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August 11, 2014

Mr. Steven L. Yerger
Pennsylvania Insurance Department
Bureau of Company Licensing and Financial Analysis
1345 Strawberry Square
Harrisburg, PA 17130

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Corporate & Financial Regulation

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Pennsylvania
Insurance Department

Dear Mr. Yerger:

Towers Watson appreciates the opportunity to respond to various questions and comments related to our work performed for OneBeacon Insurance Group, LLC ("OneBeacon") as discussed in the Public Hearing in Harrisburg on July 23, 2014 and in our reports entitled "Analysis of Unpaid Loss and LAE as of September 30, 2012, December 31, 2012 and March 31, 2012," dated September 9, 2013 (the Reserve Report), and "Stochastic Modeling of Run-Off Business Pro-forma Balance Sheet as of June 30, 2014," dated June 10, 2014 (the Stochastic Model Report). The questions and comments that we are responding to are related to the public comments made at the Public Hearing as well as certain written materials provided to the Department which are in the public domain. While we have attempted to be as thorough and exhaustive as possible in our response, please let us know if there are additional questions or clarifications that would be helpful.

The body of this letter highlights our responses in a summary fashion to what we consider key or common themes raised by the objectors and commentators. The appendix contains point by point detailed responses to comments made during the Public Hearing as well as objections and related materials submitted to the Department in writing.

Qualifications of Objectors

As a general statement, we do not believe that any of the criticisms and comments made by the objectors about our actuarial assumptions, methodologies, judgments, and caveats should be given any credibility, as they were either not being made by qualified actuaries (e.g. Mr. Terrell's report), or contained in a report that was not signed by a qualified actuary (e.g. the FTI Consulting report).

In particular, we question Mr. Terrell referring to himself as an expert on many of the issues that he has commented on. We will leave it to the disciplinary bodies of any professional organizations that Mr. Terrell is a member of to determine whether he has violated any professional standards by referring to himself as an "expert" in actuarial issues without having any actuarial designation. We would point out, however, that if Mr. Terrell were an actuary then the various mischaracterizations and speculations in his report would require us, in accordance with Precept 13 of the Code of Professional Conduct of the American Academy of Actuaries, to refer the situation to the Actuarial Board of Counseling and Discipline. Two specific examples of causes for referral for violation of that Code contained in Mr. Terrell's report are as follows:

- Mr. Terrell states: "While I would certainly concede that there are many combinations of inputs that could lead to success for the first 30 years, to come up with a >90% success rates for entities as

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thinly capitalized as the proposed runoff companies, and that are subject to the pronounced uncertainties already discussed defies credulity and is indicative of a flawed and unrealistic calibration of their stochastic model.” While this may be Mr. Terrell’s opinion, he offers no evidence of or reference to any analysis having been performed to support it.

- The report also reads: “So while RRC at least has been engaged by the Department on behalf of policyholders-i.e. unlike Towers Watson it owes no fealty to OBIG...” The insinuation that Towers Watson’s independence has been compromised because OneBeacon pays its fees is baseless and unprofessional.

Scope of Towers Watson’s work

The scope of Towers Watson’s work in the stochastic modeling report has been clearly spelled out in both the report and in the public testimony. Towers Watson’s scope was to estimate the probability that the invested assets on the proposed opening balance sheet would be sufficient to fund all of the obligations of the run-off business, including claim payments and associated expenses, and to answer the Department’s questions about the analysis. Specifically, our scope did not include:

- Estimates of the frequency and timing of “technical insolvencies,” defined as situations in which surplus is less than 0. This work would by necessity involve assumptions as to how the management of the run-off company would set reserves for the business many years into the future (in 10,000 different potential scenarios).
- Commentary as to whether the observed success rates are acceptable or desirable. We have not been engaged, nor are we necessarily qualified, to render such an opinion which we regard as being within the purview of the regulators.
- Assessments or characterizations of the adequacy or reasonability of OneBeacon’s held reserves. The stochastic model was based on Towers Watson’s projections, and therefore OneBeacon’s held reserves do not impact the results.
- Assessments as to the capital adequacy of the beginning balance sheet, based on RBC results or any other metrics (e.g. ORSA requirements).

We would also point out that none of the commentators have suggested a different approach to fulfill the scope of our engagement. FTI Consulting mentioned that stress testing and sensitivity testing should have been performed, but these approaches do not answer the question posed by the Pennsylvania Insurance Department (“PID”), which is how likely it is for the assets to be sufficient to run off the claims liabilities and associated expenses. Further, the fact that these tests are required for an ORSA submission is not relevant to our engagement.

Reliances and Limitations in Towers Watson’s Reports

Several of the commentators allege that the reliances and limitations in Towers Watson’s reports should undermine the credibility of the reports. The reliances and limitations are required based on actuarial standard of practice (ASOP) 41, and are key to allow the reader to fully understand the scope of the actuarial work and place the findings and observations in the appropriate context.

Mr. Terrell mischaracterizes reliance on OneBeacon data without audit or verification as reliance on OneBeacon’s analysis, which is clearly not the case. Towers Watson’s reliance on OneBeacon as to the accuracy of the data is consistent with ASOP 23. In contrast to Mr. Terrell’s baseless assertion and as clearly explained in our reports, Towers Watson did not rely on OneBeacon’s projections, as Mr. Terrell stated.

Towers Watson's summary reports do not and are not intended to contain the full documentation of our analyses; rather to highlight and summarize the observations and findings as well as conveying important context. The relevant documentation is contained in our full reports, which have been made available to the PID and RRC and are in compliance with the ASOPs regarding documentation of actuarial workproduct.

Uncertainty

All of the elements brought up by the commentators about uncertainty with respect to future conditions (e.g. medical inflation, uncertainty with respect to A&E losses, equity returns) were considered in Towers Watson's stochastic model, as clearly explained in our reports. The real question is whether the uncertainty is being quantified in a reasonable way.

FTI has indicated that Towers Watson did not include parameter uncertainty in its stochastic analysis. This is not true, as we stated in both the Stochastic Model Report and in our testimony, Towers Watson has considered both process and parameter risk.

Some of the objectors, such as Mr. Stockman and Mr. Terrell, appear to suggest that uncertainty is unidirectional, i.e. estimates only deteriorate and they do not improve. This assertion is contradicted by many facts, for example:

- AM Best pollution cost estimates in 1995 were \$225 billion of ultimate losses for the industry; their most recent projection is \$42 billion of ultimate losses.
- The property and casualty industry reserves have developed favorably since 2004.

Asbestos Methodology

As regards the estimation of asbestos reserves, some of the commentators quoted statements made in a Towers Watson Insights article entitled "Summary of US Property & Casualty Insurers' Asbestos Claim Reserves at Year-End 2012" and valuation model issues raised by a Mealey' Asbestos Bankruptcy Report Commentary entitled "A Third Wave in Asbestos Liabilities Lies Ahead: Actuarial Models Are Systematically Underestimating Exposures". Both articles highlighted weaknesses of certain methods and assumptions and commentators cited points in the articles as arguments against the Towers Watson analysis. However, as our testimony describes in detail (hearing transcript pages 39-44), those weaknesses and biased methodologies have all been addressed in our analysis; therefore, the criticisms raised are baseless.

Provisions for Yet to Emerge Other Mass Torts

The question of "known unknowns" (i.e. new emerging mass torts) not being reflected is brought up by several objectors. Clearly, an explicit provision for "unknowns" is impossible to determine; as such, Towers Watson estimates include an implicit provision for those, as was explained in our testimony (hearing transcript page 46).

Investment Risk

Many of the commentators take issue with the yield assumptions in the Reserve report. Per our testimony (hearing transcript page 48), these assumptions are not relevant to the output of the stochastic report because in the stochastic analysis we model a distribution of potential investment returns as well as distributions of other key variables.

Commentators also seem to take issue with investments in equities as being high risk. The risk associated with equity returns (i.e. the volatility) is reflected in the stochastic modeling, and therefore is captured appropriately in the estimate of the success rates.

Sincerely,



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Attachment 1: Appendix

RESPONSES TO TRANSCRIPT

p. 86 Stockman

“And as a result, it should come as no surprise to the Department that Towers Watson's report is equally laden with caveats and qualifications. Quote, projections of loss and LAE liabilities are subject to potentially large errors in estimation. ...”

TW Response – The Reliances and Limitations section assists the users of our report to understand the context around our estimates. Disclosure of such reliances and limitations is in fact required by actuarial standards governing the documentation of the workproduct. If Mr. Stockman had continued to read that paragraph he would have read that, “In our judgment, we have employed techniques and assumptions that are appropriate, and the estimates presented herein are reasonable, given the information currently available” (Reserve Report p. 27)

“And in fact, I thought it was commendable of Towers Watson to point out today that they are not taking into account changes in the litigation environment, and that they are specifically abjuring any expression of opinion on the adequacy of opinion on the adequacy of OneBeacon's reserving practices”

TW response – We did not account for changes in the litigation environment in our Reserve Report, per Bozman's and Santomenno's testimony. However, per Santomenno's testimony: “However, for our stochastic model, modeling the extreme low and high estimates, those below the low estimates of our Reserve Report and those above the high estimates of the Reserve Report, there is implicit provision for unforeseen events such as changes to the litigation environment.” (Transcript p.44). Further, Bozman states, “As a result, there are outcomes in the stochastic model that are considerably higher than our high reasonable estimates from the Reserve Report. While we do not individually describe the set of circumstances related to each simulation, one could think of the more extreme scenarios as being driven by changes in the future litigation environment or other unforeseen events not quantified in our Reserve Report.” (Transcript p.48)

p. 87 Stockman

“For those of us who have lived through this world for a while, experience teaches us that these uncertainties cut in onedirection only, despite OneBeacon's effort to downplay that fact.”

TW response – Towers Watson fundamentally disagrees with this assertion. As stated in Santomenno's testimony, “We note that the asbestos litigation environment has been improving for the past eight to nine years.” (Transcript p.44). As another example, since estimating industry ultimate industry environmental losses at \$225 billion in 1995, AM Best has consistently lowered its ultimate loss estimates, with the most recent estimate at \$42 billion.

“And as Towers Watson notes in a portion presumably of its full report that was quoted by RRC, there is a, quote, systematic bias in reserve estimating. The quote, I think, is meaningful and worth putting into the record today. The underlying sources for the development are inherently asymmetric and are more likely to result in upward development than downward development. We observe that unexpected outcomes and coverage litigation or settlement negotiations are more often negative than positive. We also observe that more defendants see unexpected increases than decreases of their litigation profile. Finally, discovery of new coverage limits and claim reopening are inherently unidirectional and can only move the estimated liabilities upward.”

TW response – This reference relates to asbestos only, and per Santomenno’s testimony is the reason for the inclusion of a “miscellaneous IBNR” provision in Towers Watson estimates. That is, Towers Watson has identified this as a bias in individual account estimates and reflects a provision to address this bias in its unpaid loss and loss adjustment expense estimates. The Towers Watson article is entitled “Summary of US Property & Casualty Insurers’ Asbestos Claim Reserves at Year-End 2012” which was quoted with presentation materials submitted by the Fergus Law firm on behalf of Plant Insulation Bankruptcy. [This last sentence needs to be tied to something. I assume it’s a TW article that Stockman was quoting from above?]

p. 88 Stockman

“If you kind of poke at Towers Watson’s report, it even makes clear that OneBeacon’s reserving has been, to put it charitably, overly optimistic.”

TW response – Towers Watson did not comment on the reasonableness of OneBeacon’s held reserves or comment on OB’s reserving practices, as this was not within the scope of our engagement. This conclusion is Mr. Stockman’s, not Towers Watson’s.

p. 89 Stockman

“And one point that I think is important to emphasize is that the Towers Watson reports, in our view, ask the wrong question. The issue here is not whether assets will fall to zero or below zero. It’s whether they will fall to a point that will drive this Department to put the runoff entities into statutory insolvency because of inadequate capital.”

TW response – The scope of our review was determined by OneBeacon after consultation with the Pennsylvania Insurance Department (“PID”).

p. 89-90 Stockman

“Also of significant concern about Towers Watson’s report is the fact that they do not take into account the risk of emerging mass tort claims. But experience teaches us that there will be new areas of liability. That is a certainty, both because of the evolution of medical, environmental and toxicological knowledge, but also because of the continuing ingenuity of the plaintiffs’ bar.”

TW response – This statement is inaccurate. Per Santomenno’s testimony, Towers Watson does implicitly project a provision for new mass torts. “We selected OB’s annual average payment rate using data for historical mass tort claim payments that includes payments for mass torts that are not expected to continue to generate future losses as well as for mass torts that are. By doing this we have implicitly reflected a provision for future claims arising from potentially new or unforeseen mass torts.” (Transcript p.46)

p. 90 Stockman

“Some other points of concern. The fact that the stochastic modeling is based on the central estimate of unpaid loss and ALAE. Our view informed by experience is that the range of outcomes, as we’ve suggested, does not fall in a normal distribution around that central estimate, but tends to be skewed right-ward. “

TW response – We are unclear whose opinion Mr. Stockman is referring to when he says “Our view.” The shape and skewness of the distribution is an actuarial question; as such, the topic would be outside Mr. Stockman’s (and Mr. Terrell’s) area of expertise. While the central estimate was utilized as the mean of the loss distribution for both the NICO and non-NICO lines, the distribution reflected the uncertainty inherent in loss reserves, by incorporating both parameter and process risk measures. Per Bozman’s testimony, “The modeling of the volatility and the loss payments reflects both parameter and process risks. Parameter risk refers to the risk that the selected parameters, such as the mean estimate of future payments, have been misestimated and therefore differ from their true but unknown values. Process risk reflects the risk that future outcomes deviate from the mean, even if the mean has been correctly identified.” (Transcript p.47) Our Stochastic Report contains complementary definitions of the terms: process risk is “the risk that actual outcomes may vary from expected and parameter risk is the risk that the selected parameters used to describe a distribution differ from the true, unknown, underlying parameters.” (Stochastic Report p.4). The implication that TW utilized a normal distribution is inaccurate – as stated in Bozman’s testimony, a lognormal distribution (which is right skewed) was used for the NICO lines. “For the NICO lines, we fit a statistical distribution to our low, central and high estimates. The distribution selected, the lognormal, is commonly used for modeling insurance loss distributions and has the property of being right-skewed, that is, the very high points on the distribution tend to be further from the mean than the very low points do.” (Transcript p.48)

p. 90 Stockman

“First, they assume that the aging of the asbestos claimant population would impact medical cost inflation. But of course, as we have discussed and as I’m sure the Department knows, there are new classes of claimants emerging all the time in asbestos litigation, particularly--- recently the spouses and children of asbestos workers who are developing mesothelioma because of take-home exposures.”

TW response – First of all, the first sentence as constructed is inaccurate. We do not assume that the aging of the asbestos claimant population would impact medical cost inflation. We presume Mr. Stockman is referring to the fact that our ground-up asbestos severity inflation estimate contains an offset for the aging of the claimant population. Based on our industry data (which consists of hundreds of thousands of claims) we note a strong inverse relationship between claimant age and claim award amount. Our data indicates that on average an 80 year old asbestos claimant receives nearly 50% less than a 50 year old. Mr. Stockman then refers to what is known as “take-home” exposures. The potential for those claims is reflected in our asbestos ground-up model. (Transcript p. 41)

p. 90-91 Stockman

“Towers Watson also assumes that technological improvements will offset future price inflation for environmental remediation. But this ignores countervailing developments in the science. Two examples. First, many of the environmental sites that would be addressed through this transaction are contaminated with trichloroethylene. But just within the past few months, emerging toxicology data has suggested that there may be greater risks than once were thought to be the case. And agencies now are looking into requiring more stringent cleanup standards and possibly reopening closed sites. Another example is that until very recently there was little environmental concern about the risks posed by perfluorinated compounds or MTBE. And every day we are starting to see more and more contaminants that are becoming matters of concern as toxicological understanding increases and as detection technologies enable the measurement of toxic substances in ever smaller quantities.”

TW Response - The GAO report that Mr. Terrell quotes does note that the EPA’s clean-up costs are increasing. When using this EPA information to determine site clean-up costs, however, Towers Watson has made adjustments. Towers Watson generally increases EPA Records of Decision (ROD’s) costs by as much as 200% in its pollution model.

Secondly, while the article refers to new sites continuing to be found, we note that newly discovered sites tend to be smaller than the large sites initially discovered by the EPA. Thus the average costs for clean-up of newly reported or yet-to-be discovered sites are expected to be lower (e.g., the EPA is unlikely to “discover” another Rocky Mountain Arsenal).

p. 91-92 Stockman

“What we think is more significant is what Towers Watson has stated elsewhere. In that respect I call your attention to the Insight publication that the Future’s representative for the Plant Insulation Trust submitted with their comments last night, where Towers Watson mentions the emergence of more new mesothelioma claims than expected, notes that claims forecast based on current epidemiological models can understate the number of claims, that a scenario modeling future claims where industry reserves are assumed to be adequate appears, quote, intuitively unrealistic, and again reiterating the systematic low bias in the procedures that insurers use to estimate asbestos liabilities.”

TW Response – As noted in our cover note, we do not use the methodologies and assumptions that we critiqued in the Insights article, so this comment has no relevance to the work that we performed for OneBeacon.

p. 93 Stockman

“...RRC points out that the NICO reinsurances projected under Towers Watson’s central estimate to exhaust in 15 years, and they point out that even that estimate relies on a robust investment yield on assets, 5.92 percent, which is a rate that OneBeacon projected and that Towers Watson accepted.”

TW response – While we will not speak for RRC, several clarifications are warranted. First, this excerpt is from the Reserve Report. The investment rates assumed in that report were not used in the stochastic modeling, and per Bozman’s testimony “We do not believe that the discounted figures shown in our reserve summary report are important now, however, in understanding the economics of the runoff business, as the analysis in the stochastic report is more detailed and comprehensive.” (Transcript p.34)

Secondly, the time in which the NICO cover is projected to be exhausted under our central estimate is based on our projections of loss and ALAE subject to the cover and the timing of the payments, and does not depend on the investment yield.

Thirdly, the investment rate used in the Reserve Report (which we emphasize is irrelevant to the question of asset sufficiency) was accepted by Towers Watson only after careful review.

p. 95 Stockman

“And for the non-NICO book, Towers Watson estimated its uncollectible reinsurance based principally on insolvency risk. Its counterparty risk was based on the financial strength of its reinsurers, not on their unwillingness to pay. This is not realistic in our view.”

TW response – As part of our review of the uncollectible reinsurance provision we inquired about disputes on the non-NICO book, which were minimal. In addition, any amounts not collected historically due to disputes were in the data utilized for the review, and therefore implicitly reflected in our estimates. We do not see a basis for the speculation that amounts in dispute will increase dramatically in the future.

For our review of the NICO reinsurance collectibility, we evaluated the applicability of the OneBeacon analysis to our individual account estimates. Secondly, we selected ceded provisions (which turned out to be lower than OneBeacon’s) for miscellaneous and pure IBNR.

p. 121 Terrell

“Even at the time of the proposed transaction, and according to Towers Watson's work, OneBeacon Insurance Group appeared to be under-reserved.”

TW response – Towers Watson did not comment on the reasonableness of OB's held reserves or comment on OB's reserving practices. This conclusion is Mr. Terrell's, not Towers Watson's.

p. 122 Terrell

“Again with respect to Towers Watson's actuaries, there are serious concerns and flaws in their report from my perspective. First of all, they say that it's suitable for financial reporting contexts. Financial reporting-- I come at this as an accountant--- looks at financial reporting not in materiality and in particular from a prospect of users, of stockholders taking the financial statements as a whole.”

TW response – We believe that Mr. Terrell may be confused as to the meaning of the different estimates of loss used in our reports.

As required by ASOP#43, Towers Watson's reports specify to the intended audience what the unpaid claims estimates produced intend to measure.

In the Reserve Report we state that the actuarial central estimates and the estimates within the range of reasonable estimates are suitable in financial reporting contexts. “The range of estimates is intended to encompass a range of reasonable estimates of the actuarial central estimate. We have not equated this range with a specific confidence interval. We consider the actuarial central estimate, and the range of estimates presented here suitable for use in financial reporting contexts.” (Reserve Report p.2)

In contrast, and by design, the loss outcomes being considered in the stochastic model are contained in a wider range of estimates; some of these outcomes are extreme. As such, many estimates in this wider range would not be suitable for use in a financial reporting context.

p. 123 Terrell

“But I have concerns about the discount rate that they used and the unchallenged use of the equity returns as completed by White Mountain. I also am concerned that in the high scenario, they use high inflation and higher discount rates, because the two things really have nothing to do with each other.”

TW response – This comment is about Towers Watson's discount rate assumptions in the Reserve Report. Per Bozman's testimony these assumptions were not used in the stochastic report, which employed a more comprehensive approach.

“In the Reserve Report, we discounted reserves based on the payout patterns derived in our reserve analysis and expected investment returns on the asset portfolio. We do not believe that the discounted figures shown in our reserve summary report are important now, however, in understanding the economics of the runoff business, as the analysis in the stochastic report is more detailed and comprehensive.” (Transcript p.34)

p. 123 Terrell

“Inflation in the mass tort context and the environmental context really has nothing to do with inflation in the general economy.”

TW response – There are multiple factors beyond general inflation impacting claim severity for environmental and asbestos claims which are considered in our severity trend selections.; to suggest however that claim severity changes over time “have nothing to do with inflation in the general economy,” implies that the cost drivers of these claims are not sensitive to inflation. The historical relationships between tort costs and general inflation in the United States demonstrate that there has clearly been a relationship between tort cost inflation and general inflation.

p. 123-124 Terrell

“In their asbestos estimates, they rely entirely on their proprietary model. They don't use any other benchmarks. And the survival ratio, which is an accepted--- wide-accepted technique is ignored. And AM Best in its industry report uses survival ratios and notes that White Mountain and OneBeacon Insurance Group are very significantly below industry norms. And this should be explained. The AM Best benchmark for asbestos is a survival ratio of 17. And OneBeacon Insurance Group's is well below ten. So, there can be outliers, big settlements that can impact that, but I think to ignore it is unacceptable.”

TW response – As explained in Santomenno's testimony, we believe the ground-up method is superior to other potential methods. We disagree that the survival ratio is a widely accepted technique for estimating asbestos liabilities; it is a widely accepted metric (especially for users of financial statements that do not have access to more detailed data). Ground-up exposure-based techniques are widely recognized as the most appropriate methodology for measuring asbestos liabilities. Per Santomenno's testimony, “The ground-up analysis is the approach preferred by the actuarial profession and most rating agencies. As more commonly used, actuarial methods do not work well when evaluating A&E liabilities. For example, AM Best, a leading rating agency, has stated that it will give a significantly greater weight to a company's ground-up study results than it does to the results of the agency's own study...” (Transcript p. 40)

p. 124 Terrell

“The next point is about reinsurance, and prospective reinsurance is a very, very important asset that would be transferred in due course if the transaction is approved. And based on the 2013 10K, overall the A&E book is about 39 percent reinsured, asbestos about 38 percent, so you have more or less the same. And Towers Watson informs us that they really did no work at all on this reinsurance asset, the prospective reinsurance. They relied entirely on OneBeacon Insurance Group's own internal ---.”

TW response – The statement “Towers Watson informs us that they really did no work at all on this reinsurance asset, the prospective reinsurance,” is simply not true. As stated in Bozman's testimony, a provision for uncollectable reinsurance was separately projected. Per the Reserve Report, “Our analysis was performed both net of ceded reinsurance, and net of anticipated future salvage and subrogation. Our estimates include a projection of unrecoverable reinsurance.” (Reserve Report p.2)

p. 125 Terrell

“So 2010 work, internal OneBeacon ceded reinsurance relied on entirely by Towers Watson does not satisfy me that that asset is flexible.”

TW response – Towers Watson never stated that the OneBeacon reinsurance work was relied upon entirely. While certain elements of the NICO lines ceded projections were not subject to independent testing, as disclosed in our Reserve Report, we considered all of the available data and information in drawing our conclusions. In fact, Towers Watson's indicated net to gross ratio for unpaid is lower than OneBeacon's net to gross ratio based on held reserves.

p. 125-126 Terrell

“And the blanket seven and a half percent allowance that they have made, to my mind, is a huge, gaping hole in the reliability of this Towers Watson report, because it’s such a major aspect and so subject to coverage disputes. And they’ll admit those coverage disputes are under the radar because most reinsurance disputes are settled by confidential arbitrations. You don’t see them in the record in the same way as you do on the direct side.”

TW Response – The 7.5 percent estimate was made by Towers Watson after considering all of the data and available information and is in addition to uncollectible provisions otherwise estimated at the account level.

For our review of the NICO reinsurance collectability, we evaluated the applicability of the OneBeacon analysis to our individual account estimates. Secondly, we selected ceded provisions (which turned out to be lower than OneBeacon’s) for miscellaneous and pure IBNR. Towers Watson does not agree that reinsurance coverage disputes are “under the radar,” as material disputed balances are required to be disclosed in the Notes to the Financial Statements of statutory annual statements. Mr. Terrell seems to assume that reinsurance disputes will increase dramatically in the future, but he has offered no analysis to support this assertion.

p. 126 Terrell

“On the environmental, they assume that the payoff pattern is going to be based on their industry experience. But they know it already in the roll forward period that they got it wrong, and they have to change it by \$10 million because there have been a couple of large environmental settlements, even in this very short roll forward period.”

TW Response – Actuaries continually update their estimates based on new information. Towers Watson disclosed that the estimates are uncertain, and built the estimated uncertainty into the stochastic modeling. It is unreasonable to expect that there would be no changes in actuarial central estimates over a roll-forward period for a book of business. We would certainly not characterize this change in estimates as indicating that the underlying methodology was flawed, which we suppose is Mr. Terrell’s assertion.

p. 126 Terrell

“And while they have --- I have somewhat sarcastically said they’ve so much of their work by looking entirely in the rear view mirror. In this case they have ignored history, because what we know is that new mass torts do emerge on a regular basis, all sorts of pharmaceuticals. I’ve testified in many of these. Agent Orange, Fen Pen, breast implants, tainted blood and various kinds of construction defects, vibrations, hearing loss. I mean, there’s all sorts. There are masses of mass torts that have emerged over the time periods. And to make zero allowance for that, to my mind, is just unacceptable.”

TW Response – Towers Watson does make an implicit allowance for newly emerging mass torts, as discussed in Santomenno’s testimony. ““We selected OB’s annual average payment rate using data for historical mass tort claim payments that includes payments for mass torts that are not expected to continue to generate future losses as well as for mass torts that are. By doing this we have implicitly reflected a provision for future claims arising from potentially new or unforeseen mass torts.” (Transcript p.46)

p. 126-127 Terrell

"In their central estimate, and that's March 31, 2013 they had \$153 million for this--- for other mass torts, that's known other mass torts, not unknown ones. And even doubling that would put this new entity out of capital, just on that one assumption alone."

TW Response – Towers Watson's central estimate does make an allowance for newly emerging mass torts, as discussed in Santomenno's testimony. No analysis has been presented to suggest that a more appropriate estimate is double the Towers Watson estimate.

p. 127 Terrell

"I'm very concerned that RRC has not had the opportunity to really delve into the mysteries of the proprietary and confidential model, and that is unacceptable to me."

TW Response – We believe the use of the term "mysteries" is inappropriate in this context. With respect to the Igloo software, we believe the fact that AM Best and seven of the top ten global property and casualty insurance companies license the software should provide the Department with sufficient comfort that the software functions appropriately. With respect to the asbestos model, Towers Watson has estimated asbestos, environmental and other latent liabilities for a wide variety of policyholders, insurers and reinsurers, including insurers ranked within the "Top Ten" in terms of held reserves, as well as many small and medium-sized companies.

While we will not speak for RRC, RRC consultants have had opportunities to discuss the models with us to obtain the confidence to complete their analysis.

p. 127 Terrell

"But in addition, there are a number of other-worldly assumptions in the model. And actually we heard afresh this morning, that the asbestos litigation environment has been improving for the last eight or nine years. And I really wonder on what planet that is true, because on this planet, and my experience working with major asbestos defendants every day, all day, is this is getting no better. It's getting worse."

TW Response – As support for our assertion in Santomenno's testimony, we point to the Judge Jack decision in 2006, and asbestos tort reforms in several states from 2004 through 2006, and the recent Garlock bankruptcy decision. While there have been recent increases in claim filings since 2009, our data indicates that they are not up to the levels observed in 2001-2003. We also note that severity inflation by disease has been benign in recent years. Finally, the financial impact of second hand exposures and lung cancer cases is by no means clear. Many states are not imposing a duty on the manufacturer to warn about second hand exposures. One lawyer is filing lung cancer cases but it is far from clear at this juncture whether these will be compensated at all, and if they are, it will almost certainly not be at the same level of compensation as mesothelioma cases.

p. 127-128 Terrell

"Secondly, the assumption about medical inflation ... For start, there's no linkage between asbestos claim settlements and medical inflation. It's a function of economics and it's a function of anticipated trial verdicts."

TW Response – It's true that changes in claim award amounts are driven by societal and legal factors, so claim inflation may exceed the general inflation rate in some situations and be lower in others. In the mid-2000s, asbestos litigation experienced a massive change as claim activity changed from mass filings and bulk settlements to individual adjudication. Because many of the weaker claims were no longer being filed and plaintiffs litigated the remaining claims more intensely, the average claim award amounts jumped sharply. However, we believe that this was a one-time event; it is not appropriate to extrapolate this one-time increase to the future. Long term, in the absence of similar mass dislocations in the litigation environment, a natural assumption is that claim values will trend upward at the underlying medical and wage inflation rate. The data that we have (hundreds of thousands of claims) shows that claim value trends since the late 2000s are consistent with our long term assumptions.

p. 128 Terrell

"Secondly, settlement values don't go down with age. I looked at 7,000 asbestos settlements a few days ago before I finalized my report, covering the last few years. And there's no discernible trend for settlements in 50, 60, 70 or 80-year-olds when 95 percent of those settlements were --- sure, a 40-year-old may get paid more, but there are very few of those."

TW Response - Our industry data, consisting of hundreds of thousands of claims, shows a strong inverse relationship between claimant age and claim award amount. Our data indicates that on average an 80 year-old asbestos claimant receives nearly 50% less than a 50 year old. There is, of course a wide range of claim values at each age group, such that it is possible to find an 80-year-old with favorable circumstances receiving a larger award than a 50-year-old with unfavorable circumstances.

"Multi-generational claims. Many claims are coming from children of the originally exposed defendants. Asbestos dust falling off overalls while daddy's getting changed after work type thing."

TW Response – There have been mixed decisions on these cases as to the duty to warn. Towers Watson is aware of this potential issue, and per Santomenno's testimony (Transcript p. 41), its current model reflects this potential.

"We are hearing from leading pulmonologists and asbestos medicine conferences who are telling us about exciting new breakthroughs in medical science that allow detection of mesothelioma several years earlier than is current. Right now there's about 18 months between diagnosis and death. That's going to be moved up by a couple of years and add a couple of years of expensive medical intervention."

TW Response – Since our benchmark filing patterns are regularly calibrated for current asbestos filings and settlements, we determined and adjusted for changes due to potential increased time between diagnosis and death.

p. 128-129 Terrell

"And finally, there's a- many of my clients are really beside themselves on this one, that the link between lung cancer and asbestos and the exposed population of lung cancer is enormous. And lung cancer being linked to asbestos exposure is something that the plaintiffs lawyers put their teeth into and is considered a huge potential liability that is just coming to the surface now."

TW Response – Again, this is speculative. There is no evidence that these will be paid and not all defendants have been targeted. While we note that one law firm has filed a large amount of lung cancer cases during 2012-2013, this firm has admitted (in an article with the Madison County Record “Napoli firm says last year’s ‘wave’ of lung cancer asbestos cases has leveled off” July 22, 2014) that its 2014 filings will be closer to historical (pre-2012) levels. And it’s important to remember that our modeling implicitly accounts for changes in the litigation environment. Per Santomenno’s testimony, “However, for our stochastic model, modeling the extreme low and high estimates, those below the low estimates of our Reserve Report and those above the high estimates of the Reserve Report, there is implicit provision for unforeseen events such as changes to the litigation environment.” (Transcript p.44)

p. 129 Terrell

“The other other-worldly assumption is that environmental remediation technology would offset inflation. And sure, it’s kind true in the 1990s when this was emerging, that there were huge increases in environmental science at that time. But we don’t see that on the ground. I mean, even look at the GAO--GAO report recently that is exhibited to my report. You will see that environmental costs are going up, not down.”

TW Response – The reference to the GAO report is being used out of context. The report discusses the number of sites, not the costs.

The GAO report that Mr. Terrell quotes does note that the EPA’s clean-up costs are increasing. When using this EPA information to determine site clean-up costs, however, Towers Watson has made adjustments. Towers Watson generally increases EPA Records of Decision (ROD’s) costs by as much as 200%, in its pollution model.

Secondly, while the article refers to new sites continuing to be found, we note that newly discovered sites tend to be smaller than the large sites initially discovered by the EPA. Thus the average costs for clean-up of newly reported or yet-to-be discovered sites are expected to be lower (e.g., the EPA is unlikely to “discover” another Rocky Mountain Arsenal).

p. 130-131 Terrell

“As I said, the reality on the ground is that there is no end in sight. Mesothelioma cases are not declining according to the epidemiological and demographic survey that was taken by Nicholson and Selikoff in the 1970s, which have informed pretty much all forecasters of asbestos. And what we’re seeing is that mesothelioma claims should have peaked some years ago.”

TW Response – As stated in Santomenno’s testimony, we do not rely on the Nicholson work. The Towers Watson Mesothelioma Benchmark Filing Pattern has not shown a peak yet.

p. 131 Terrell

“Secondly, values for mesothelioma are increasing.”

TW Response - We have not observed this in our Industry data.

“Defense costs are as high as ever. New companies are being targeted, multi-generational claims and early diagnosis, as I mentioned earlier.”

TW Response – Per Santomenno’s testimony, our modeling reflects this.

"And they've used speculative and optimistic analysis based on a unsupported future return on investments."

TW Response – As discussed in our Stochastic report and in Bozman's testimony, investment returns were produced by our economic scenario generator, with some modifications based on input from our investment consulting practice. The economic scenario generator is not speculative – it is calibrated based on historical data. The conclusion that the investment return assumptions are optimistic are Mr. Terrell's, and he offers no support for that conclusion.

p. 149 Fergus

"You would think they would put a stake in the ground and say, we have a reasonable belief that our estimate of the reserves, that there's no possibility that it might --- the statutory language is might --- the financial condition might adversely impact policyholders. But they didn't say that today. They didn't say it to the SEC. They said, we cannot do it and we think there's a really good chance we'll go through our reserves and we will go through our assets. So they hired Towers Watson. Towers Watson came in and they said very clearly that they cannot tell you that that standard has been met."

TW Response – Towers Watson did not opine on whether any standard has been met nor was that in the scope of our work. Our scope was to answer a specific question related to the probability that the invested assets on the opening balance sheet would be sufficient to pay all the claims and related expenses.

"They cannot say that the reserves will be adequate."

TW Response – Per Bozman's testimony, we were not engaged to provide commentary on the adequacy of OneBeacon's held reserves.

p. 151 Fergus

"But guess what? RRC says, we've looked at the actuarial literature and guess what? It really doesn't work for this. There is a risk, and I quote, however --- page three --- based on our review of the actuarial literature, we believe the user should be cautioned that the statistical estimation of the variance that exists in a book of loss reserve is difficult to measure and may not be captured completely."

TW Response - TW agrees that the statistical estimation of the variance may be difficult to measure, as it is with respect to any insurer. This does not imply that it has been under-estimated. For clarity, we note that RRC's statement applied to the bootstrapping technique, which was used for non-NICO lines.

p. 153-154 Fergus

"Ironically, one of the comments that was made, opening comment is, it's just not possible to estimate the reserves at the 100 percent level. Yet, if you look at the Towers Watson, the very first thing they say, for the next ten years they've had no failures. Absolutely none, 100 percent success rate where they won't run out of money."

TW Response – There is no inconsistency between the projected 100 percent success rate after 10 years and the fact that reserves cannot be estimated with 100 percent certainty. Reserve estimates are to ultimate, not 10 years. The observed success rates in the first ten years are in large part a reflection of the significant reinsurance protections, most notably the NICO cover and the General Reinsurance Adverse Development cover.

p. 154-155 Fergus

"You don't know what bootstrapping was done to the model, the underlying model that's being used by Towers to predict what are the reserves that are going to be needed. It's very clear. They say it many places and so does RRC. The data they're relying upon is the historical data for OneBeacon. It does not take into account the other variables, the changes in mortalities, the changes in by-standards, women being exposed more, children being exposed more through secondary exposures of people who worked there."

TW Response – Mr. Fergus appears to be confused about our actuarial analysis. As discussed in Bozman's testimony and the Stochastic report, bootstrapping was performed for the non-NICO lines, not the NICO lines as Mr. Fergus appears to be implying by his reference to factors that affect asbestos claims values. For the non-NICO lines we utilize our ground-up model which, per Santomenno's testimony, does reflect updated views on mortality, and the potential for second-hand exposure claims.

p. 156-157

"So you asked earlier on, what questions would you ask Towers Watson? I'd ask one, where have you done this that these miles that you're talking about, that this bootstrapping has accurately predicted what the reserves should be. Where have you done it? And to say that it's really hard to do, to say that there is inherent risk and A&E are the toughest to do, I would think is not an adequate answer. This is one of those that what matters is getting it right if you're going to be putting together a model that says this does it. And there's no evidence that this model, that this 10,000 does it."

TW Response – We do not understand the questions posed. Bootstrapping is not a technique that is used to predict what reserves "should be"; it is used to measure reserve variability, and furthermore, it was not applied to A&E. We have utilized the best available techniques in carrying out the stochastic analysis.

p. 158 Fergus

"Second, they say, we are unable to predict the future of A&E losses. But if history is any guide, it would be prudent to expect further adverse development. If in fact there is a third wave of asbestos claims, this might well be considered a change in litigation environment not explicitly incorporated in the modeling."

TW Response – First of all, we state that we are unable to predict future A&E losses with certainty, which is true of any actuarial analysis. Secondly, historical industry or OneBeacon reserve adverse development does not imply that Towers Watson's estimates are understated. Thirdly, per Santomenno's testimony, "However, for our stochastic model, modeling the extreme low and high estimates, those below the low estimates of our Reserve Report and those above the high estimates of the Reserve Report, there is implicit provision for unforeseen events such as changes to the litigation environment."
(Transcript p.44)

p. 167-168 Healy

"They didn't assess the technical insolvency, which goes to the timing issue. They, as we heard earlier, talked about failure as zero, nothing left at all. And they didn't look at what might happen before you get to the point of having nothing left at all. They also didn't test the surplus adequacy. They came at this, as far as we can tell, from a cash point of view and the capital requirements were not tested."

TW Response – As stated in our cover note, our scope was determined by OneBeacon with input from the Pennsylvania Insurance Department (PID).

p. 168 Healy

“But even all that aside, accepting the other features of the report, the failure rate is probably higher than 12 percent. That’s sort of the best case scenario that they’re able to present. And we know that the timely payments will actually happen before the 30 years at which they put that 12 percent. And even 12 percent is not exactly an ideal rate. That’s where they stopped the presentation today, with their 30 years and 12 percent failure rate. They didn’t go beyond that.”

TW Response – The assertion that our analysis is the best case scenario that we were able to present is baseless, and we disagree with it. Also, the failure rate is not 12 percent at 30 years – it’s just under 10 percent. Finally, our analysis went beyond 30 years, as explained in our reports and our testimony – our projections in the stochastic analysis were performed over a 70-year period.

p. 169 Healy

“Now, from Towers Watson’s own report, it puts the entire group of runoff companies --- not just Potomac, the entire group of runoff companies, which should have a number even higher than \$232 million, at \$161.5 million.”

TW Response – To clarify, although the \$161.5 million figure is the surplus on the proposed opening balancing sheet and is displayed in our Stochastic Report, the proposed opening balance sheet was provided by OneBeacon, and not determined by Towers Watson. Towers Watson estimated the probability of success, as defined in the Stochastic Model report, given that balance sheet.

p. 170 Healy

“We also have some other problems with the Towers Watson report. The numbers are not exactly up to date. We heard an explanation of that earlier today that, well, based in the long term scheme of all of this, it doesn’t really matter if we use last year or this year. To us, that’s not an adequate explanation. Why wouldn’t you use the most up-to-date information? This is not a short proceeding. This has already been going on over a year. Why wouldn’t you want to have the most updated information?”

TW response – When we began the stochastic analysis, the most recent available information was as of September 30, 2013. We used this data to “roll-forward” our earlier estimates. The roll-forward process was appropriate, and if significant changes in ultimate projections had been indicated by the roll-forward analysis, then additional work would have been done to understand the reasons for the differences, and if necessary, a full review would have been performed for certain segments.

p. 172-173 Healy

“And one of the key points, though, is that really from a review of the Towers Watson report--- I have in here an earnest interpretation of our--- our actuary with an honest interpretation of the Towers Watson report, is there actually is a reason not to approve this transaction. It actually establishes why you should not approve this transaction. And that we think is quite telling. It shows you why these companies truly are undercapitalized. And that’s the measurement just against the normal industry standards, without getting into all of the specifics of the prior actions here.”

TW Response – Slide 9 of the handouts (which is being referred to here) in no way demonstrates that the run-off companies are undercapitalized. We also point out that Mr. Kaufmann (the actuary being referred to in this passage) did not make these points in his testimony.

p. 174-175 Healy

“Another issue with the Towers Watson and RRC reports is that they largely miss the point of what a lot of people have been talking about today, which is, so what is the effect going to be on policyholders? It's simply not addressed. And not only is that a very important consideration, it's one of the considerations in the statute. And they don't address what will happen as the assets become depleted over time in these runoff companies going forward. And they don't address how that will affect claim payment, and there's certainly no explanation of why it's a benefit to the policyholders.”

TW Response – See earlier comments clarifying Towers Watson's scope. It was not within the scope of our work to assess the effect of the transaction on policyholders.

p. 177-178 Healy

“And again, when you put the number at \$200 million --- and we believe that the failure rate, if you take into account near misses, which I'll get to, is actually more like 18 percent. And because of all of this, the 30-year projection at a 12 percent failure rate is what you get from Towers Watson. It's simply not reasonable and it doesn't have any real basis, because it's missed so many of the points it needs to take into consideration to reach that conclusion.”

TW Response – Our reading of the FTI Consulting report is that the 18 percent figure is the result of a “what if” analysis based on a speculative “near miss” assumption. Therefore, the conclusion that 18 percent is the failure rate is unsupported by any analysis. Stating that Towers Watson's conclusions are unsupported simply ignores the explanations given in the Stochastic Model report and in the testimony provided at the Hearing.

p. 178 Healy

“Similarly, if you look at the next slide, it's some of the same types of concepts. And this is to summarize with regard to technical insolvency, and this talks about the near misses, which is failure to timely pay, even though they're not completely out of money and they may be able to pay in the future, but they aren't able to pay timely. We think that if you take into consideration the near misses on an actuarial basis, then the failure rate actually increases, based on the information we have today which we don't believe is complete, rises up to 18 percent. So this would put --- this would also put the time at which the runoff companies would be insolvent well before the 30 years, which again is problematic.”

TW Response – First of all, during any delay in payments to policyholders during a “technical insolvency,” assets would continue to earn investment income. Secondly, we have seen no actuarial analysis that supports an 18 percent failure rate. It is purely the mathematical result of a speculative assumption.

p. 180 Healy

“As I mentioned before, Towers Watson tested cash as its model and did not test capital requirements. We think that that would have been the norm, to test more than simply one model.”

TW Response – Mr. Healey is incorrectly referring to our scope (which we have clarified previously) as our “model.”

p. 180-181 Healy

“They also failed to perform stress testing, preferred stress testing and sensitivity tests. And this is a somewhat larger conceptual issue, which is it carries to what it is they're looking for. And again, this goes back to the definition of failure that I mentioned in the beginning. What they were looking for is whether or not there are assets, one dollar meaning there are assets. They weren't looking at, at what point is this beginning to fail? What's causing it to fail? We did drill down into the failure – just not for the public summaries. What are the points at which we need to really look at, because they will be problems in the future, or at least the most likely problem in the future? And by failing to perform these types of tests, they can tell them that they simply don't know. They don't know either. If they do know, they haven't disclosed it. And so we think that the failure on Towers Watson's part to perform these types of tests leaves a big gap. And as the Department can see, we're trying to figure out the answers to these questions because we think it would be something necessary for you to have access to look at.”

TW Response – It is difficult for us to understand the point of this, but as best we can determine, we believe Mr. Healy is criticizing our scope and the fact that we did not perform stress and sensitivity tests. As discussed in our cover letter, we believe stochastic modeling is the best and most appropriate approach to fulfilling our scope.

p. 181-182 Healy

“The Towers Watson report also does not test or identify the company action level for the runoff companies. You saw a slide before that's based on what we've gleaned from the Towers Watson numbers to get what we put together using those numbers. And we think, as I went through before, that that triggers we prefer regulatory involvement essentially on day one, exactly from day one.”

TW Response – It was not within our scope to assess when or if surplus drops below RBC-based company action levels.

p. 182 Healy

“And this falls as part of what we would consider to be the industry standards for figuring out what would really be the situation with these runoff companies, what would be their ability to succeed and for how long. The industry standards, IRMA and ORSA, do call for multiple forms of modeling. And here we have essentially a single form of modeling.”

TW Response – Other approaches, such as stress testing and sensitivity testing, are inferior to stochastic modeling in the context of the scope of our analysis. ORSA standards and guidance were developed for the purpose of evaluating an ongoing insurer's overall risk management process and therefore are not relevant to the scope of our work. We were not asked to prepare an ORSA submission.

p. 182-183 Healy

“And they just took the central and used that to do the stochastic modeling. And that was performed on just the lognormal slope, if you will. And so they took one set of information, and that's what they ran through the software 10,000 times. And again, software performs these tests. And so while they may have performed 10,000 different scenarios, it's based on one set of inputs. And your testing's only going to be as good as your inputs. I mean, if you only put in one set of inputs, then that necessarily drives the results on those 10,000 scenarios. And we think it would have been much more prudent, if not necessary, to perhaps try some different inputs to find out what might cause major changes since the inputs are based on the assumptions that we've been hearing about today, in that a number of policyholders have expressed real concern today, because a number of those assumptions have been

drawn in OneBeacon's favor. They're not necessarily the type of assumptions that we would draw, particularly because we're dealing with here the asbestos and environmental type of liability where no one is sitting here saying it's very easy to predict and you don't have to worry; you can just go with your one set of assumptions and not worry about if your modeling is going to come out okay. We're hearing various different people say that's not the case. These are difficult to do. There are no rote assumptions. You have to rely on the historical data, but after all, you're making projections. So why wouldn't you want to try to run as many different models as you can reasonably perceive in the time to look at? Here we just have one and we think that's insufficient.”

TW Response – We presume the “one set of inputs” criticism is based on Mr. Healey's and FTI's misperception that we did not consider parameter risk. This is untrue – parameter risk was considered in the underlying distributions utilized for the stochastic modeling. It appears that the FTI's suggested approach would be to start with distributions that exclude parameter risk, and then probability weight the resulting distributions from various sets of inputs, although no suggestion has been made as to how to select the probabilities. We believe that such an approach would be clearly inferior in that it would be unwieldy and would involve the speculative assessment of the weights assigned to various sets of inputs. Some may also infer from Mr. Healey's comments that the stochastic model relies strictly on the central estimate with no variation around it. For the sake of clarification, we emphasize that the stochastic modeling produced a wide range of outcomes, including outcomes above the high reasonable estimates from our Reserve Report.

p. 183-184 Healy

“And we're going over some of the assumptions, but Towers Watson in RRC actually identified them for you. They say there are what we refer to as knowns, unknowns. Basically they know, they don't know the answers to these and so they're putting caveats in their report and highlighting that they haven't been able to figure out. And while we're trying to project these, maybe that's another reason why we need to have more information and perhaps more stochastic modeling that takes into account the fact that the assumptions for these unknowns aren't necessarily going to be just one answer.”

TW Response – As noted previously, Towers Watson stochastic modeling implicitly considers “known unknowns.”

p. 184

“And so we have this set out for you, some of the different statements from the RRC --- FDRCS report which is the stochastic modeling report. And Towers excluded outliers from this data. I mean, the failure rate may actually be higher than the 11.7 percent. So these things actually matter. These aren't just assumptions that get thrown into so many different things that it gets evened out. The risks created by such missing information include that the models used are not appropriate modelings. That seems like a pretty big problem. They fail to include modeling of the variability from lognormal distribution of claims; I mentioned that before. They only do the lognormal, which is just one of the various sets of data they could have looked at.”

TW Response – It is difficult to understand Mr. Healey's point. We used professional judgment and experience to exclude some historical outliers (both high and low) from the data used for bootstrapping, which is commonly done and completely consistent with the actuarial code of conduct which requires that work be performed with skill and care. Mr. Healey does not appear to understand that the lognormal distribution is used to model variability, and that the lognormal distribution is not “data.”

p. 184-185 Healy

“And we heard earlier about the medical inflation models, that they may actually vary from historical data, and vary more than indicated by results of the model. And beyond that, they then took the medical modeling and offset it with additional favorable assumptions, including to the interest rates that may have the effect of underestimating the true impact claims theory. So we have a number of different things, some of which are sort of assumptions on top of assumptions that are heavily in OneBeacon's favor, and not necessarily made to reach the most accurate conclusion that can be reached.”

TW Response – We do not know what Mr. Healy is referring to when he states “and vary more than indicated by the results of the model.” We do not offset medical inflation projections with interest rates – there is no basis for this comment. Finally, while we have by necessity made a number of assumptions, we believe they are balanced and reasonable. The insinuation that our assumptions were not designed to reach accurate conclusions is absolutely baseless.

p. 187-188 Kauffmann

“Allan Kauffman, FTI Consulting. Two items that are really confirming what appears to be the case from the reports. One is that table one. Is it done on a cash basis literally as they say, that it marks the time when cash runs out? That that's important as Dan has indicated, because that just --- if it's cash, that's a very misleading --- the effect is very misleading because the talk of cash running out 30 years could be something that the model --- by modeling the reserves would have identified as the technical insolvency after five years, much as the Home didn't have to wait 20 to 30 years to run out of cash to know --- the regulators to know that it was insolvent, that the estimates did that. So number one is to make sure that that's really what it's doing, in which case the --- which maybe they could confirm today, in which case it does serve to be a misleading table in regard to timing.”

TW Response – As stated in our Stochastic Model Report, failure is defined as a scenario in which invested assets go to zero. Therefore, the time of failure in our Report is the time in which invested assets go to zero.

p. 188-189 Kauffmann

“Mr. Johnson, you've indicated maybe the standard could be different, but it would appear there ought to be some standard and that standard ought to be included in the model. That kind of concept seemed to be in the RRC engagement letter, but it appears to me --- I believe that the simplest beginning question is, is it really done with zero capital as the standard for the companies' operations would be cut in?”

TW Response – We refer to earlier clarifications with respect to the scope of our review.

p. 189 Kauffmann

“Third is the reserves on the opening balance sheet. It's not clear in some indications that the --- not from the point of view of the stochastic modeling, but the point of view of understanding the basis for the financial statements. Are those based on Towers Watson's central estimates or no? It looks as if they're not, in which case we have a discontinuity, a discrepancy, a difference between the view of the experts on what the right starting point and the view of the financial statement. And that would of course affect the starting surplus and a view of how the company, from a financial point of view, apart from the stochastic level.”

TW Response – The reserves on the opening balance sheet are OneBeacon's estimates, not Towers Watson's. The stochastic model utilizes Towers Watson's estimates and assumptions. That is, actual loss and expense payments are modeled according to Towers Watson (not OneBeacon) estimates when measuring asset sufficiency.

p. 189 Kauffmann

“And finally, what is the basis for effectively --- not quite concluding, but suggesting that a 12 and a half percent --- that a 12 percent failure rate is good enough?”

TW Response – As stated in our cover letter, we are not opining on the appropriate or desirable success rate.

COMMENTS ON WRITTEN MATERIALS

Fergus July 22, 2014 letter page 3:

“Towers Watson’s Analysis of the Run-Off Companies Reserves is Far More Optimistic that (sic) OneBeacon’s SEC Reporting About the Same Liability”

TW Response – There is no basis for this false statement. Towers Watson’s central estimates for A&E claims exceed OneBeacon’s carried reserves (therefore, clearly not “more optimistic”) and both Towers Watson and OneBeacon acknowledge uncertainty in their respective estimates.

Terrell Report p. 23

“We are also left wondering why Towers Watson declined to offer any confidence intervals for the range of their estimates.”

TW Response – We did not produce confidence intervals in the Reserve Report. Confidence intervals, however, are a by-product of the stochastic modeling.

Terrell Report, page 19, footnote 49 – quoting the RRC report

“...as Towers itself notes, new judicial precedents or other unforeseeable actions could adversely impact this book and “that the ultimate cost of these claims will exceed the high end of Towers’ range due to the purpose of the high estimate as noted above.”

TW Response – The exact quote from the RRC report (page 4) is that “The possibility exists that the ultimate cost of these claims will exceed the high end of Towers’ range due to the purpose of the high estimate as noted above.” By omitting the beginning of the sentence, Mr. Terrell completely changed the intended meaning.

Terrell Report, p. 27

“For the reasons discussed in more detail above, there is no assurance that the Towers Watson reserve estimates are adequate to account for future claims. There is no assurance that the high estimates are either. The Towers Watson reports are so riddled with disclaimers that it appears they have little confidence in these estimates either.”

TW Response – As discussed in our cover note, the reliances and limitations that we presented are consistent with actuarial standards of practice. It should also be noted that our Stochastic Report contains scenarios with outcomes above our high estimates.

Terrell Report, p. 13

“The Towers Watson projection of cash flows for environmental claims is based on their aggregate loss development projection, but they acknowledge that this could be completely wrong, because single large payments or unusual settlement activity could invalidate their assumptions.”

TW Response – We never suggested that this projection could be “completely wrong.”

Terrell Report, p. 10

“Towers Watson's use of significantly discounted loss reserves based on White Mountain Advisors' aspirational investment returns, including a particularly speculative compound return on US equities, is inappropriate as a matter of basic insurance accounting.”

TW Response – This comment refers to our Reserve Report. Per Bozman's testimony, “We do not believe that the discounted figures shown in our Reserve Summary Report are important now, however, in understanding the economics of the runoff business, as the analysis in the Stochastic Report is more detailed and comprehensive.” (Transcript p.34). Furthermore, we did not and would not suggest that the discounted figures shown are appropriate to carry under statutory accounting. A separate section of the report shows our derivation of the statutory reserve estimates – “For the non-NICO lines, our projected net statutory unpaid loss and LAE as of September 30, 2012 is \$404.0 million, with a range of \$299.1 million to \$529.3 million. These statutory unpaid amounts reflect workers compensation tabular discounting, but otherwise are presented on an undiscounted basis. As of March 31, 2013, our projected net statutory unpaid loss and LAE is \$318.7 million, with a range of \$215.1 million to \$428.5 million.” (Reserve Report p. 10)

Terrell Report, p. 12 – 13

“Towers Watson's approach to estimating the prospective reinsurance associated with environmental liabilities is even more questionable than its asbestos approach. They simply assume a 50% net-to-gross ratio based on historic experience and assert without any substantiating data that the 2010 OBIG review will accurately predict the future. There are many reasons why the actual net-to-gross ratio may be materially different than that experienced in the past, especially if a more aggressive buyout strategy is adopted by the Acquired Companies, as is typically the case with runoff operations. If that occurs, the number of reinsurance disputes and payment delays will increase substantially.”

TW Response – Mr. Terrell's claim that reinsurers are more likely to dispute cessions when the primary company is extracting favorable settlements from the policyholders defies common sense. Furthermore, the continuity of Resolute's involvement in the claims handling for a number of years should contribute to the stability of disputes.

Terrell Report, p. 17

“RRC correctly stated, therefore, that the prospective ‘change in company ownership has the potential to alter the historical payout patterns underlying the loss reserve study. To the extent that this occurs, ultimate losses can be different than those based on historical data.”

TW Response – A change in future payout patterns, in and of themselves, would not necessarily impact ultimate losses. Ultimate loss projections could be impacted by changes in claim handling under new ownership (noting that for the NICO lines, claim handling would not change unless and until the NICO cover is exhausted on a paid basis, at least) but losses could be better than projected based on historical data.

Terrell Report, p. 20

“With respect the non-NICO lines, Towers Watson did not even conduct an independent stochastic review of this portion "of the runoff book, including some business segments (primarily Workers Compensation involuntary pools)." Moreover, its limited review of Workers' Compensation losses was "subject to assumptions with respect to settlement, mortality, and changing practice in claim handling." RRC did not

conduct (because it presumably was not asked to conduct) a critical evaluation of the non-NICO lines, but merely deferred to Towers Watson - who in turn relied solely on OneBeacon's internal data and projections."

TW Response – These statements are utterly false. Towers Watson's independent stochastic review of the non-NICO book, and even for the Workers Compensation Involuntary pools, assumed a distribution of potential outcomes. The review of workers compensation considered assumptions with respect to settlement, mortality, and changing practice in claim handling, but was not limited to these elements. Towers Watson did not rely on OneBeacon's projections, only OneBeacon's data, which is consistent with ASOP 23.

Terrell Report, p. 22

"Additionally, the way in which OBIG and Towers Watson have experimented with the equity mix suggests that they are trying to justify predetermined investment yields and are more focused on what OBIG can get away with than providing the tangible security that policyholders need."

TW Response – This comment is misleading. Running the model with different potential investment allocations is a logical and reasonable exercise when performing stochastic modeling. We note that the returns and volatility of the returns associated with individual investment classes are determined based on our ESG [spell this acronym out], with input from our investment consulting practice, and that the projections by investment class were not dependent on the allocations by investment class. We have been transparent in presenting the results under different versions of the model. To suggest that this implies that Towers Watson somehow conspired with OBIG to justify a predetermined assumption is unprofessional and baseless.

FTI Consulting, p. 2

"The starting point for TW's analysis of loss reserves is older than necessary."

TW response – When we began the stochastic analysis, the most recent available information was as of September 30, 2013. We used this data to "roll-forward" our earlier estimates. The roll-forward process was appropriate, and if significant changes in ultimate projections had been indicated by the roll-forward analysis, then additional work would have been done to understand the reasons for the differences, and if necessary, a full review may have been performed for certain segments.

"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."

TW response – As noted in our cover note and in our Summary Reports, the Summary Reports only contain partial documentation. The intention of the Summary Reports is to provide an overview of the methodology and results, and to give the reader the appropriate context for understanding the results. Full documentation has been provided to the PID in the full reports.

FTI Consulting, p. 4

"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 testing and reverse stress testing.

- Sensitivity testing: shows the effect of changes in parameters, such as inflation"

TW Response – As stated previously, we believe sensitivity testing and reverse stress testing are inferior to stochastic modeling in fulfilling the scope of our engagement. In particular, we note that volatility in

inflation was included in our stochastic modeling, as discussed in our Stochastic Model report and in Bozman's testimony.

FTI Consulting, p. 8

"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 million 1 is over \$50 million, which is material to the Run-off Companies."

TW response – The tolerance for variation is based on professional judgment informed by the methods utilized in the full review and an understanding of typical fluctuations in actual versus expected emergence. FTI Consulting appears to imply that a percentage difference in observed actual versus expected activity should be applied to the reserves, but such an extrapolation is generally not valid for long-tailed lines.

"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."

TW response – OneBeacon's view of reserves and the assumptions and methods used to derive those reserves are not the same as TW's, so movements in OneBeacon's reserve estimates would not necessarily provide information about whether TW's estimates should be adjusted.

FTI Consulting, Attachment 1

"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

TW Response – While this statement is true, it doesn't convey any additional information. The converse is also true – to the extent that there is less uncertainty or less correlation between lines of business in OneBeacon's book than has been modeled, the failure rate may actually be lower.

"There is also the potential uncertainty resulting from the possibility that the models used are not appropriate (model risk)."

TW Response – We acknowledge that we have not attempted to quantify additional uncertainty stemming from the possibility that the models used to measure uncertainty may not be appropriate (this is pointed out in our Stochastic Report, pages 17 – 18). In our professional judgment, we have utilized the most appropriate models.

"TW may overlook 'scenarios in which claims inflation significantly exceeds returns on assets.'"

TW Response – this is a quote from the RRC report and is not accurate. Our stochastic model incorporates scenarios in which claims inflation significantly exceeds asset returns.

“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%.”

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

TW Response – The first paragraph is a quote from the RRC report. The superimposed inflation element was not applied to the NICO lines because, based on our analysis of A&E industry data, we did not view this adjustment as necessary.