability, for instance, the mean superimposed inflation was 2%.”³¹

FTI observes that, for an unspecified reason, TW does not appear to apply the superimposed inflation to the NICO lines.

- TW’s “internal asbestos model assumes a long term ground-up severity trend that reflects future medical inflation partially offset by the favorable impact of the aging of the claimant population. We [RRC] observe that this offset may have the effect of underestimating the true impact of claim severity.”³²

²⁹ *Ibid.*, p. 11.

³⁰ *Ibid.*, p. 11.

³¹ *Ibid.*, p. 11.

³² *Ibid.*, p. 11.

ATTACHMENT II

Ultimate Parent	As of December 31, 2013 ⁽²⁾																	
	Pro Forma 6/30/14 ⁽¹⁾	Armour Group	Berkshire Hathaway	ACE	Enstar	Clarendon America Insurance Company	Enstar	Clarendon National Insurance Company	Enstar	Providence Washington Insurance Company	Enstar	Seaton Insurance Company	Enstar	York Insurance Company	ACE	Indemnity Insurance Company of North America	ACE	National Union Fire Insurance Company
Total Invested Assets	279,900,000	279,900,000	1,248,717,840	600,390,690	194,404,469	626,711,695	120,101,611	55,756,931	17,501,934	273,635,317	20,361,284,173	500,141,972						
Total Admitted Assets	347,300,000 ⁽³⁾	347,300,000	1,257,670,525	964,270,390	209,267,370	643,158,921	124,559,135	79,690,525	17,611,556	361,371,690	24,709,620,069	526,375,306						
Recoverable on Unpaid Losses & LAE ⁽⁴⁾	968,800,000	968,800,000	52,690,841	902,131,367	182,190,693	336,444,714	32,666,732	33,761,789	2,498,218	1,092,911,656	31,588,434,851	126,636,830						
Gross Losses & LAE Reserve ⁽⁵⁾	1,185,000,000	1,185,000,000	426,587,216	1,619,281,478	243,871,817	629,288,035	84,727,581	95,990,890	9,598,153	1,246,804,195	44,196,935,294	226,314,364						
Surplus	161,500,000	161,500,000	812,142,223	25,000,000	135,243,027	290,891,161	29,056,442	8,137,023	9,426,362	105,337,249	5,836,478,587	348,161,725						
Gross Losses & LAE to Invested Assets	423%	423%	34%	270%	125%	100%	71%	172%	55%	456%	217%	45%						
Gross Losses & LAE to Surplus	734%	734%	53%	6477%	180%	216%	292%	1180%	102%	1184%	757%	65%						
Admitted Assets + Recoverable on Unpaid Losses & LAE	90%	90%	33%	87%	62%	64%	54%	85%	48%	86%	70%	35%						
Total Adjusted Capital	161,500,000 ⁽⁵⁾	161,500,000	812,142,223	(9,996,000)	135,243,027	290,891,161	29,056,442	8,137,023	9,426,362	92,627,249	5,069,805,587	348,161,725						
Authorized Control Level (ACL) RBC	116,225,801 ⁽⁵⁾	116,225,801	50,497,265	131,909,463	16,259,749	48,301,351	6,875,046	13,767,324	730,577	18,543,750	1,371,575,212	41,752,364						
Company Action Level (CAL) RBC ⁽⁶⁾	232,451,602	232,451,602	100,994,530	263,818,926	32,519,498	96,602,702	13,750,092	27,534,648	1,461,154	37,087,500	2,743,150,424	83,504,728						
Triggers RBC Event (ACL or CAL)?	CAL	CAL	No	ACL	No	No	No	ACL	No	No	No	No						
Active or Run-off Entity	Run-off	Run-off	Run-off	Run-off	Run-off	Run-off	Run-off	Run-off	Run-off	Active	Active	Active						
State of Domicile	Pennsylvania	Pennsylvania	Connecticut	Pennsylvania	New Jersey	New Jersey	Rhode Island	Rhode Island	Rhode Island	Pennsylvania	Pennsylvania	Pennsylvania						

Notes:
 (1) TW Modeling Report, p. 6.
 (2) 2013 Annual Statement for each respective company.
 (3) For purposes of this analysis, FTI has assumed that the Total Assets reported on the pro forma balance sheet are admitted.
 (4) Numbers are presented before the effects of discounting.
 (5) The June 30, 2014 pro forma Total Adjusted Capital and RBC levels for the Run-off Companies are unknown. For demonstrative purposes, FTI assumed that the Total Adjusted Capital is equal to the pro forma surplus of \$161.5 million, and that the Authorized Control Level (ACL) RBC equals the amount reported by Potomac in its 2013 Annual Statement. Even using the RBC of a single Run-off Company, the Company Action Level RBC would be triggered without additional capital funding.
 (6) Company Action Level (CAL) RBC is calculated as Authorized Control Level (ACL) RBC * 2.