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Pennsylvania
Insurance Department

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December 17, 2014

VIA E-MAIL & HAND DELIVERY

Kimberly A. Rankin, Director
Company Licensing & Financial Analysis
Office of Corporate and Financial Regulation
Pennsylvania Insurance Department
1345 Strawberry Square
Harrisburg, PA 17120

RE: Corrected Hearing Transcript – July 23, 2014 Hearing on Proposed Acquisition of Control of OneBeacon Insurance Company, Potomac Insurance Company, OneBeacon America Insurance Company & The Employers' Fire Insurance Company by Trebuchet U.S. Holdings, Inc.

Dear Ms. Rankin:

As you are aware, the OneBeacon Insurance Group, LLC ("OneBeacon") identified some transcription errors and needed clarifications to the Hearing Transcript as prepared by Sargent's Court Reporting Service, Inc. ("Sargent's") for the above-referenced hearing and provided to Sargent's an Errata Sheet indicating requested corrections.

In reviewing the notes and tape recording of the hearing, Sargent's made the revisions in the corrected hearing transcript as set forth on the Errata Sheet, both enclosed herewith, as being consistent with the verbatim recording and court reporter notes from the hearing.

Please let me know if you have any questions or require additional information.

Sincerely,

SAUL EWING LLP

Frances R. Roggenbaum
Attorneys for OneBeacon Insurance Group, LLC

Enclosures

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PROPOSED ACQUISITION OF CONTROL OF ONEBEACON INSURANCE COMPANY, POTOMAC INSURANCE COMPANY, ONEBEACON AMERICA INSURANCE COMPANY AND THE EMPLOYERS' FIRE INSURANCE COMPANY BY TREBUCHET U.S. HOLDINGS, INC.

JULY 23, 2014 PUBLIC INFORMATIONAL HEARING TRANSCRIPT: ONEBEACON GROUP ERRATA SHEET

PAGE(S)	LINE(S)	CHANGE AND/OR CORRECTION	REASON
1	###	Change from: Armor	Transcription Error
8	7	Change to: Armour	
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JULY 23, 2014 PUBLIC INFORMATIONAL HEARING TRANSCRIPT: ONEBEACON GROUP ERRATA SHEET

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26	21	Change from: Under Change to: Unearned	Transcription Error
27	13	Change from: consolidate basis Change to: consolidated basis	Transcription Error
27	13	Change from: claims Change to: claims?"	Transcription Error

JULY 23, 2014 PUBLIC INFORMATIONAL HEARING TRANSCRIPT:
ONEBEACON GROUP ERRATA SHEET

PAGE(S)	LINE(S)	CHANGE AND/OR CORRECTION	REASON
28	6	Change from: lost Change to: loss	Transcription Error
28	8	Change from: competence Change to: confidence	Transcription Error
30	14	Change from: Rescue Change to: ResQ	Transcription Error
33	11	Change from: NCIO Change to: NICO	Transcription Error
34	20	Change from: role Change to: roll	Transcription Error
35	6	Change from: general reinsurance Change to: General Reinsurance	Transcription Error
37	23	Change from: 30 years and Change to: 30 years in	Transcription Error
38	18	Change from: tail Change to: tailed	Transcription Error
39	13	Change from: I'm associate of the Change to: I'm an Associate of the	Clarification
40	2	Change from: asbestos conclusion liabilities, Change to: asbestos and pollution liabilities,	Clarification
40	8-9	Change from: agencies. As more commonly used, actuarial Change to: agencies as more commonly used actuarial	Transcription Error
40	11	Change from: A Invest, Change to: AMBest,	Transcription Error
41	17	Change from: Towers Watson's industry Change to: Towers Watson's Industry	Transcription Error
43	5-6	Change from: issues that may be --- may be in effect. Change to: issues that may be in effect.	Clarification

JULY 23, 2014 PUBLIC INFORMATIONAL HEARING TRANSCRIPT: ONEBEACON GROUP ERRATA SHEET

PAGE(S)	LINE(S)	CHANGE AND/OR CORRECTION	REASON
44	17	Change from: there is implicit provision Change to: there is an implicit provision	Transcription Error
44	21	Change from: uses proprietary ground-up Change to: uses a proprietary ground-up	Clarification
47	1	Change from: NICO treaty, we're applied to each Change to: NICO treaty were applied to each	Transcription Error
47	17	Change from: timed series of interest rates, Change to: time series of interest rates,	Transcription Error
48	3	Change from: we put a statistical Change to: we fit a statistical	Clarification
48	22	Change from: by the stream. Change to: by the ESG.	Clarification
49	7	Change from: analysis is that he future Change to: analysis is that the future	Transcription Error
49	15	Change from: uncertainty in the lost payment amounts Change to: uncertainty in the loss payment amounts	Transcription Error
49	16	Change from: time at a constant Change to: timing at a constant	Clarification
49	17	Change from: used the USG as a basis Change to: used the ESG as a basis	Clarification
207	2	Change from: Appreciate Change to: I appreciate	Clarification
208	23	Change from: that could happen Change to: that can happen	Clarification
209	13	Change from: would immunized going forward Change to: would be immunized going forward	Transcription Error

BEFORE THE PENNSYLVANIA INSURANCE COMMISSION

* * * * * * * * *

IN RE: APPLICATION FOR ACQUISITION OR CONTROL BY ARMOUR GROUP HOLDINGS LIMITED THROUGH ITS SUBSIDARY, TREBUCHET U.S. HOLDINGS, INC., OF ONEBEACON INSURANCE COMPANY, POTOMAC INSURANCE COMPANY, ONEBEACON AMERICA INSURANCE COMPANY AND THE EMPLOYERS' FIRE INSURANCE COMPANY

* * * * * * * * *

Stenographic report of a Hearing held at Pennsylvania Insurance Department, Administration Room 200, 901 North Seventh Street, Harrisburg, Pennsylvania, on

Wednesday

July 23, 2014

at 9:01 a.m.

BEFORE: STEPHEN JOHNSON, Deputy Insurance Commissioner, Office of Corporate and Financial Regulation

AMY DAUBERT, Deputy Chief Counsel, Office of Chief Counsel

KIMBERLY RANKIN, Director of Bureau of Company Licensing & Financial Analysis

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Sargent's Court Reporting Service, Inc.
(814) 536-8908

WITNESSES: Christopher Bozman, Sandy Santomenno, Brad Huntington, Craig Moore, Michael C. Dubin, Paul McDonough, Paul Stockman, Esquire, Jonathan Terrell, Brian Scarbrough, Esquire, Gary Fergus, Esquire, Dan Healy, Esquire, Allan Kauffman

Reporter: Lindsey Powell

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NONE OFFERED

P R O C E E D I N G S

MR. JOHNSON:

Good morning, and welcome to the Pennsylvania Insurance Department's public informational hearing on the transaction involving the application for acquisition or control by Armour Group Holdings, Limited through its subsidiary, Trebuchet U.S. Holdings, Inc., of OneBeacon Insurance Company, Potomac Insurance Company, OneBeacon America Insurance Company and the Employers' Fire Insurance Company, all of which are Pennsylvania Domestic Stock Casualty Insurance Companies.

My name is Steve Johnson and I serve as Deputy Insurance Commissioner for the Office of Corporate and Financial Regulation. I'm responsible for licensing and financial oversight, including onsite financial examination of approximately 275 domestic insurance companies and 4,100 non-domestic insurance companies and 230 continuing care retirement communities. In addition, as Deputy Insurance Commissioner, I'm responsible with the able assistance of my staff, for the review of all corporate transactions involving Pennsylvania domestic insurance companies. And I will assist Commissioner Considine

to enable him to make a decision on the filing.

I would like to introduce the members of the Department staff responsible for reviewing the file. Kim Rankin, my Director of Company Licensing and Financial Analysis. In the back at the registration desk, Steve Yerger, Company Licensing Specialist. Amy Daubert, my Deputy Chief Counsel. And Jodi Frantz, who's in the back of the registration desk, is also Department Counsel in the filing.

I'd like to welcome and introduce the individuals from Risk & Regulatory Consulting, LLC, the Department's expert who has been retained pursuant to the Insurance Holding Companies Act, Craig Moore. Okay. Craig's here. Mike Dubin at the table, and then in the audience here, Anne Kelly and Pat Tracy. Additionally, the Department has retained outside Counsel to assist in the review of this transaction. With us today from the Law Firm of Drinker, Biddle and Reath, LLP, are Dan Krane, Alicia Hickok and Sandra Miller, who's out in the audience.

By way of background, the Department's review process began in February 2013 with an initial application filed pursuant to Section 1402 of the Holding Company Act. This application is commonly known as a Form A Filing. The Department published

notice of the filing in the Pennsylvania Bulletin in February 23rd, 2013. The notice invited interested parties and persons to provide comment to the Department about the filing. The Department received a number of public comments, all of which are available on the Department's website at www.insurance.pa.gov.

The filing was amended twice on June 19th of 2014 and on June 25th, 2014, to include OneBeacon America Insurance Company and the Employers' Fire Insurance Company, who just completed their re-domestication from Massachusetts to Pennsylvania. The publicly available record thus far consists of the initial and amended filings made by the Applicant, the public comments and supplemental documents. Public portions of the Form A Filing, the amendments thereto and related documents have been and remain available on the Department's website.

The public files are also available for review and copying at the Department's offices in Harrisburg. The government rate for copying is 25 cents per standard page and $2 for a legal-sized page. We request that the copying and shipping charges be pre-paid. In addition, there is an index of all the documents posted on the website. Copies of the public

file index are also available for inspection at the registration table.

The subject of the hearing today is the proposed transit --- proposed transaction described in the Form A Filing before the Department. The purpose of today's hearing is not to reach a final decision on the Form A Filing. Instead, the purpose of the hearing is to receive comments from interested persons to aid the Department in making a decision as to whether it will be approved --- it will approve the transaction.

The Insurance Department will make a decision based upon the standards set forth in the statute known as the Insurance Holding Companies Act. The Act requires the Department to look at a number of factors, including the impact of the transaction on the insurance marketplace, whether the transaction would be hazardous to the insurance buying public and whether the plans proposed of the acquiring party are fair, reasonable, confer benefit on policyholders and are in the public interest. Another factor the Department will look at is the competency, integrity and experience of the acquiring party.

The entire record of the filing, including the transcript of the hearing, and any

materials submitted in connection with or following the hearing will be reviewed by the Department. Before any final conclusions are reached, the Department will closely consider any comments about the filing presented here today. Once again, no final decision will be rendered at the conclusion of today's hearing.

This is a public informational hearing. All interested persons are invited to provide their comments or raise questions for the parties' and the Department's consideration about the Form A Filing. Comments and the information gathered here today will be considered, along with other material the Department has received, as it continues its review and analysis of the filing.

To facilitate the review, this hearing is being recorded by a court reporter. The Department will review the transcript of today's hearing as part of its examination of the filing. A copy of the transcript will be available on our website.

Please note that because of the nature of today's proceeding, Cross Examination or interrogation of speakers will not be permitted. Commenters are asked to direct their questions to the Department. The Department will take those questions

into account. The Department may have questions for the Applicant and may pose commenters' questions to the Applicant as well.

The Applicant is asked to respond to these questions to the best of their ability, but may supplement or provide its answers in writing. Indeed, the Applicant is not required to respond to those questions today. Following today's hearing, the Department will require written responses to all questions raised during the hearing, irrespective of whether they're raised by the commentators or by the Department. And we'll make those responses available on our website.

We will begin this morning with the presentation by the seller and the Applicant. These presentations may include presentations by multi-individuals. Next, the Department's expert will make a presentation. Then the public comment portion of the hearing will begin. During this segment of the hearing, any member of the public may make a presentation. The Department would welcome any commentator to also submit a written copy of their presentation and any other written materials or comments that it wishes the Department to consider. Anyone wishing to speak should sign up at the

registration desk, if you have not already.

When speaking, please indicate if you're speaking on your own behalf. If you're speaking in a representative capacity, please identify your role and the relationship to the represented organization. Your remarks should be specific and related to the Form A Filing that is before the Department. As noted earlier, any public commenter may pose questions for the Applicant, but such questions should be given to the Department in writing. Additionally, the Department may have questions for the commentators' during the commentators' presentations.

At the conclusion of the public comment portion of the hearing, we'll take a short break, then the Department will ask the Applicant questions. All responses will be sworn. At the end of the question and answer portion of the hearing, if time permits, the members of the general public may present brief additional comments. Then the Applicant will have the opportunity to present a brief closing statement.

So with that, we will begin the hearing today with the seller's presentation. And again, as you --- please introduce yourselves for the record and your position and organization as you do so.

ATTORNEY PHILLIPS:

Thank you. Good morning. I'm Maureen Phillips, General Counsel and Senior Vice President of OneBeacon Insurance Group. I've been involved in and overseeing the legal and regulatory work on OneBeacon's side of the transaction. We would like to thank Deputy Commissioner Johnson and other members of the Pennsylvania Insurance Department for scheduling this hearing, for the substantial efforts the Department has made in its consideration of the proposed transaction, and between what --- the proposed transaction between OneBeacon Insurance Group and Trebuchet U.S. Holdings, the transaction that brings all of us here today.

Trebuchet is a subsidiary of Armour Group Holdings Limited. And for the sake of convenience today, we will refer to that entity as Armour throughout the rest of this presentation. In terms of the purpose of the presentation, we understand that this public hearing is designed to provide an opportunity for interested persons and policyholders to present their comments about the transaction in a public forum.

The Department has received and reviewed a very substantial amount of information relating to the proposed transaction. And our speakers today do

not intend to repeat or summarize all of that information that is already in the public record. Various public comments have also been submitted to the Department, and those comments, as well as our written responses, are also in the record.

In addition to my remarks today, you will hear from our Chief Financial Officer, Paul McDonough. Paul's presentation will be followed by two speakers from Towers Watson, independent actuaries who have reviewed the strength of the proposed closing balance sheets and tested those balance sheets in a rigorous stochastic modeling analysis. Mr. Brad Huntington, CEO of Armour, will then address Armour's purchase and its extensive and successful experience in managing runoff insurance operations and portfolios. Our remarks today will focus on the background of this transaction and how the transaction meets the statutory standards under Pennsylvania law, including the benefits of the transaction to the public and to the policyholders.

Seven factors are primarily the outline for --- under Pennsylvania's Insurance Holding Company Act that guides this transaction and the Insurance Department's consideration. The Insurance Holding Companies Act provides that the Department shall

approve this transaction unless one or more of the seven factors set forth in the Act, Section 1402, actually requires disapproval. The record here demonstrates that those factors do not apply and that this transaction should be approved.

The first, second and seventh factors listed in Section 1402 involve situations that are simply not implicated here, such as the creation of a monopoly or the conversion of a mutual insurance company to a stock company. Factors three through six of the Act relate to the public interest issues, and in analyzing those factors, it's clear that the Act supports approval of this transaction. The third and fifth factors under the Act, for example, allow the Department to review the financial condition, competence and experience of Armour.

Under the fourth factor, the Department reviews the transaction to determine whether Armour intends to make any material changes to the management of the business that are, quote, unfair and unreasonable and fail to confer benefit on the policyholders of the insurer and are not in the public interest, unquote. There is no financial instability, potential harm or absence of managerial experience at issue here today. In fact, as Mr. McDonough will

explain, there are clear benefits to policyholders. Armour is an experienced runoff manager and the record demonstrates that Armour will have the right amount of dedicated assets available to manage the business as it continues to runoff.

The proposed closing balance sheets are consistent with the needs of the business. These are all benefits of efficiency and focus for the policyholders of the insurance companies involved in this transaction, including both the policyholders of OBIC and the policyholders of ASIC.

Finally, the sixth factor provides that the Department should consider whether the acquisition of control is likely to be hazardous or prejudicial to the insurance-buying public, generally. There is nothing prejudicial or hazardous about this transaction. Armour is an experienced and well-qualified runoff manager with the deep expertise and focus needed to effectively manage the runoff companies. The liabilities of the runoff companies will be managed with sufficient assets specifically designed for that very purpose.

The Department has gone to tremendous lengths, working with the parties to this transaction, working with its own in-house experts and outside

Counsel, and with two sets of independent experts in its analysis, in order to ensure that the assets of the runoff companies post sale, which include both reserves and surplus, will be adequate to satisfy the liabilities of the runoff companies into the future. In fact, those runoff policyholders --- in fact, those policyholders of the runoff companies who have filed written comments and who are appearing today have framed the issue in the very same manner in which it has been analyzed by the Department.

For example, in its public comment filed with the Department, the Pennsylvania Manufacturers' Association framed this issue as a, quote, interest in assuring that the acquired companies are adequately capitalized, properly reserved and capable of providing timely and professional claims management services for the foreseeable future, end quote. In its public comments, Colgate likewise has identified the exact same issues. The relevant information about the capitalization of the runoff companies is in the record, and that information, which will be summarized by various speakers today, demonstrates that this transaction meets the statutory standards.

In just a few moments, Paul McDonough will present the background that explains how we

arrived here today, and he will review some of the relevant details, including benefits for policyholders of the runoff companies. Paul will also review the closing balance sheets which reflect the very significant assets that will be exclusively dedicated to satisfying the runoff companies' liabilities. Following Mr. McDonough, you will hear from Mr. Christopher Bozman and Ms. Sandra Santomenno of Towers Watson, one of the leading global actuarial consulting firms, who will present their findings with respect to the proposed transaction.

At the Department's suggestion that OneBeacon hire experts to prepare two independent studies relating to the transaction, we retained Towers Watson. They prepared a ground-up study of the liabilities of the runoff companies, and then prepared a stochastic study of the assets and liabilities on the proposed balance sheets of the runoff companies at closing.

Finally, you will hear from representatives of Armour, Steve Davis and Brad Huntington, regarding Armour's substantial qualifications and experience in managing runoff portfolios. Mr. McDonough will be available after the conclusion of the formal presentation and following

public comments to answer any of the Department's questions.

One final comment. We received a letter from Counsel for Colgate Palmolive last Friday evening containing comments on the transaction, and an exhibit with additional comments from someone retained by Counsel for Colgate to review the Tower Watson reports. We also received a letter yesterday, a letter from Counsel for the PMA with a report from Mr. Jonathan Terrell. Lastly, three other comment letters were also received very late in the day yesterday.

As we informed the Department by letter on Monday, it's our full intention to formally address the matters raised in those new submissions --- it's not our intention to address those issues raised in those submissions yesterday, but rather, given the lateness of their delivery and the recognition of this proceeding, that it is time primarily intended to address the public --- to allow the public to address their comments. We will respond in full in writing following the hearing.

Of course, following --- depending upon the content of the public comments by the participants herein today, we may conclude that it would be appropriate and helpful to provide a few additional

comments later in the proceeding for purposes of clarification or correction of the record. We trust the Department will indulge us in that event. I will now turn this over to Paul.

MR. MCDONOUGH:

Thank you, Maureen. I echo my colleague's thanks to the Department for the work around the transaction and for the opportunity to speak here today. I will focus my comments primarily on, number one, our motivation in selling our runoff business, and number two, the benefits of the proposed transaction to the policyholders of the transferring companies. In the process, I'll also provide some perspective on the financial terms of the transaction, including the proposed closing balance sheets pro forms as of June 30, 2014.

OneBeacon began a restructuring process in 2009, which we believed would be in the best interest of all of our policyholders and also the future of the company. The transaction that is the subject of this hearing is one step in that process. Our primary motivation in selling our runoff business has been to allow the OneBeacon management team to focus exclusively on managing our ongoing specialty operation and to transfer the management of the runoff

operations to runoff specialists who focus exclusively on managing runoff business.

After reviewing a number of options, we determined that a transaction with Armour was the best alternative because, number one, it is economically neutral to OneBeacon. That is, the cost of the sale is comparable to the cost of continuing to administer the runoff business internally. And secondly, it meets OneBeacon's goal of freeing up the OneBeacon management team to focus exclusively on the ongoing business while transferring the runoff business to a runoff specialist focused exclusively on managing runoff business, which again was our primary motivation and objective in exploring the sale. An additional and important benefit to the transaction is that the sale to Armour would put the ongoing and runoff liabilities under separate ownership with separate assets designated to support each separate set of liabilities.

Our runoff business consists of legacy liabilities predating the White Mountain's acquisition of CGU back in 2001 and more recent liabilities relating to our standard commercial operation that was sold on a renewal rights basis in 2009. In the wake of the 2009 sale, we began to organize our claims

operation into two separate groups, one that manages our ongoing claims and one that manages our runoff claims. In addition, and after a series of discussions with the Department, we began the process of rationalizing our legal entity structure.

During that process, we began to think about the benefits of creating two separate groups of legal entities, one to support our ongoing business and one to support our runoff business. This led to the restructuring that we initiated in the fourth quarter of 2012. The main elements of the restructuring include, first, terminating the former OneBeacon pooling arrangement wherein the ongoing and runoff liabilities surplus and assets were comingled in a single group of companies; second, establishing a new set of intra-company reinsurance arrangements that cede all of the ongoing specialty business to Atlantic Specialty Insurance Company as the lead company in support of the ongoing business, and cede all of the runoff business to OneBeacon Insurance Company as the lead company in support of the runoff business.

Third, moving capital between and among the companies through a series of capital contributions and dividends in a way that is consistent with the runoff and specialty liabilities

being ceded via the new intra-company reinsurance agreements. Fourth, merging certain companies into other companies to simplify the number of legal entities and states of domicile. And lastly, creating new companies where necessary to support the ongoing specialty operations, all of which, of course, was subject to and received regulatory approval.

The first page of the handouts that you have, the packet that you have, under the tab labeled Paul McDonough, summarizes the legal entity organization structure as of June 30, 2014, after much of the restructuring had already been completed. Note that although we have ceded all of the ongoing business to Atlantic Specialty Insurance Company and all of the runoff business to OneBeacon Insurance Company, and as I just mentioned, have adjusted capital accordingly, since the two companies are under common ownership and Atlantic Specialty Insurance Company is a subsidiary of OneBeacon Insurance Company, they still operate effectively as a single group.

The second page in this section of the handout represents the effect of the final step of the restructuring, which is to dividend Atlantic Specialty Insurance Company from OneBeacon Insurance Company to

its parent, OneBeacon, LLC, which would complete the separation of the ongoing and runoff groups of companies and would position the runoff companies to be transferred to Armour in the proposed sale. The next page in the handout, the final page in my section, summarizes the balance sheet of OneBeacon Insurance Company on a consolidated basis, including its subsidiary, Atlantic Specialty Insurance Company, and combined with Potomac Insurance Company as of June 30, 2014, in the left-hand column, and pro forma for the final step of the restructuring and the proposed sale in the right-hand column.

Note that before the final step of the restructuring and the proposed sale, OneBeacon Insurance Company on a consolidated basis and combined with Potomac has more assets and more surplus than post sale. But before the final step of the restructuring and the proposed sale, it also has more liabilities, not just the runoff liabilities, but also liabilities of the ongoing specialty business, including the lost reserves and unearned premium reserves of the specialty business, with exposure to natural catastrophe and terrorism related losses. Pre-final restructuring step and proposed sale, the consolidated OneBeacon Insurance Company also remains

exposed to certain emerging risks that may relate to our ongoing book of business, but would likely not relate to our runoff book of business. For example, risks relating to new theories of cyber liability or nano technology or climate change or hydrofracking, et cetera.

The primary question post sale is with the runoff liabilities now separate and distinct, and importantly, under separate ownership from the liabilities of OneBeacon's ongoing specialty business, are the assets in OneBeacon Insurance Company at the closing of the sale sufficient to fund the projected claim payments of OneBeacon Insurance Company on a consolidated basis to the ultimate resolution of those claims? This is the central question posed to us by the Pennsylvania Insurance Department in the context of their review of the proposed transaction.

To answer this question, we engaged Towers Watson to perform a stochastic analysis of how the business can be expected to perform with our proposed closing balance sheet as the starting point. You'll hear from Towers Watson directly later in this hearing, but the conclusion of the stochastic modeling is that the proposed closing balance sheet has a very high probability of funding all of the potential

future claims across a wide distribution of potential outcomes, including extreme scenarios in the tail of the distribution of potential outcomes. It's worth noting that no insurance company, whether ongoing or runoff, no matter how well capitalized, has a 100 percent probability of funding all of its potential future claims. The tail risk associated with loss reserves and other enterprise risks is simply too great. The confidence level for the runoff companies in this proposed transaction we believe is more than sufficient to meet the appropriate applicable regulatory standards.

In the context of the results of the Towers Watson stochastic modeling of the proposed closing balance sheet, we believe it is reasonable to conclude that policyholders of OneBeacon Insurance Company are better off after the proposed sale than before it, due to the following primary benefits of the transaction: first, the management of OneBeacon Insurance Company post close would be focused exclusively on managing the runoff operation, which we believe will result in better outcomes on average for all policyholders. And second, the runoff liabilities post close of the sale would be under separate ownership from the ongoing liabilities with assets

designated exclusively for the satisfaction of the runoff liabilities with no exposure to the ongoing liabilities and risks of the ongoing company.

That concludes my prepared remarks. Thank you again for the opportunity to speak. I believe Mr. Bozman and Ms. Santomenno from Towers Watson will now review with you the process and conclusions of their loss and loss adjustment calculations, as well as the results of their stochastic modeling in relation to the proposed closing balance sheet.

MR. BOZMAN:

Thank you. Good morning. I am Chris Bozman and I am a Director of Consulting Services for the risk consulting and software business of Towers Watson. I am a fellow of the Casualty Actuarial Society and a member of the American Academy of Actuaries, and I meet the Academy's qualification standards to perform the services pertinent to this testimony.

I have been working in the actuarial field for nearly 25 years. I am joined today by my colleague, Sandy Santomenno. Sandy is a Senior Consultant at Towers Watson. I am currently the head of the Property and Casualty Consulting Practice for

the Philadelphia office of Towers Watson, and I serve as co-leader for our Loss Reserving Product Group for the Americas. My main practice areas are loss reserving, economic capital modeling and mergers and acquisitions works as part of the risk consulting and software, or RCS business, of Towers Watson. Sandy and I oversaw the work on the engagements that we will discuss this morning.

Now, I would like to give you some more background on Towers Watson. Towers Watson is a leading global professional services company with more than 14,000 associates around the world. The RCS business, in addition to its consulting role, brings leading software products to the market, including the Igloo financial modeling software and ResQ reserving software, both of which were used for this assignment.

The RCS business is part of the risk and financial services line of business, which also includes our investment consulting business. In addition, Towers Watson maintains a robust professional excellence policy. Before undertaking any work, we must be confident that we have the necessary qualifications and resources to do the work and that there are no real or perceived conflicts of interest.

Relevant to these assignments, we have industry leading expertise in asbestos and environmental reserving. In fact, Towers Watson Consultants first developed ground-up exposure-based methodologies in the 1990s. We have significant expertise in Workers' Compensation reserving. Since 2012, our firm has reviewed over $50 billion in industry Workers' Compensation reserves. Our Igloo financial modeling software is perfectly suited for stochastic financial modeling. And on the consulting side, we advise a large number of companies on economic capital modeling, and in particular, reserve variability.

All the work on these projects was subject to independent peer review by qualified colleagues not otherwise involved in the work, and our project team had access to all the firm's intellectual capital and expertise on a global basis. Towers Watson's fees for this project were based on hourly time charges and were in no way contingent upon the results of the work.

Now, I will provide some background on Towers Watson's role in this process. We were originally engaged by OneBeacon at the end of 2012 to perform an independent review and report on

OneBeacon's loss and loss adjustment expense reserves for the business subject to the proposed sale to Armour. We understood that at that time that our work would be reviewed by the Pennsylvania Insurance Department as part of the Form A process. We completed our report in September of 2013 and a summary report has been made public in the Form A materials.

Then in December of 2013, OneBeacon engaged Towers Watson to perform stochastic modeling of the runoff companies for the purpose of providing estimates of the probability that the assets on the proposed balance sheet as of June 30th, 2014, would be sufficient to fund all of the obligations of the runoff companies. In response --- and this was done in response to a request from the Pennsylvania Insurance Department. This report was completed in June of 2014 and a summary report is also available in the Form A materials.

To provide you with an overview of what we will review today, I will first provide some discussion on the high level approach and conclusions from both our reserve analysis and our stochastic modeling, then move on to a more detailed discussion of the approach and methodologies we used for lines

other than asbestos, pollution and other mass torts, the non-NICO lines. My colleague, Sandy Santomenno, will follow and provide a similar discussion for the NICO lines, which are the asbestos, pollution and other mass torts. After Ms. Santomenno's remarks, I will review the general approach we used for the stochastic modeling and conclude our presentation.

In the reserve report, Towers Watson derived independent estimates of actuarial central estimates and a range of reasonable estimates of reserves on a net of reinsurance basis. We analyzed the NICO and the non-NICO lines separately. The actuarial central estimate is intended to represent the expected loss and loss adjustment expense values over a range of reasonably foreseeable outcomes. The ranges in our reserve report were intended to represent ranges of reasonable estimates of the actuarial central estimate and were not intended to encompass all possible outcomes.

Our review encompassed all loss and loss adjustment expense reserves, including unallocated loss adjustment expenses and a separate provision for uncollectable reinsurance. Our analysis was performed both gross and net of two large reinsurance streams, the general reinsurance adverse development cover,

applying to the runoff of accident year 2000 and prior claims for the non-NICO lines, and the NICO cover, applying to future asbestos, pollution and other mass tort losses subject to an aggregate limit.

The focus of our review was to provide an independent estimate of the unpaid loss and loss adjustment expenses, not to provide commentary on OneBeacon's held reserves. So we did not directly compare our conclusions with the corresponding amounts held by OneBeacon in select reserves. 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 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.

In our reserve report, we updated our NICO and non-NICO projections using data through March 31st, 2013. In conducting this roll forward, we reviewed actual versus expected paid and reported loss and LAE activity for the period between the evaluation date of the review and March 31st, 2013.

I am now going to discuss our key

conclusions from the reserve report, which are summarized on the slides on the handout with the title Christopher Bozman. So if you go to slide one after the title page, this shows our actuarial central estimate and range of reasonable estimates on an undiscounted basis for the non-NICO lines, net of all reinsurance except for the General Reinsurance adverse development cover at various evaluation dates.

First, we show our estimates as of September 30th of 2012, which was the evaluation date of the data that we used for our full independent study of the non-NICO lines. As shown on the slide, our actuarial central estimate of unpaid loss in LAE --- or ALAE as of September 2012 for the non-NICO lines was $861 million gross of the general reinsurance adverse development cover on an undiscounted basis for the projected range of reasonable estimates of $786 million to $996 million. In our reserve report, we then conducted a roll forward of the results to March 31st, 2013. The resulting range of estimates is also shown on the slide.

In our stochastic report, we then reviewed the data as of September 30th, 2013 and conducted a similar roll forward from March 31st, 2013

to September 30th, 2013. And the results are shown on the slide as well. Finally, we derived an estimate of the unpaid amounts as of June 30th, 2014 by subtracting the estimates paids from September 2013 to June 30th, 2014. These resulting estimates at June 2014, which are shown here, are then directly used in our stochastic model.

Now I will turn to the NICO lines, if we refer to the next slide. This slide shows our actuarial central estimate and range of reasonable estimate on an undiscounted basis for the NICO lines, net of all reinsurance except for the NICO treaty and at various evaluation dates. On NICO lines we reviewed all the reserves independently using data as of December 31st, 2012. For asbestos and pollution, we used Towers Watson's proprietary ground-up exposure based models, which Sandy will describe in more detail shortly.

As shown on the slide, our actuarial central estimate of net unpaid loss and LAE for the NICO lines on an undiscounted basis and before the application of the NICO treaty was $1 billion and $5 million, with a range of reasonable estimates from $885 million to $1,214,000,000. For reference, the remaining NICO treaty limit applicable loss and LAE

payments after December 31st, 2012 was $984 million. Similar to the non-NICO lines, we then conducted the roll forward of the estimates for the NICO lines. The estimated unpaid as of June 2014 shown on this slide was then also used in the stochastic modeling.

Now, let's move on to the stochastic report. As just described, the roll forward of the estimates from the reserve report warrants a basis for the parameterization performed in the stochastic modeling. The focus of the stochastic analysis was the construction of a probabilistic distribution of potential future outcomes for the runoff business subject to this transaction through the use of a stochastic modeling. This distribution was then used to estimate the percentage of future scenarios in which the assets on the open balance sheet would be sufficient to fund the obligations in the runoff companies in the future, including claim payments and all associated expenses.

Please turn to the third slide, which reflects the results from running 10,000 simulations from our stochastic model. As you can see from the slide, the company is projected to meet all of its obligations through the first 30 years in about 90 percent of the time. Through 70 years, when we expect

all claims to have been paid, the company is projected to meet all of its obligations in over 88 percent of the cases.

As I mentioned, I will now provide a more detailed discussion of our approach and methodologies for both the reserve report and the stochastic modeling of the non-NICO lines. We used several actuarial sound approaches in preparing the two reports. In our reserve report, Towers Watson developed estimates of the non-NICO lines based primarily on traditional generally accepted actuarial methods, most notably the incurred loss development method and the paid loss development method. For personal injury protection, or PIP, individual modeling was performed at the claim level, incorporating estimates of medical inflation and mortality.

For Workers' Compensation, which was the largest and longest tailed line in the non-NICO segment, a great deal of effort went into projecting tail development factors. And much of the uncertainty in the range of estimates was due to the uncertainty in the tail factors. Our final ranges in the reserve report reflect diversification between the lines based on expected correlations between the lines of

business.

Now I would like to turn this over to my colleague, Sandy Santomenno. Sandy will provide further detail with respect to our reports as they relate to the NICO lines.

MS. SANTOMENNO:

Good morning. I just want to provide a little background on myself. I'm the Senior Consultant at Towers Watson. I'm part of the Towers Watson asbestos and environmental, or A&E, Team and I provide A&E expertise to manufacturers or policyholders, insurance and reinsurance companies. I have more than 34 years working in an actuarial capacity. I'm an Associate of the Casualty Actuarial Society and a member of the American Academy of Actuaries, and I meet the Academy's qualification standards to perform the services pertinent to this testimony.

I have spent the past 26 years providing actuarial and risk evaluation services on discontinued businesses and A&E exposures. My role in this assignment was project manager for both the reserving and stochastic modeling projects. I was also the A&E project lead.

As Chris mentioned, I will discuss our

modeling approaches, specifically with respect to the NICO lines. We relied upon two basic approaches to evaluating asbestos and pollution liabilities, a ground-up exposure analysis and aggregate methods. A ground-up exposure analysis is based on an insurer's own evaluation of policyholder costs based on policies written for defendants. 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, AMBest, a leading rating agency, has stated that it will give significantly greater weight to a company's ground-up study results than it does to the results of the agency's own study, which typically employs aggregate methods. Aggregate methods rely upon aggregate benchmarks determined by the industry data and experience, and should be used with caution since it is possible that an individual's --- individual company's own claim experience may deviate perhaps significantly from that of the industry.

Within the context of this analysis, we did not use the aggregate approach for asbestos because the exposure-based method is clearly superior

to the aggregate approach. For the pollution analysis, we placed most of our reliance on the ground-up model and only minimal reliance on the results of the aggregate methods.

Now moving into the asbestos analysis. For our asbestos exposure analysis, Towers Watson has used the ground-up method for nearly two decades with updates and improvements as litigation and legislation of environments have changed. The ground-up exposure analysis was pioneered by TW and involves identifying and studying a large proportion of individual policyholder open accounts and determining each account's ground-up asbestos liabilities using a frequency and severity approach.

Claim frequency is the number of claims alleging asbestos exposure expected to be filed against the policyholder. We forecast claim frequency using Towers Watson's Industry benchmark claim filing patterns. Towers Watson's --- their filing pattern --- benchmark filing patterns are based on epidemiological assumptions and observed industry claim data and are regularly calibrated for the following emerging issues, such as increased mortality assumptions as people are living longer, non-occupation or take-home exposure claims, increased

filings due to the role of social media and recruitment and better diagnosis of asbestos-related disease. Once we determine the future number of claims expected to be filed against the policyholder, we determine how many of these claims will be paid and how many will be dismissed without payment, which is called the payment rate.

Next we move on to severity. Claim severity or the average claim costs are then determined by looking at the policyholder's historical indemnity losses divided by the number of claims they have closed with payment. The average claim cost is then trended for future inflation using the following inflation assumptions: we use a long-term medical claims inflation rate of three percent. We reduce this by one percent to reflect the aging of claimants over time. We note that the actual claim severities over the past eight years have exhibited flat to negative severity trends by disease.

Once we forecast the number of future claims, the frequency and their future trended average cost, severity, the product of the two is the forecast of future indemnity losses for each policyholder from the ground up. The next step is to determine OneBeacon's share of the future loss estimate. We

worked with OneBeacon and NICO claims to determine OneBeacon's gross losses by applying the terms and conditions of OneBeacon's policies to estimate OneBeacon's gross share of the policyholder ground-up loss. And we also incorporate the impact of special claims settlements or coverage issues that may be in effect. Next we apply OneBeacon's own reinsurance protections, facultative and treaty reinsurance, by account to estimate OneBeacon's net losses.

Now so far I've talked about estimated losses on known policyholder accounts. Next we estimate incurred but not reported, or IBNR, losses, which fall into two categories. The first category is an IBNR provision for claim development on known policyholder accounts, which contemplates potential upwards development of count estimates based on the emergence of additional information. We observe these trends historically. The second category of IBNR is a pure IBNR provision which contemplates the development of newly emerging or previously unknown policyholder accounts with asbestos exposures.

Up until now we've described the process of forecasting indemnity by account. Next we determined what the defense cost estimates will be. For defense costs, we estimate a provision for future

costs by using a ratio of defense costs to indemnity costs. And secondly, we also estimate a provision for future coverage disputes --- the cost of future coverage disputes, generally by using the ratio of costs to indemnity costs.

For our reserve report, to determine a range around our central estimate, we vary most of the parameter selections I've just discussed. However, we do not vary assumptions associated with the asbestos litigation environment, for better or worse, since this would be highly speculative. We note that the asbestos litigation environment has been improving for the past eight to nine years. 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 an implicit provision for unforeseen events such as changes to the litigation environment.

Moving on to our pollution analysis. Towers Watson uses a proprietary ground-up pollution model based on studies pioneered by Towers Watson affiliates and detailed and actuarial research papers published in 1994, but also improved and updated as litigation and legislative environments have changed.

The steps taken are similar to the steps described in the asbestos analysis. For example, frequency, severity, IBNR and reinsurance with the following exceptions: there are additional steps taken to determine site remediation costs, the shares of individual policyholders and the method of allocation of losses to policy years. There is also a provision in the forecast for potential future natural resources damages.

Secondly on pollution, we employed two aggregate development approaches, an aggregate loss development approach, which is based on payment and reporting patterns constructed by modeling the process of site discovery, litigation and remediation. Although there can be significant uncertainty with regard to remediation costs and the cost shares of individual insureds, we know that the Towers Watson pollution payment pattern simulations have produced consistent results for many years. Lastly, we employed a market share approach, which was used as a reasonableness check on the other methods, but we view this as the least reliable approach of the approaches used.

For OneBeacon's other mass tort claims subject to the NICO treaty, we used a survival

approach. The survival approach measures how many years OneBeacon's reserves will last, assuming an average annual payment rate. We selected four, six and eight years for our low, central and high estimates of OneBeacon's mass tort --- other mass tort reserves. We selected OneBeacon's annual payment rate, using data for historical mass tort claim payments. That includes payments for mass torts that are not expected to continue or generate future losses, as well as mass torts that are. By doing this, we have implicitly reflected a provision for future claims arising for potentially new or unforeseen mass torts.

With that, I will turn this back over to Chris for his final remarks about the stochastic study and conclusions.

MR. BOZMAN:

Thank you, Sandy. I would like to supplement those comments with a brief summary of our general report to the stochastic modeling for both the NICO and the non-NICO lines. We used Towers Watson's Igloo software. We simulated 10,000 potential future outcomes over a 70-year period, at which time it is expected all claims will have been paid. The terms of the General Reinsurance adverse development cover in

the NICO treaty were applied to each of the 10,000 simulated scenarios explicitly.

Volatility in asset returns was reflected as well as volatility in loss payments, both in the amounts of payments and the timing of payments. 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.

For each scenario, we used Towers Watson's economic scenario generator, which we call the ESG, which is used as basis to project a simulated time series of interest rates, yield curves, credit spreads, equity returns and price and wage inflation. The volatility in the ESG output is calibrated based on the observed historical volatility for each variable.

A significant part of the work done in this project involves quantifying the uncertainty in the amount and timing of future loss payments. As I discussed earlier, our roll forward estimates to June

30th, 2014 were used as the mean of the future loss and loss expense payments.

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. 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.

For most non-NICO lines, we applied the following steps: we estimated future claims inflation for each line by estimating claims inflation as a function of future price and wage inflation as produced by the ESG. We estimated the remaining uncertainty using a bootstrapping technique, which was applied to the historical data on a constant cost basis.

The bootstrapping technique is a well-known and accepted technique commonly used by actuaries in the insurance industry to estimate and quantify uncertainty in reserve estimates, as well as the timing of future payouts. The inherent assumption in the bootstrapping technique as applied in this analysis is that the future volatility in the payments at the current cost levels will be similar to the historical observed volatility, once volatility due to inflation is removed. For the lines of business in which we applied this technique, we believe this to be a reasonable assumption.

So turning back to the stochastic results on the third slide. Once we have derived the future uncertainty in the loss payment amounts and the uncertainty in the timing at a constant cost level, we used the ESG as a basis for stochastically projecting both future claims inflation and asset returns. We separately projected 10,000 simulations of 70 years of claim payments for the runoff business, and as I previously explained, the results of this modeling exercise demonstrate a high level of success throughout the universe of the 10,000 scenarios that we tested and a success rate of over 90 percent, as shown on the slide for the first 30 years.

So to conclude, Towers Watson has provided OneBeacon and the Department with its full reserve analysis report and stochastic model forecast report, pursuant to which we employed the methodologies outlined here and reached the conclusions shown on these slides. Separate summaries of both reports were prepared and have been posted on the Department's website. We thank you for your time. And next up is Brad Huntington, the CEO of Armour.

MR. JOHNSON:

Okay, thank you. Armour want to come up? This is the actual Applicant. Good morning.

MR. HUNTINGTON:

Good morning. I am Brad Huntington, one of the two founders as well as the Chairman and CEO of the Armour Group. Firstly, I'd like to thank the Insurance Department for scheduling this hearing and for the significant amount of time and effort that has been put in to the application in connection with the proposed transaction.

The purpose of my presentation today as set out on page two of the handout is to focus on the following items: firstly, who is Trebuchet U.S. Holdings, Inc. Secondly, what is Trebuchet's intent with respect to the OneBeacon runoff entities and

their liabilities? Thirdly, who is Armour Group? Fourthly, what is the expertise and experience of Armour and Trebuchet? And finally, why we believe the sale to Trebuchet should be approved.

Taking each of those in turn, the first item is who is Trebuchet U.S. Holdings? This is contained on page three of the handout. Trebuchet is a recently formed Delaware company, which was established to act as the purchaser in the proposed transaction. Its ultimate parent is Armour Group Holdings Limited, the holding company for what is known in the insurance industry as Armour Group.

Importantly and as already outlined in the detail provided by Mr. McDonough, at closing of the proposed transaction, Trebuchet will have the necessary amount of dedicated capital and assets available to acquire OneBeacon runoff entities and to begin the supervision of control over the entire runoff process. Further, as part of the approval process, considerable time and effort and attention has been addressed by all of the parties on the issue of capital adequacy and whether the proposed closing balance sheets are consistent with the proper management of the OneBeacon runoff entities as they continue runoff.

Importantly, when considering the interest of the underlying policyholders is the fact that the transaction will not affect any of the third-party reinsurance arrangements that already exist in the OneBeacon runoff entities. These third-party reinsurances represent literally hundreds of millions of dollars in protection from some of the world's largest reinsurers, even before taking into account the well-documented and discussed NICO and Gen Recovers. These third-party reinsurances provide significant current and future protections over and above any capital in the entities.

Importantly, while these protections may not be that apparent to policyholders, they provide very material protections which benefit policyholders. Further, the credit quality of these reinsurance obligations lies with some of the highest rated balance sheets in the insurance industry globally. The nature, detail and impact of these reinsurance protections has been previously disclosed to the Department in numerous previous filings.

The next item taken in turn, what is Trebuchet's intent or plan for the OneBeacon runoff entities. First and foremost, I'd like to point out that absent the change of shareholding, one of the key

components of the proposed transaction is continuity in the servicing of the claims and the operations of the entities. As described on page four of the handout, there is already in place a dedicated team of professionals servicing the OneBeacon runoff, and the proposed transaction will ensure that this same group of professionals be transferred to a Trebuchet affiliate and that they will continue to have responsibility for the day-to-day management of the net claims portfolio post-closing, subject always to the supervision and oversight of the seasoned runoff professionals in Trebuchet and its affiliates.

It is expected that the integration of this team will utilize an existing U.S.-based Trebuchet affiliate, which already has existing offices and staff in Pennsylvania, thus ensuring as smooth a transition as possible. Integration of the runoff into existing operations gives rise to large potential cost efficiencies which will ultimately significantly benefit policyholders of the runoff. Every dollar of expense savings will equate to a dollar available as capital to support policyholder liabilities. A significant amount of time and effort on the part of both OneBeacon and Armour has already gone into the transition in related issues so as to

ensure as smooth a transition as possible should the transaction be completed.

The experience of the professionals at Trebuchet and its affiliates also brings added measures of focus and direction, while maintaining the continuity as discussed. It is clear from any historical review of runoff portfolios that a focused approach on runoff claims ensures better outcomes of the liabilities, thus preserving capital and benefiting all the policyholders. Continuity will also apply to the pre-existing claims servicing arrangements which will be made to Berkshire Hathaway affiliates, which are unrelated to either OneBeacon or to Armour, and which arrangements will remain in place together with oversight by Trebuchet's expertise and people. This will provide overall strength, continuity and focus, which is important to certain claims issues in the runoff of the OneBeacon entities.

Turning to page five of the handout, who is Armour Group. Armour Group's a Bermuda headquartered group of companies focused on niche opportunities in the insurance and reinsurance markets, including runoff opportunities. For those of you unfamiliar with Bermuda as a jurisdiction, it is usually seen by most commentators as representing one

of the largest and most respected reinsurance marketplaces in the world. Armour Group is 100 percent privately held by its management. And its operations include the ownership and/or operational control of licensed insurance and reinsurance companies in multiple jurisdictions globally, including an existing Pennsylvania licensed entity.

Armour Group's management is fairly broad-based and in the aggregate represents hundreds of years of industry experience. This experience includes the completion of acquisitions, including --- or totaling billions of dollars of assets and liabilities, and Armour Group and its inaffiliates --- and its affiliates currently manage in excess of 1.3 billion U.S. dollars in insurance liabilities with this figure increasing to beyond $2 billion if you take into account pending transactions, without including the current transaction we're here talking about today.

Slide six of the handout contains brief bios of some of the senior management team of Armour Group. And you'll see from the descriptions that Armour's management brings a wealth of experience to the table, and that they have all been operating in highly regulated insurance and reinsurance

marketplaces for very long periods of time. Importantly, this experience includes the business lines which form the basis of the OneBeacon runoff portfolios.

In addition to the wealth of people resources available within Armour, it should also be noted that although privately held, Armour Group also has extensive industry and capital market contacts which enable it to source significant additional capital when required as part of its business. Armour Group currently provides exclusive third-party advisory services to dedicated capital entities currently in excess of $150 million and growing.

Lastly and perhaps most importantly, is that Armour is justifiably proud of its reputation in the insurance industry and its reputation with regulators in the industry. Armour and its team has had previous dealings related to runoff within the State of Pennsylvania and filed detailed strategic and financial information on its operations within the Pennsylvania Insurance Department. It has done all of this over a multi-year period of time. Unlike the sometimes poorly informed commentators with little if any experience with Trebuchet and Armour and almost no knowledge of either Trebuchet or Armour, the

Pennsylvania Insurance Department is in a good, if not the best, position to make judgments concerning the expertise, integrity, financial standing and character of the Armour Group.

Turning to the final page, why approve the sale of Trebuchet. To make a final brief bullet points concerning the request for approval by the Department, firstly, Trebuchet and its affiliates have demonstrable expertise in completing acquisitions of runoff portfolios. Second, Trebuchet and its affiliates have demonstrable expertise in the efficient servicing of runoff portfolios and administrated such portfolios in conformance with all regulatory requirements, resulting in tangible policyholder benefits.

Thirdly, Trebuchet and its affiliates have existing Pennsylvania operations which will add to the smooth transition of people in systems, and importantly, ensure the capture of significant potential cost efficiencies, while continuing existing service levels, again all to the benefit of policyholders. Fourthly, as has previously been discussed by the OneBeacon presentations and the more detailed presentation review by Towers Watson, we believe that Trebuchet will have the necessary amount

of assets and dedicated capital at closing available to acquire the OneBeacon runoff entities, and the proposed balance sheets are consistent with the proper management of the OneBeacon runoff entities as they continue to run off.

And finally, unlike the most poorly informed commentators with little if any experience with Trebuchet and Armour, we believe that the Pennsylvania Insurance Department is well-equipped with the experience and information and previous interaction with Armour and its people to make necessary judgments concerning the expertise, integrity, financial standing and character of Armour and Trebuchet, its people and subsidiaries. Thank you for your time.

MR. JOHNSON:

Thank you. At this time we'll switch seats again and bring up the Department's consultants, Risk & Regulatory Consultants, LLC, to give us a summary of the services and --- they provided the Department, and their conclusions.

MR. MOORE:

Good morning. My name is Craig Moore and I'm a partner in the firm of Risk & Regulatory Consulting, LLC, or RRC. I'm the partner in charge of

this engagement and am ultimately for the delivery of the final results of our review to the Pennsylvania Insurance Department.

RRC is a national professional services firm dedicated to providing regulatory consulting services to state insurance departments, including actuarial services, as well as services related to financial examinations, market conduct examinations, insolvencies and receiverships, investment analysis and reinsurance expertise. RRC's actuarial team includes qualified property and casualty actuaries, with significant expertise in reserve analysis of asbestos and environmental, or A&E for short, Workers' Compensation and other property casualty lines of business. I will be speaking today about the overall scope of our engagement with the Department, as well as the general nature of our conclusions. In a few moments I will turn over our presentation to Michael Dubin, senior consulting actuary with RRC, who will describe in a little more detail the approach taken in our review of the Towers Watson reports.

Our comments today are taken from our summary reports, both dated June 20th, 2014, which contain more detail than we plan to present today and have been made part of the public record. The two

reports referenced are titled as follows: first, Report on Review of OneBeacon Insurance Group, LLC, Analysis of Unpaid Loss and LAE as of September 30th, 2012, December 31st, 2012 and March 31st, 2013, as prepared by Towers Watson. And second, Report on Actuarial Review of OneBeacon Insurance Group, LLC, Stochastic Modeling of Runoff Business Pro Forma Balance Sheet, as also prepared by Towers Watson.

First, I would like to cover the scope of our engagement. RRC was engaged by the Pennsylvania Insurance Department to provide actuarial support in the review of Armour's Form A Filing and related materials regarding the acquisition of control of what is referred to as the runoff companies. As has been covered in previous presentations today, the runoff companies include OneBeacon Insurance Company, Potomac Insurance Company, OneBeacon America Insurance Company and the Employers' Fire Insurance Company, all of which are Pennsylvania domestic insurers.

RRC's primary function was to advise the Department as to the reasonableness of the assumptions and analyses in both of the Towers Watson's reports, ultimately assisting the Department in its objective of determining whether or not the runoff companies, at the time of and following the acquisition by Armour,

contains sufficient assets and sufficient liquidity to pay out on a timely basis all amounts due to policyholders and claimants.

The scope of the overall engagement involved two primary tasks. First was to review and analyze Towers Watson's analysis of unpaid loss and LAE of the runoff companies, which I will refer to as the reserve report, and secondly, analyze Towers Watson's stochastic scenario modeling on projected runoff outcomes under a large number of independent projection scenarios, which I will refer to as the stochastic model report.

We did not perform independent actuarial calculations as a part of our engagement, but were engaged to understand the methodologies employed by Towers and the reasonableness of their conclusions. The two Towers reports are closely related. The stochastic model report uses the actuarial central estimates of the reserve report rolled forward to June 30th of 2014 and expected payment patterns from the reserve report as the basis for modeling expected ultimate payments.

I will now break out our primary conclusions from the work performed into two separate buckets, one for each of the two Towers reports. For

the Towers reserve report, we found that the actuarial central estimates of ultimate losses utilized actuarial methodologies that are generally accepted and appropriately applied. While our actuaries found that the reserves in the reserve report were considered to be a reliable central estimate, they recognized that Towers' high reasonable estimates are not meant to encompass all adverse scenarios which might befall the runoff companies. Actuarial estimates related to A&E generally contain more inherent uncertainty than other property casualty lines. Accordingly, Towers included in its reserve report numerous caveats, with which RRC concurs, concerning the inherent uncertainty of quantifying ultimate A&E losses, which make up a significant portion of the overall reserves of the runoff companies.

As noted in our analysis of the reserve report, Towers' ground-up reserve study was conducted using data as old as September 30th, 2012. These results were rolled forward to March 30th, 2013, for the purposes of the Towers reserve report by adjusting for actual emerged losses through that date. In addition, the losses have also been rolled forward to September 30th of 2013 using actual emerged losses

through that date, and then to June 30th of 2014 as inputs for the stochastic model. This was accomplished by adjusting from losses expected to emerge between September of 2013 and June of 2014.

We reviewed the roll forward process and found it to be appropriately performed. Although we concluded that some risk of undetected adverse development exists in relying on older data, we note that OneBeacon itself performs actuarial reviews of its data each year, and that we determined that the data was adequate for use in the stochastic model process.

For our review of the stochastic model report, we found that Towers' work in its conclusions regarding failure scenarios were based on accepted assumptions and methodologies, met applicable actuarial standards and practices and provided a reasonable basis for the purpose of determining whether the assets would be adequable (phonetic) under --- adequate under most circumstances to fund the obligations of the runoff companies. This included many of the significantly stressed scenarios simulated in the stochastic model report.

It is inherently difficult to predict future A&E loss payments because, as Towers notes in

its reports, events that have not occurred, legal or judicial actions for example, can affect the ultimate cost of these liabilities. It remains a risk that events not explicitly included in the model could result in the exhaustion of the runoff companies' assets before all claims are paid. But this is primarily due to the nature of A&E exposure. Consistent with Towers' use of the term, we define the words fail or failure to mean scenarios in the Towers' stochastic model report in which the modeled assets fall below zero at any point during the runoff.

In its stochastic model report, Towers concluded that the collective runoff companies fail or exhaust their assets in 11.7 percent of the total 10,000 scenarios modeled over a 70-year period. Conversely, this equates to a success rate of 88.3 percent over 70 years. None of the failure scenarios resulted in assets reaching zero in the first ten years, and less than five percent of the total scenarios resulted in failure in the first 20 years. We concluded that the results of the Towers' stochastic model were reasonable.

Now I would like to turn our presentation over to Michael to describe in some detail the process employed during our review, as well

as some additional detail on our conclusions from our review of the two Towers Watson reports.

MR. DUBIN:

Thank you, Craig. Good morning. My name is Michael Dubin. I will discuss the actuarial work that Risk & Regulatory Consulting performed in reviewing actuarial reports prepared by Towers Watson. I am a fellow of the Casualty Actuarial Society, a fellow of the Conference of Consulting Actuaries and a member of the American Academy of Actuaries. On behalf of clients throughout my consulting career, I have reviewed many actuarial reports containing the lines of insurance, actuarial issues and methodologies that are most relevant to this transaction, including Workers' Compensation and asbestos and environmental reserves. This actuarial review was performed by myself and Anne Kelly, who is also a fellow of the Casualty Actuarial Society and a member of the American Academy of Actuaries.

In general, when actuaries independently assess another actuary's work, we review the subject actuarial report and supporting documentation and then discuss it with the actuary who performed the work. Then in the role of reviewing actuary, we assess whether important aspects of the work, methodologies

and assumptions for example, were reasonable and whether professional standards were met. In this case, based on performing those steps, we believe that the actuarial work provided by Towers to support the Form A Filing is reasonable, as it contains reasonable conclusions, assumptions and methodologies, appropriately highlights major risk areas and meets applicable professional standards.

We reviewed the reports in the context of their intended use and focused on results most relevant to the objective of our review. As Craig mentioned earlier, in this case the intended use was to project a range of possible financial results and we focused on the models' projected likelihood of success. We use the word success in our report to describe the scenarios for which assets are projected to be sufficient to pay all valid claims. We did not review every number in the reports. In my presentation today, I will explain the work that RRC performed in reviewing the two actuarial reports produced by Towers, as referenced by Craig.

First is the reserve report. As previously mentioned, there are two major liability components reviewed by Towers in its reserve report. The first is the runoff companies' asbestos and

environmental liabilities, also called A&E reserves. This segment is reinsured under an adverse loss development treaty with National Indemnity Insurance Company, and is referred to as the NICO segment. The second liability segment includes traditional property casualty lines, roughly half of which is Workers' Compensation. This segment is reinsured under a separate adverse loss development treaty and is referred to as the non-NICO segment.

We undertook an in-depth review of Towers' work and reserve report and we found the 1,700-page reserve report to be well-documented and to meet applicable actuarial standards. The approaches taken by Towers in reviewing the NICO and non-NICO segments were quite different, as would be expected, and I'll address --- I'll discuss our review for each separately.

Towers used proprietary exposure-based models to quantify asbestos and environmental losses in the NICO segment. These models utilized individual policyholder and claim information and were supplemented by relevant industry benchmarks. We concluded that the work done by Towers to estimate asbestos and environmental losses was thorough and that the application of the proprietary models was

appropriate. We did not review the underlying algorithms of the proprietary models themselves, as these are not standard actuarial methodologies. We did receive full description of these models and satisfactory answers to our questions about the models.

For the pollution component of A&E, which is smaller than asbestos, the results of the Towers' proprietary model are supplemented for the standard actuarial technique, along with the commonly used metric known as survival ratio. Survival ratio is simply the reserve estimate divided by the current rate of annual claim payments. Towers' appropriately used actuarial judgment in selecting the methods to be used and in incorporating policyholder and claim information and in selecting its actuarial central estimate of NICO losses.

We observe that the recent history of industry-wide upward loss development of A&E reserves has not yet abated, and believe that even with a more refined reserve --- more refined reserve estimation methods, future deterioration is a possibility. Actuarial reserve estimates related to A&E generally contain more inherent uncertainty than other property and casualty reserves. Accordingly, Towers included

in its reserve report numerous caveats, providing examples of the inherent uncertainty which could negatively impact the A&E reserves.

RRC concurs with these examples, which include new claims, new causes of action, new judicial precedents and other unforeseeable actions. Towers noted both in its reserve report and stochastic model reports that, and this is a quote, projection of A&E loss liabilities are subject to potentially large errors of estimation, since the ultimate disposition of claims incurred prior to the financial statement date, whether reported or not, is subject to the outcome of events that have not yet occurred. Towers goes on to say, any estimate of future costs is subject to the inherent limitation on one's ability to predict the aggregate course of future events, unquote.

The reserve roll forward calculation is a key component of the Towers' analysis because its result is an input to the stochastic model. The roll forward was provided in sufficient detail to follow the emergence of actual loss payments subsequent to the data analyzed in the report and compared to expected loss payments. Because over a year has passed without a new ground-up reserve study, we

questioned Towers on why they chose a roll forward approach as opposed to a new ground-up reserve study. Considering the long tail nature of the business of the reserves, the relatively short time frame covered by the roll forward calculations and the subsequent payment detail review by Towers in its roll forward work, we concluded that the resulting ultimate loss estimates were sufficiently reliable to use as inputs for the stochastic model.

We have confidence in the reserve report and the estimate of the runoff companies' ultimate losses, but note that it is possible that these --- that future reserve studies utilizing more recent claims history could result in a different estimate. In order to confirm our understanding of the report, we had multiple conference calls and meetings with Towers, OneBeacon and Armour. We discussed Towers' estimates of tail liability for Workers' Compensation, and believe that Towers appropriately allowed for considerable tail development.

Another key element we discussed in detail with Towers was the incurred but nor reported reserves, or IBNR, for the NICO segment. Towers noted that the IBNR provision is intended to allow for some unforeseeable emergence of future claims. The reserve

report includes extensive documentation of several standard reserving methodologies using aggregate data to project 28 segments of non-NICO losses. Towers supplemented these methods with an analysis of individual claim data and made reasonable actuarial central estimates based on the results of these methods. It should be noted that approximately $70 million of the non-NICO reserves, consisting primarily of involuntary Workers' Compensation pools, were not reviewed by either Towers or RRC.

Throughout our review, we focused on areas and judgments which we deemed to be the most important in driving the results. The Towers report contains a great many calculations, projections, assumptions and judgments, and there is a great deal of interdependence among many of these parameters. While we might not have chosen the same parameters, methods and assumptions in all areas, we found that in the aggregate, the results were reasonable. Inflation and the impact of change in ownership are two examples of areas which we found important in reviewing Towers' work.

First, the inflation assumption --- assumptions used by Towers in both its reserve and stochastic models affect each model's generated asset

returns and loss development for both NICO and non-NICO lines. Towers has provided a reasonable array of inflation assumptions varying from two percent to eight percent, and maintains consistent assumptions for inflation within its assumed interest rates.

Medical inflation in particular is a key component of both A&E and Workers' Compensation estimates. For A&E, a range of medical inflation assumptions is used based on relationships to the consumer price index, or CPI. Uncertainty is especially high for medical inflation, as evidenced by the variation in historical differences between medical inflation and CPI. Since the length of time being projected in the stochastic modeling is very long, 70 years, even a small misestimation of inflation could materially affect the results.

Next, we discussed the impact of the change in ownership. When a company changes its business model and its approach to claims handling, it is probable that reserves would be impacted to some degree. Addressing the impact of ownership on claims handling and reserve calculations is a matter of professional judgment in the actuarial community. Some actuaries conclude that reserves would not be

impacted when a company undergoes changes such as those expected in this case, while others would reflect explicit changes in their reserve calculations. We believe that a change in company ownership has the potential to alter historical payment patterns underlying the loss reserve study. To the extent that this occurs, ultimate losses can be different from those based on historical data.

Next, I discuss our review of Towers' stochastic model report. The stochastic modeling results are intended to help answer the question of how likely it is that assets on the proposed balance sheet will be sufficient to pay all claims and expenses. This question is answered by examining the portion of scenarios for which the companies are able to pay all the claims before assets are exhausted. This is a particularly complicated model given the expected variability and correlations among the inputs, including the future performance of the assets.

There is also an element of uncertainty introduced given the fact that the models are not the only possible models that could be used. This is known as model risk, which should always be considered when models are used. Projecting ultimate losses

without projecting future economic conditions would not be sufficient to determine the likelihood of success, because claims are expected to be paid many years in the future. Moreover, the companies are expected to be reimbursed for NICO losses until the NICO treaty is exhausted, which could be many years from now. As a result, assumptions regarding future economic conditions such as the rate of inflation and interest rates, as well as the timing of future loss payments, particularly for the NICO segment, also play a critical part in estimating the likelihood of success. The model's results also provide useful insight about the causes of potential failures.

Our general approach to reviewing the stochastic model report was similar to our review of the reserve report and included an in-depth analysis of the report, as well as follow-up conversations with Towers, OneBeacon and Armour on the matters we found significant. We did not review the detail of the underlying algorithms of Towers' proprietary stochastic model, as it not a standard actuarial methodology. We did receive a full description and receive satisfactory answers to our related questions.

Similar to our findings regarding the reserve report, we found the stochastic model report

to be well-documented and to meet applicable actuarial standards. We held multiple meetings and conference calls on the stochastic model report in order to obtain further information on the selection of parameters, possible changes to the cash flow following the exhaustion of the NICO treaty, and liquidity assumptions for securities on deposit with state insurance departments.

In the stochastic model report, reserve variability for the non-NICO losses was estimated using a statistical technique called bootstrapping. The technique itself, as well as the parameters and assumptions used, were well-explained by Towers. Based on our review of the professional literature, as well as our own experiences, we recognized that bootstrapping can underestimate the actual variance in reserves. We questioned Towers on this point and were satisfied with their reply that they had addressed most of the issues raised in the professional literature, including inflation adjustments. We asked for and received sufficient details of the inflation --- of the adjustments made to the loss development triangles to remove the inflationary impacts.

In their stochastic model report, Towers Watson concluded that the collective runoff companies

fail or exhaust their assets in 1,172 out of 10,000 scenarios, or 11.7 percent over 70 years. None of the failure scenarios resulted in assets reaching zero in the first ten years, and only 4.1 of the --- percent of the scenarios resulted in failure in the first 20 years. To the extent that there may be more uncertainty or more correlation between the segments than has been modeled, the failure rate may actually be higher than 11.7 percent. According to the model output, 90.1 percent of the scenarios did not fail within the first 30 years.

As noted in our report, success is also tied to earning an adequate return on investments over the period of time necessary to settle all claims. Towers considered different assumptions as to starting assets, all of which are included in its stochastic model report. Towers' final version utilized a smaller percentage of total assets held in the form of equity investments than was initially considered in one of the other versions included in their report.

The final version of the model we reviewed assumed a maximum of 15 percent equities throughout the first 30 years. Some investment in equities, according to OneBeacon, is a key element of the transaction because much of the anticipated loss

payments are not expected for many years, and investment in equities is expected to produce a higher return over the long term than other investments. As a result, the final modeling has a reduced probability of failure due to poor equity performance in the initial modeling, which assumed a higher percentage of investments in equities.

During the course of Towers' preparing its stochastic model report, OneBeacon added an additional $6.7 million in starting assets funded through an additional surplus note. We note that the starting balance sheet as currently proposed is more conservative than the initial version because of the additional $6.7 million surplus note and the smaller allocation of assets to equity securities.

As Craig mentioned earlier, we conclude that the actuarial estimates of ultimate losses in the Towers reserve report and its stochastic model report utilize actuarial methodologies that are generally accepted and appropriately applied. In addition, we conclude that Towers' work and its conclusions regarding failure scenarios in its stochastic modeling are based on accepted assumptions and methodologies, meet applicable actuarial standards and practices, and provide a reasonable basis for determining whether the

assets would be adequate under most circumstances to fund the obligations of the runoff companies. Thank you.

MR. JOHNSON:

Thank you. Okay. As we go to the public comment period, I want to make sure I have the complete population on who wants to speak. So let me kind of go down the list. Let me see. So I have Paul Stockman? Okay. You might as well --- you'll be first up, so you might as well come up. Jonathan Terrell? You still want to speak? Brian Scarbrough?

ATTORNEY SCARBROUGH:

Yes.

MR. JOHNSON:

Okay.

OFF RECORD DISCUSSION

MR. JOHNSON:

William --- your handwriting's like mine. Green ---?

ATTORNEY GREANEY:

Yeah, it's Greaney. I actually only have to speak if these gentlemen disappoint. I think ---.

MR. JOHNSON:

Well, that's okay.

ATTORNEY GREANEY:

I don't anticipate ---.

MR. JOHNSON:

Okay.

ATTORNEY DAUBERT:

But you have to be ready. We understand.

MR. JOHNSON:

Okay. Who else is on this page? Gary Fergus?

MR. FERGUS:

Here.

MR. JOHNSON:

Okay. And Dan Healy?

MR. HEALY:

Yes, I'm here.

MR. JOHNSON:

Okay. So let me count that number. So that gives us how many people? Is there anybody else that wants to speak that I didn't do in the roll call?

Okay. And we'll put a place marker with you. Two, three, four, five, six --- so that's six people that want to speak, which is fine. To give you some parameters, then, with six people wanting to speak, is if you could hold your remarks to no more

than a half an hour. That'll give three hours of, you know, public comment. Because we still want to go through questioning, as well as the ability to come back and make some final remarks both from the public, as well as the Applicant and Seller. So does that work? Does anybody have any concerns about the time limit you have on your remarks?

ATTORNEY DAUBERT:

The other --- the other thing is you will be able to make supplementary written remarks, so this is not your entire opportunity.

MR. JOHNSON:

Right. As we said in my opening remarks, if part of your questions --- part of your comments or questions back to the Applicant, we may ask them here today. If not, the Applicant's still going to be responsible for responding to all questions asked by the public in a supplemental filing. So, you know, if there's additional questions that aren't answered today, they will be answered in the supplemental filings to this hearing. And at the conclusion of it all, I'll go --- give you kind of the outline of where we go from here with the filing as part of my closing remarks.

Okay. Mr. Stockman, you'll lead us off.

ATTORNEY STOCKMAN:

Okay. Good morning. Thank you, Mr. Johnson. I am Paul Stockman from the Pittsburgh office of McGuire Woods. I am here today representing Pennsylvania Manufacturers' Association, Associated Industries of Massachusetts, Crosby Valve, LLC, ITT Corporation, PolyOne Corporation, the Proctor & Gamble Company, United Technologies Corporation and the William Powell Company. In addition, while I do not represent proposed Interveners, Belden, Incorporated and 3M Company, they have also authorized me to speak on their behalf today.

I'd like to thank the Department for convening this public hearing and for giving us an opportunity to comment on the proposed transaction and to elaborate on our objections to the transaction as it is presently structured. Before I turn to the substance of those objections, I do want to make one procedural observation --- which as we have previously stated, we do not necessarily view this as a substitute for our full participation as Interveners in the proceeding. That our ability to evaluate this proposed transaction and to comment meaningfully on it has been rather limited. Some of the most significant documents have been withheld from public scrutiny.

We've been unable to review the complete Form A Filing, the full Towers Watson reports or the underlying data that support Towers Watson's analyses.

Importantly, then we cannot use that data to perform our own analyses to test the conclusions that have been offered here today. And I'll note that even RRC has not been able to get behind the proprietary reserve analyses that support this transaction. We believe that the ability to do that is critical for our power to assess the effect of this transaction on our interests and on the interests of other policyholders. And as a result, we continue to believe that the Department should allow us to intervene. As we've made clear, we are more than happy to enter into confidentiality agreements to protect proprietary or confidential information, but we would like to have that opportunity. Also, we believe that the Department should withhold a decision on the application until we have had an opportunity to fully review and analyze all of that underlying data that is not yet available to us.

Turning to the substance of our comments, even the limited information that Applicants have shared to date suggests that this proposed transaction is profoundly against the public interest.

We view this as a transparent effort on the part of OneBeacon Insurance Group to abandon its contractual obligations to its policyholders. It would transfer ownership of the runoff entities from a healthy, profitable, well-capitalized insurer with ongoing underwritings operations and an ongoing earning stream to a thinly capitalized entity that lacks the ability to sustain the runoff as necessary through additional capital infusions if they are required.

Moreover, the nature and structure of the runoff operation incentivizes the runoff managers to obstruct legitimate claims. My clients have encountered that firsthand in their dealings with both OneBeacon and with other insurers, and have every reason to believe that that will continue into the future. Therefore, we urge the Department to deny the transaction as it's now proposed.

Much of the technical detail that underlies that conclusion has been set out in the analysis that was provided by Jonathan Terrell, and also that has been supplemented in a very helpful analysis that FTI prepared for Colgate Palmolive. Mr. Terrell, as you can see, is in the audience today and will be making remarks, and he will be prepared to respond to any questions that the Department may have

either today or in the future. And we would welcome and encourage the Department to pose any such questions to Mr. Terrell.

My overview will be more qualitative in nature, and that overview is this. The proposed transaction creates a teetering edifice built upon overly optimistic assumptions without sufficient supporting assets that will, almost certainly, in our view, lead to insolvency and leave OneBeacon's existing policyholders without the insurance coverage they paid for and on which they justifiably rely.

The first and most important reason this is the case is because the existing loss reserve projections are not sufficient. Because this runoff company will not have any profits from an ongoing insurance business to provide funding for legacy claims, the solvency of this runoff entity going forward will depend entirely on whether there are sufficient assets available in the form of reinsurance recoveries or capital to pay those claims. And the sufficiency of these assets in turn depends on the accuracy of future claims projections. And unfortunately, the information available to us gives us no confidence that OneBeacon's loss projections are sufficient or realistic.

As an initial matter, while OneBeacon has told the Department that it, quote, is confident that it has determined the runoff companies' liabilities through sophisticated and ongoing actuarial reviews, we think it's opportune to point out that its public statements and securities filings, where misstatements have much greater consequences, don't paint nearly so sanguine a picture. In its most recent 10K, OneBeacon noted that, quote, estimating our exposure to A&E claims is subject to a high degree of uncertainty and final ultimate loss and LAE could exceed coverage available under our reinsurance arrangements.

They also note that, quote, significant uncertainties, including but not limited to case law developments, medical and cleanup cost increases and industry settlement practices, limit our ability to accurately estimate ultimate liability, and we may be subject to A&E losses beyond currently estimated amounts. As a result, OneBeacon conceded that it, quote, cannot reasonably estimate at the present time loss reserve additions arising from any such future adverse loss reserve developments, and cannot be sure that allocated loss reserves plus the remaining capacity under the NICO cover and other reinsurance

contracts will be sufficient to cover additional liability arising from any such adverse loss reserve development.

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. No assurance can be given that OneBeacon's actual loss and LAE liabilities will not materially exceed the estimates contained herein. The inherent uncertainty associated with projection of loss and expense liabilities is increased when dealing with toxic torts due to the nature of these losses. The technological, judicial and political climates involving toxic torts such as asbestos and pollution continue to change and traditional actuarial methods are not optimal for projecting toxic tort liabilities.

As a result, the projection of liabilities for asbestos and pollution claims is subject to great uncertainty. 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

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

The data showed that the property casualty industry as a whole and OneBeacon in particular have historically underestimated A&E exposures, often materially so, and are continually playing catch-up in an attempt to correct past mistakes. For example, the cumulative incurred losses for the property casualty industry as a whole at the end of 2012 paid claims plus existing reserves was, according to A Invest, $75 billion. But A Invest projected the ultimate cost at that point to be $85 billion. As a result, at the end of 2012, the property casualty industry as a whole was cumulatively under-reserved by $10 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. OneBeacon's historical reserving process is consistent with this observation. For example, OneBeacon transferred $955 million in existing A&E reserves to NICO in return for $2.5 billion reinsurance. But at this point, only $198 million of that two and a half billion is unexhausted on an incurred basis. This shows that OneBeacon's reserves as of 2001 on some of the same baskets of risks that it seeks to transfer here turned out to be at least $1.347 billion too low.

Moreover, OneBeacon increased in its A&E reserves by 45 percent from 2005 to 2011. 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. OneBeacon's midpoint --- or Towers Watson's midpoint estimate of A&E liabilities as of the end of 2012 was $1.239 billion.

But at that point, OneBeacon was only carrying $1.162 billion in reserves. And on a net basis, Towers Watson estimated $849 million in A&E liabilities, but OneBeacon's net reserves were only $728 million.

Candidly, Towers Watson's reports for their part do no alleviate our concerns about the reserve projections. 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.

Once that happens, harm to policyholders is essentially complete. At that point, any payment to policyholders gets measured in cents on the dollar and will be delayed by years. All the while, capital is being depleted by the incredible cost of insolvency proceedings. Given that the Department has been involved in reliance insolvency, I don't need to remind the Department how expensive those proceedings are.

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.

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. Further, the modeling assumes certain future loss development trends that we believe are speculative at best and counterfactual in all likelihood.

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.

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.

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 Plan 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.

We appreciate the work that RRC has done, but nor, with due respect to them, does their review soften our view that the economics of this transaction doom OneBeacon and Potomac to insolvency and failure if the transaction goes forward as proposed. RRC concededly could not review many of the key assumptions that Towers Watson used. They could not review the underlying algorithms driving the proprietary models. They did not independently audit or verify the underlying data and were, you know, not tasked for that matter with performing independent analyses. In short, to use an analogy from trial practice, RRC's conclusions that Towers Watson used acceptable methodologies in acceptable fashion, would mean that Towers Watson's expert report gets admitted into evidence in a trial as expert evidence that satisfies the Frye and Daubert standards, but not

necessarily evidence that that report is credible or factual.

And in fact, RRC, I think, helpfully pointed out that the acquired companies remain solvent only if certain of OneBeacon's rosy assumptions hold up. 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.

Here I'll point out that one --- according to OneBeacon's 10K, its average return on investments for the past three years has been 3.0 percent, 4.0 percent and 3.8 percent. RRC correctly concludes that if either of these conditions, length of time assets are held or average investment yield, were to fall short, the present value of future payments would exceed the discounted liability estimates in the Towers report and additional assets could be required to meet liabilities.

Now of course, the reason that my clients are here today is that there's no source for these additional assets. OneBeacon will have walked away years before. That is, after all, the whole

point of this transaction.

RRC also properly notes that the failure to project new contingencies limits the utility of the analysis. Quote, if history is any guide, it would be prudent to expect further adverse development. In short, the transaction is based precariously on inappropriately optimistic and unsubstantiated views of what the projected losses are going to be going forward. And in fact, although we are not privy to OneBeacon's reserves, we can reasonably estimate based on positions that OneBeacon has taken in negotiations and in coverage litigation, that for the proposed Intervener group alone, without considering any other policyholders, the difference between OneBeacon's view of its exposure and our view is measured in the hundreds of millions of dollars.

As one example. Depending on the outcome of only one coverage issue for one policyholder in our group, OneBeacon's losses could increase by $110 million. And of course, the proposed Interveners here are only a small fraction of OneBeacon's 876 open A&E accounts. In short, we're confident that these estimates will ultimately prove to be massively understated and the policyholders and ultimately state guarantee funds will end up bearing

the consequences, just as they did with Reliance and Home.

I also want to note that even if loss reserves were adequate, that still provides little comfort. After all, you know, essentially all of the funds available to pay claims come from reinsurance. And even if we assume that NICO and Gen Re will pay a hundred percent when called upon to do so, there's still other underlying reinsurance that may not do so. According to OneBeacon's 10K, it was 39 percent reinsured for A&E exposures, not taking into account the NICO cover. If any of that underlying reinsurance is uncollectible, it hastens the exhaustion of the NICO and GEN RE reinsurance programs, but neither OneBeacon nor the Towers Watson report appear to fully recognize the risk that reinsurers will be unwilling or unable to make these payments.

You know, for example, in the asbestos liability context, Towers --- Towers Watson used a 7.5 percent provision for uncollectible reinsurance due to reinsurance coverage disputes, a figure that OneBeacon assumed in its ceded model and that Towers Watson assumed and incorporated in its estimates. 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.

I'd like to quote Richard Stewart, who is a former New York insurance commissioner and former NAIC President, and in fact one of the authors of the model Insurance Holding Company Act. He wrote, delayed payments means substantial additional investment income and payment reductions through litigation and compromise can be in the tens, even hundreds of millions of dollars. With such big financial benefits in view, an insurer can afford excellent counsel and a tenacious defense. As one would expect, such claims practices have spread to reinsurers. Substantial reinsurance claims end up in arbitration and litigation, which renders payment uncertain and delays it for years. Yet primary insurers continue to carry disputed reinsurance recoverable as an asset.

Mr. Terrell, for his part, agrees with this conclusion and also, I think helpfully, points out that a runoff operation has an overriding incentive to generate cash flow by commuting reinsurance for less than full value. So when we look

at the existing reserves in the reinsurance and once we conclude those are inadequate, what we're left is what --- to pay claims is what capital is left in the existing organization.

And the existing capital is not sufficient. As we pointed out, OneBeacon has already stripped out more than $700 million in surplus from these companies. You know, of the capital that remains, as Mr. Terrell notes, the pro forma balance sheet improperly includes $34 million in net deferred taxes that can never be efficiently captured or effectively captured. As FTI notes, Potomac Insurance Company's projected surplus is already approaching, if not below the level that will require Department intervention practically from day one after the transaction closes.

And of course, Armour Group is not able to provide the needed funds from its own resources. In the 2011 financial statement that they provided to the Department, they listed total assets of only $9.2 million. Clearly, there's no capital infusion coming from Armour Group if the existing assets of the runoff operation are inadequate. I mean, I think it's telling that the statements from Armour Group today about why the Department should approve the

transaction focus solely on their background and on their claims handling, not on their financial capability to pay insurance claims if reinsurance is exhausted.

Now, perhaps it would be worth assuming these risks if they were necessary to ensure OneBeacon's stability as a going concern. But that's not the case here. OneBeacon's ratings are high, they're steady. There's no indication that their ability to write new business has been impacted. There's nothing to suggest they're having difficulty raising capital or that they are at risk of being placed under regulatory scrutiny. This is purely an attempted exercise at financial engineering.

You know, as an aside, as OneBeacon pointed out this morning, this is supposed to be revenue neutral. But if it's correctly estimated its losses and appropriately reserved for them, it shouldn't have a financial benefit from this transaction. But if so, why do it? I mean, what that makes plain to us is that OneBeacon at some level doesn't believe the representations it's making to the Department, or at least is very worried about whether or not they will turn out to be accurate. Because if they were correct, there would be no financial reason

to do this.

We view the justifications that OneBeacon has put forward to be blatantly contextual. We believe it's telling that OneBeacon has offered no concrete evidence to support the alleged inefficiencies or management challenges or distractions that this runoff portfolio purportedly creates. And that's because we cannot see how there could be such evidence. For more than a decade, most of this portfolio has been managed and controlled by Resolute Management as part of the reinsurance agreement with NICO. It's hard to see under those circumstances how OneBeacon could complain that the runoff portfolio challenges or distracts its management or hinders employee recruitment and retention efforts.

More importantly, this will not benefit policyholders. There already is a focused team managing the runoff, Resolute Management. And as we'll point out in a moment, the runoff entity's focus on running off claims actually works to policyholders' detriment.

We also think the risk from ongoing underwriting activity is nonexistent. The ongoing underwriting activity is largely short tail policies

that do not have the long-term risks of the existing legacy commercial union portfolio. And frankly, on an ongoing basis, the industry is excluding coverage for the most volatile of such risks. So I --- Mr. Terrell had it exactly right when he wrote that OneBeacon's proffered rationales are nothing more than a, quote, cynical and opportunistic set of justifications for restructuring, whose sole purpose is to boost OneBeacon's and White Mountain's share price at policyholder expense.

Now, turning from the finances to the --- and I'm almost --- I'm almost getting to the end, Steve, so you don't need to worry.

MR. JOHNSON:

Just watching the time.

ATTORNEY STOCKMAN:

That segregation of runoff claims in a separate entity with no ongoing business harms policyholders because of the incentives it creates. A runoff company's incentives are far different from the incentives that a company has if they're actively writing new business. Because a runoff company's only source of income is investment earnings, they're incentivized to hold funds longer to make more money. And as a result, they benefit from delaying and

obstructing even the most legitimate claims.

To quote Mr. Stewart again in an observation that rings true to all of us who have spent our careers representing policyholders, quote, that a troubled insurance company will get tougher on claims is not new or surprising. As long as a claim is in dispute, there is cash on hand and a loss reserve to manipulate. What is new is how widespread claim resistance has become by healthy insurers as well as troubled ones. Faced with what look like black holes of asbestos and pollution liability, many companies put up a blanket refusal to pay without a fight. Delayed payment means substantial additional investment income.

Mr. Stewart went on to observe that post-restructuring runoff companies are, quote, worst of all. Such insurers have no concern about customer relations because they do not write business. For the same reason, they have no restraining concerns about reputation. Their managements are sometimes awarded compensation contingent on financial results or even on there being money left when all the claims are run off. Either way, it is compensation contingent on not paying claims. This is true, of course, because a restructured runoff company of this sort that's

proposed to be created here, quote, has to be managed to preserve the limited assets it was given in the split. Otherwise, quote, it will not have the money to pay the contingent compensation. Give a person such strong incentives and he or she will follow them. And in that regard, the existing remedies under the law are not a suitable deterrent.

As you know, many states limit or preclude entirely extra-contractual remedies, and even when they're permitted, they're available only after prolonged and costly litigation. Under those circumstances, it's unreasonable to trust runoff managers to disregard their own self-interest because an inchoate risk that there may be extra-contractual liability or regulatory action down the road.

As a result, history tells us that these restructurings do not succeed and end badly. To assess the likely path that the acquired companies will follow if the Department approves this transaction, one need only to look to the history of the Home Insurance Company. The Home was once one of America's oldest and most venerable insurance companies, but it heavily underwrote umbrella liability coverage for industrial companies in the '60s and '70s, much like Commercial Union did, which

is why we're here today.

As a result, by the early 1990s, the Home was heavily burdened by long tail claims and in June of 1995, Zurich acquired its renewal business, leaving the remaining long tail liabilities in the Home as a runoff vehicle. Despite the objections of policyholders and experts, the New Hampshire Insurance Department approved the transaction. This was based in part upon the opinion from Zurich's and Home's experienced executives and qualified actuaries that the remaining assets would be sufficient to pay policyholder claims for 40 years.

Nonetheless, less than two years thereafter, the New Hampshire Insurance Department placed the Home under regulatory supervision. And by 2003, seven years after the transaction, the Home was in liquidation and policyholders have yet to be paid more than ten years later. And so the question that we would pose to the Department is does the Department wish to preside over a similar debacle?

Accordingly, we ask the Department to disapprove the proposed transaction. You know, as Ms. Phillips noted, the Department has broad authority to disapprove this transaction if the financial condition of the acquiring party might jeopardize the financial