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COZEN O'CONNOR

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November 3, 2014

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Stephen J. Johnson, CPA
Deputy Insurance Commissioner
Office of Corporate and Financial Regulation
Pennsylvania Insurance Department
1345 Strawberry Square
Harrisburg, PA 17120

Re: Application of Armour Group Holdings Limited for Approval of Acquisition of Control of OneBeacon Insurance Company, One Beacon American Insurance Company, The Employers' Fire Insurance Company and Potomac Insurance Company

Dear Mr. Johnson:

We are in receipt of your letter dated October 6, 2014 (the "October 6 Letter") requesting clarification and/or additional information in certain areas as part of the Department's continuing review of the above-referenced application. Our responses are identified in Section II below by reference to the corresponding number in your requests.

I. Preliminary Comments

We wish to respond briefly to recent public comments on the transaction. Immediately prior to the closing of the public comment period, several commenters who provided oral comments at the July 23, 2014 public informational hearing (and who submitted lengthy prior written objections to the transaction) filed additional materials with the Department. For the most part, the latest comments essentially re-state previously provided written and oral comments. OneBeacon, Armour and Towers Watson responded to virtually all of these arguments in their filings of August 11 and 12, 2014. The responses below to the questions in the Department's October 6 Letter provide additional detail that is relevant to many of these same arguments. We do not intend, nor do we think it is necessary, to again address these matters unless further clarification is requested by the Department. However, we think it is important to make a number of general points about the latest round of comments.

The report filed by Mr. Allan Kaufman suggests additional work be performed to test how the timing of any "technical insolvency" impacts the failure rates of the transferring companies. Mr. Kaufman's focus on "technical insolvency" is off the mark for this transaction. This response, including the narrative and exhibit that responds to Request #13 of the October 6 Letter, addresses the appropriate regulatory posture as it relates to the oversight of a property and casualty insurer in runoff under the Department's supervision.

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Several commenters have suggested "conditions" to be added to any Order of Approval that might be fashioned by the Department. In particular, suggestions have been made that significant additional capital should be added, in the hundreds of millions of dollars, or a corresponding level of reinsurance be purchased. Such conditions are not only unnecessary and inappropriate in light of both the assets that are already reflected in the proposed balance sheet and the conclusions from the Towers Watson updated stochastic analysis[1] (concluding there is a 94.6% likelihood of success over the first 30 years and a 93.5% likelihood of success through ultimate paydown of all claims), they are also premised on faulty or inapplicable analysis.

Mr. Kaufman's report, along with comments from others, suggests the use of risk-based capital (RBC) ratios to argue that the transferring companies are undercapitalized relative to other insurers or to the transferring companies themselves at previous points in time. The commenters then use these comparisons to argue that the Department should require the parties to inject additional capital or provide additional reinsurance.

We disagree with these conclusions, and in particular the use of RBC calculations to reach them. Briefly, the RBC ratio approach was not intended to quantify the capital needed by an insurer, whereas the internal model approach used by Towers Watson is a more robust tool for evaluating capital adequacy.

As the Department is well aware, RBC ratios are a regulatory tool with a specific and well-defined purpose – to provide state insurance departments a structured and formulaic way of obtaining a regular indication as to the financial health of an individual insurer calculated in a consistent manner across insurers. At the time it was introduced, the RBC approach provided a more holistic view of an insurance company's financial condition than did the individual Insurance Regulatory Information System (IRIS) ratios that preceded it. Precisely because of their formulaic nature, though, RBC ratios do not account for many insurer-specific financial items that can significantly affect the actual balance sheet. For OBIC, these specific items would include but not be limited to: a lack of accurate reflection of the impact of the NICO and Gen Re covers on the timing of loss payments, risk differences between runoff and ongoing insurers, and the credit quality of the company's reinsurers. It is impossible based on reported financial statements for us to know what insurer-specific issues exist at the other companies and what if any bias those would produce in the RBC ratios that Mr. Kaufman used in his comparison. This is precisely why comparing the RBC ratios between companies can be misleading.

Further, the National Association of Insurance Commissioners (NAIC) Working Group on RBC stated that "the formula is intended to identify insurers that require regulatory attention and does not purport to compute a target level of capital."[2] The Working Group goes on to caution that "this formula should not be used to rate insurers, as many other factors must be taken into consideration in such an evaluation."[3] In other words, the RBC ratio is intended to alert

[1] The Towers Watson updated stochastic analysis reflects the roll-forward requested by the Department, plus an additional level of capital and a reduced level of management expenses, as discussed later in this letter.

[2] Sholom Feldblum, *NAIC Property/Casualty Insurance Company Risk-Based Capital Requirements*, Proceedings of the Casualty Actuarial Society, 1996, LXXXIII, pp.380-381 (www.casact.org/pubs/proceed/proceed96/96297.pdf).

[3] *Id.* The same clear cautions against using RBC to rank insurers or determine target levels of capital are found in the NAIC RBC Model Act, the substance of which has been adopted by most states, including Pennsylvania. Section 8(E) of the Act states that RBC "is a regulatory tool which may indicate the need for possible corrective action with respect to the insurer, and is not intended as a means to rank insurers generally." The potentially misleading use of

Footnote continued on next page

regulators to companies that may be under financial duress and merit further analysis such as the internal capital model approach used by Towers Watson, not provide a rating or a target capital level. The somewhat imprecise nature of RBC calculations is the reason why regulators are given substantial discretion regarding the actions they take based on an individual insurer's RBC ratio, including not taking the otherwise prescribed mandatory control level actions if an insurer is in runoff.

A report issued by an American Academy of Actuaries committee states that "the use of customized (internal) models, rather than one standard formula, if done properly, can lead to improved accuracy in the calculation of required capital."[4] More generally, the International Association of Insurance Supervisors states,

> "By its very nature a standardised approach may not be able to fully and appropriately reflect the risk profile of each individual insurer. Therefore, where appropriate, a supervisor should allow the use of more tailored approaches subject to approval. In particular, where an insurer has an internal model (or partial internal model) that appropriately reflects its risks and is integrated into its risk management and reporting, the supervisor should allow the use of such a model to determine more tailored regulatory capital requirements, where appropriate."[5]

This approach was taken by the State of Pennsylvania when it adopted the Model Act of the National Association of Insurance Commissioners regarding Own Risk and Solvency Assessments (ORSA). Specifically, the ORSA Model Act requires all insurers meeting certain size and/or financial criteria to submit annual reports assessing their own solvency, along with other aspects of risk management. Those assessments will generally be performed through a combination of one-year stochastic modeling and multi-year scenario testing. The modeling performed regarding the OBIC Runoff companies takes this analysis a step further by using multi-year stochastic modeling. In summary, it is clear that the Towers Watson stochastic model results provide a much more reliable and appropriate foundation for establishing the required levels of capital than RBC ratios with or without adjustment.

In addition to the suggestions that further substantial amounts of capital requirements be added as conditions to the transaction, several commenters have proposed that the Department impose some additional forms of oversight and review to the transferring companies' ongoing claims administration. We believe that the Department is well suited to review and regulate such conduct in accordance with applicable law and regulation and does not need further oversight of its own regulatory supervision.

Finally, as we have advised the Department in other correspondence, Armour and OneBeacon have agreed, subject to the Department's consideration and approval, to provide an

Footnote continued from previous page
RBC calculations is so great that the Model goes on to prohibit agents, insurers and others in the insurance business from "making, publishing...of any advertisement, announcement, or statement...with regard to RBC levels of any insurer, or any component derived in the calculation...."

[4] *Safety Levels in NAIC Property/Casualty Risk-Based Capital,* Subcommittee on Safety Levels in Property/Casualty Risk-Based Capital of the Property/Casualty Risk-Based Capital Committee, American Academy of Actuaries, January 2011, p. 9 (www.actuary.org/pdf/life/NAIC_Letter_PCRBC_SMIJointReport_Feb2011.pdf).

[5] *Insurance Core Principles, Standards, Guidance, and Assessment Methodology*, International Association of Insurance Supervisors, October 19, 2013, p 207.

additional level of capital and a reduced level of management expenses to the transaction. OneBeacon has proposed to provide an additional surplus note in the amount of $20.1 million (bringing the total amount of surplus notes to $101 million) and Armour has agreed, again subject to the Department's approval, to reduce their management fee level for servicing the runoff business from 15% to 10% over cost. These proposed changes to the capital and fees in the transaction have been used in calculating the surplus analysis in the answer to Request #13 herein. They have also been provided to Towers Watson, who has used these proposed revised contributions in their updated stochastic report, which includes an updated proposed pro-forma opening balance sheet based on a roll-forward of reserves. The updated stochastic report is being provided in response to Request #1 herein. That report has been filed with the Department and a summary report will be submitted concurrent with this response.

II. Armour and One Beacon's Responses to the October 6 Letter

Our responses to the requests in the Department's October 6 Letter are set forth below.

Request 1: The Department understands that Towers Watson will use paid and case incurred data through June 30, 2014 to roll forward the nominal reserve ranges and the payment forecast from the Analysis of Unpaid Loss and LAE as of September 30,2012, December 31,2012, and March 31,2013, which is dated September 9, 2013. As part of this roll forward, Towers Watson also will provide qualitative analyses of the potential impact of recent data on the stochastic model and the impact of any significant claim developments. Please also provide a comparison analysis and demonstrate how Towers Watson's A&E models have been updated during this time. The Department further understands that re-estimation and update will be completed and delivered to the Department no later than mid-October. If this timing changes, or if the Department's understanding of the roll forward is not correct, please provide prompt notice to the Department.

As noted above, the updated stocastic report from Towers Watson, which includes a roll-forward of reserves, was filed with the Department under separate cover. A summary version of the report is being filed concurrent with this response.

Request 2: In June, Armour representatives informed the Department that Armour would submit to the Department a copy of the proposed Purchaser Intercompany Agreement (as defined in the SPA), along with a detailed explanation as to why the agreement, including the fees set forth therein, is fair and reasonable. Please provide a copy of this agreement and explanation without further delay.

A copy of the proposed Purchaser Intercompany Agreement (the "Services Agreement") is being submitted separately with the required confidential Form D filing. The terms of the proposed Services Agreement are fair and reasonable because they resulted from an arms-length negotiation between Armour and OneBeacon. OneBeacon is not affiliated with Armour and has an economic interest in negotiating favorable terms because of its ongoing financial interest in the companies Armour is seeking to acquire. OneBeacon's ongoing financial interest is a function of the fact that as a result of the sale, it will hold surplus notes issued by the transferring companies.

In addition, the fairness and reasonableness of the terms of the proposed Services Agreement is demonstrated by a comparison to fees charged in the market. The Armour team has considerable third-party servicing experience, having managed designated services for many years for nearly 100 major clients via simple engagement letters through to complex service level agreements (SLAs). All of these agreements involved a balance between client objectives (value creation/protection), safeguarding reputations, fairness and costs associated with service tasks performed.

Because the runoff market has so much variance and flexibility, negotiated service agreement terms, all of which reflect the specific needs and requirements of the parties, are hard to compare. However, based on Armour's experience, the negotiated and market-based margin is typically driven by two major factors: (i) the fixed % margin (which is charged over and above costs), and (ii) the variable potential profit share, comprised of a profit sharing element. These two factors are interrelated. For instance, one may discover a contract in the market with a low fixed % margin but an unusually high profit sharing component. One may also find a high % fixed margin where there is no chance to earn variable compensation. The two elements also vary depending on the nature of the book of business (*e.g.*, price variations occur because certain types of business are more easily commuted than others).

In Armour's experience, the range one typically finds in the insurance and reinsurance marketplace for the fixed component would be approximately 5% to 25% while the profit sharing range is between 0% and 40%. In a separate and confidential Form D filing, Armour is submitting an appendix which lists contracts involving the Armour team and one with which it is otherwise familiar. This list could be extended considerably, but it was felt it was more important to show recently agreed-to service level contract terms. Through the diversity of the clients and the international spread, this list evidences Armour's view of the market range.

Based on the foregoing, we believe the terms of the proposed Services Agreement are fair and reasonable for the services contemplated.

Request 3: During the public informational hearing, Armour was asked specific questions regarding its expected cost savings. In the August 12, 2014 submission, Armour provided some general examples of expected cost savings. The Department seeks more detail as to these examples, and inquires whether other cost savings are anticipated. Please provide the analysis underlying the statement that Armour expects its cost savings to be 50% or more when compared to the legacy systems, initially up to $1.5 million annually, with more savings potentially realizable in the future. In this regard, please also provide, if possible, specific examples from Armour's experience with Excalibur.

In Armour's August 12, 2014 submission, several specific examples of anticipated cost savings were provided, all of which are based on existing initiatives related to the proposed transaction. These include:

a. Savings from implementing a purpose-built operating platform for claim administration and financial processing. Pursuant to the October 17, 2012 Stock Purchase Agreement (SPA) between OneBeacon and Armour, Armour is able to continue processing business using the OneBeacon legacy claims and administrative systems. These are referred to as the "IT Base Services" in the Transition Services Agreement and are being provided by OneBeacon for one year at a cost of $1,284,000. Armour anticipates replacing these services with an integrated claims system with a first-year cost of $600,000, reducing to $300,000 annually thereafter, resulting in annualized savings of $884,000 to the regulated entities.

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b. Savings from reducing leased office space and utilizing Class B space. OneBeacon's historical costs for runoff claims offices in Quincy, MA and Amherst, NY were $575,000 in 2013. This can be compared with a projected annual cost of $250,000 from January, 2015 forward, resulting in annual savings of $325,000 to the regulated entities.

c. Initiatives planned or underway to reduce costs associated with statistical reporting and offsite storage costs. OneBeacon's current spend on items such as storage and statistical reporting for the runoff business alone totals in excess of $800,000 annually. Armour's projected spending on these items is $400,000 annually, resulting in annual savings of $400,000 to the regulated entities.

Together, the savings described in the three paragraphs above total over $1.6 million annually.

Separately, OneBeacon has also provided Armour with estimated ULAE costs for the run-off business totaling $13.4 million for the next three years as currently structured before the proposed sale. Armour's management fee projections indicate total costs of $10.8 million, resulting in $2.6 million in projected savings over the period.

Request 4: During the public informational hearing, Armour was asked to provide support for the statement that Armour has access to different kinds of capital. Please provide a response, with supporting documentation.

As described at the public informational hearing, Armour has access to significant transactional-based sources of capital when circumstances require. Details of these additional capital sources have been provided to the Department on a confidential basis. The current One Beacon transaction does not contemplate the use of outside capital being sourced by Armour.

Request 5: The Department observes that under Section 6 of SPA Amendment 3, subject to required regulatory approvals, Armour may elect to have One Beacon America Insurance Company prepay all or some of the surplus notes "in connection with OneBeacon Insurance entering into one or more reinsurance agreements to provide surplus relief to replace some or all of surplus represented by the Surplus Notes." Please explain what, if anything, the parties are contemplating under this provision and what impact such a transaction might have on each of the target domestic insurers.

It is not contemplated that the sections of the SPA allowing for reinsurance to be requested in lieu of certain surplus notes (see Section 6 of SPA Amendment 3) will be used. If required by the Department, Armour is willing to certify that it will not use this option.

Request 6: The Department also observes that the Amended Retained Business Reinsurance Agreement (Amended SPA Exhibit 3) and the Amended Run-off Business Reinsurance Agreement (Amended SPA Exhibit 6) each changed the definition of "Policy" (i.e., the Policies being reinsured under the reinsurance agreement). Under the amended definition, it appears that the term Policy now include policies issued by the cedent and all reinsurance contracts under which the subject type of business is assumed by the cedent through the closing date of the transactions contemplated by the SPA. Please consider amending the language to clarify that there will be no business

covered by either reinsurance agreement that has not been accounted for in the Towers Watson modeling.

Amendment 1 to the Form A made a parallel change to the definition of "Policy" found in the Amended Retained Business Reinsurance Agreement (Exhibit 3 to the Stock Purchase Agreement) and the Amended Run-Off Business Reinsurance Agreement (Exhibit 6 to the Stock Purchase Agreement). The change was made to clarify that reinsurance contracts are covered by each agreement's definition of policy, consistent with the original intent of the parties. The Towers Watson modeling submitted to the Department includes everything that the parties intended to be captured by the definition of "Policy."

Request 7: Please explain why net loss reserves are projected to decrease by 61% by December 2017, but cash and investment assets are projected to decrease by 39% by that same time.

The principal reason for the difference between the balance sheet's projected decreases in net loss reserves and the balance sheet's projected decrease in invested assets is the assumption that no surplus note principal will be repaid for five years. Because no surplus note principal is being repaid during the first five years, assets that would have been used to repay the notes remain on the balance sheet. In contrast, when the surplus notes begin being repaid, which we have assumed begins in 2019, capital is reduced. After these surplus-note-driven capital reductions take effect, the percentage decrease in invested assets, net loss reserves, and surplus is similar. An illustrative chart is attached as Exhibit A.

Request 8: Towers Watson's August 12, 2014 response referenced an analysis of uncollectible reinsurance it had conducted in connection with its work. Please provide this analysis to RRC for RRC's review. In addition, to the extent an analysis of ceded reinsurance was conducted, please provide that analysis.

See response number 8 in the attached letter from Towers Watson (Exhibit B).

Request 9: The Department understands that Towers Watson made several adjustments to its proprietary Economic Scenario Generator in the area of asset yield assumptions based on a consultation with Towers Watson's investment consulting group. Please provide additional information about this investment consulting group, including the group's analysis, what recommendations it made, what recommendations were accepted, and what recommendations, if any, were rejected.

See response number 9 in the attached letter from Towers Watson (Exhibit B).

Request 10: Towers Watson made the following statement on page 12 of its August 12, 2014 response: "We also note that severity inflation by disease has been benign in recent years." Please provide statistical support for that statement.

See response number 10 in the attached letter from Towers Watson (Exhibit B).

Request 11: Please explain why OBIG's reserves shown on its proposed consolidated closing date balance sheet are lower than the central estimate used by Towers Watson in its stochastic model.

The reserves shown on the proposed consolidated closing balance sheet are consistent with the reserves currently held by OneBeacon representing management's best estimate of ultimate loss for the business. While this estimate is below the central estimate used by Towers Watson in its stochastic model, it is within Towers Watson's range of reasonable reserve estimates and consistent with the Armour management team's own evaluation of ultimate loss exposures.

Request 12: Please confirm that Towers Watson did not use deferred tax assets in its stochastic model and that any deferred tax assets will not have any impact on the model.

See response number 12 in the attached letter from Towers Watson (Exhibit B).

Request 13: Some commenters were concerned that the definition of "failure" is too narrow. Although the Department believes the definition of failure is appropriate, it would be valuable to see an analysis using alternative definitions. For example, if projected loss reserves for the current runoff business were substituted for paid claims in the stochastic model, in what percentage of the cases - measured at various points in time - does the model project that assets will be inadequate to cover those reserves? Additional alternative definitions of failure could also be considered (e.g., a specific level of surplus).

The definition of failure in the Towers Watson stochastic model is "any scenario in which the invested assets fall to zero before the last claim is paid."

Armour and OneBeacon believe this is the correct definition given the information that they understand the Department is wishing to see developed from the stochastic modeling exercise; namely, the probability that the assets in the closing balance sheet will be sufficient to fund the projected claim payments to the ultimate resolution of the claims.

An alternative definition might be any scenario in which the statutory surplus falls below zero, in which case one might consider the probability that the booked statutory reserves at various points in time will exceed statutory assets. In other words, the probability that statutory surplus will be less than zero.

Addressing this alternative definition with a stochastic model would be extremely difficult. The model would have to first forecast a range of reasonable reserve estimates at various points in time for each of the 10,000 scenarios, then predict management's best estimate within that range. In addition, the answer to the question would depend on whether the reserves were booked on a nominal basis, net of a standard statutory workers' comp discount, or as a permitted practice, on an economic present value basis.

Rather than attempting to make the above-described predictions in all 10,000 scenarios, Armour and OneBeacon believe it would be more useful to leverage the existing stochastic model to project statutory financial statements for a set of key scenarios. While this analysis does not generate the probability of achieving a specific outcome, it does provide some insight into what the statutory financial statements may look like under varying levels of stress.

Specifically, in Exhibit C OneBeacon has projected statutory financial statements under the following two scenarios:

- Mild Stress – Mean loss payout projections and mean investment returns by asset class from the Towers Watson stochastic model. Note that this represents a loss scenario more severe than what OneBeacon and Armour expect will happen.

- Severe Stress – Loss payout projections equal to the high end of the Towers Watson reasonable range for each of the NICO and non-NICO liabilities and mean investment returns by asset class from the worst 25% of loss scenarios in the stochastic model.

In preparing these statutory financial projections:

- Reserve strengthening is reflected over time, as the beginning reserves are below the selected ultimate payments. The logic applied to calculate the amount of reserve strengthening in each period on a nominal basis is to multiply the proportion of paid loss in the period relative to ultimate paid loss by the total amount of strengthening required (as reflected by the sum of all paid losses in the model less the initial held reserves). All reserves are recorded on a nominal basis with a statutory workers' comp discount.

- It is assumed that the two subsidiaries of OneBeacon Insurance Company (OneBeacon America Insurance Company and Employers Fire Insurance Company) are merged into OneBeacon Insurance Company in year 6.

- The revised proposed closing balance sheet pro forma as of June 30, 2014, which is also used in the updated stochastic report referenced in response to Request #1, includes $101 million in surplus notes and the projected financials reflect a reduction in Armour's management fee from 15% to 10%.

In addition to the highlights provided below, Exhibit C provides summary statistics for each case. Note that surplus remains positive through the ultimate resolution of all claims, even in the severe stress scenario.

- Mild Stress:
  - Policyholder surplus remains positive throughout.
  - Surplus notes are paid down significantly, but not in full.

- Severe Stress:
  - Policyholder surplus remains positive throughout.
  - No surplus note principal is repaid, though some interest payments are made.

Some commenters have suggested that the Department will be required under Pennsylvania law to monitor certain metrics of the statutory balance sheets of the transferring companies, and that if certain metric thresholds are crossed, the Department would be required to take certain actions which would serve to reduce or slow down the payment of claims. This argument is simply not true. The runoff companies at issue will be subject to ongoing and close Department oversight after the sale. As Deputy Commissioner Johnson pointed out during the July 23, 2014 public hearing, because of this close oversight, the Department is not required under Pennsylvania law to take any prescribed actions so long as the company is under such oversight. This regulatory reality informs the definition of failure in the stochastic model. Additionally, the scenario analysis referenced above clearly indicates that surplus is highly likely to stay positive through ultimate resolution of all of the runoff claims.

Please let me know if you need any additional information or clarifications.

Sincerely,

COZEN O'CONNOR

By: James R. Potts

CARLTON FIELDS JORDEN BURT

James J. Jorden /JRP

By: James J. Jorden

EXHIBIT A

OneBeacon Insurance Company

Changes in Key Asset, Liability, and Surplus Accounts

	Jun-14	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19
Cash and investments	226.4	210.0	177.2	153.1	139.2	104.1	65.2
% change from Jun-14		*7%*	*22%*	*32%*	*39%*	*54%*	*71%*
Net loss and lae reserves	156.5	134.8	99.2	76.2	61.0	49.1	38.8
% change from Jun-14		*14%*	*37%*	*51%*	*61%*	*69%*	*75%*
Total surplus	150.9	121.3	115.8	111.7	109.5	84.9	55.6
% change from Jun-14		*20%*	*23%*	*26%*	*27%*	*44%*	*63%*
RBC (TAC to ACL) [1]	277%	250%	305%	363%	428%	383%	299%

[1] It was assumed that no surplus note principal would be repaid until 2018, causing an increase in RBC through Dec-17, before declining to a steady state in 2019 and beyond. That steady state is between 275% and 300% (above the 250% target) due to the timing of excess surplus releases.

EXHIBIT B

TOWERS WATSON

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Philadelphia, PA 19102-4790

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November 3, 2014

Mr. Stephen J. Johnson
Deputy Insurance Commissioner
Office of Corporate & Financial Regulation
Pennsylvania Insurance Department
1326 Strawberry Square
Harrisburg, PA 17120

Dear Mr. Johnson:

The questions that we are responding to below are documented in a letter dated October 6, 2014 written from The Pennsylvania Insurance Department (PID) to James R. Potts, Esq, of Cozen O'Conner ("the Letter").

Towers Watson appreciates the opportunity to respond to these questions which relate to 1) our work performed for OneBeacon Insurance Group, LLC ("OneBeacon") as discussed in the Public Hearing in Harrisburg on July 23, 2014; and 2) our August 11, 2014 letter to the PID which is referenced in the August 12, 2014 response to the objecting policyholders submitted by OneBeacon and Armour Group Holdings Limited.

Throughout this document, we will refer to our report entitled "Analysis of Unpaid Loss and LAE as of September 30, 2012, December 31, 2012 and March 31, 2013," dated September 9, 2013 as "the Reserve Report," and to the report "Stochastic Modeling of Run-Off Business Pro-forma Balance Sheet as of June 30, 2014," dated June 10, 2014 as "the Stochastic Model Report."

This letter details our responses to items #8, #9, #10 and #12 in the Letter.

8. Towers Watson's August 12, 2014 response referenced an analysis of uncollectible reinsurance it had conducted in connection with its work. Please provide this analysis to RRC for RRC's review. In addition, to the extent an analysis of ceded reinsurance was conducted, please provide that analysis.

Towers Watson performed an independent projection of uncollectible reinsurance for the non-NICO business based on assigning default probabilities to OneBeacon's reinsurers. This analysis is included in and documented in our confidential reserve report, which has been made available to RRC for its review. Additionally, any amounts not collected historically due to disputes were reflected in the data used in our review.

For the NICO book, the analysis of uncollectible reinsurance cessions must address the effects of disputed balances in addition to the impact of reinsurer insolvencies. As explained in our Reserve Report our analysis considered the potential for uncollectible balances for modeled known accounts as well as for the miscellaneous and pure IBNR components.

For modeled known accounts, we developed initial estimates of ceded liabilities based on our evaluation of OneBeacon's calculations and conclusions on the collectability of cessions for material individual accounts, including direct fact-finding and discussions with OneBeacon claims handlers. We then included an additional provision of 7.5% of the cessions which addresses the potential for reinsurance terms to be applied differently than assumed in the historical ceded models.

For the miscellaneous and pure IBNR components, the ceded amounts were based on the aggregated provisions by account and consideration of how cessions are expected to vary between the IBNR and the known accounts components. An additional 7.5% provision was included, as for modeled known accounts.

Supporting workpapers for the NICO analysis, if necessary, can be made available to the PID and RRC on a confidential basis. As our report states, we were not able to perform an independent analysis of the additional provision. However, based on our review of all of the available information, we concluded that it is reasonable.

9. The Department understands that Towers Watson made several adjustments to its proprietary Economic Scenario Generator in the area of asset yield assumptions based on a consultation with Towers Watson's investment consulting group. Please provide additional information about this investment consulting group, including the group's analysis, what recommendations it made, what recommendations were accepted, and what recommendations, if any, were rejected.

Towers Watson's investment consulting business has more than 750 associates worldwide and its clients include more than 1,000 pension funds and institutional investors. The investment research team is part of the investment consulting group, and employs more than 150 professionals. We consulted with this group on several adjustments to the economic scenario generator output. The most significant adjustments were an increase in the mean equity returns for the first three years of projections by approximately 300 basis points, so that they approximate long term average equity returns more closely, and an adjustment to BBB default rates to more closely match the 15-year S&P historical cumulative default rate based on the S&P transition matrix. In addition, we increased the length of mean reversion of the interest rate yield curve by three years.

The investment consulting group agreed that all of the adjustments proposed were reasonable. The project team did not make any other recommendations for changes to the Economic Scenario Generator output to the Investment Consulting Group.

10. Towers Watson made the following statement on page 12 of its August 12, 2014 response: "We also note that severity inflation by disease has been benign in recent years." Please provide statistical support for that statement.

Towers Watson maintains a benchmark severity index by year and disease, which is based on its analysis of tens of thousands of annual defendant claims collected from client assignments. While the underlying data itself is proprietary and confidential and therefore cannot be shared, we will make the benchmark severity index available to the PID and RRC on a confidential basis.

12. Please confirm that Towers Watson did not use deferred tax assets in its stochastic model and that any deferred tax assets will not have an impact on the model.

The proposed closing balance sheet pro forma as of June 30, 2014, which is the starting point for the updated stochastic model and which is also reflected in the financial exhibit to the Form A, includes

$27.8 million of deferred tax assets, which we understand from OneBeacon and Armour consist largely of $27.0 million of deferred tax assets related to reserve strengthening taken as part of the proposed closing adjustments. That $27.0 million is entirely offset, both in the stochastic model and in the financial exhibit to the Form A, by a deferred tax liability, which according to OneBeacon and Armour relates to the buyer's gain on sale that would be accrued in the period immediately after closing. The recording of the deferred tax asset as part of the closing adjustments and the offsetting deferred tax liability related to the buyers' gain on sale have no net impact on the results of the stochastic model.

The stochastic model does capture deferred tax assets on an ongoing basis, driven by the tax discount of loss reserves and net operating loss carry-forwards. Such carry-forwards are used to reduce the payment of cash taxes in the later years of certain scenarios in which there is taxable income. These cash tax savings on the margin can then be used to fund claim and/or expense payments, whereas deferred tax assets themselves are not at any time in any scenario used to fund claim or expense payments. Ignoring taxes altogether in the model would improve the modeled success rate by less than ten basis points.

Please let us know if there are additional questions or clarifications that would be helpful.

Sincerely,

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Director
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Sandra C. Santomenno, ACAS, MAAA
Senior Consultant
Direct Dial: (908) 879-9254

EXHIBIT C

Model Summary Statistics
(in millions)

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 10	Year 20	Year 30	Ultimate
Mild Stress Model										
Consolidated:										
Cash and investments	300.6	268.8	247.5	247.7	247.8	221.6	178.0	104.1	56.6	0.6
Net reserves	158.9	130.7	113.3	111.7	110.7	111.8	114.0	69.5	33.4	0.0
Surplus notes	101.0	101.0	101.0	101.0	101.0	101.0	64.0	27.2	16.1	10.0
Total surplus	183.0	143.6	138.0	135.9	137.1	109.8	63.9	34.6	23.2	0.6
Severe Stress Model										
Consolidated:										
Cash and investments	300.6	268.8	248.4	249.1	248.9	253.8	292.5	206.8	101.5	0.6
Net reserves	158.9	148.7	146.2	155.3	163.2	171.7	269.4	157.4	67.8	0.0
Surplus notes	101.0	101.0	101.0	101.0	101.0	101.0	101.0	101.0	101.0	101.0
Total surplus	183.0	130.8	116.9	93.8	85.7	82.1	23.1	49.6	34.1	0.6