1 stability of the insurer or prejudice the interests of
2 its policyholders, if the plans and proposals are
3 unfair and unreasonable and fail to confer benefit on
4 policyholders, if it would not be in the interests of
5 policyholders and the public to permit the acquisition
6 or if the acquisition is likely to be hazardous or
7 prejudicial to the insurance buying public. We ask
8 the Department to exercise this authority and
9 disapprove the transaction.
10 At a minimum, if the Department is
11 inclined to approve this transaction, we believe
12 substantial additional safeguards are necessary.
13 These could include required additional capital. They
14 could include required additional reinsurance. We'll
15 note that if the existing reinsurance is indeed
16 adequate, the additional reinsurance should be
17 inexpensive.
18 We would propose perhaps a dividend
19 retention plan or other sort of intracompany guarantee
20 requiring OneBeacon --- the OneBeacon Group to keep
21 skin in the game and to keep the runoff companies'
22 surplus at or above an appropriate level. We'll note
23 that this was an important component of the 1996 INA
24 Century Indemnity transaction that the Department
25 approved. You know, by doing that, just as Ace now

1 has an ongoing interest in the continued performance
2 of Century, the OneBeacon Group will have a continued
3 economic interest in the viability of the spun-off
4 entities.
5 And lastly, we believe that the
6 Department would need to exercise close ongoing
7 monitoring of the --- of any runoff company. In this
8 respect we'll point out one thing that the Delaware
9 Insurance Department did in the course of approving
10 the Royal and Sun Alliance spinoff of its U.S.
11 business. There they required the appointment of an
12 independent claims monitor at Arrowood's expense.
13 Finally, we would suggest that the Department adopt
14 one of the procedures set out in the NAIC White Paper
15 and incorporate a provision for obtaining policyholder
16 consent as a precondition for the approval of the
17 transaction.
18 Thank you for the opportunity to
19 comment. We would welcome any questions the
20 Department has either now or later.
21 MR. JOHNSON:
22 I let you go a little over, but I'll ---
23 that's okay.
24 ATTORNEY STOCKMAN:
25 I appreciate the indulgence.

1 MR. JOHNSON:

2 Just so I understand --- and all the
3 speakers --- we understand uncertainty. Been doing
4 this a long time. I was a author of --- one of the
5 authors of the Century Indemnity transaction in 1996,
6 so I understand uncertainty. But certainly, you have
7 to understand too, that's why we had 10,000 scenarios
8 ran, because of uncertainty. And this uncertainty
9 goes across the whole industry, not just runoff
10 companies.

11 I mean, this --- A&E --- some of your
12 comments I will say just generally, you picked on
13 runoff companies. But go to any company. I mean,
14 there was just an article today, A Invest, about
15 Travelers and their litigation in a case. Whether
16 it's an active company or a runoff company, these
17 tactics that you describe are used by many in the
18 industry, whether it's to hold on money or to force
19 commutations. That's not just runoff companies. I
20 just want you to --- in my opinion, at least to be
21 fair, that this doesn't just go to runoff companies.

22 ATTORNEY STOCKMAN:

23 And we would fully agree with that. But
24 I think the problem is when a runoff company --- when
25 you divorce payment of claims from ongoing

1 underwriting activity, it creates two problems.
2 First ---.
3 MR. JOHNSON:
4 Let me ask you a question about that, so
5 why don't you just hold off a second. Now, we do have
6 a bunch of --- a few different petitions to intervene.
7 ATTORNEY DAUBERT:
8 Yes, we do.
9 MR. JOHNSON:
10 So again, we will at some point in the
11 future, be taking some action on these requests for
12 intervention. Just so you know. We have them, we
13 understand them and we will be taking action sometime
14 into the future on those requests. And I will say,
15 too, just to be point out to be fair --- and certainly
16 the Applicant can speak for themselves.
17 Just to point out that the risk based
18 capital will allow those companies in runoff to be in
19 mandatory control level, meaning they can go down to a
20 dollar of capital under the supervision of the
21 Insurance Department and still maintain its runoff
22 status. So though you've talked about capital and
23 gave kind of --- that it's not just assets, it is
24 about assets, because the RBC law allows a company to
25 be in mandatory control level if it's in runoff and

1 under the supervision of the Department, just to be
2 clear what the law allows.
3 Let me --- and certainly we're --- not
4 that --- this doesn't go to you, and you had some good
5 comments here. But to others who speak and subsequent
6 in any correspondence you want to give to us,
7 generally as anybody in their research knows, in these
8 transactions, we do --- not just Pennsylvania, but all
9 regulators usually have a fair number of conditions as
10 part of if they --- if we approve a transaction like
11 this or any transaction that we approve, we certainly
12 have the ability to add conditions. We certainly will
13 take comment on --- give us some --- ones today, but
14 if anybody has, not just today, but subsequent to
15 today, has suggestions about conditions we should
16 consider if we decide to approve the transaction.
17 That's something good to comment to us on, because
18 that is normal course of business. If you've seen our
19 orders in the past, not just Pennsylvania but any of
20 our --- my fellow regulators from around the country.
21 Let me ask you this, though. The status
22 quo. So you're for the status quo. And that's fine,
23 I understand that. But what I want to understand is
24 what is your belief, is how does OneBeacon have to
25 fund future adverse development within the runoff

1 operation? What legal requirement is there when there
2 are separate corporate entities involved? And what is
3 --- why do you believe the status quo could be more
4 beneficial than the transaction itself? And it's just
5 an open question. Knowing that --- there's no really
6 legal requirement for OneBeacon, the holding company
7 to fund any of its corporate entities going forward in
8 the future.
9 ATTORNEY STOCKMAN:
10 No. And obviously, you know, we can
11 elaborate on this in more detail. I think there are
12 two important points to point out in that respect.
13 First, there's reputational risk. You know, those of
14 us who represent policyholders have seen contested
15 claim situations all the time where the --- you know,
16 where a contested claim is resolved because the
17 insurer is concerned about its ongoing reputation in
18 the industry, either with that policyholder and that
19 policyholder's continued patronage, or with respect to
20 the industry as a whole. Obviously some insurers are
21 more easily swayed by that than others, but
22 reputational risk is an important constraining factor
23 when the runoff entity remains within the corporate
24 family.
25 The second is, of course, there are

1 existing legal remedies that penetrate that wall of
2 corporate separation if an ongoing company has
3 deliberately walled off a subsidiary in an
4 undercapitalized state and allowed it to wither on the
5 vine. They're certainly not sure things, but that
6 again provides a disincentive for a company who is
7 keeping a, quote/unquote, bad bank in its corporate
8 family, to leave that bad bank starved for assets.
9 And I'm sure once I get a chance to ---
10 MR. JOHNSON:
11 Yes, and ---.
12 ATTORNEY STOCKMAN:
13 --- get back to the office and ---
14 MR. JOHNSON:
15 Again ---.
16 ATTORNEY STOCKMAN:
17 --- think about it more ---
18 MR. JOHNSON:
19 Right.
20 ATTORNEY STOCKMAN:
21 --- I'll come up with some other things.
22 But those are the --- those are the issues that
23 immediately spring to mind.
24 MR. JOHNSON:
25 I would suggest to other commenters to

1 consider the concept of why the status quo is better
2 or --- than the transaction in your remarks or
3 subsequent, obviously. We're going to continue to
4 take public comment, and I'll get to that in my
5 closing remarks.
6 One of the things you said that I'm a
7 little concerned. Since the Home --- which again, the
8 Home goes back to the mid '90s. We're 20 years from
9 the Home. A lot of things have changed dramatically
10 in many respects, both regulatory and environment.
11 But since then, I don't --- what other runoff company,
12 pure runoff company --- because I'm not sure I'm aware
13 of a pure runoff company that actually has been placed
14 into liquidation up to this point in time subsequent
15 to, you know, the early 2000s.
16 And if you have examples, it's important
17 to point them out. But personally, and I regulate a
18 number of runoff companies, and none of them are going
19 under yet. And certainly within companies like the A
20 situation with Century Indemnity hasn't gone under yet
21 and hasn't had any more additional capital needed from
22 its parent company under the structure that was formed
23 back in 1996.
24 So when you make a statement like that,
25 I would appreciate if you have some backup other than

1 the Home on pure runoffs. Please supplement your
2 comments today, because I haven't seen a lot of these
3 runoff companies yet --- yet. Understanding all this
4 uncertainty. And I understand all this uncertainty.
5 Believe me, I live it as much as you live it. It
6 could happen in the future, but up to today I don't
7 think there's been a lot. But you certainly can
8 supplement there.
9 ATTORNEY STOCKMAN:
10 If you have no other questions, I'll sit
11 down and shut up and let someone else talk. Thank you
12 again for the opportunity to speak.
13 MR. JOHNSON:
14 Yep. Okay. Next up we'll go with,
15 since he mentioned you a couple of times, Jonathan
16 Terrell. Am I pronouncing your last name, or
17 what ---?
18 MR. TERRELL:
19 Terrell's fine. I respond to that.
20 ATTORNEY DAUBERT:
21 But how do you say it?
22 MR. TERRELL:
23 Well, as you might have observed, I've
24 got a slight English accent still after 26 years in
25 America, and parts of my family say it both ways, so I

1 respond to both, Terrell and Terrell (changes
2 pronunciation).
3 MR. JOHNSON:
4 Okay. Thank you.
5 MR. TERRELL:
6 Well, first part looking at my note was
7 my name, so I think I've got that straight. I was
8 retained to give expert advice and opinions on behalf
9 of the same group of companies identified by Mr.
10 Stockman in his remarks. I incorporate --- I
11 reference the report that I filed on Monday into my
12 remarks today. I will attempt to avoid repeating what
13 Mr. Stockman said, though I agree with his comments
14 and endorse them.
15 I would also like to acknowledge the
16 expert analysis of Mr. Kaufman from FTI. He is an
17 actuary, not an accountant. We've got lawyers here,
18 so I'll forget the bad joke but --- so recalling of
19 the issues was similar but different perspectives, but
20 I very much appreciate and endorse his analysis and
21 observations as well.
22 I'll say a couple words about my
23 background. I've been around the issues presented in
24 the proposed transaction my entire working life. I
25 began work in 1984 at the accounting firm Ernst &

1 Young in London. I worked on the audit of Lloyd's
2 syndicates as that market was beginning to come to
3 terms with its own massive under-reserving for
4 asbestos and environmental liabilities. Thirty (30)
5 years later we're struggling with the same subjects,
6 reserve adequacy for asbestos and environmental
7 liabilities. Truly, the more things change, the more
8 they seem to stay the same.
9 In between, I worked for six years as a
10 senior officer of Zurich Financial Services, a
11 subsidiary then of Risk Enterprise Management, formed
12 to manage the runoff of the Home Insurance Company. I
13 personally negotiated most of their largest
14 environmental and asbestos settlements during that
15 time period and was intimately familiar with its
16 runoff strategy. I have therefore had firsthand
17 experience of what may be in store for policyholders
18 if the proposed transaction is approved.
19 Twelve (12) years ago I founded an
20 consulting firm, KCIC, focused on providing
21 reinsurance and risk management consulting services to
22 policyholders. One of our consulting services is
23 providing claims administration and reinsurance
24 spending services to corporate asbestos defendants.
25 We process thousands of asbestos complaints each year

1 and bill insurers under at least 50 different coverage
2 in place agreements each month.
3 I am deeply involved in the realities on
4 the ground of defendant companies dealing with major
5 exposures, and also with their strategies to collect
6 their triggered insurance assets. I am particularly
7 knowledgeable and have expertise in insurance company
8 restructurings, both liability based restructurings
9 such as the proposed transaction, and loss portfolio
10 transfers such as the many retroactive reinsurance
11 deals with Berkshire Hathaway.
12 I have testified before the Delaware
13 Insurance Department concerning the Royal Arrowood
14 transaction described in my report. I gave evidence
15 to the North Carolina Insurance Department concerning
16 a proposed liability based restructuring for Chartis,
17 or AIG. I've given expert testimony concerning the
18 current credit risk associated with Century Indemnity
19 Company, itself the subject of an LBR 15 years ago.
20 I've also been retained as an expert witness in
21 numerous matters concerning Berkshire Hathaway and its
22 involvement in retroactive reinsurance deals of the
23 very type important in the proposed transaction.
24 I'll now give a brief summary of my
25 opinion, and as previewed by Mr. Stockman. The

1 proposed transaction is the most opportunistic and
2 most cynical insurance company restructuring I have
3 ever seen. I am surprised the proposal is still on
4 the table and it has not been summarily rejected long
5 ago.
6 The proposed transaction is manifestly,
7 severely prejudicial to the interests of policyholders
8 due to a combination of several things. One, the
9 substitution of a weak parent for a strong one. Two,
10 inadequate capitalization by upstreaming of capital
11 out of OneBeacon Insurance Company. Three, inadequate
12 reserving for volatile books of business, especially
13 asbestos and environmental. And four, an undue
14 reliance on investment performance that is purely
15 speculative.
16 In addition, the proposed transaction is
17 manifestly prejudicial to the public interest for two
18 reasons. One, it undermines the trust in the
19 insurance bargain, and by the insurance bargain, I
20 mean quite obviously the premium gets paid up front.
21 Sometime later a claim gets paid --- well, a claim is
22 made and may be paid. And the trust in that insurance
23 bargain is a public good. And secondly, it undermines
24 confidence in the regulatory process to protect that
25 insurance bargain.

1 The proposed transaction has not been
2 reviewed in accordance with the best practices of the
3 NAIC guidance on liability based restructurings. In
4 particular, policyholders have not enjoyed acceptable
5 levels of disclosure. And that White Paper recommends
6 that in return for signing adequate confidentiality
7 agreements, that policyholders do have access to
8 confidential information. Secondly, policyholders
9 have not been allowed to fully participate in the
10 regulatory process to date, notwithstanding the
11 welcome opportunity to comment publicly. Finally, in
12 my opinion there is a strong likelihood of adverse
13 consequences to regulators and guarantee funds as
14 eventual insolvency appears inevitable. The Reliance
15 Insurance insolvency gives a foretaste of what to
16 expect.
17 I am now going to make several
18 observations that I analyzed at interminable length in
19 my report about the inability of actuaries to
20 adequately project reserves for business especially
21 environmental and asbestos. The history of reserving
22 for long term liabilities by insurance companies
23 teaches us, indeed, to disbelieve actuarial estimates.
24 At December 31, 2001, which is the end of the year in
25 which the White Mountain's CGM Mutual transaction took

1 place, the A&E reserves, which were summarized from
2 note 33 of the regulatory filings on A Invest, were
3 $22.8 billion net for prospective reinsurance for
4 asbestos and environmental. Industry incurred losses
5 since through December 31, 2012, are $44.4 billion.
6 That's a deterioration of 195 percent. With the
7 benefits of perfect hindsight therefore, which is a
8 wonderful thing to have, the reserves at December 31,
9 2001, should have been $67.2 billion, not $22.8
10 billion.
11 If you go back to 1995, and I have the A
12 Invest reports back through then, the deterioration is
13 even more profound. Actuarial science has got
14 reserving for these classes of claims spectacularly
15 wrong. Actuarial science has been compared to driving
16 a car entirely by looking in the rearview mirror. And
17 several of the remarks we heard today are very much in
18 reliance of looking into the future based on looking
19 entirely in the rear view mirror.
20 OneBeacon Insurance Group also has a
21 chronic history of under-reserving. A good place to
22 look for this is in the difficult to understand, but
23 informative retroactive reinsurance disclosures in
24 Potomac Insurance Company. As we know, Potomac is the
25 counterparty to the two retroactive reinsurance deals

1 with Berkshire Hathaway and itself reinsures other
2 members of the OneBeacon Group. Looking at the 2002
3 statutory regulatory filing of Potomac, we see that
4 the initial reserves transferred under the NICO cover
5 were $955 million. We are informed that as of today,
6 the unexhausted capacity in that copy is $198.3
7 billion. It's a $2.5 million cover, so by simple
8 arithmetic we can conclude that there has been
9 $1,347,000,000 in adverse development since that
10 retroactive reinsurance deal was struck, which is 131
11 percent.
12 A similar analysis is possible for the
13 GLC copy legitimate cover, which is for the
14 non-asbestos and environmental and other mass tort
15 liabilities programming in this conversation. The
16 initial reserves transferred under that cover
17 identified in the 2002 Potomac statutory filing were
18 $170 million. Unexhausted capacity based on the 2013
19 regulatory filing is $8 million. And a $170 million
20 to recover, so again, simple arithmetic tells there's
21 been $392 million in adverse development cover, or 231
22 percent, even worse than on NICO recover.
23 I've reviewed the OneBeacon Insurance
24 Group and OneBeacon Insurance Company financial
25 statements going back through 2001, and for asbestos

1 and environmental, there were significant material
2 increases in reserves in the years 2001, 2005 and
3 2011. On a gross basis, indeed, in 2005, reserves for
4 asbestos and environmental were increased by $811
5 million, which is 59 percent over the year end before.
6 And in 2011, they were increased by $489 million,
7 which is 48 percent above closing reserves at the end
8 of 2010.
9 It's interesting to juxtapose those
10 reserve increases with the actuarial opinions that
11 form part of the regulatory record of the companies.
12 And I pool those and the First Warehouse opinion from
13 2004, the year end before this material increase, and
14 the opinion on the file with the regulatory term at
15 the end of 2010, the year before the 2011 increase,
16 are both clean actuarial opinions. They give no hint
17 whatsoever of the enormous reserve increases that are
18 to come. And indeed, they echo the language that I've
19 heard repeated this morning so many times. They say
20 that the reserves have been calculated in accordance
21 with, I paraphrase, Pennsylvania Insurance. They say
22 that they've been computed according to established
23 actuarial techniques.
24 So I'm not trying to impugn the
25 professionalism in any sense of any of the actuaries

1 involved in this. But the level of assurance of their
2 opinions can't come to --- which are very much along
3 the lines of okay, they did a professional job --- are
4 not very comforting, with all due respect to the
5 concerns of policyholders who want to know not did
6 they do a good job, but did they get it right?
7 There's too much at risk. And there's no reason to
8 expect the future to be any different. A Invest has
9 always had the White Mountain's Insurance Group in the
10 top 10 or 15 insurers ranked by the signs of their
11 environmental and asbestos exposures.
12 Even at the time of the proposed
13 transaction, and according to Towers Watson's work,
14 OneBeacon Insurance Group appeared to be
15 under-reserved. OneBeacon Insurance Group discloses
16 A&E reserves close with respect to the insurance
17 before which ultimately affects the length of cover,
18 and in 2012 of $1.162 billion. The range of Towers
19 Watson as of that date is from a low of $9.949
20 billion, a midpoint of $1.239 billion and a high of
21 $1.59 billion. So the carried reserves were
22 significantly below even the midpoint of the Towers
23 Watson range as of that date.
24 Secondly, on a net basis, net
25 prospective reinsurance, but without giving effect to

1 length of cover, net reserves at 12/31/12 were $0.728
2 billion and the range of the Towers Watson was $0.707
3 on the low end, $0.849 on the midpoint and $1.045 on
4 the high point. So on net basis, they were barely
5 above the low end of the range.
6 I won't torture you by going through the
7 same disclosures on the non-NICO book, but they're
8 even worse. And they're disclosed in the 10K of
9 OneBeacon Insurance Group at the time of March 31.
10 The carried reserves on the non-NICO book were below
11 the low end of the Towers Watson range, and there was
12 an immediate reserve strengthening that brought it
13 above the low end, but nowhere near the midpoint.
14 Again with respect to Towers Watson's
15 actuaries, there are serious concerns and flaws in
16 their report from my perspective. First of all, they
17 say that it's suitable for financial reporting
18 contexts. Financial reporting --- I come at this as
19 an accountant --- looks at financial reporting not in
20 materiality and in particular from a prospect of
21 users, of stockholders taking the financial statements
22 as a whole. The situation at hand, however, is not
23 ongoing, growing from some financial reporting. It is
24 a risk transfer of --- a final transfer, I might add,
25 for policyholders whose counterparty will now be in

1 all but name a completely different economic animal to
2 the one they had. So financial reporting context, to
3 my mind, does not give the kind of assurance that is
4 needed by policyholders who have a material financial
5 asset tied up with a completely different counterparty
6 as a result of this transaction.
7 I will move through these points
8 quickly, but again, explored at interminable length in
9 my report. But I have concerns about the discount
10 rate that they used and the unchallenged use of the
11 equity returns as completed by White Mountain. I also
12 am concerned that in the high scenario, they use high
13 inflation and higher discount rates, because the two
14 things really have nothing to do with each other.
15 Inflation in the mass tort context and the
16 environmental context really has nothing to do with
17 inflation in the general economy.
18 I have concerns that Towers Watson notes
19 that change in organization for the non-NICO case
20 department, which is now moved to a so-called
21 settlement solvency and I view that as a euphemism.
22 And they don't really know whether payoff patterns are
23 going to continue in the future as they have in the
24 past, because that is a material change.
25 In their asbestos estimates, they rely

1 entirely on their proprietary model. They don't use
2 any other benchmarks. And the survival ratio, which
3 is an accepted --- wide-accepted technique is ignored.
4 And A Invest in its industry report uses survival
5 ratios and notes that White Mountain and OneBeacon
6 Insurance Group are very significantly below industry
7 norms. And this should be explained. The A Invest
8 benchmark for asbestos is a survival ratio of 17. And
9 OneBeacon Insurance Group's is well below ten. So
10 there can be outliers, big settlements that can impact
11 that, but I think to ignore it is unacceptable.
12 The next point is about reinsurance, and
13 prospective reinsurance is a very, very important
14 asset that would be transferred in due course if the
15 transaction is approved. And based on the 2013 10K,
16 overall the A&E book is about 39 percent reinsured,
17 asbestos about 38 percent, so you have more or less
18 the same. And Towers Watson informs us that they
19 really did no work at all on this reinsurance asset,
20 the prospective reinsurance. They relied entirely on
21 OneBeacon Insurance Group's own internal ---.
22 BRIEF INTERRUPTION
23 OFF RECORD DISCUSSION
24 MR. TERRELL:
25 And OneBeacon's own work was done in

1 2010. So 2010 work, internal OneBeacon ceded
2 reinsurance relied on entirely by Towers Watson does
3 not satisfy me that that asset is flexible. And I'm
4 not talking about in terms of credit, and no
5 reinsurance is littered with insolvency far worse than
6 on the direct side. I'm talking about the estimates
7 that they make, especially reinsurance.
8 And again, my experience of sitting
9 through weekly large and complex claim committee
10 meetings at Zurich and the Home Insurance Company only
11 would look at reinsurance for every one of the claims
12 for which we're given authority tells me that there's
13 a high degree of judgment that goes into interpreting
14 the various coverage positions that may influence the
15 flexibility of the insurance, not because of credit,
16 but because of the position. And the joke goes, if
17 you think direct insurance is tough to collect, try
18 collecting reinsurance.
19 And the blanket seven and a half percent
20 allowance that they have made, to my mind, is a huge,
21 gaping hole in the reliability of this Towers Watson
22 report, because it's such a major aspect and so
23 subject to coverage disputes. And they'll admit those
24 coverage disputes are under the radar because most
25 reinsurance disputes are settled by confidential

1 arbitrations. You don't see them in the record in the
2 same way as you do on the direct side.
3 On the environmental, they assume that
4 the payoff pattern is going to be based on their
5 industry experience. But they know it already in the
6 roll forward period that they got it wrong, and they
7 have to change it by $10 million because there have
8 been a couple of large environmental settlements, even
9 in this very short roll forward period. And the other
10 particular concern I have is that there is no
11 allowance at all for other new mass torts.
12 And while they have --- I have somewhat
13 sarcastically said they've so much of their work by
14 looking entirely in the rear view mirror. In this
15 case they have ignored history, because what we know
16 is that new mass torts do emerge on a regular basis,
17 all sorts of pharmaceuticals. I've testified in many
18 of these. Agent Orange, Fen Pen, breast implants,
19 tainted blood and various kinds of construction
20 defects, vibrations, hearing loss. I mean, there's
21 all sorts.
22 There are masses of mass torts that have
23 emerged over the time periods. And to make zero
24 allowance for that, to my mind, is just unacceptable.
25 In their central estimate, and that's March 31, 2013,

1 they had $153 million for this --- for other mass
2 torts, that's known other mass torts, not unknown
3 ones. And even doubling that would put this new
4 entity out of capital, just on that one assumption
5 alone.
6 Moving on to the really fun part now,
7 the Towers Watson stochastic model. Everybody loves
8 an actuary, don't they? And every problem with the
9 first Towers Watson report on the loss reserves
10 impacts the stochastic model as well. I'm very
11 concerned that RRC has not had the opportunity to
12 really delve into the mysteries of the proprietary and
13 confidential model, and that is unacceptable to me.
14 But in addition, there are a number of
15 other-worldly assumptions in the model. And actually
16 we heard afresh this morning, that the asbestos
17 litigation environment has been improving for the last
18 eight or nine years. And I really wonder on what
19 planet that is true, because on this planet, and my
20 experience working with major asbestos defendants
21 every day, all day, is this is getting no better.
22 It's getting worse.
23 Secondly, the assumption about medical
24 inflation, future asbestos being offset by the aging
25 claimant population has no resemblance to reality on

1 the ground. For start, there's no linkage between
2 asbestos claim settlements and medical inflation.
3 It's a function of economics and it's a function of
4 anticipated trial verdicts.
5 Secondly, settlement values don't do
6 down with age. I looked at 7,000 asbestos settlements
7 a few days ago before I finalized my report, covering
8 the last few years. And there's no discernible trend
9 for settlements in 50, 60, 70 or 80-year-olds when 95
10 percent of those settlements were --- sure, a
11 40-year-old may get paid more, but there are very few
12 of those.
13 Multi-generational claims. Many claims
14 are coming from children of the originally exposed
15 defendants. Asbestos dust falling off overalls while
16 daddy's getting changed after work type thing. We are
17 hearing from leading pulmonologists and asbestos
18 medicine conferences who are telling us about exciting
19 new breakthroughs in medical science that allow
20 detection of mesothelioma several years earlier than
21 is current. Right now there's about 18 months between
22 diagnosis and death. That's going to be moved up by a
23 couple of years and add a couple of years of expensive
24 medical intervention.
25 And finally, there's a --- many of my

1 clients are really beside themselves on this one, that
2 the link between lung cancer and asbestos and the
3 exposed population of lung cancer is enormous. And
4 lung cancer being linked to asbestos exposure is
5 something that the plaintiffs lawers put their teeth
6 into and is considered a huge potential liability that
7 is just coming to the surface now.
8 The other other-worldly assumption is
9 that environmental remediation technology would offset
10 inflation. And sure, it's kind true in the 1990s when
11 this was emerging, that there were huge increases in
12 environmental science at that time. But we don't see
13 that on the ground. I mean, even look at the GOO ---
14 GAO report recently that is exhibited to my report.
15 You will see that environmental costs are going up,
16 not down.
17 I'll say a couple words about RRC. And
18 first of all, I do very much appreciate the engagement
19 of RRC, who are engaged by the Department on behalf of
20 policyholders and they are on our team. But their
21 independence is of limited value. They've undertaken
22 no independent review of the underlying data and
23 financial assumptions. They discussed and they
24 questioned and they met and had conference calls. I
25 mean, great. That's helpful, but they haven't done

1 any real independent work digging into this problem on
2 behalf of policyholders.
3 Nevertheless, they do share many of our
4 concerns. They many times emphasize the inherent
5 uncertainties of forecasts, and they in particular
6 share our concern about the payoff pattern under the
7 NICO cover, and also this rather robust --- to quote
8 them, robust investment yield on assets. And they
9 note that if either of those assumptions is invalid,
10 then the transaction potentially fails and more assets
11 will be needed.
12 Their report on the stochastic modeling
13 also raises significant concerns, again about the
14 difficulty about forecasting eventual costs. They
15 note the significant risks were not contemplated in
16 the stochastic model. They emphasize the uncertainty
17 about A&E reserves in the investment strategy and note
18 that the 15 percent investment in equities is down
19 from a high wire of 46 percent. And the fact that it
20 even gets disclosed in this pro forma financial
21 statement in this model for the future with even at
22 one time contemplated 46-percent equity investment is
23 staggeringly alarming to me.
24 As I said, the reality on the ground is
25 that there is no end in sight. Mesothelioma cases are

1 not declining according to the epidemiological and
2 demographic survey that was taken by Nicholson and
3 Selikoff in the 1970s, which have informed pretty much
4 all forecasters of asbestos. And what we're seeing is
5 that mesothelioma claims should have peaked some years
6 ago. But for many, many different companies, they are
7 just stable or increasing. Secondly, values for
8 mesothelioma are increasing. Defense costs are as
9 high as ever. New companies are being targeted,
10 multi-generational claims and early diagnosis, as I
11 mentioned earlier.
12 Moving on to the projected balance
13 sheet, which will be in my opinion undercapitalized.
14 I've often asked for explanation as to why these
15 deferred tax assets has been recognized as an admitted
16 asset on the opening balance sheet and written off the
17 next day. I don't count it as far as I'm concerned.
18 But adjusting for that, they have about a surplus of
19 $127 million, which should be contrasted with
20 OneBeacon Insurance Company's December 31 surplus of
21 $866 million and put in the context of $983 million
22 being upstreamed from OneBeacon Insurance Company to
23 the group over the last five years. Clearly this
24 revisation has been contemplated for a long time.
25 Adjusting for that deferred tax asset in

1 this case this case caps the ratio at opening is 215
2 percent. I'm noting, sir, your comments about there
3 being negative --- no leeway for a runoff company on
4 that leeway close to the authorized control level.
5 Nevertheless, on any sense it's a small margin for
6 error. And some form of regulatory involvement, even
7 if it is not authorized control, is around the corner,
8 to my mind, based on that opening balance sheet. And
9 I don't think that's what anyone wants. I don't think
10 regulators approve transactions in these kinds of
11 circumstances because they want to be supervising
12 something very soon. Regulators to some extent have
13 no choice but to get involved in these situations, but
14 this is a situation where that's not a regulatory
15 imperative right now.
16 Net opening reserves, net opening loss
17 reserves. This is for full book, net of reinsurance
18 is $156.5 million. If you look at the combined NICO
19 and non-NICO central estimates of Towers Watson, just
20 add them together, you get $2.15 million, and the
21 highest mix around $2.8 million. How do you get from
22 $2.1 billion to $156 million? One's a big number;
23 relatively one's a small number. And there are a lot
24 of sets.
25 One, there's not adequacy and I spouted

1 off a lot, and other people will, about the inherent
2 --- the massive inherent uncertainty about reserve
3 adequacy. Secondly, we have to do a roll forward.
4 And we've noted already problems in the roll forward,
5 and secondly, that one is getting out of date day by
6 day.
7 Thirdly, the diversification ---
8 diversification adjustment. Well, what does that
9 mean? It means risk does not add up in a linear
10 fashion. As I said in my report, it's not raining
11 everywhere all the time. So you have to allow for the
12 fact that this doesn't add up at all. And that's
13 fine, I don't dispute it. But as Towers Watson said,
14 and RRC concurred, that is a matter of significant
15 professional judgment.
16 Ceded reinsurance. I won't even say how
17 inadequate the work is on ceded reinsurance. But
18 proactive reinsurance, actually in that opening
19 reserve there's nothing, not a nickel, for the NICO
20 coverages, the A&E. That's all completely out of the
21 bus reserves because they are within the retroactive
22 reinsurance cover. And when you look at the size of
23 the gross risks in the A&E, whatever it is going on
24 there, the potential of A&E to actually creep onto
25 that balance sheet is, in my mind, a lot more likely

1 than Counsel for OneBeacon would have us believe. And
2 as they said in their response to the people who I'm
3 speaking on behalf of today, they view a 25 percent
4 deterioration of A&E reserves to be highly unlikely.
5 And I think I've given plenty of analysis already
6 today as to why that's really quite likely.
7 And finally, a time value of money. And
8 time value of money, for one, discounting reserves is
9 not allowed under statutory or Generally Accepted
10 Accounting Principles, except for Workmen's
11 Compensation. So discounting any kind of asbestos and
12 environmental is a very imprudent technique. Maybe
13 you could argue it from an economic point of view, but
14 in terms of regulatory analysis, a higher standard is
15 required. And they've used speculative and optimistic
16 analysis based on a unsupported future return on
17 investments. And for this transaction to succeed or
18 fail based on investment performance is putting a lot
19 of risk on the policyholders.
20 They go on to tell us --- and this
21 really, really amazes me. But surplus notes for
22 start, why should this entity be burdened with
23 interest bearing surplus notes? Why should this
24 entity have to be paying interest? Capital should be
25 sufficient from the get-go, but they have forecasted

1 they will start repaying surplus notes in 2018, just
2 four years out into a massive decade runoff. And the
3 settlement strategy, we've seen net reserves of $156.5
4 million, which are full cost to half in just 30 months
5 and to quarter three years after that.
6 I mean, for start, it's unrealistic.
7 You can't run off a book of business. But secondly,
8 what it tells us is this so-called settlement strategy
9 that has already been identified by Towers Watson,
10 that it is expected that that will continue under the
11 Armour Group, which is going to be not so much about
12 paying valid claims as they've told you, it's going to
13 be about commutations. And that is the first play in
14 the runoff playbook. Commutations, finality, that's
15 what we want.
16 But you compare this to the robust yield
17 they're expecting on their assets, and that is why we
18 want you to see that projecting the risk based capital
19 ratios are going to hugely increase in the first few
20 years, because what they're projecting is that these
21 reserves will be paid off very quickly and in the
22 meantime they will enjoy returns. But that's not
23 believable assumptions.
24 Counsel for OneBeacon had offered no
25 plausible justification for this deal. They talk

1 about complicated accounting and reporting. I mean,
2 are we supposed to shed a tear for that? And
3 distraction from the poor business. And we heard from
4 the CFO this morning. He gave us two reasons why this
5 was good for policyholders. It allows management to
6 focus exclusively on managing the ongoing business. I
7 mean, whoopee. What about policyholders?
8 And secondly, it will be economically
9 neutral. I'm sorry, I'm looking at the wrong page
10 here. So we heard management. We've heard secondly,
11 runoff liabilities will be separate from the ongoing
12 liabilities. That's really not an offset. As we
13 know, the volatility on the books that will be
14 transferred is tremendous because we're talking about
15 emerging claims on policies that were written decades
16 ago. The specialty business of OneBeacon Insurance
17 Group is a short tail book. And there is a particular
18 uncertainty, nothing approaching uncertainty on the
19 long tail book. And to say that policyholders will
20 now be insulated from the ongoing liabilities is just
21 --- it's cynical.
22 MR. JOHNSON:
23 Do you have much longer?
24 MR. TERRELL:
25 The financial --- huh?

1 MR. JOHNSON:

2 Because you're coming up to your half an

3 hour here.

4 MR. TERRELL:

5 Okay. Can I have two more minutes?

6 MR. JOHNSON:

7 Two more minutes, fine.

8 MR. TERRELL:

9 Thank you. The financial condition of

10 Armour cannot compare. Very limited data made

11 available that the 2011 financial statements in the

12 record tells of an equity of about $6 million and they

13 made a loss in 2011 of $0.3 million. So we're

14 substituting the mighty resources of OneBeacon

15 Insurance Group for something that has a meager set of

16 financial assembly.

17 We heard from their CFO this morning

18 they have access to all kinds of capital. Well, very

19 interesting when it wasn't explained to us what

20 capital they have available to us and why that's going

21 to be a benefit for policyholders. In my report I

22 explain why the economics and motivations are

23 different in runoff, and I have that from firsthand

24 experience of working on the Home runoff and also from

25 dealing on the other side of the table with Equitas

1 and Kemper and many others.
2 So finally, I would just say today if
3 they are so confident in the sophistication of their
4 actuarial analysis and their financial projections,
5 they should put their money where their mouth is. And
6 as Mr. Stockman said, if these reserve deterioration
7 was so unlikely, get an access policy to sit above the
8 NICO cover. Should be pretty cheap. I'm sure they
9 can convince Mr. Buffett that this is very small and
10 should be cheap.
11 Secondly, the INA transaction. I
12 recently gave a credit opinion on that. The
13 transaction actually succeeded. Century Indemnity is
14 part of Ace, so they're certainly intertwined. Beyond
15 the $25 million surplus, they have plenty of other
16 funds or assets that are off balance sheets that would
17 give them potential plan and other covers.
18 Thirdly, protection for policyholders
19 along the lines of the Royal transaction and Arrowood.
20 And finally, you can achieve all of management's goals
21 without doing a spinoff of this at all. You can
22 restructure this within OneBeacon Insurance Group and
23 have focused management and some installation of the
24 two sides of the business. It doesn't have to be a
25 spinoff at all. And with that, I will rest my case.

1 MR. JOHNSON:

2 Okay. Well, within your oral and in

3 your written remarks, there is a lot of issues you've

4 raised that the Applicant and --- the Seller and the

5 Applicant will have to be responding to, because

6 there's a lot of points. So we'll make sure that the

7 Applicant --- I think the Applicant sent a letter, or

8 the Seller sent a letter. His Counsel did the other

9 day saying they will respond to the report subsequent

10 to the hearing. So you make a lot of good --- you

11 make a lot of points that they need to respond to.

12 I will say on a couple points, though,

13 that I just want to ---. You say it's summarily been

14 dismissed. Just so you understand how it works. We

15 have to give all interested parties due process.

16 Including the Applicant and the Seller here, so ---.

17 MR. TERRELL:

18 I speak somewhat into a passion,

19 but ---.

20 MR. JOHNSON:

21 That's fine. I just want to get the

22 record straight and you have to --- you know.

23 MR. TERRELL:

24 On the face of it, to my mind, this

25 doesn't even come close.

1 MR. JOHNSON:

2 That's fine, but you have to give
3 everybody their due process, so --- and I will say,
4 too, as a person who was involved in the NAIC's White
5 Paper, it was a White Paper. It was not a best
6 practices. A lot of those items within the report
7 were disputed amongst regulators, including myself at
8 the time. So I would not couch it as a person who was
9 on the working group that developed that paper, that
10 it's a best practices --- it's just a White Paper,
11 with different viewpoints from different regulators
12 and different interested parties, just to make the
13 record clear there.

14 And then on the surplus note, just to
15 make the record straight, though, that you're correct
16 on the factual that I think 2018 they show some
17 interest being paid. Again, just for the record, we
18 have control as regulators on any payment of a surplus
19 note, whether it's interest of principal, no matter
20 what they put in the projections. 2018 comes around,
21 we don't think they're meeting their projections if
22 --- again, if that transaction's approved, we can deny
23 any payment of interest and --- interest or principal
24 forever. So just so ---.

25 MR. TERRELL:

1 Understood.
2 MR. JOHNSON:
3 I thought you did, but I just wanted to
4 make the record straight on those three points. Other
5 than that, the Applicant and the Seller will be
6 responding to your numerous issues that you've laid
7 out in front of us today. And we appreciate that as
8 trying to be unbiased regulators in this.
9 So we're going to take a lunch break now
10 'til 1:30. And then we'll start with --- Brian will
11 come up next when we get back at 1:30. So thank you.
12 SHORT BREAK TAKEN
13 MR. JOHNSON:
14 Good afternoon. We'll continue the
15 public informational hearing with additional public
16 comment. And we'll start with Brian.
17 ATTORNEY SCARBROUGH:
18 Good afternoon. My name is Brian
19 Scarbrough. I'm an attorney at Jenner & Block and I
20 am here today on behalf of Olin Corporation. Olin is
21 a OneBeacon policyholder and Olin previously submitted
22 a petition to intervene in this proceeding and
23 proposed transaction, and Olin also submitted written
24 comments last week as well. And Olin had a number ---
25 like other policyholders who petitioned to intervene,

1 Olin had a number of procedural and substantive issues
2 and objections, and those are laid out in its petition
3 and the comments it submitted last week. And by
4 participating today, Olin doesn't waive any of those
5 objections or petitions.
6 MR. JOHNSON:
7 We've been waiting for that. Where was
8 that earlier? Been waiting all day for that comment.
9 ATTORNEY DAUBERT:
10 We're not going to assume anyone has
11 waived anything.
12 MR. JOHNSON:
13 Yes, thank you.
14 ATTORNEY SCARBROUGH:
15 Thank you. I don't anticipate to take
16 nearly the 30 minutes here.
17 ATTORNEY DAUBERT:
18 Thank you.
19 ATTORNEY SCARBROUGH:
20 These will be brief remarks, so I want
21 to make two points that Olin in particular has
22 regarding this --- concerns that Olin has regarding
23 the proposed transaction here. And they're points
24 that Olin feels strongly about and strongly urges the
25 Department to consider these.

1 The first point is a jury verdict that
2 Olin obtained against OneBeacon last November 2013 in
3 Federal Court in New York. Olin obtained a jury
4 verdict against OneBeacon in a environmental coverage
5 case regarding five environmental sites. That
6 judgment --- well, that litigation remains pending in
7 part to enter a judgment based on that jury verdict.
8 And Olin claims that that verdict could result in a
9 judgment exceeding $60 million and potentially
10 material more than $60 million.
11 In addition, Olin has claims pending
12 against OneBeacon as to the same five environmental
13 sites, claims under Massachusetts General Law, Chapter
14 93(a) regarding claims handling and other issues.
15 Those are set to be tried beginning December 1st,
16 2014, in the same federal court. And if Olin's
17 successful on those claims, that could result in
18 treble damages, so a total judgment could exceed $180
19 million and may materially exceed that amount.
20 So Olin's concern is what account
21 OneBeacon's taken of that, that jury verdict and
22 potential judgment, both in setting its reserves.
23 Olin has no idea how that's factored into OneBeacon's
24 reserves, if there's a specific case reserve set for
25 this claim or not, and what information OneBeacon's

1 given to you, the Department, to evaluate --- help
2 evaluate the proposed transaction and the adequacy of
3 OneBeacon's reserves, particularly in this situation.
4 This could be pollution related environmental clause.
5 So if the proposed transaction were
6 approved, Olin's fears that it will be --- when it
7 comes time to enforce its judgment, it will have to
8 turn to Armour. And the fear is that Armour will not
9 have sufficient capital to pay what could be a fairly
10 substantial, multi-million dollar --- hundreds of
11 million dollar judgment.
12 Another concern that's been raised by
13 the policyholders that Olin also has is, as pointed
14 out by RRC, in $10 million pollution reserve increase
15 that OneBeacon took and the nine months ended in
16 September 2013. That's not Olin related to our
17 knowledge, and it's a sizeable increase, eight to ten
18 percent over OneBeacon's central reserve estimates.
19 Now Olin has a jury verdict that could well result in
20 judgment many times that $10 million, and it has
21 concerns that nothing's been disclosed --- or to the
22 public about how OneBeacon has factored in that
23 central judgment.
24 The second point I wanted to make
25 briefly was the impact of new legal developments or

1 judicial precedents on the adequacy of setting
2 reserves, particularly in this case, environmental and
3 pollution reserves. So Olin's been in coverage
4 litigation for a long time in New York and OneBeacon's
5 been part of that for quite a while. Olin has
6 obtained some favorable rulings recently, again ---
7 recently on a general liability policy language,
8 including language that shows up in OneBeacon policies
9 that OneBeacon issued full. In particular, the
10 rulings both from a federal court in New York, the
11 Southern District of New York, and affirmed by the
12 United States Court of Appeals through the Second
13 Circuit deals with a provision that, for shorthand, is
14 offering for to ask a continuing coverage provision.
15 And very, very briefly, what this ---
16 what these rulings permit Olin to do is when it's
17 seeking coverage, for example, property damage from
18 environmental losses from pollution or contamination,
19 it can seek coverage not only for property damage that
20 took place in the actual policy year that that insurer
21 issued the policy for, but also property damage that
22 continued on after the policy period into later years
23 and sort of sweep that back into the policy year that
24 was issued.
25 It's important, vis à vis OneBeacon,

1 because OneBeacon issued to Olin several general
2 liability policies, accepting a very low excess player
3 in the 1970 year with no pollution exclusions. And
4 policies issued to Olin in later years do have
5 pollution exclusions. So what the continuing coverage
6 provision permits Olin to do is to seek coverage from
7 OneBeacon not just for property damage that happened
8 in 1970, but also that continued in the years and
9 decades, even multiple decades after 1970. And that's
10 materially an increase in OneBeacon's exposure and
11 liability pool.
12 That's a new development that happened
13 in the past couple years, and that's something that we
14 hadn't seen before in the case law. And it raises
15 concerns with Olin because there's no indication what
16 consideration OneBeacon's taken of that in setting its
17 reserves or what it's disclosed to you in terms of
18 evaluating the adequacy of its reserves.
19 That's the type of new legal development
20 that RRC has said and they reiterated today, and
21 Towers Watson has said, make it extremely hard to
22 adequately set reserves for these types of claims.
23 And it's something that should seriously be --- we
24 submit should be seriously looked at and considered in
25 evaluating OneBeacon's reserves here. And it's not

1 just an Olin issue. This continuing coverage
2 provision language is standard form language, at least
3 in the '60s and '70s in general liability policies.
4 So there could well be many other policyholder ---
5 OneBeacon policyholders that have this language.
6 And it raises an issue with us on what
7 account OneBeacon's taken not just of their increased
8 liability exposure to Olin, but to actually hundreds
9 of other policyholders that have that and what it's
10 presented to you, the Department. So Olin, along with
11 a lot of other policyholders, doesn't want to find out
12 for the first time, if this transaction's approved,
13 that OneBeacon did not adequately take account of this
14 new legal development and doesn't have the reserves
15 adequately set when it comes time to pay these sorts
16 of claims.
17 So those are the two points I wanted to
18 make. I hope you will seriously consider both of
19 those and that you will seriously evaluate the
20 petitions we filed and the written submissions we
21 made. And thank you for the opportunity to speak.
22 MR. JOHNSON:
23 Thank you.
24 ATTORNEY DAUBERT:
25 Thank you.

1 MR. JOHNSON:
2 Gary Fergus?
3 ATTORNEY FERGUS:
4 Thank you. My name is Gary Fergus,
5 Attorney. I'm appointed by the Court in the Northern
6 District of California to represent the retired
7 Honorable Charles Renfrew. He's a former --- he's
8 retired, former United States District Court Judge,
9 and the former Deputy Attorney General of the United
10 States. He has been appointed by that Court to
11 represent future claimants in the Plant bankruptcy.
12 In the Plant bankruptcy, OneBeacon companies insured
13 Plant during key years, '65 to '73, with primary
14 insurance policies, with high levels of coverage.
15 Now, I will join in the comments made by
16 previous policyholder speakers, and perhaps I'll plead
17 to take up the rest of the time of the prior speaker
18 so that I can have more than my 30 minutes, but ---
19 ATTORNEY DAUBERT:
20 No, no, no.
21 ATTORNEY FERGUS:
22 --- perhaps not.
23 MR. JOHNSON:
24 No, we got to be fair.
25 ATTORNEY FERGUS:

1 One of the things that I expected to
2 hear and hoped to hear today in the testimony from the
3 expert witnesses is that we have done this before, we
4 know how to get the reserves correct, we've done it
5 right. In fact, we have over-reserved using our
6 models, and in fact, there was too much money put
7 aside. But that's not what we heard today. In fact,
8 what we heard is ---. Well, you'd think OneBeacon ---
9 very experienced insurance company. You would think
10 they would put a stake in the ground and say, we have
11 a reasonable belief that our estimate of the reserves,
12 that there's no possibility that it might --- the
13 statutory language is might --- the financial
14 condition might adversely impact policyholders.
15 But they didn't say that today. They
16 didn't say it to the SEC. They said, we cannot do it
17 and we think there's a really good chance we'll go
18 through our reserves and we will go through our
19 assets. So they hired Towers Watson. Towers Watson
20 came in and they said very clearly that they cannot
21 tell you that that standard has been met. They cannot
22 say that the reserves will be adequate.
23 What they can say is they have done
24 10,000 iterations based on their models using their
25 proprietary software. So Towers Watson has not been

1 able to give that opinion. RRC came in and they say,
2 we cannot give you the estimate. We cannot tell you,
3 and in fact, there are significant risks that there
4 will not be enough money.
5 Now, interestingly enough, Towers
6 Watson, in the insight report that was described as of
7 the end of 2012 --- it's on their website. They went
8 through very clearly and said, guess what? The
9 industry has been under-reserving continuously and
10 that it is intuitively unreasonable to believe that
11 they're adequately reserved. Now I'm speaking in very
12 general terms.
13 And so what so we have? We have a very
14 detailed analysis that is done with proprietary
15 software and RRC has said, we've looked at it
16 actuarially and we think that those are reasonable
17 assumptions. I call that black box reasonableness.
18 Because if you look at it --- and that is the only
19 thing --- I believe Deputy Commissioner Johnson, you
20 said earlier, there's inherent risk, we all know that,
21 we deal with it and that's why they did 10,000, 10,000
22 various iterations.
23 The fundamental problem, though is when
24 you look at the evidence in this case. There is
25 significant evidence that every single time it's been

1 wrong when there's inherent wrong, and it's always
2 been wrong the same way, under-reserved. And so now
3 you get to the question, well, okay, Towers Watson is
4 --- they're very good actuaries, they have excellent
5 credentials, they've done all these scientific things.
6 But guess what? RRC says, we've looked
7 at the actuarial literature and guess what? It really
8 doesn't work for this. There is a risk, and I quote,
9 however --- page three --- based on our review of the
10 actuarial literature, we believe the user should be
11 cautioned that the statistical estimation of the
12 variance that exists in a book of loss reserve is
13 difficult to measure and may not be captured
14 completely.
15 So one of the things that we found when
16 we go through the report, we find that there is an
17 analysis that's done that's called bootstrapping.
18 Now, when I was a young lawyer, that was an argument
19 you would make to a court when you have nothing else.
20 I'm very pleased that it's now become part of the
21 professional literature in the actuarial field and can
22 be used. But that is what is being done.
23 And in particular, the --- it is not
24 clear what epidemiological model that Towers Watson
25 was using. If they were using Nicholson or Nicholson

1 KPMG, the epidemiological studies from the 1980s, it's
2 well-known there were two fundamental flaws at least.
3 One was the mortality tables they used at the time
4 turned out not to be true. People are living longer.
5 So that has to be taken into account. Second, it
6 didn't take into account non-occupational exposures,
7 the third wave.
8 I call your attention to Exhibit Two of
9 the materials I submitted and I also brought. These
10 were submitted yesterday electronically, but I also
11 brought hard copies for anyone who wants them. But if
12 you look at the report in Mealy's of --- it's
13 basically a survey of the actuarial evidence. It
14 says, actuarially we are guessing and underestimating
15 the actual liability of what it is.
16 All right. So where are we? Where does
17 that leave us with this black box reasonableness?
18 Well, OneBeacon can't tell you. Towers can't tell
19 you. RRC can't tell you. What Towers can say is we
20 did 10,000, but you don't know where they started.
21 You don't know --- if you start a journey in the wrong
22 place and you do 10,000 variations on it, that is a
23 problem, especially in a public process. There should
24 be no black box reasonableness for the Commission to
25 make a decision as important in this case as it is to

1 all the policyholders, in particular, the 7,000 people
2 that my client is a fiduciary for. It's going to be
3 looking for these policies.
4 And so if what's going to be said ---
5 because ultimately what OneBeacon is looking for is
6 the --- and when I say stamp of approval, I mean after
7 all of your process and everything is done, if you
8 were to approve this, they got the stamp of approval
9 from the Commission. It's no longer their problem;
10 it's now onto Armour, thank you very much and we're
11 off and running. But the policyholders and the
12 individuals who were damaged, they don't have that
13 option.
14 And so it seems to me that in terms of
15 the question well, what about the status quo? Well,
16 the status quo is where we are, and we're stuck with
17 it. And if they run out of money, if they do various
18 things, then that's OneBeacon and that's what they do.
19 And they have the consequences of that. But to
20 basically give them a get out of the asbestos and get
21 out of the pollution card free, as they say it's
22 economically neutral, we do not believe is
23 appropriate.
24 Ironically, one of the comments that was
25 made, opening comment is, it's just not possible to

1 estimate the reserves at the 100 percent level. Yet
2 if you look at the Towers Watson, the very first thing
3 they say, for the next ten years they've had no
4 failures. Absolutely none, 100 percent success rate
5 where they won't run out of money.
6 Given the uncertainties that are all
7 well-known, I suggest to you that there are --- well,
8 first of all, this application as it is currently
9 structured should be denied. But there is --- but
10 there are alternatives, some of which have been
11 described by other policyholders, to basically say if
12 this is really right, let's have some clawback, let's
13 have some skin in the game for OneBeacon as to what is
14 in fact in this black box.
15 Now, one of the things that was
16 described in the public report is, well, we did some
17 adjustments for inflation, consumer price adjustments,
18 medical inflation, and then there's something that
19 says litigiousness. It's a black box; you don't know
20 what it is. You don't know how it was. You don't
21 know what bootstrapping was done to the model, the
22 underlying model that's being used by Towers to
23 predict what are the reserves that are going to be
24 needed. It's very clear. They say it many places and
25 so does RRC. The data they're relying upon is the

1 historical data for OneBeacon. It does not take into
2 account the other variables, the changes in
3 mortalities, the changes in by-standards, women being
4 exposed more, children being exposed more through
5 secondary exposures of people who worked there.
6 So where does that leave us? We are in
7 a situation where there are 10,000 models that were
8 run reasonably through the standards of actuaries, and
9 from that there are these other reasonable things
10 done, but they're all based on black box
11 reasonableness. Because one of the things that it
12 would seem to me that you would want to do, is you'd
13 want to be able to say, all right, let's try this
14 model. Let's throw in a new mortality table, see what
15 happens when you run one of those. Let's increase the
16 population. Let's see how that actual model is
17 dealing with the real life things that we are saying.
18 Now another example. Johns-Manville
19 went through bankruptcy. There was a prediction as to
20 how many future claims there were going to be. It was
21 done by a gentleman by the name of Stollard. They
22 went out, they were paying 100 cents on the dollar.
23 They lasted, as I recall, about two years and they
24 completely underestimated the liability. They redid
25 it, they went down to a very low percentage, they

1 redid it again and each time they've done it they've
2 gotten it wrong. That's the largest asbestos
3 manufacturer and installer there ever was.
4 And guess what? Towers Watson has been
5 retained by the Manville Trust, because what's
6 happened in the last two calendar years is the
7 Manville Trust has run out of money. They stopped
8 paying claims partway through the year because they
9 have a cap on how much they can spend in a particular
10 year. They've had to reduce the payment percentage
11 that they pay to people, because they got it wrong.
12 So now they have hired Towers Watson in
13 the fall of last year and in the January report,
14 financial report from the trust, they say they're
15 still working. Okay. So that's a real live, you
16 know, put your money where your mouth is example that
17 Towers Watson's going to have to get it right if in
18 fact they're doing the estimating and they are the
19 ones who are going to determine whether or not in fact
20 the Manville Trust is going to be able to pay the
21 claims throughout the whole year. Well, they haven't
22 done that.
23 So you asked earlier on, what questions
24 would you ask Towers Watson? I'd ask one, where have
25 you done this that these miles that you're talking

1 about, that this bootstrapping has accurately
2 predicted what the reserves should be. Where have you
3 done it? And to say that it's really hard to do, to
4 say that there is inherent risk and A&E are the
5 toughest to do, I would think is not an adequate
6 answer. This is one of those that what matters is
7 getting it right if you're going to be putting
8 together a model that says this does it. And there's
9 no evidence that this model, that this 10,000 does it.
10 So I go back to the might. Question is
11 whether or not the financial condition of Armour might
12 adversely impact the policyholder, or it might not be
13 beneficial to them. Well, here's what RRC says.
14 However, there are significant risks, some
15 contemplated in the stochastic modeling and some not
16 contemplated, that could result in the exhaustion of
17 the runoff companies' assets before all claims were
18 paid.
19 Significant risks that could result. In
20 my book, that's might. The statute doesn't say
21 reasonably likely, more probable than not, clear and
22 convincing evidence. The statute says might. I say,
23 that satisfies your standard that there is evidence
24 from your own expert that the financial condition of
25 Armour, if this transaction goes forward, might

1 adversely affect policyholders.

2 Second, they say, we are unable to

3 predict the future of A&E losses. But if history is

4 any guide, it would be prudent to expect further

5 adverse development. If in fact there is a third wave

6 of asbestos claims, this might well be considered a

7 change in litigation environment not explicitly

8 incorporated in the modeling. I submit that equals

9 might. We're not talking about speculation. We're

10 talking about what has happened with the development

11 of medical and through litigation, and what's now

12 known by science about exposure to asbestos.

13 One thing the Commission might consider

14 doing is waiting. See what happens when Towers Watson

15 does their estimate for the Manville Trust and see if

16 the Manville Trust actually is able to rely on that

17 estimate and pay claims all through the years. That'd

18 be the real world litmus test. But there are other

19 conditions, I think, that if you were all inclined to

20 grant this, that need to be done, significantly more

21 assets, more skin in the game to protect the

22 policyholders in order to meet that statutory

23 standard. Do you have any questions? Thank you for

24 your time.

25 MR. JOHNSON:

1 Thank you.
2 ATTORNEY FERGUS:
3 Would you like the hard copies?
4 MR. JOHNSON:
5 Yeah.
6 ATTORNEY DAUBERT:
7 Thank you.
8 MR. JOHNSON:
9 Thank you.
10 MS. RANKIN:
11 Thank you.
12 MR. JOHNSON:
13 Okay. Dan? Dan Healy?
14 ATTORNEY HEALY:
15 We've prepared some slides that I was
16 going to put up, but if you'd like me to hand them
17 out, we can do that.
18 MR. JOHNSON:
19 Yes.
20 ATTORNEY DAUBERT:
21 Absolutely.
22 MR. JOHNSON:
23 Uh-huh (yes).
24 OFF RECORD DISCUSSION
25 MR. JOHNSON:

1 If you could at least --- the Seller and
2 the Applicant get one, too, at least at a minimum.
3 ATTORNEY HEALY:
4 Okay. My name is Dan Healy and I'm here
5 from Anderson Kill. I have with me --- well, with my
6 colleague, Alexander Hardiman, also from Anderson
7 Kill, and next to me is Allan Kauffman from FTI
8 Consulting. He's an actuary there and has been
9 involved previously as the actuary in the Equitas
10 transaction.
11 Thank you for the opportunity to present
12 public comments today. I appreciate the fact that you
13 pointed out; there's no waiver this morning, so I
14 won't have to go through that. But the short
15 statement is I'm here on behalf of Colgate Palmolive
16 and we do not consider this to be a substitute for the
17 motion and we maintain our rights.
18 I'll preface my comments today by
19 stating that the full information concerning this
20 transaction has not been made available. And so while
21 we will present information to the best of our
22 ability, our ability is necessarily limited by the
23 fact that we do not have all of the information that
24 we believe is relevant and needed for policyholders to
25 figure out what is really happening here and to assess

1 the Towers Watson and RRC reports, as well as the
2 other information that's been filed by the Applicants.
3 And the information isn't just missing
4 from the Towers Watson report and the RRC report.
5 There hasn't been full information provided on the
6 transaction details. There's not full information
7 provided about all of the reinsurance. There are
8 other documents in the file to the Department that
9 have been marked as confidential. And as has been
10 covered by many of the other speakers today, the
11 Towers Watson reports --- report and summary and the
12 RRC reports are made based on RRC admitting that it
13 didn't have the information that Towers Watson had in
14 order to perform any sort of independent analysis.
15 As you may be aware, Colgate Palmolive
16 did actually seek a number of those documents through
17 a Right to Know law request and was able to obtain
18 some of them, but not all of them. Essentially
19 OneBeacon and Armour have been very careful and very
20 aggressive in defending the confidentiality of their
21 information they do not want policyholders to know
22 what it is. We think that's somewhat telling in this
23 circumstance where they are trying to say that this is
24 actually to the benefit of their policyholders. From
25 the information we do have and that has been made

1 available, all indications are that the proposed
2 acquisition that we're here about today is not in the
3 benefit --- is not in the best interest of the
4 policyholders and will not be to the benefit of
5 policyholders.
6 Now, since I think I'm the last speaker,
7 I'll try not to repeat too much of what's already been
8 covered, but to touch on what we think it is important
9 and get to what we can offer that might be slightly
10 different from the prior speakers. We think the key
11 issue is there are obvious causes for concern, even on
12 this complete record, are that the runoff companies
13 are undercapitalized, they lack adequate reinsurance
14 and that these are going to be runoff companies, and
15 that leaves Armour as the backstop.
16 And we haven't heard anyone today even
17 attempt to argue that Armour will have the financial
18 ability to make up the gap or to cover what everyone
19 sees will be the failure of these runoff companies in
20 the future. And we also haven't heard anyone say that
21 these companies aren't going to fail in the future.
22 What we really think is that issue here is how soon
23 it's going to be. And that's based, again, just on
24 the incomplete record. We assume that if we had more
25 information, then that would probably paint a bleaker

1 picture for these runoff companies.
2 So in some ways I'll try and use the
3 slides; hopefully it makes it, if nothing else,
4 slightly more interesting. But if we turn to the
5 first slide titled proposed acquisition, I don't think
6 there are any new surprises there. We think that this
7 proposed acquisition that's going to transfer not only
8 traditional commercial lines, but as we've heard a lot
9 about today, asbestos and environmental exposures is
10 not in the best interest of policyholders and is going
11 to set up these runoff companies to fail in the
12 future. Basically these companies will be left, as I
13 stated, undercapitalized.
14 Given that, we don't think that the
15 proposed acquisition should be approved, because under
16 the sections of the Pennsylvania statute that the
17 Department is required to look at, this is not going
18 to be in the best interests of policyholders. It also
19 is going to create financial instability for these
20 companies. I don't think OneBeacon can credibly argue
21 based on the information that's available that that is
22 not the case. And I'll try and go through some of
23 that information today and lay out why we think that
24 it is clearly against the interest of the
25 policyholders.

1 In looking at this, one of the things we
2 noticed is that there is not very much analysis of the
3 likelihood of non-payment of coverage. We think
4 that's a major issue for policyholders, and what we
5 haven't heard a lot about is what is the likelihood
6 that these companies won't be able to pay, that they
7 won't be able to pay on time. We heard earlier the
8 definitions of failure --- I think it was the speaker
9 from RRC --- as being zero assets, as being nothing.
10 And you yourself were talking about the one dollar.
11 Hopefully what we're not talking about, though, is
12 whether or not this will result in there being one
13 dollar left, even if that's not technically a failure.
14 Now, the last thing is that this
15 proposed transaction as is, we believe would not only
16 increase the likelihood of the Department having to
17 stay involved with these companies in regulatory
18 oversight rule, but that it might be --- lead to a
19 need for immediate intervention. And we think that
20 sort of highlights the level of the problem presented
21 by this transaction.
22 Turn to the fifth page, slide. We
23 believe that as proposed, this transaction will leave
24 the runoff companies significantly less likely to be
25 able to pay coverage on a timely basis. And paying on

1 a timely basis is very important. Even Travelers in
2 their submission to the Department stated that Armour
3 has a reputation for not paying on time, and that in
4 doing so it's actually been found to be in bad faith,
5 and that that causes material consequences for other
6 insurance companies, let alone the actual
7 policyholders.
8 And so setting up a system where whether
9 or not they've reached a technical failure, but that
10 there is an inability to pay timely the claims that
11 are --- or we can all just say the claims that are
12 agreed to be payable, is a major shortcoming. And
13 even if that isn't 30 years out, that's significantly
14 sooner --- which we believe it is based on just the
15 limited available information --- then this is
16 certainly not an issue for policyholders and will lead
17 to significant harm to policyholders.
18 Now here in the second bullet point,
19 you'll see at least $200 million of additional
20 capital. Again, and I know I've been harping on it,
21 but that's based on incomplete information. We're not
22 offering that as an absolute number. We see that
23 number as probably a four based on the amount of
24 information we have so far. We think that without at
25 least that much more money in, based on the limited

1 amount of information from the Towers Watson report,
2 these companies are going to be in need of immediate
3 regulatory oversight. They're going to fall below the
4 company action level. And the issues that may result
5 from the timing --- I'm sorry, the issues that may
6 result from the lack of capital and lack of
7 reinsurance that will affect the ability to pay timely
8 will be in the very near future.
9 Now, part of this is that the
10 reinsurance sources that have been referenced by
11 OneBeacon and Armour are basically insufficient. And
12 the NICO cover has been sort of a focus and it's
13 becoming more of a focus, particularly with comments
14 today. And it is simply insufficient to cover what
15 the projected losses will be. And so we'll go through
16 that in a little bit more detail, but that doesn't
17 save it. And again, it doesn't make up the gap and
18 shortfall this will have in capitalization.
19 And again, because at this point in
20 time, OneBeacon is looking to get rid of the runoff
21 companies and be completely separated from them, that
22 means it's going to be left to Armour which no one has
23 said will ever have the ability to pay this. And from
24 the financial records and information, they don't.
25 They wouldn't be able to make up the shortfall.

1 And so to the extent that down the road
2 we'd have some other sort of hearing or proceeding
3 before this Department, OneBeacon, I'm sure, would
4 take the position that if this transaction goes
5 through, they're not going to be part of it, unless
6 there's something that's done today or as part of this
7 acquisition, to make sure that they are part of that.
8 And since they have the capital that's necessary and
9 no one's sitting there saying, oh, we have to get rid
10 of these companies because we lack capital, I think
11 that's an important consideration for the Department.
12 Now, turn to the next slide, which
13 should be here somewhat. Further reasons why we
14 believe that the proposed acquisition should not be
15 approved is that there are major shortcomings to the
16 Towers Watson report. It's not just simply, oh, we
17 don't have the information they had. From our review
18 of their reports, we believe there are major
19 shortcomings.
20 They didn't assess the technical
21 insolvency, which goes to the timing issue. They, as
22 we heard earlier, talked about failure as zero,
23 nothing left at all. And they didn't look at what
24 might happen before you get to the point of having
25 nothing left at all. They also didn't test the

1 surplus adequacy. They came at this, as far as we can
2 tell, from a cash point of view and the capital
3 requirements were not tested.
4 But even all that aside, accepting the
5 other features of the report, the failure rate is
6 probably higher than 12 percent. That's sort of the
7 best case scenario that they're able to present. And
8 we know that the timely payments will actually happen
9 before the 30 years at which they put that 12 percent.
10 And even 12 percent is not exactly an ideal rate.
11 That's where they stopped the presentation today, with
12 their 30 years and 12 percent failure rate. They
13 didn't go beyond that.
14 So summarizing some of the issues here
15 before we move on to more actuarial information. Even
16 assuming the facts as presented are all the facts,
17 then already we know they need significant more
18 capital. We put the number at $200 million worth of
19 more capital in order to be secure and to be
20 adequately capitalized to move forward. You might
21 say, where did we pull that number from? And we do
22 have a reasoned approach.
23 Basically, the Towers Watson report,
24 Potomac, which is just one of the runoff companies,
25 had an authorized control of $116 million. That's

1 OneBeacon's number; that's not our number. So if we
2 just work off of the NAIC Model Act, which says two
3 times that, and they have --- the amount would be $232
4 million.
5 Now, from Towers Watson's own report, it
6 puts the entire group of runoff companies --- not just
7 Potomac, the entire group of runoff companies, which
8 should have a number even higher than $232 million, at
9 $161.5 million. And that's where we get the
10 conclusion that hey, from day one we're going to have
11 a problem with these companies. And that's not like a
12 couple million dollars. That's a pretty significant
13 gap. So we think that is quite problematic, and
14 that's based on the Towers Watson report and limited
15 information we have. So without additional capital,
16 we think that this is certainly not in the interest of
17 policyholders. We would like to have that money paid
18 and paid on time.
19 Also, we'll go through a chart in a few
20 moments, but if you look at other insurance companies
21 that have a ratio of capital to the gross liabilities,
22 or the losses and the LAIE that are similar to what's
23 presented in the Towers Watson report for these runoff
24 companies, a number of them are under Department
25 supervision already or have a grievance that are with

1 a larger insurance company structure that has adequate
2 capital. That is the only reason they're not being
3 subject to Department oversight. Obviously one of the
4 things that's come up today is the Century Indemnity
5 Company, and that would be a good example.
6 We also have some other problems with
7 the Towers Watson report. The numbers are not exactly
8 up to date. We heard an explanation of that earlier
9 today that, well, based in the long term scheme of all
10 of this, it doesn't really matter if we use last year
11 or this year. To us, that's not an adequate
12 explanation. Why wouldn't you use the most up-to-date
13 information? This is not a short proceeding. This
14 has already been going on over a year. Why wouldn't
15 you want to have the most updated information?
16 Also, if we step back a little bit and
17 sort of look at the overall picture in terms of the
18 most up-to-date information, prior to the information
19 we have today, we have a number of steps whereby
20 OneBeacon systematically removed the capital from
21 these runoff companies. And several of the speakers
22 referred to some of these transactions and transfers
23 of money between OneBeacon companies, and I --- we
24 have --- Colgate Palmolive in its prior submissions
25 has seen a number of these, and I'm not going to

1 belabor you with all of them today.
2 But there are some pretty significant
3 transfers. One of the ones that has been raised a
4 number of times by different policyholders is the
5 extraordinary distribution of $146 million upstream to
6 non-runoff companies. There are other transactions
7 where dividends were paid by runoff companies upstream
8 to non-runoff companies in the amounts of $65 million
9 and --- I think there's another one for $40 million,
10 there's another one for $25 million. And you can run
11 through these; it's in the financial documents, it's
12 been documented in submissions before the Department.
13 The point is that during the course of
14 2012, there were a lot of these transfers where
15 basically cash and real assets and securities in non-
16 affiliated companies were being removed or sold by and
17 then cash being removed from the runoff companies. In
18 return, the runoff companies largely got stock in
19 affiliated companies, meaning the runoff companies.
20 And one of the more significant transfers is the --- a
21 specialty transfer where it's basically holding
22 roughly a billion dollars, I believe most of this
23 involves.
24 Again, this is in the financial
25 statements, this is public information. And that's

1 going to retransfer back if this proposed acquisition
2 goes through. It's not going to be one of the runoff
3 companies. I haven't sat down and done the exact
4 math, but that's the majority, I believe, of the
5 assets that are being held right now and it's going
6 --- it's not going to be part of the runoff companies.
7 So what we have is over the course of
8 2012 we have runoff companies being depleted for
9 capital. And so looking at all of the steps of this,
10 which I think is appropriate, that leads to many of
11 the problems that we see today, these companies being
12 undercapitalized. And one telling point is that I
13 think both OBIC and OBA, all of the securities that
14 they held in non-affiliated companies beginning of
15 2012 --- they did not hold anymore at the end of 2012.
16 So they basically liquidated all of those positions
17 and only were holding affiliates.
18 Now, turning to slide nine, again, we do
19 not believe that the proposed acquisition should be
20 approved as it stands. And we were looking to the
21 Towers Watson and RRC reports to answer the questions
22 that we had pointed out in prior filings. We haven't
23 seen those answers, and that's a major concern to us.
24 And one of the key points, though, is
25 that really from a review of the Towers Watson report

1 --- I have in here an earnest interpretation of our
2 --- our actuary with an honest interpretation of the
3 Towers Watson report, is there actually is a reason
4 not to approve this transaction. It actually
5 establishes why you should not approve this
6 transaction. And that we think is quite telling. It
7 shows you why these companies truly are
8 undercapitalized. And that's the measurement just
9 against the normal industry standards, without getting
10 into all of the specifics of the prior actions here.
11 I've gone through, again, some of the
12 systematic depletion of these runoff companies that we
13 highlight on ten. But this was in the base of
14 statements from OneBeacon to the Department, where
15 they said, quote, OBIG is confident and has determined
16 that the acquired companies' or runoff companies'
17 liabilities through sophisticated and ongoing
18 actuarial reviews. And further, in 2012, despite the
19 fact that they state that they've got it all figured
20 out, they experienced over $24 million in unfavorable
21 losses. And so we think that their statements
22 shouldn't necessarily be taken at face value, that
23 there should be testament of this. And that's why we
24 were looking to the Towers Watson report for answers,
25 and unfortunately, we're not finding them there.

1 And again, turning to the next page,
2 there's really no evidence of reinsurance that would
3 be sufficient to close the gap here, financial gap.
4 So that goes back to --- this is sort of getting to
5 the end of my first couple points where we have
6 undercapitalized companies and we have --- well, we've
7 heard a lot today about how volatile and problematic
8 predicting asbestos and environmental liabilities can
9 be. And we've heard that over time they've largely
10 grown and become more of a problem, and that is
11 consistent with the fact that they shouldn't be taking
12 capital out of these companies, leaving them with
13 insufficient reinsurance and then transferring them to
14 a company that doesn't have the capital to support
15 runoff companies, which would be Potomac, which would
16 be carrying these asbestos and environmental
17 liabilities.
18 Another issue with the Towers Watson and
19 RRC reports is that they largely miss the point of
20 what a lot of people have been talking about today,
21 which is, so what is the effect going to be on
22 policyholders? It's simply not addressed. And not
23 only is that a very important consideration, it's one
24 of the considerations in the statute. And they don't
25 address what will happen as the assets become depleted

1 over time in these runoff companies going forward.
2 And they don't address how that will affect claim
3 payment, and there's certainly no explanation of why
4 it's a benefit to the policyholders.
5 So there's been no opinion on the
6 fairness to policyholders, but also, they don't really
7 talk about the applicable actuarial standards from
8 ---. And because of that, the conclusions they reach
9 aren't necessarily tied to questions that we believe
10 the Department needs to answer. They've reached some
11 conclusions, which is that fair and reasonable things
12 have been done, but they haven't really talked about
13 why, what the effect on policyholders will be and a
14 number of other questions the Department needs to
15 answer.
16 So again, we've been talking --- I
17 mentioned already that we're concerned about the
18 timely payments. Neither one of the reports provides
19 any information that will help the Department assess
20 whether or not these runoff companies will be able to
21 pay claims on a timely basis. And here we mention
22 technical insolvency, which really gets into the
23 timely question, but I think it's also just somewhat
24 commonsense that if what they're looking at is when
25 you hit zero, then there may be technical insolvency

1 well before they ever get to the point that they're
2 calling failure. And regulatory action doesn't equate
3 until we get to the zero point, in terms of ---. And
4 the reason for that is because we need to protect the
5 policyholders and be involved in the management of a
6 company that doesn't have enough capital.
7 So turn to the next slide. To summarize
8 with regard to inadequate surplus, which is an issue
9 here, we have a number of things I've covered, but
10 they all go to whether or not these companies have
11 adequate surplus, which is a major issue in looking at
12 the appropriateness of the proposed acquisition. And
13 Potomac alone would be subject to regulatory action.
14 We think the other companies would as well. And they
15 can't maintain their surplus in a RBC risk-based
16 capital threshold, which is problematic to say the
17 least.
18 And again, when you put the number at
19 $200 million --- and we believe that the failure rate,
20 if you take into account near misses, which I'll get
21 to, is actually more like 18 percent. And because of
22 all of this, the 30-year projection at a 12 percent
23 failure rate is what you get from Towers Watson. It's
24 simply not reasonable and it doesn't have any real
25 basis, because it's missed so many of the points it

1 needs to take into consideration to reach that
2 conclusion.
3 Similarly, if you look at the next
4 slide, it's some of the same types of concepts. And
5 this is to summarize with regard to technical
6 insolvency, and this talks about the near misses,
7 which is failure to timely pay, even though they're
8 not completely out of money and they may be able to
9 pay in the future, but they aren't able to pay timely.
10 We think that if you take into consideration the near
11 misses on an actuarial basis, then the failure rate
12 actually increases, based on the information we have
13 today which we don't believe is complete, rises up to
14 18 percent. So this would put --- this would also put
15 the time at which the runoff companies would be
16 insolvent well before the 30 years, which again is
17 problematic.
18 And we prepared a chart of some of these
19 similar --- similarly situated types of insurance
20 companies. And the first column there that's in blue
21 is for the runoff companies, and it sets forth a
22 number of figures that are all straight from the
23 Towers Watson report. These are not our figures. And
24 you can see there that it has the gross loss as a
25 million in reserve at $1.185 billion. And under it

1 you have the surplus at the $161.5 million figure that
2 I mentioned earlier.
3 And so below that you have the various
4 ratios. And if you look at those ratios and you go
5 across, we've highlighted the ratios in red that we
6 think are most relevant. And under there, as I
7 mentioned before, the first one as you go across the
8 page is Century Indemnity, which you mentioned earlier
9 as well. And then there you have the entire
10 restructuring that's had to take place. And that is
11 under Department supervision and has been subject to
12 regulatory action. And in place there is the dividend
13 retention fund, which we don't have here and it hasn't
14 been proposed.
15 And so even though that's similarly
16 situated, what they really have is a tie-in where they
17 do have access to additional capital. And beyond
18 that, you mentioned earlier that you were involved in
19 this directly and you asked about additional capital
20 being added. And you probably have a more myriad of
21 facts than I do, but it's my understanding that over
22 the years --- well, starting initially and then
23 subsequently about $475 million has been included that
24 was additional capital. That's from financial
25 statements that we've been able to find. So again,

1 that's another situation where there's been additional
2 capital provided. But we distinguish it from the
3 proposed acquisition that we have before us today.
4 We can move on to the next column. This
5 is a company that's in Rhode Island, the Caseatmen
6 (phonetic) Insurance Company, and that has ratios that
7 are --- has an 85 percent ratio of committed assets of
8 costs recoverable. Again, it's subject to Department
9 supervision and they are still under the supervision.
10 And I think they have $8.1 million surplus. So ---
11 and they've been under supervision since 2008.
12 Also, the two other columns with the red
13 ratios there, the AIG column with National Union,
14 based on their public filings, AIG provides an
15 unconditional capital maintenance agreement whereby
16 it's going to keep the companies bundled. So even
17 though that's not under regulatory supervision and
18 it's not subject to regulatory action at this time,
19 because it has basically an unconditional guarantee
20 from its parent company, AIG, which again, we don't
21 have being proposed here.
22 And then the last one there, which is
23 the Indemnity Insurance Company of North America.
24 That has an agreement whereby there's a 100 percent
25 reinsurance agreement in place from Ace Pioneer ---

1 Ace INA. Again, that distinguishes it from the
2 proposed acquisition we have right now. Before you
3 had mentioned are there different ways that we might
4 be able to address some of the problems raised by this
5 proposed acquisition. We think these are real life
6 examples ways in which those problems have been
7 addressed. Notably, they all involve the company
8 that's in the shoes of OneBeacon to remain involved in
9 the companies, the runoff companies going forward.
10 Now, the numbers that we just ran
11 through and that are on that chart, like I said, were
12 out of the Towers Watson report. And so that's just
13 taking those numbers, which we're not necessarily
14 saying we agree with and we're saying actually we
15 think are probably worse. But if we look at why the
16 Towers Watson report may not have arrived at the right
17 conclusions to its model, there are some things that
18 we believe that they should have done and didn't. As
19 I mentioned before, Towers Watson tested cash as its
20 model and did not test capital requirements. We think
21 that that would have been the norm, to test more than
22 simply one model.
23 They also failed to perform stress
24 testing, preferred stress testing and sensitivity
25 tests. And this is a somewhat larger conceptual

1 issue, which is it carries to what it is they're
2 looking for. And again, this goes back to the
3 definition of failure that I mentioned in the
4 beginning. What they were looking for is whether or
5 not there are assets, one dollar meaning there are
6 assets. They weren't looking at, at what point is
7 this beginning to fail? What's causing it to fail?
8 What are the points at which we need to really look
9 at, because they will be problems in the future, or at
10 least the most likely problem in the future?
11 And by failing to perform these types of
12 tests, they can tell them that they simply don't know.
13 They don't know either. If they do know, they haven't
14 disclosed it. And so we think that the failure on
15 Towers Watson's part to perform these types of tests
16 leaves a big gap. And as the Department can see,
17 we're trying to figure out the answers to these
18 questions because we think it would be something
19 necessary for you to have access to look at.
20 The Towers Watson report also does not
21 test or identify the company action level for the
22 runoff companies. You saw a slide before that's based
23 on what we've gleaned from the Towers Watson numbers
24 to get what we put together using those numbers. And
25 we think, as I went through before, that that triggers

1 we prefer regulatory involvement essentially on day
2 one, exactly from day one.
3 And this falls as part of what we would
4 consider to be the industry standards for figuring out
5 what would really be the situation with these runoff
6 companies, what would be their ability to succeed and
7 for how long. The industry standards, IRMA and ORSA,
8 do call for multiple forms of modeling. And here we
9 have essentially a single form of modeling. And as we
10 understand it based on the report, without having
11 access to information underlying the report, it was
12 performed on just take the low, central and high. And
13 they just took the central and used that to do the
14 stochastic modeling. And that was performed on just
15 the lognormal slope, if you will.
16 And so they took one set of information,
17 and that's what they ran through the software 10,000
18 times. And again, software performs these tests. And
19 so while they may have performed 10,000 different
20 scenarios, it's based on one set of inputs. And your
21 testing's only going to be as good as your inputs. I
22 mean, if you only put in one set of inputs, then that
23 necessarily drives the results on those 10,000
24 scenarios.
25 And we think it would have been much

1 more prudent, if not necessary, to perhaps try some
2 different inputs to find out what might cause major
3 changes since the inputs are based on the assumptions
4 that we've been hearing about today, in that a number
5 of policyholders have expressed real concern today,
6 because a number of those assumptions have been drawn
7 in OneBeacon's favor. They're not necessarily the
8 type of assumptions that we would draw, particularly
9 because we're dealing with here the asbestos and
10 environmental type of liability where no one is
11 sitting here saying it's very easy to predict and you
12 don't have to worry; you can just go with your one set
13 of assumptions and not worry about if your modeling is
14 going to come out okay. We're hearing various
15 different people say that's not the case. These are
16 difficult to do. There are no rote assumptions. You
17 have to rely on the historical data, but after all,
18 you're making projections. So why wouldn't you want
19 to try to run as many different models as you can
20 reasonably perceive in the time to look at? Here we
21 just have one and we think that's insufficient.
22 And we're going over some of the
23 assumptions, but Towers Watson in RRC actually
24 identified them for you. They say there are what we
25 refer to as knowns, unknowns. Basically they know,

1 they don't know the answers to these and so they're
2 putting caveats in their report and highlighting that
3 they haven't been able to figure out. And while we're
4 trying to project these, maybe that's another reason
5 why we need to have more information and perhaps more
6 stochastic modeling that takes into account the fact
7 that the assumptions for these unknowns aren't
8 necessarily going to be just one answer.
9 And so we have this set out for you,
10 some of the different statements from the RRC ---
11 FDRCS report which is the stochastic modeling report.
12 And Towers excluded outliers from this data. I mean,
13 the failure rate may actually be higher than the 11.7
14 percent. So these things actually matter. These
15 aren't just assumptions that get thrown into so many
16 different things that it gets evened out. The risks
17 created by such missing information include that the
18 models used are not appropriate modelings. That seems
19 like a pretty big problem. They fail to include
20 modeling of the variability from lognormal
21 distribution of claims; I mentioned that before. They
22 only do the lognormal, which is just one of the
23 various sets of data they could have looked at.
24 And we heard earlier about the medical
25 inflation models, that they may actually vary from

1 historical data, and vary more than indicated by
2 results of the model. And beyond that, they then took
3 the medical modeling and offset it with additional
4 favorable assumptions, including to the interest rates
5 that may have the effect of underestimating the true
6 impact claims theory. So we have a number of
7 different things, some of which are sort of
8 assumptions on top of assumptions that are heavily in
9 OneBeacon's favor, and not necessarily made to reach
10 the most accurate conclusion that can be reached.
11 And here we have on the next slide then
12 here, that RRC --- Towers make judgmental adjustments
13 to interest rates, equity returns and A&E defaults,
14 and all such adjustments were not unreasonable; they
15 were adding somewhat to the riskiness of the model
16 results. So you have a single model being run and you
17 have --- they're filled with assumptions that
18 essentially make it risky. And we think that, again,
19 is insufficient and that the Department is entitled to
20 more information to make this decision. The
21 policyholders are entitled to more information to find
22 out what this really will involve.
23 And because the information that the
24 Towers Watson report is based on has been kept from
25 us, people like Mr. Kauffman can't perform the types

1 of modeling for his own actuarial report to figure out
2 what the real answers are. And that goes to the
3 prejudice to policyholders, which is we can't even
4 figure this out. We can't --- we don't have the
5 information we need if we wanted to say fine, we'll do
6 it. We can't. It's not been provided to us. We've
7 gone through a Right to Know appeal and gotten as much
8 information as we could, but OneBeacon and Armour
9 don't want to provide the information to us.
10 And RRC concludes that the runoff
11 companies are likely to meet the obligations, but
12 under considerable stress. Considerable stress is not
13 defined, and given the problems I've already gone
14 through with the modeling and the fact that RRC itself
15 admits that it didn't have the information to really
16 test or perform any independent analysis on the Towers
17 Watson report, it's pretty difficult to determine what
18 it is they mean that the current companies are likely
19 to meet their obligations, because I'm not sure that
20 Armour really knows either.
21 And I covered this before, but we'd like
22 to see the up-to-date reserve data and claim
23 information used, because why wouldn't you want to
24 look at the best information you can get? We haven't
25 heard any real reason why we can't do that.

1 We think all of this is very relevant,
2 not only under the standards that you have to
3 consider, but because as policyholders, obviously a
4 number of different companies have broken up. But
5 this is something that's very important to them that
6 these liabilities --- these insurance policies are
7 very important to them. And we think it's due the
8 consideration by the Department.
9 Earlier --- actually in your opening
10 remarks, I believe you had asked about whether or not
11 people had questions. So if you don't mind Mr.
12 Kauffman come up with a couple of questions that we
13 think would be appropriate to have answered as part of
14 the process.
15 MR. JOHNSON:
16 Could you state your name and your
17 affiliation?
18 MR. KAUFMAN:
19 Allan Kauffman, FTI Consulting. Two
20 items that are really confirming what appears to be
21 the case from the reports. One is that table one. Is
22 it done on a cash basis literally as they say, that it
23 marks the time when cash runs out? That that's
24 important as Dan has indicated, because that just ---
25 if it's cash, that's a very misleading --- the effect

1 is very misleading because the talk of cash running
2 out 30 years could be something that the model --- by
3 modeling the reserves would have identified as the
4 technical insolvency after five years, much as the
5 Home didn't have to wait 20 to 30 years to run out of
6 cash to know --- the regulators to know that it was
7 insolvent, that the estimates did that. So number one
8 is to make sure that that's really what it's doing, in
9 which case the --- which maybe they could confirm
10 today, in which case it does serve to be a misleading
11 table in regard to timing.
12 Secondly, with respect to the model in
13 capital adequacy, it appears that the model is done as
14 if zero capital is the cutoff point. So that's to
15 kind of confirm what might be obvious. And that's
16 important because both the number of insolvencies and
17 the timing of insolvencies would depend on the capital
18 standard. And in terms of what we've said about the
19 amount of additional capital that's needed, that's key
20 to say, well, maybe they ought to have at least the
21 company actual capital.
22 Mr. Johnson, you've indicated maybe the
23 standard could be different, but it would appear there
24 ought to be some standard and that standard ought to
25 be included in the model. That kind of concept seemed

1 to be in the RRC engagement letter, but it appears to
2 be --- I believe that the simplest beginning question
3 is, is it really done with zero capital as the
4 standard for the companies' operations would be cut
5 in?
6 Third is the reserves on the opening
7 balance sheet. It's not clear in some indications
8 that the --- not from the point of view of the
9 stochastic modeling, but the point of view of
10 understanding the basis for the financial statements.
11 Are those based on Towers Watson's central estimates
12 or no? It looks as if they're not, in which case we
13 have a discontinuity, a discrepancy, a difference
14 between the view of the experts on what the right
15 starting point and the view of the financial
16 statement. And that would of course affect the
17 starting surplus and a view of how the company, from a
18 financial point of view, apart from the stochastic
19 level.
20 And finally, what is the basis for
21 effectively --- not quite concluding, but suggesting
22 that a 12 and a half percent --- that a 12 percent
23 failure rate is good enough? If anything, I know
24 about good enough from insurance subs they require
25 much higher safety levels of that risk-based capital,

1 company action level, individual line of business,
2 risk charges are calibrated to roughly 12 percent.
3 And that's the company action level for just those
4 factors, the overall risk-based capital aims for
5 company action level to be safer than that. So 12
6 percent for table one is not in any standard I know of
7 a safe level of --- a safe measure of failure rate.
8 So the specific question is, is it
9 really based just on cash? Is there no capital
10 adequacy testing in the model and what basis, if any,
11 is there for a presumption created that 12 percent is
12 safe enough? And I'm sure through counsel we'll have
13 other questions.
14 ATTORNEY HEALY:
15 That's all I have for now.
16 MR. JOHNSON:
17 Okay. Well, I think --- just a couple
18 of points to clear the record always. One is, just so
19 everybody's aware of --- I think you are but it never
20 comes out here --- Potomac's already in an action
21 level today. So just remember, again, my points that
22 the RBC level does given the commissioner flexibility
23 and runoff companies that are property and casualty to
24 be in mandatory control level if it's under the
25 supervision of the insurance commissioner. And

1 Potomac's already in an action level, so it's not like
2 this is like newsworthy. So just put ---.
3 Two, again, as I mentioned before, we
4 mentioned it a number --- is that Century Indemnity
5 had a lot of conditions in its order. Those
6 conditions gave us additional oversight. So if you
7 believe we may be --- again, as I said earlier, we may
8 be going down a path to approve. Certainly you
9 believe conditions would help your clients. You
10 should comment on what conditions would help your
11 clients for us to consider. That's if we go down that
12 road.
13 So I bring that up again because Century
14 Indemnity's class A example of there's like 30, 35
15 conditions within that order that gives us additional
16 oversight of the runoff of these --- of Century
17 Indemnity. And I will say Century Indemnity --- just
18 to clarify because obviously I was involved in the
19 transaction. In the letter --- who signed it from
20 Anderson Kill? This is the Jerry Goldman letter of
21 July 18. It says, notably the Department has required
22 Century to be guaranteed by Ace.
23 I just want to make the record clear
24 here while we're together and you brought it up,
25 that's not the case. What's in place is an excess of

1 loss treaty of $800 million between Century Indemnity
2 and the active United States insurance companies, the
3 active pool companies in the United States. It is
4 capped at $800 million, and then we have the dividend
5 retention fund of $50 million. So there is $850
6 million, of which some of that $800 million at this
7 point, I think 200 --- I just looked at it yesterday.
8 $220 million of the $800 has been used up so far of
9 the XOL. So just to be clear, Ace has not done a
10 blanket guarantee.
11 I will say you are correct on the AIG,
12 that they do have a parental capital maintenance
13 agreement. That's true. We don't have anything like
14 that --- we don't have that type of guarantee set up
15 within the Century Indemnity transaction, just to make
16 clear.
17 ATTORNEY HEALY:
18 Okay. So just to quickly respond to
19 your prior comment about Potomac already seen at the
20 action level, it's OneBeacon and Armour, though, that
21 have asked for this transaction to be approved by the
22 Department despite the fact that Potomac is already in
23 a company action level and it's their burden to
24 establish why that is something you should approve.
25 MR. JOHNSON:

1 Okay. Thank you. So we're down to
2 William. Was anything not covered you may want to
3 make some remarks?
4 ATTORNEY GREANEY:
5 Five minutes.
6 MR. JOHNSON:
7 That's fine.
8 ATTORNEY GREANEY:
9 Guarantee. I never really met a lawyer
10 who actually ---.
11 MR. JOHNSON:
12 Yeah, right. No, I haven't, so ---.
13 ATTORNEY GREANEY:
14 I actually just wanted to respond to a
15 couple of questions that you had earlier, Mr. Johnson.
16 One is you asked about other runoffs that failed. I
17 think your point was to say Home was back in the '90s
18 when things were done differently and we --- the
19 regulatory community has learned a lot. And I grant
20 all that is true. But I mean --- and I --- we can
21 probably provide you with a more complete list. I
22 assume you were focused on this side of the Atlantic,
23 because obviously across ---
24 MR. JOHNSON:
25 Yes.

1 ATTORNEY GREANEY:
2 --- the pond ---
3 ATTORNEY DAUBERT:
4 We are.
5 ATTORNEY GREANEY:
6 --- you've got a lot of runoff
7 failures ---
8 MR. JOHNSON:
9 Correct.
10 ATTORNEY GREANEY:
11 --- because they're relatively
12 unregulated and poorly capitalized. And they're even
13 more without arrangement. Over here, I mean, a fairly
14 I think spectacular example of a recent runoff failure
15 is Kemper. They went into runoff in 2003, 2004 to
16 most people's considerable surprise. I actually had
17 an advance awareness that that was coming because of a
18 particularly meddlesome asbestos account that they had
19 and wanted to deal with. But most people were quite
20 surprised by it, and by '05, '06 that beautiful
21 building they had with the golf course out in Long
22 Grove that used to be a beehive of activity, there
23 were 100 people remaining there. And they struggled
24 around in runoff for the next maybe nine years. And
25 then in 2013, you know, they went into liquidation,

1 which is going to take literally years to play out.
2 So there are --- another impending,
3 unfortunately, runoff casualty is probably going to be
4 Arrowood. And to be fair to the Delaware Insurance
5 Department, he didn't have a whole lot of leverage,
6 because there you had a very different situation. You
7 had a UK parent company that basically got sick and
8 tired of dealing with the U.S. legal system and said,
9 we're getting out of the United States, not just GL,
10 but everything. We're out of here. And when you
11 don't have a parent organization that's committed to
12 the U.S. market, no regulator can insist on the sun,
13 the moon and the stars.
14 So I think the Delaware Department did
15 about the best it could by insisting that they forgive
16 indebtedness to the runoff entities. And I think it
17 was close to a $300 million capital infusion,
18 submitting the jurisdiction and establishing a claims
19 monitor. That being said, if you take a look at the
20 capital debasement that's occurred since 2006 with
21 Arrowood, it's very difficult to look at that entity
22 and think that it's really long for this world. It's
23 pretty much limping along.
24 And I'd also point out that the damage
25 --- you also asked another question, why is the status

1 quo better? On the ground level, the damage that is
2 done by runoff entities is very significant. I cannot
3 tell you how many times I have negotiated coverage in
4 place arrangements, both in and out of litigation,
5 with a bunch of insurers to resolve asbestos claims on
6 a long term prospective basis with everybody picking
7 up a share, including the policyholder, just to get it
8 done, just to get it done, only to have Arrowood and
9 --- or Kemper come in at the last minute and say, we
10 don't do that anymore, we don't do coverage in place
11 arrangements. We want to buy out on the cheap, cents
12 on the dollar or we're not going to --- we're just
13 going to throw a monkey wrench in the whole gear.
14 Those of us who have dealt with runoff companies, they
15 see that every day.
16 And you mentioned Travelers getting
17 hammered in the press. But let's talk about
18 Travelers. That's a good example of an active
19 underwriter committed to the U.S. market that
20 aggressively managed and controlled it's A&E exposure
21 for that very reason. They input Travelers Indemnity
22 in their runoff. Hartford, they set up the Heritage
23 Group, but they didn't put Hartford Accident and
24 Indemnity into runoff. Why? Because they are
25 committed to the U.S. market, the property casualty

1 side of the market. They bit the bullet, they
2 repeatedly raised their reserves and increased them
3 over time. They aggressively did commutations for
4 fair value, they aggressively entered into coverage in
5 place arrangements.
6 And I have no brief for Travelers and
7 Hartford. I litigate against them all the time. But
8 there's a huge difference in the way they behave as
9 active ongoing underwriters and what a runoff entity
10 does, which they don't --- they don't proactively work
11 to really resolve coverage litigation. They
12 effectively invite or engender coverage litigation
13 because it puts things on hold for a long period of
14 time while they work to commute reinsurance and raise
15 cash and generate investment returns and do the sort
16 of things that runoff companies do.
17 So the problem that Travelers and
18 Hartford and Liberty have is that as hard as they have
19 worked to manage and reduce their A&E liability,
20 they've been hit with third and fourth generation
21 claims which is all new policies and exposures, which
22 would put them in difficult straights again. But it's
23 not like they haven't done a good job of managing
24 their exposure or been unfair across the board to
25 policyholders.

1 And in terms of Ace, the --- Ace is an
2 example of a parent, and you mentioned the controls
3 that you placed on them, which God knows, those are a
4 lot better than what's being proposed over here, which
5 is a walk-away, complete disassociation with the
6 legacy business. They go in one direction, the runoff
7 rump operation remains with a thinly capitalized
8 ownership structure that's not going to infuse any
9 capital if the actuaries are wrong.
10 And the reason that they're wrong is not
11 because they're good at --- bad at math. It's because
12 a lot of what goes into estimating asbestos and mass
13 tort liabilities has more to do with social science
14 and human psychology than it does with algorithms. So
15 if they're wrong, if the mathematicians and actuaries
16 are wrong, we're left without any source of capital
17 infusion, meaning you won't get it from OneBeacon
18 because they'll be long gone. And it's quite clear
19 from Armour Group's balance sheet that they won't be
20 in a position to do it.
21 So with the Ace transaction, not only
22 did we have the dividend retention plan, $2.5 billion
23 retroactive reinsurance and $800 million excess of
24 loss arrangement that you spoke about, we also had an
25 insurance company that was concerned about the severe

1 reputational consequences of not permitting Century to
2 fail. I mean, the same policyholders that buy D&O
3 coverage or Bermuda form coverage from Ace today, also
4 bought coverage from I&A and have legacy liabilities.
5 Ace can't afford to have Century fail.
6 But in the OneBeacon situation, not only
7 would there be no residual capital infusion protection
8 in the event that the actuaries got it wrong, but
9 you'll basically have a group of legacy policyholders
10 like the ones I represent, P&G, ITT, United
11 Technologies and others, who don't buy --- buys sort
12 of middle market specialty coverages that OneBeacon
13 sees itself as offering in the future.
14 So it's for those reasons that we really
15 hope --- and I take you --- I take your point that you
16 want specifics. I think there are some specifics in
17 the Terrell report. We'd be happy to provide more,
18 but what I'm --- my clients at least are looking for
19 is some residual protections. Because we just don't
20 share the optimism fundamentally that Towers Watson
21 does. And RRC is not optimistic; let's call it like
22 it is. They're --- they said, well, it's standard
23 actuarial methodology, but I mean, they're not
24 standing behind this report as a completely accurate
25 projection of what we're going to see in the future.

1 So we're just looking for residual protections.
2 That's the long and short of it. Thank you.
3 MR. JOHNSON:
4 Thank you.
5 ATTORNEY DAUBERT:
6 Thank you.
7 MR. JOHNSON:
8 We're going to take a 15-minute break so
9 we can huddle and determine whether we want to ask
10 some questions before we go through the rest of the
11 agenda. So we'll be back at 3:10.
12 SHORT BREAK TAKEN
13 MR. JOHNSON:
14 We'll get started again. I only really
15 have one question, though I have some additional
16 comments. And I think Brad, you want to come up just
17 for ---? And certainly as we talked about, you can
18 supplement this with additional information subsequent
19 to this. But I don't remember if there was something
20 in the Form A or not --- you had talked about in your
21 remarks that you believe you're going to have an
22 expense savings in running this compared to the
23 expense load that OneBeacon currently has.
24 MR. HUNTINGTON:
25 Correct.

1 MR. JOHNSON:

2 Have you done any analytics on that to
3 demonstrate? Has that been put into the Form A
4 Filing? How do you determine that you think you can
5 run it off at a less expense load than currently
6 OneBeacon is doing?

7 MR. HUNTINGTON:

8 We have done our own internal analytics
9 as part of the negotiation of the transaction. We
10 have not disclosed what we think those savings are to
11 either OneBeacon or to the Department. I would be
12 happy to put some numbers around historical cost
13 savings in other transactions that we participated. I
14 think I'd be hesitant to put it into this transaction
15 in that they're speculative and just an assumption
16 about the efficiencies that can be obtained by putting
17 an existing operation together with another operation.

18 Obviously when you have claims people, a
19 claims examiner can handle more than one file, so if
20 they have X files already and you add another ten to
21 their file load, then it doesn't cost you
22 incrementally more money. So there are some natural
23 cost savings by putting together organizations. And
24 we can provide examples ---.

25 ATTORNEY DAUBERT:

1 I think we're asking for specifics of
2 where your claims of cost savings are coming from.
3 MR. HUNTINGTON:
4 It can be significant. We'll put some
5 rough numbers that I think will help the Department
6 get an understanding of the potential.
7 MR. JOHNSON:
8 Okay. If you would do so.
9 MR. HUNTINGTON:
10 Okay.
11 MR. JOHNSON:
12 Okay. That's it. Thank you.
13 MR. HUNTINGTON:
14 Thank you.
15 MR. JOHNSON:
16 Why we decided not to ask anymore
17 additional questions is we believe that today the
18 public has put a lot of questions and comments on the
19 record, that I don't think we have the time today
20 orally off the cuff, so to speak, to get into kind of
21 responses --- the kind of responses as a regulator I'd
22 like to see, real analytics around a response. So
23 that's why I'm not going to ask any more questions.
24 But what I'm going to task again, as I
25 did at the beginning, that all the comments of the ---

1 of the public commenters need to be appropriately
2 addressed by the Applicant if it's a question
3 concerning the Applicant, or the Seller, if it's
4 concerning the Seller. We will have --- we are
5 targeting to have the transcript of this up on our
6 website next Thursday, the 31st of July. I'm sure
7 everybody took a lot of notes also, but you'll have
8 the transcript to review and go through.
9 But really, there's a lot of information
10 that the public has brought forth today that really
11 needs specific kind of thoughtful, analytical response
12 to from either the Applicant and/or the Seller. And
13 certainly, if the public has even more questions or
14 thoughts, there'll be more time, as I'll get into in
15 my closing remarks, to add to the record about this
16 transaction in the public comment period that I'll get
17 into shortly when we close.
18 So just --- I don't think --- otherwise
19 I think any questions that we ask today would be not
20 really effective answers, because this was a lot of
21 very detailed kind of comments and questions from the
22 presenters today, from the public presenters.
23 So with that, I will give an opportunity
24 if the commenters, any commenters want to add any
25 additional comments. Very short, but you've heard

1 from other commenters. I'll give you your opportunity
2 if you have a few minutes that you want to add
3 anything else to the record before we close down the
4 hearing.
5 ATTORNEY STOCKMAN:
6 Mr. Johnson, I just have about one
7 minute's worth of comments. Should I just stand here
8 and deliver them?
9 MR. JOHNSON:
10 Sure.
11 ATTORNEY STOCKMAN:
12 And they really are addressed to the
13 point you raised in response to my comments, which is
14 an important one, which is that this case turns on
15 uncertainty. But it's not so much as to whether
16 they're uncertainty. Of course there is. Rather,
17 it's who should bear the risk of that uncertainty.
18 My clients, who bought broad, general or
19 umbrella liability coverage, purchased something that
20 was intentionally designed to give them certainty in
21 an uncertain world. They paid a sum certain in return
22 for a promise that Commercial Union companies would
23 cover unexpected liabilities that happened to be
24 asserted against them. That quasi-fiduciary nature of
25 that obligation is why the Department even regulates

1 this sort of stuff in the first place.
2 Now, my clients can't get complete
3 certainty now. No one can, but we submit that the
4 risk of that uncertainty should fall upon the insurer
5 and not upon the policyholder who paid a premium to
6 shift the risk to a company who is by definition a
7 professional taker of risks. At a minimum, our
8 clients deserve better than the chances of success or
9 failure that appear to be faked into the transaction
10 as it's now structured.
11 We would ask the Department to ensure
12 that there's sufficient assets available to give
13 policyholders what they bought. And we would also ask
14 the Department to enable policyholders to make their
15 own calculations as to what that level of assets
16 should be and to appropriately offer our views to the
17 Department based on a complete base of knowledge.
18 In making that core determination,
19 whether the proposed transaction accurately accounts
20 for the future uncertainty associated with asbestos
21 and environmental liabilities, our best basis now for
22 predicting what's likely to happen in the future is of
23 course what's happened in the past. While it's cliché
24 to say that those who forget the past are doomed to
25 repeat it, that cliché like most clichés has a core of

1 truth. And the industry's track record in the context
2 of asbestos and environmental reserve estimation is
3 frankly not encouraging.
4 So we would ask the Department to keep
5 these transactions in --- or concepts in mind in
6 deciding whether to permit this transaction to move
7 forward at all, or if it does elect to have the
8 transaction move forward, in deciding what conditions
9 are appropriate to protect the policyholders. Thank
10 you again for the opportunity to speak.
11 MR. JOHNSON:
12 Any other public commenters want to add
13 anything at this point?
14 Seeing none, does either the Seller or
15 Applicant want to have any closing remarks at all, or
16 any of your representatives?
17 MR. MCDONOUGH:
18 I would like --- excuse me. I would
19 like to make a ---
20 MR. JOHNSON:
21 Sure.
22 MR. MCDONOUGH:
23 --- comment.
24 MR. JOHNSON:
25 Come on up.

1 MR. MCDONOUGH:

2 I appreciate the opportunity to make a
3 closing comment. We certainly look forward to
4 responding in writing to the comments that we heard
5 today and related filings that were put out in the
6 course of the last few days. And I certainly
7 acknowledge that some of them are thoughtful and
8 substantive. But I would characterize much of what
9 we've heard as full of exaggeration and distortion and
10 conjecture and a number of blatant falsehoods. And
11 we'll address those in our response.

12 Having said that, I would also like to
13 address the basic premise that I think cuts across all
14 of the policyholders' comments. And that is in the
15 event this transaction is not approved, the current
16 group of companies, including both the ongoing and
17 runoff business combined, will never be capital
18 constrained. That seems to be the premise. Or put
19 another way, that the management team of OneBeacon
20 will always under every circumstance be prepared to
21 contribute additional capital into the regulated
22 operating companies if necessary.

23 I suggest this is a false premise. In
24 the event the transaction is approved, in the rare
25 scenarios where the company runs out of assets before

1 it has paid its last dollar of claims, it is not
2 likely to reach that eventuality for 20 or 30 years or
3 more, as demonstrated in the stochastic modeling
4 completed by Towers Watson. During that period, the
5 capital needs of OneBeacon's ongoing business will be
6 subject to exposures and business contingencies that
7 cannot be predicted with any degree of certainty.
8 We submit that assuming the transaction
9 is not approved, whether OneBeacon will have the
10 resources or the intention to add additional capital
11 to a runoff subsidiary 20 or 30 years from now
12 provides less certainty to policyholders than the
13 certainty provided by the significant asset transfer
14 and the dedicated management provided for in the
15 proposed transaction. While in the absence of this
16 transaction it would certainly continue to be the
17 intention of the current OneBeacon management team to
18 manage the business in such a way that capital never
19 becomes an issue, that was also the intention of the
20 management team of every insurance company in the past
21 that has gone from a viable ongoing enterprise to a
22 company headed toward insolvency, and we all know that
23 can happen very quickly.
24 In addition, the current OneBeacon
25 management team is not likely to be in place 20 years

1 from now. My point is that even with no transaction,
2 there is simply no guarantee of solvency indefinitely,
3 or in this case, over a 20 to 30-year period or to
4 ultimately a 70-year period that takes us to the
5 ultimate resolution of the claims, as the risk factors
6 in the 10K of every public property casualty insurance
7 company very clearly spells out.
8 If on the other hand the transaction is
9 approved, what we believe is clear from the Towers
10 Watson stochastic modeling is that the transferring
11 companies are adequately and appropriately capitalized
12 in the context of a very wide distribution of
13 potential outcomes, and they would be immunized going
14 forward from any of the risks of the ongoing company,
15 both those relating to the current business and those
16 relating to any business that they undertake in the
17 future. In addition, the proposed transaction has the
18 benefits associated with transferring the ownership
19 and management responsibilities of the runoff
20 liabilities to dedicated runoff specialists.
21 Thank you again for the opportunity to
22 speak.
23 MR. JOHNSON:
24 Thank you. Is there anybody, since this
25 is a public informational hearing, that has anything

else to say before we close it out?

Okay. On behalf of the Department, I'd like to thank everybody for their participation here today. I think it was very productive. As I noted earlier, a transcript of this hearing will be posted on the Department website when it becomes available. As I said earlier, we hope by next Thursday.

Additionally, as I mentioned earlier, the Applicant will be required to file written responses to all questions and comments posed at today's hearing. Such responses will be posted on the Department's website. The public comment period will be reopened immediately and will close 30 days after the transcript is made available and after all questions and responses are compiled. The official close of the comment period will be noticed in the Pennsylvania Bulletin.

Again, thank you, everybody, for coming and your comments today. We are adjourned.

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HEARING CONCLUDED AT 3:26 P.M.

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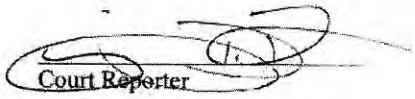
CERTIFICATE

I hereby certify, as the stenographic reporter, that the foregoing proceedings were taken stenographically by me, and thereafter reduced to typewriting by me or under my direction; and that this transcript is a true and accurate record to the best of my ability.