BEFORE THE PENNSYLVANIA INSURANCE COMMISSION

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

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

Wednesday

July 23, 2014

at 9:01 a.m.

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

AMY DAUBERT, Deputy Chief Counsel, Office of Chief Counsel

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

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

Reporter: Lindsey Powell

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I N D E X (cont'd)

E X H I B I T S

Docket Exhibits:

Number	Description	Page Identified	Page Admitted

NONE OFFERED

Petitioner's Exhibits:

Number	Description	Page Identified	Page Admitted

NONE OFFERED

P R O C E E D I N G S

MR. JOHNSON:

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

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

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

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

By way of background, the Department's review process began in February 2013 with an initial application filed pursuant to Section 1402 of the Holding Company Act. This application is commonly known as a Form A Filing. The Department published notice of the filing in the Pennsylvania Bulletin in February 23rd, 2013. The notice invited interested parties and persons to provide comment to the Department about the filing. The Department received a number of public comments, all of which are available on the Department's website at www.insurance.pa.gov.

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

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

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

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

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

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

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

Please note that because of the nature of today's proceeding, Cross Examination or interrogation of speakers will not be permitted. Commenters are asked to direct their questions to the Department. The Department will take those questions into account. The Department may have questions for the Applicant and may pose commenters' questions to the Applicant as well.

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

We will begin this morning with the presentation by the seller and the Applicant. These presentations may include presentations by multi-individuals. Next, the Department's expert will make a presentation. Then the public comment portion of the hearing will begin. During this segment of the hearing, any member of the public may make a presentation. The Department would welcome any commentator to also submit a written copy of their presentation and any other written materials or comments that it wishes the Department to consider. Anyone wishing to speak should sign up at the registration desk, if you have not already.

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

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

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

ATTORNEY PHILLIPS:

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

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

The Department has received and reviewed a very substantial amount of information relating to the proposed transaction. And our speakers today do not intend to repeat or summarize all of that information that is already in the public record. Various public comments have also been submitted to the Department, and those comments, as well as our written responses, are also in the record.

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

Seven factors are primarily the outline for --- under Pennsylvania's Insurance Holding Company Act that guides this transaction and the Insurance Department's consideration. The Insurance Holding Companies Act provides that the Department shall approve this transaction unless one or more of the seven factors set forth in the Act, Section 1402, actually requires disapproval. The record here demonstrates that those factors do not apply and that this transaction should be approved.

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

Under the fourth factor, the Department reviews the transaction to determine whether Armor intends to make any material changes to the management of the business that are, quote, unfair and unreasonable and fail to confer benefit on the policyholders of the insurer and are not in the public interest, unquote. There is no financial instability, potential harm or absence of managerial experience at issue here today. In fact, as Mr. McDonough will explain, there are clear benefits to policyholders. Armor is an experienced runoff manager and the record demonstrates that Armor will have the right amount of dedicated assets available to manage the business as it continues to runoff.

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

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

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

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

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

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

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

Finally, you will hear from representatives of Armor, Steve Davis and Brad Huntington, regarding Armor's substantial qualifications and experience in managing runoff portfolios. Mr. McDonough will be available after the conclusion of the formal presentation and following public comments to answer any of the Department's questions.

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

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

Of course, following --- depending upon the content of the public comments by the participants herein today, we may conclude that it would be appropriate and helpful to provide a few additional comments later in the proceeding for purposes of clarification or correction of the record. We trust the Department will indulge us in that event. I will now turn this over to Paul.

MR. MCDONOUGH:

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

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

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

Our runoff business consists of legacy liabilities predating the White Mountain's acquisition of CGU back in 2001 and more recent liabilities relating to our standard commercial operation that was sold on a renewal rights basis in 2009. In the wake of the 2009 sale, we began to organize our claims operation into two separate groups, one that manages our ongoing claims and one that manages our runoff claims. In addition, and after a series of discussions with the Department, we began the process of rationalizing our legal entity structure.

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

Third, moving capital between and among the companies through a series of capital contributions and dividends in a way that is consistent with the runoff and specialty liabilities being ceded via the new intra-company reinsurance agreements. Fourth, merging certain companies into other companies to simplify the number of legal entities and states of domicile. And lastly, creating new companies where necessary to support the ongoing specialty operations, all of which, of course, was subject to and received regulatory approval.

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

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

Note that before the final step of the restructuring and the proposed sale, OneBeacon Insurance Company on a consolidated basis and combined with Potomac has more assets and more surplus than post sale. But before the final step of the restructuring and the proposed sale, it also has more liabilities, not just the runoff liabilities, but also liabilities of the ongoing specialty business, including the lost reserves and under premium reserves of the specialty business, with exposure to natural catastrophe and terrorism related losses. Pre-final restructuring step and proposed sale, the consolidated OneBeacon Insurance Company also remains exposed to certain emerging risks that may relate to our ongoing book of business, but would likely not relate to our runoff book of business. For example, risks relating to new theories of cyber liability or nano technology or climate change or hydrofracking, et cetera.

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

To answer this question, we engaged Towers Watson to perform a stochastic analysis of how the business can be expected to perform with our proposed closing balance sheet as the starting point. You'll hear from Towers Watson directly later in this hearing, but the conclusion of the stochastic modeling is that the proposed closing balance sheet has a very high probability of funding all of the potential future claims across a wide distribution of potential outcomes, including extreme scenarios in the tail of the distribution of potential outcomes. It's worth noting that no insurance company, whether ongoing or runoff, no matter how well capitalized, has a 100 percent probability of funding all of its potential future claims. The tail risk associated with lost reserves and other enterprise risks is simply too great. The competence level for the runoff companies in this proposed transaction we believe is more than sufficient to meet the appropriate applicable regulatory standards.

In the context of the results of the Towers Watson stochastic modeling of the proposed closing balance sheet, we believe it is reasonable to conclude that policyholders of OneBeacon Insurance Company are better off after the proposed sale than before it, due to the following primary benefits of the transaction: first, the management of OneBeacon Insurance Company post close would be focused exclusively on managing the runoff operation, which we believe will result in better outcomes on average for all policyholders. And second, the runoff liabilities post close of the sale would be under separate ownership from the ongoing liabilities with assets designated exclusively for the satisfaction of the runoff liabilities with no exposure to the ongoing liabilities and risks of the ongoing company.

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

MR. BOZEMAN:

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

I have been working in the actuarial field for nearly 25 years. I am joined today by my colleague, Sandy Santomeno. Sandy is a Senior Consultant at Towers Watson. I am currently the head of the Property and Casualty Consulting Practice for the Philadelphia office of Towers Watson, and I serve as co-leader for our Loss Reserving Product Group for the Americas. My main practice areas are loss reserving, economic capital modeling and mergers and acquisitions works as part of the risk consulting and software, or RCS business, of Towers Watson. Sandy and I oversaw the work on the engagements that we will discuss this morning.

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

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

Relevant to these assignments, we have

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

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

Now, I will provide some background on Towers Watson's role in this process. We were originally engaged by OneBeacon at the end of 2012 to perform an independent review and report on OneBeacon's loss and loss adjustment expense reserves for the business subject to the proposed sale to Armor. We understood that at that time that our work would be reviewed by the Pennsylvania Insurance Department as part of the Form A process. We completed our report in September of 2013 and a summary report has been made public in the Form A materials.

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

To provide you with an overview of what we will review today, I will first provide some discussion on the high level approach and conclusions from both our reserve analysis and our stochastic modeling, then move on to a more detailed discussion of the approach and methodologies we used for lines other than asbestos, pollution and other mass torts, the non-NICO lines. My colleague, Sandy Santomeno, will follow and provide a similar discussion for the NICO lines, which are the asbestos, pollution and other mass torts. After Ms. Santomeno's remarks, I will review the general approach we used for the stochastic modeling and conclude our presentation.

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

Our review encompassed all loss and loss adjustment expense reserves, including unallocated loss adjustment expenses and a separate provision for uncollectable reinsurance. Our analysis was performed both gross and net of two large reinsurance streams, the general reinsurance adverse development cover, applying to the runoff of accident year 2000 and prior claims for the non-NICO lines, and the NICO cover, applying to future asbestos, pollution and other mass tort losses subject to an aggregate limit.

The focus of our review was to provide an independent estimate of the unpaid loss and loss adjustment expenses, not to provide commentary on OneBeacon's held reserves. So we did not directly compare our conclusions with the corresponding amounts held by OneBeacon in select reserves. In the reserve report, we discounted reserves based on the payout patterns derived in our reserve analysis and expected investment returns on the asset portfolio. We do not believe the discounted figures shown in our reserve summary report are important now, however, in understanding the economics of the runoff business, as the analysis in the stochastic report is more detailed and comprehensive.

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

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

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

In our stochastic report, we then reviewed the data as of September 30th, 2013 and conducted a similar roll forward from March 31st, 2013 to September 30th, 2013. And the results are shown on the slide as well. Finally, we derived an estimate of the unpaid amounts as of June 30th, 2014 by subtracting the estimates paids from September 2013 to June 30th, 2014. These resulting estimates at June 2014, which are shown here, are then directly used in our stochastic model.

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

As shown on the slide, our actuarial central estimate of net unpaid loss and LAE for the NICO lines on an undiscounted basis and before the application of the NICO treaty was $1 billion and $5 million, with a range of reasonable estimates from $885 million to $1,214,000,000. For reference, the remaining NICO treaty limit applicable loss and LAE payments after December 31st, 2012 was $984 million.

Similar to the non-NICO lines, we then conducted the roll forward of the estimates for the NICO lines. The estimated unpaid as of June 2014 shown on this slide was then also used in the stochastic modeling.

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

Please turn to the third slide, which reflects the results from running 10,000 simulations from our stochastic model. As you can see from the slide, the company is projected to meet all of its obligations through the first 30 years and about 90 percent of the time. Through 70 years, when we expect all claims to have been paid, the company is projected to meet all of its obligations in over 88 percent of the cases.

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

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

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

MS. SANTOMENO:

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

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

As Chris mentioned, I will discuss our modeling approaches, specifically with respect to the

NICO lines. We relied upon two basic approaches to evaluating asbestos conclusion liabilities, a ground-up exposure analysis and aggregate methods. A ground-up exposure analysis is based on an insurer's own evaluation of policyholder costs based on policies written for defendants. The ground-up analysis is the approach preferred by the actuarial profession and most rating agencies. As more commonly used, actuarial methods do not work well when evaluating A&E liabilities.

For example, A Invest, a leading rating agency, has stated that it will give significantly greater weight to a company's ground-up study results than it does to the results of the agency's own study, which typically employs aggregate methods. Aggregate methods rely upon aggregate benchmarks determined by the industry data and experience, and should be used with caution since it is possible that an individual's --- individual company's own claim experience may deviate perhaps significantly from that of the industry.

Within the context of this analysis, we did not use the aggregate approach for asbestos because the exposure-based method is clearly superior to the aggregate approach. For pollution --- for the pollution analysis, we placed most of our reliance on the ground-up model and only minimal reliance on the results of the aggregate methods.

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

Claim frequency is the number of claims alleging asbestos exposure expected to be filed against the policyholder. We forecast claim frequency using Towers Watson's industry benchmark claim filing patterns. Towers Watson's --- their filing pattern --- benchmark filing patterns are based on epidemiological assumptions and observed industry claim data and are regularly calibrated for the following emerging issues, such as increased mortality assumptions as people are living longer, non-occupation or take-home exposure claims, increased filings due to the role of social media and recruitment and better diagnosis of asbestos-related disease. Once we determine the future number of claims expected to be filed against the policyholder, we determine how many of these claims will be paid and how many will be dismissed without payment, which is called the payment rate.

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

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

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

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

Up until now we've described the process of forecasting indemnity by account. Next we determined what the defense cost estimates will be. For defense costs, we estimate a provision for future costs by using a ratio of defense costs to indemnity costs. And secondly, we also estimate a provision for future coverage disputes --- the cost of future coverage disputes, generally by using the ratio of costs to indemnity costs.

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

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

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

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

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

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

MR. BOZEMAN:

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

Volatility in asset returns was reflected as well as volatility in loss payments, both in the amounts of payments and the timing of payments. The modeling of the volatility and the loss payments reflects both parameter and process risks. Parameter risk refers to the risk that the selected parameters, such as the mean estimate of future payments, have been misestimated and therefore differ from their true but unknown values. Process risk reflects the risk that future outcomes deviate from the mean, even if the mean has been correctly identified.

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

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

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

For the NICO lines, we put a statistical distribution to our low, central and high estimates. The distribution selected, the lognormal, is commonly used for modeling insurance loss distributions and has the property of being right-skewed, that is, the very high points on the distribution tend to be further from the mean than the very low points do. As a result, there are outcomes in the stochastic model that are considerably higher than our high reasonable estimates from the reserve report. While we do not individually describe the set of circumstances related to each simulation, one could think of the more extreme scenarios as being driven by changes in the future litigation environment or other unforeseen events not quantified in our reserve report.

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

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

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

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

MR. JOHNSON:

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

MR. HUNTINGTON:

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

The purpose of my presentation today as set out on page two of the handout is to focus on the following items: firstly, who is Trebuchet U.S. Holdings, Inc. Secondly, what is Trebuchet's intent with respect to the OneBeacon runoff entities and their liabilities? Thirdly, who is Armor Group? Fourthly, what is the expertise and experience of Armor and Trebuchet? And finally, why we believe the sale to Trebuchet should be approved.

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

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

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

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

The next item taken in turn, what is Trebuchet's intent or plan for the OneBeacon runoff entities. First and foremost, I'd like to point out that absent the change of shareholding, one of the key components of the proposed transaction is continuity in the servicing of the claims and the operations of the entities. As described on page four of the handout, there is already in place a dedicated team of professionals servicing the OneBeacon runoff, and the proposed transaction will ensure that this same group of professionals be transferred to a Trebuchet affiliate and that they will continue to have responsibility for the day-to-day management of the net claims portfolio post-closing, subject always to the supervision and oversight of the seasoned runoff professionals in Trebuchet and its affiliates.

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

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

Turning to page five of the handout, who is Armor Group. Armor Group's a Bermuda headquartered group of companies focused on niche opportunities in the insurance and reinsurance markets, including runoff opportunities. For those of you unfamiliar with Bermuda as a jurisdiction, it is usually seen by most commentators as representing one of the largest and most respected reinsurance marketplaces in the world. Armor Group is 100 percent privately held by its management. And its operations include the ownership and/or operational control of licensed insurance and reinsurance companies in multiple jurisdictions globally, including an existing Pennsylvania licensed entity.

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

Slide six of the handout contains brief bios of some of the senior management team of Armor Group. And you'll see from the descriptions that Armor's management brings a wealth of experience to the table, and that they have all been operating in highly regulated insurance and reinsurance marketplaces for very long periods of time. Importantly, this experience includes the business lines which form the basis of the OneBeacon runoff portfolios.

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

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

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

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

Thirdly, Trebuchet and its affiliates have existing Pennsylvania operations which will add to the smooth transition of people in systems, and importantly, ensure the capture of significant potential cost efficiencies, while continuing existing service levels, again all to the benefit of policyholders. Fourthly, as has previously been discussed by the OneBeacon presentations and the more detailed presentation review by Towers Watson, we believe that Trebuchet will have the necessary amount of assets and dedicated capital at closing available to acquire the OneBeacon runoff entities, and the proposed balance sheets are consistent with the proper management of the OneBeacon runoff entities as they continue to run off.

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

MR. JOHNSON:

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

MR. MOORE:

Good morning. My name is Craig Moore and I'm a partner in the firm of Risk & Regulatory Consulting, LLC, or RRC. I'm the partner in charge of this engagement and am ultimately for the delivery of the final results of our review to the Pennsylvania Insurance Department.

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

Our comments today are taken from our summary reports, both dated June 20th, 2014, which contain more detail than we plan to present today and have been made part of the public record. The two reports referenced are titled as follows: first, Report on Review of OneBeacon Insurance Group, LLC, Analysis of Unpaid Loss and LAE as of September 30th, 2012, December 31st, 2012 and March 31st, 2013, as prepared by Towers Watson. And second, Report on Actuarial Review of OneBeacon Insurance Group, LLC, Stochastic Modeling of Runoff Business Pro Forma Balance Sheet, as also prepared by Towers Watson.

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

RRC's primary function was to advise the Department as to the reasonableness of the assumptions and analyses in both of the Towers Watson's reports, ultimately assisting the Department in its objective of determining whether or not the runoff companies, at the time of and following the acquisition by Armor, contains sufficient assets and sufficient liquidity to pay out on a timely basis all amounts due to policyholders and claimants.

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

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

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

As noted in our analysis of the reserve report, Towers' ground-up reserve study was conducted using data as old as September 30th, 2012. These results were rolled forward to March 30th, 2013, for the purposes of the Towers reserve report by adjusting for actual emerged losses through that date. In addition, the losses have also been rolled forward to September 30th of 2013 using actual emerged losses through that date, and then to June 30th of 2014 as inputs for the stochastic model. This was accomplished by adjusting from losses expected to emerge between September of 2013 and June of 2014.

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

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

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

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

Now I would like to turn our presentation over to Michael to describe in some detail the process employed during our review, as well as some additional detail on our conclusions from our review of the two Towers Watson reports.

MR. DUBIN:

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

In general, when actuaries independently assess another actuary's work, we review the subject actuarial report and supporting documentation and then discuss it with the actuary who performed the work. Then in the role of reviewing actuary, we assess whether important aspects of the work, methodologies and assumptions for example, were reasonable and whether professional standards were met. In this case, based on performing those steps, we believe that the actuarial work provided by Towers to support the Form A Filing is reasonable, as it contains reasonable conclusions, assumptions and methodologies, appropriately highlights major risk areas and meets applicable professional standards.

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

First is the reserve report. As previously mentioned, there are two major liability components reviewed by Towers in its reserve report. The first is the runoff companies' asbestos and environmental liabilities, also called A&E reserves. This segment is reinsured under an adverse loss development treaty with National Indemnity Insurance Company, and is referred to as the NICO segment. The second liability segment includes traditional property casualty lines, roughly half of which is Workers' Compensation. This segment is reinsured under a separate adverse loss development treaty and is referred to as the non-NICO segment.

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

Towers used proprietary exposure-based models to quantify asbestos and environmental losses in the NICO segment. These models utilized individual policyholder and claim information and were supplemented by relevant industry benchmarks. We concluded that the work done by Towers to estimate asbestos and environmental losses was thorough and that the application of the proprietary models was appropriate. We did not review the underlying algorithms of the proprietary models themselves, as these are not standard actuarial methodologies. We did receive full description of these models and satisfactory answers to our questions about the models.

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

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

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

The reserve roll forward calculation is a key component of the Towers' analysis because its result is an input to the stochastic model. The roll forward was provided in sufficient detail to follow the emergence of actual loss payments subsequent to the data analyzed in the report and compared to expected loss payments. Because over a year has passed without a new ground-up reserve study, we questioned Towers on why they chose a roll forward approach as opposed to a new ground-up reserve study. Considering the long tail nature of the business of the reserves, the relatively short time frame covered by the roll forward calculations and the subsequent payment detail review by Towers in its roll forward work, we concluded that the resulting ultimate loss estimates were sufficiently reliable to use as inputs for the stochastic model.

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

Another key element we discussed in detail with Towers was the incurred but nor reported reserves, or IBNR, for the NICO segment. Towers noted that the IBNR provision is intended to allow for some unforeseeable emergence of future claims. The reserve report includes extensive documentation of several standard reserving methodologies using aggregate data to project 28 segments of non-NICO losses. Towers supplemented these methods with an analysis of individual claim data and made reasonable actuarial central estimates based on the results of these methods. It should be noted that approximately $70 million of the non-NICO reserves, consisting primarily of involuntary Workers' Compensation pools, were not reviewed by either Towers or RRC.

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

First, the inflation assumption --- assumptions used by Towers in both its reserve and stochastic models affect each model's generated asset returns and loss development for both NICO and non-NICO lines. Towers has provided a reasonable array of inflation assumptions varying from two percent to eight percent, and maintains consistent assumptions for inflation within its assumed interest rates.

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

Next, we discussed the impact of the change in ownership. When a company changes its business model and its approach to claims handling, it is probable that reserves would be impacted to some degree. Addressing the impact of ownership on claims handling and reserve calculations is a matter of professional judgment in the actuarial community. Some actuaries conclude that reserves would not be impacted when a company undergoes changes such as those expected in this case, while others would reflect explicit changes in their reserve calculations. We believe that a change in company ownership has the potential to alter historical payment patterns underlying the loss reserve study. To the extent that this occurs, ultimate losses can be different from those based on historical data.

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

There is also an element of uncertainty introduced given the fact that the models are not the only possible models that could be used. This is known as model risk, which should always be considered when models are used. Projecting ultimate losses without projecting future economic conditions would not be sufficient to determine the likelihood of success, because claims are expected to be paid many years in the future. Moreover, the companies are expected to be reimbursed for NICO losses until the NICO treaty is exhausted, which could be many years from now. As a result, assumptions regarding future economic conditions such as the rate of inflation and interest rates, as well as the timing of future loss payments, particularly for the NICO segment, also play a critical part in estimating the likelihood of success. The model's results also provide useful insight about the causes of potential failures.

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

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

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

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

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

The final version of the model we reviewed assumed a maximum of 15 percent equities throughout the first 30 years. Some investment in equities, according to OneBeacon, is a key element of the transaction because much of the anticipated loss payments are not expected for many years, and investment in equities is expected to produce a higher return over the long term than other investments. As a result, the final modeling has a reduced probability of failure due to poor equity performance in the initial modeling, which assumed a higher percentage of investments in equities.

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

As Craig mentioned earlier, we conclude that the actuarial estimates of ultimate losses in the Towers reserve report and its stochastic model report utilize actuarial methodologies that are generally accepted and appropriately applied. In addition, we conclude that Towers' work and its conclusions regarding failure scenarios in its stochastic modeling are based on accepted assumptions and methodologies, meet applicable actuarial standards and practices, and provide a reasonable basis for determining whether the assets would be adequate under most circumstances to fund the obligations of the runoff companies. Thank you.

MR. JOHNSON:

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

ATTORNEY SCARBROUGH:

Yes.

MR. JOHNSON:

Okay.

OFF RECORD DISCUSSION

MR. JOHNSON:

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

ATTORNEY GREANEY:

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

MR. JOHNSON:

Well, that's okay.

ATTORNEY GREANEY:

I don’t anticipate ---.

MR. JOHNSON:

Okay.

ATTORNEY DAUBERT:

But you have to be ready. We understand.

MR. JOHNSON:

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

MR. FERGUS:

Here.

MR. JOHNSON:

Okay. And Dan Healy?

MR. HEALY:

Yes, I'm here.

MR. JOHNSON:

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

Okay. And we'll put a place marker with you. Two, three, four, five, six --- so that's six people that want to speak, which is fine. To give you some parameters, then, with six people wanting to speak, is if you could hold your remarks to no more than a half an hour. That'll give three hours of, you know, public comment. Because we still want to go through questioning, as well as the ability to come back and make some final remarks both from the public, as well as the Applicant and Seller. So does that work? Does anybody have any concerns about the time limit you have on your remarks?

ATTORNEY DAUBERT:

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

MR. JOHNSON:

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

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

ATTORNEY STOCKMAN:

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

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

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

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

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

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

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

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

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

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

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

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

And as a result, it should come as no surprise to the Department that Towers Watson's report is equally laden with caveats and qualifications. Quote, projections of loss and LAE liabilities are subject to potentially large errors in estimation. No assurance can be given that OneBeacon's actual loss and LAE liabilities will not materially exceed the estimates contained herein. The inherent uncertainty associated with projection of loss and expense liabilities is increased when dealing with toxic torts due to the nature of these losses. The technological, judicial and political climates involving toxic torts such as asbestos and pollution continue to change and traditional actuarial methods are not optimal for projecting toxic tort liabilities.

As a result, the projection of liabilities for asbestos and pollution claims is subject to great uncertainty. And in fact, I thought it was commendable of Towers Watson to point out today that they are not taking into account changes in the litigation environment, and that they are specifically abjuring any expression of opinion on the adequacy of

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

The data showed that the property casualty industry as a whole and OneBeacon in particular have historically underestimated A&E exposures, often materially so, and are continually playing catch-up in an attempt to correct past mistakes. For example, the cumulative incurred losses for the property casualty industry as a whole at the end of 2012 paid claims plus existing reserves was, according to A Invest, $75 billion. But A Invest projected the ultimate cost at that point to be $85 billion. As a result, at the end of 2012, the property casualty industry as a whole was cumulatively under-reserved by $10 billion.

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

Finally, discovery of new coverage limits and claim reopening are inherently unidirectional and can only move the estimated liabilities upward. OneBeacon's historical reserving process is consistent with this observation. For example, OneBeacon transferred $955 million in existing A&E reserves to NICO in return for $2.5 billion reinsurance. But at this point, only $198 million of that two and a half billion is unexhausted on an incurred basis. This shows that OneBeacon's reserves as of 2001 on some of the same baskets of risks that it seeks to transfer here turned out to be at least $1.347 billion too low.

Moreover, OneBeacon increased in its A&E reserves by 45 percent from 2005 to 2011. If you kind of poke at Towers Watson's report, it even makes clear that OneBeacon's reserving has been, to put it charitably, overly optimistic. OneBeacon's midpoint --- or Towers Watson's midpoint estimate of A&E liabilities as of the end of 2012 was $1.239 billion.

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

Candidly, Towers Watson's reports for their part do no alleviate our concerns about the reserve projections. And one point that I think is important to emphasize is that the Towers Watson reports, in our view, ask the wrong question. The issue here is not whether assets will fall to zero or below zero. It's whether they will fall to a point that will drive this Department to put the runoff entities into statutory insolvency because of inadequate capital.

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

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

Some other points of concern. The fact that the stochastic modeling is based on the central estimate of unpaid loss and ALAE. Our view informed by experience is that the range of outcomes, as we've suggested, does not fall in a normal distribution around that central estimate, but tends to be skewed right-ward. Further, the modeling assumes certain future loss development trends that we believe are speculative at best and counterfactual in all likelihood.

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

Towers Watson also assumes that

technological improvements will offset future price inflation for environmental remediation. But this ignores countervailing developments in the science. Two examples. First, many of the environmental sites that would be addressed through this transaction are contaminated with trichloroethylene. But just within the past few months, emerging toxicology data has suggested that there may be greater risks than once were thought to be the case. And agencies now are looking into requiring more stringent cleanup standards and possibly reopening closed sites.

Another example is that until very recently there was little environmental concern about the risks posed by perfluorinated compounds or MTBE. And every day we are starting to see more and more contaminants that are becoming matters of concern as toxicological understanding increases and as detection technologies enable the measurement of toxic substances in ever smaller quantities.

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

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

And in fact, RRC, I think, helpfully pointed out that the acquired companies remain solvent only if certain of OneBeacon's rosy assumptions hold up. RRC points out that the NICO reinsurances projected under Towers Watson's central estimate to exhaust in 15 years, and they point out that even that estimate relies on a robust investment yield on assets, 5.92 percent, which is a rate that OneBeacon projected and that Towers Watson accepted.

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

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

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

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

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

You know, for example, in the asbestos liability context, Towers --- Towers Watson used a 7.5 percent provision for uncollectible reinsurance due to reinsurance coverage disputes, a figure that OneBeacon assumed in its ceded model and that Towers Watson assumed and incorporated in its estimates. And for the non-NICO book, Towers Watson estimated its uncollectible reinsurance based principally on insolvency risk. Its counterparty risk was based on the financial strength of its reinsurers, not on their unwillingness to pay. This is not realistic in our view.

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

Mr. Terrell, for his part, agrees with this conclusion and also, I think helpfully, points out that a runoff operation has an overriding incentive to generate cash flow by commuting reinsurance for less than full value. So when we look at the existing reserves in the reinsurance and once we conclude those are inadequate, what we're left is what --- to pay claims is what capital is left in the existing organization.

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

And of course, Armor Group is not able to provide the needed funds from its own resources. In the 2011 financial statement that they provided to the Department, they listed total assets of only $9.2 million. Clearly, there's no capital infusion coming from Armor Group if the existing assets of the runoff operation are inadequate. I mean, I think it's telling that the statements from Armor Group today about why the Department should approve the transaction focus solely on their background and on their claims handling, not on their financial capability to pay insurance claims if reinsurance is exhausted.

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

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

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

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

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

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

MR. JOHNSON:

Just watching the time.

ATTORNEY STOCKMAN:

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

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

Mr. Stewart went on to observe that post-restructuring runoff companies are, quote, worst of all. Such insurers have no concern about customer relations because they do not write business. For the same reason, they have no restraining concerns about reputation. Their managements are sometimes awarded compensation contingent on financial results or even on there being money left when all the claims are run off. Either way, it is compensation contingent on not paying claims. This is true, of course, because a restructured runoff company of this sort that's proposed to be created here, quote, has to be managed to preserve the limited assets it was given in the split. Otherwise, quote, it will not have the money to pay the contingent compensation. Give a person such strong incentives and he or she will follow them. And in that regard, the existing remedies under the law are not a suitable deterrent.

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

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

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

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

Accordingly, we ask the Department to disapprove the proposed transaction. You know, as Ms. Phillips noted, the Department has broad authority to disapprove this transaction if the financial condition of the acquiring party might jeopardize the financial stability of the insurer or prejudice the interests of its policyholders, if the plans and proposals are unfair and unreasonable and fail to confer benefit on policyholders, if it would not be in the interests of policyholders and the public to permit the acquisition or if the acquisition is likely to be hazardous or prejudicial to the insurance buying public. We ask the Department to exercise this authority and disapprove the transaction.

At a minimum, if the Department is inclined to approve this transaction, we believe substantial additional safeguards are necessary. These could include required additional capital. They could include required additional reinsurance. We'll note that if the existing reinsurance is indeed adequate, the additional reinsurance should be inexpensive.

We would propose perhaps a dividend retention plan or other sort of intracompany guarantee requiring OneBeacon --- the OneBeacon Group to keep skin in the game and to keep the runoff companies' surplus at or above an appropriate level. We'll note that this was an important component of the 1996 INA Century Indemnity transaction that the Department approved. You know, by doing that, just as Ace now has an ongoing interest in the continued performance of Century, the OneBeacon Group will have a continued economic interest in the viability of the spun-off entities.

And lastly, we believe that the Department would need to exercise close ongoing monitoring of the --- of any runoff company. In this respect we'll point out one thing that the Delaware Insurance Department did in the course of approving the Royal and Sun Alliance spinoff of its U.S. business. There they required the appointment of an independent claims monitor at Arrowood's expense. Finally, we would suggest that the Department adopt one of the procedures set out in the NAIC White Paper and incorporate a provision for obtaining policyholder consent as a precondition for the approval of the transaction.

Thank you for the opportunity to comment. We would welcome any questions the Department has either now or later.

MR. JOHNSON:

I let you go a little over, but I'll --- that's okay.

ATTORNEY STOCKMAN:

I appreciate the indulgence.

MR. JOHNSON:

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

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

ATTORNEY STOCKMAN:

And we would fully agree with that. But I think the problem is when a runoff company --- when you divorce payment of claims from ongoing underwriting activity, it creates two problems. First ---.

MR. JOHNSON:

Let me ask you a question about that, so why don't you just hold off a second. Now, we do have a bunch of --- a few different petitions to intervene.

ATTORNEY DAUBERT:

Yes, we do.

MR. JOHNSON:

So again, we will at some point in the future, be taking some action on these requests for intervention. Just so you know. We have them, we understand them and we will be taking action sometime into the future on those requests. And I will say, too, just to be point out to be fair --- and certainly the Applicant can speak for themselves.

Just to point out that the risk based capital will allow those companies in runoff to be in mandatory control level, meaning they can go down to a dollar of capital under the supervision of the Insurance Department and still maintain its runoff status. So though you've talked about capital and gave kind of --- that it's not just assets, it is about assets, because the RBC law allows a company to be in mandatory control level if it's in runoff and under the supervision of the Department, just to be clear what the law allows.

Let me --- and certainly we're --- not that --- this doesn't go to you, and you had some good comments here. But to others who speak and subsequent in any correspondence you want to give to us, generally as anybody in their research knows, in these transactions, we do --- not just Pennsylvania, but all regulators usually have a fair number of conditions as part of if they --- if we approve a transaction like this or any transaction that we approve, we certainly have the ability to add conditions. We certainly will take comment on --- give us some --- ones today, but if anybody has, not just today, but subsequent to today, has suggestions about conditions we should consider if we decide to approve the transaction. That's something good to comment to us on, because that is normal course of business. If you've seen our orders in the past, not just Pennsylvania but any of our --- my fellow regulators from around the country.

Let me ask you this, though. The status quo. So you're for the status quo. And that's fine, I understand that. But what I want to understand is what is your belief, is how does OneBeacon have to fund future adverse development within the runoff operation? What legal requirement is there when there are separate corporate entities involved? And what is --- why do you believe the status quo could be more beneficial than the transaction itself? And it's just an open question. Knowing that --- there's no really legal requirement for OneBeacon, the holding company to fund any of its corporate entities going forward in the future.

ATTORNEY STOCKMAN:

No. And obviously, you know, we can elaborate on this in more detail. I think there are two important points to point out in that respect. First, there's reputational risk. You know, those of us who represent policyholders have seen contested claim situations all the time where the --- you know, where a contested claim is resolved because the insurer is concerned about its ongoing reputation in the industry, either with that policyholder and that policyholder's continued patronage, or with respect to the industry as a whole. Obviously some insurers are more easily swayed by that than others, but reputational risk is an important constraining factor when the runoff entity remains within the corporate family.

The second is, of course, there are

existing legal remedies that penetrate that wall of corporate separation if an ongoing company has deliberately walled off a subsidiary in an undercapitalized state and allowed it to wither on the vine. They're certainly not sure things, but that again provides a disincentive for a company who is keeping a, quote/unquote, bad bank in its corporate family, to leave that bad bank starved for assets. And I'm sure once I get a chance to ---

MR. JOHNSON:

Yes, and ---.

ATTORNEY STOCKMAN:

--- get back to the office and ---

MR. JOHNSON:

Again ---.

ATTORNEY STOCKMAN:

--- think about it more ---

MR. JOHNSON:

Right.

ATTORNEY STOCKMAN:

--- I'll come up with some other things. But those are the --- those are the issues that immediately spring to mind.

MR. JOHNSON:

I would suggest to other commenters to

consider the concept of why the status quo is better or --- than the transaction in your remarks or subsequent, obviously. We're going to continue to take public comment, and I'll get to that in my closing remarks.

One of the things you said that I'm a little concerned. Since the Home --- which again, the Home goes back to the mid '90s. We're 20 years from the Home. A lot of things have changed dramatically in many respects, both regulatory and environment. But since then, I don't --- what other runoff company, pure runoff company --- because I'm not sure I'm aware of a pure runoff company that actually has been placed into liquidation up to this point in time subsequent to, you know, the early 2000s.

And if you have examples, it's important to point them out. But personally, and I regulate a number of runoff companies, and none of them are going under yet. And certainly within companies like the A situation with Century Indemnity hasn't gone under yet and hasn't had any more additional capital needed from its parent company under the structure that was formed back in 1996.

So when you make a statement like that, I would appreciate if you have some backup other than the Home on pure runoffs. Please supplement your comments today, because I haven't seen a lot of these runoff companies yet --- yet. Understanding all this uncertainty. And I understand all this uncertainty. Believe me, I live it as much as you live it. It could happen in the future, but up to today I don't think there's been a lot. But you certainly can supplement there.

ATTORNEY STOCKMAN:

If you have no other questions, I'll sit down and shut up and let someone else talk. Thank you again for the opportunity to speak.

MR. JOHNSON:

Yep. Okay. Next up we'll go with, since he mentioned you a couple of times, Jonathan Terrell. Am I pronouncing your last name, or what ---?

MR. TERRELL:

Terrell's fine. I respond to that.

ATTORNEY DAUBERT:

But how do you say it?

MR. TERRELL:

Well, as you might have observed, I've got a slight English accent still after 26 years in America, and parts of my family say it both ways, so I respond to both, Terrell and Terrell (changes pronunciation).

MR. JOHNSON:

Okay. Thank you.

MR. TERRELL:

Well, first part looking at my note was my name, so I think I've got that straight. I was retained to give expert advice and opinions on behalf of the same group of companies identified by Mr. Stockman in his remarks. I incorporate --- I reference the report that I filed on Monday into my remarks today. I will attempt to avoid repeating what Mr. Stockman said, though I agree with his comments and endorse them.

I would also like to acknowledge the expert analysis of Mr. Kaufman from FTI. He is an actuary, not an accountant. We've got lawyers here, so I'll forget the bad joke but --- so recalling of the issues was similar but different perspectives, but I very much appreciate and endorse his analysis and observations as well.

I'll say a couple words about my background. I've been around the issues presented in the proposed transaction my entire working life. I began work in 1984 at the accounting firm Ernst &

Young in London. I worked on the audit of Lloyd's syndicates as that market was beginning to come to terms with its own massive under-reserving for asbestos and environmental liabilities. Thirty (30) years later we're struggling with the same subjects, reserve adequacy for asbestos and environmental liabilities. Truly, the more things change, the more they seem to stay the same.

In between, I worked for six years as a senior officer of Zurich Financial Services, a subsidiary then of Risk Enterprise Management, formed to manage the runoff of the Home Insurance Company. I personally negotiated most of their largest environmental and asbestos settlements during that time period and was intimately familiar with its runoff strategy. I have therefore had firsthand experience of what may be in store for policyholders if the proposed transaction is approved.

Twelve (12) years ago I founded an consulting firm, KCIC, focused on providing reinsurance and risk management consulting services to policyholders. One of our consulting services is providing claims administration and reinsurance spending services to corporate asbestos defendants. We process thousands of asbestos complaints each year and bill insurers under at least 50 different coverage in place agreements each month.

I am deeply involved in the realities on the ground of defendant companies dealing with major exposures, and also with their strategies to collect their triggered insurance assets. I am particularly knowledgeable and have expertise in insurance company restructurings, both liability based restructurings such as the proposed transaction, and loss portfolio transfers such as the many retroactive reinsurance deals with Berkshire Hathaway.

I have testified before the Delaware Insurance Department concerning the Royal Arrowood transaction described in my report. I gave evidence to the North Carolina Insurance Department concerning a proposed liability based restructuring for Chartis, or AIG. I've given expert testimony concerning the current credit risk associated with Century Indemnity Company, itself the subject of an LBR 15 years ago. I've also been retained as an expert witness in numerous matters concerning Berkshire Hathaway and its involvement in retroactive reinsurance deals of the very type important in the proposed transaction.

I'll now give a brief summary of my opinion, and as previewed by Mr. Stockman. The proposed transaction is the most opportunistic and most cynical insurance company restructuring I have ever seen. I am surprised the proposal is still on the table and it has not been summarily rejected long ago.

The proposed transaction is manifestly, severely prejudicial to the interests of policyholders due to a combination of several things. One, the substitution of a weak parent for a strong one. Two, inadequate capitalization by upstreaming of capital out of OneBeacon Insurance Company. Three, inadequate reserving for volatile books of business, especially asbestos and environmental. And four, an undue reliance on investment performance that is purely speculative.

In addition, the proposed transaction is manifestly prejudicial to the public interest for two reasons. One, it undermines the trust in the insurance bargain, and by the insurance bargain, I mean quite obviously the premium gets paid up front. Sometime later a claim gets paid --- well, a claim is made and may be paid. And the trust in that insurance bargain is a public good. And secondly, it undermines confidence in the regulatory process to protect that insurance bargain.

The proposed transaction has not been reviewed in accordance with the best practices of the NAIC guidance on liability based restructurings. In particular, policyholders have not enjoyed acceptable levels of disclosure. And that White Paper recommends that in return for signing adequate confidentiality agreements, that policyholders do have access to confidential information. Secondly, policyholders have not been allowed to fully participate in the regulatory process to date, notwithstanding the welcome opportunity to comment publicly. Finally, in my opinion there is a strong likelihood of adverse consequences to regulators and guarantee funds as eventual insolvency appears inevitable. The Reliance Insurance insolvency gives a foretaste of what to expect.

I am now going to make several observations that I analyzed at interminable length in my report about the inability of actuaries to adequately project reserves for business especially environmental and asbestos. The history of reserving for long term liabilities by insurance companies teaches us, indeed, to disbelieve actuarial estimates. At December 31, 2001, which is the end of the year in which the White Mountain's CGM Mutual transaction took place, the A&E reserves, which were summarized from note 33 of the regulatory filings on A Invest, were $22.8 billion net for prospective reinsurance for asbestos and environmental. Industry incurred losses since through December 31, 2012, are $44.4 billion. That's a deterioration of 195 percent. With the benefits of perfect hindsight therefore, which is a wonderful thing to have, the reserves at December 31, 2001, should have been $67.2 billion, not $22.8 billion.

If you go back to 1995, and I have the A Invest reports back through then, the deterioration is even more profound. Actuarial science has got reserving for these classes of claims spectacularly wrong. Actuarial science has been compared to driving a car entirely by looking in the rearview mirror. And several of the remarks we heard today are very much in reliance of looking into the future based on looking entirely in the rear view mirror.

OneBeacon Insurance Group also has a chronic history of under-reserving. A good place to look for this is in the difficult to understand, but informative retroactive reinsurance disclosures in Potomac Insurance Company. As we know, Potomac is the counterparty to the two retroactive reinsurance deals with Berkshire Hathaway and itself reinsures other members of the OneBeacon Group. Looking at the 2002 statutory regulatory filing of Potomac, we see that the initial reserves transferred under the NICO cover were $955 million. We are informed that as of today, the unexhausted capacity in that copy is $198.3 billion. It's a $2.5 million cover, so by simple arithmetic we can conclude that there has been $1,347,000,000 in adverse development since that retroactive reinsurance deal was struck, which is 131 percent.

A similar analysis is possible for the GLC copy legitimate cover, which is for the non-asbestos and environmental and other mass tort liabilities programming in this conversation. The initial reserves transferred under that cover identified in the 2002 Potomac statutory filing were $170 million. Unexhausted capacity based on the 2013 regulatory filing is $8 million. And a $170 million to recover, so again, simple arithmetic tells there's been $392 million in adverse development cover, or 231 percent, even worse than on NICO recover.

I've reviewed the OneBeacon Insurance Group and OneBeacon Insurance Company financial statements going back through 2001, and for asbestos and environmental, there were significant material increases in reserves in the years 2001, 2005 and 2011. On a gross basis, indeed, in 2005, reserves for asbestos and environmental were increased by $811 million, which is 59 percent over the year end before. And in 2011, they were increased by $489 million, which is 48 percent above closing reserves at the end of 2010.

It's interesting to juxtapose those reserve increases with the actuarial opinions that form part of the regulatory record of the companies. And I pool those and the First Warehouse opinion from 2004, the year end before this material increase, and the opinion on the file with the regulatory term at the end of 2010, the year before the 2011 increase, are both clean actuarial opinions. They give no hint whatsoever of the enormous reserve increases that are to come. And indeed, they echo the language that I've heard repeated this morning so many times. They say that the reserves have been calculated in accordance with, I paraphrase, Pennsylvania Insurance. They say that they've been computed according to established actuarial techniques.

So I'm not trying to impugn the professionalism in any sense of any of the actuaries involved in this. But the level of assurance of their opinions can't come to --- which are very much along the lines of okay, they did a professional job --- are not very comforting, with all due respect to the concerns of policyholders who want to know not did they do a good job, but did they get it right? There's too much at risk. And there's no reason to expect the future to be any different. A Invest has always had the White Mountain's Insurance Group in the top 10 or 15 insurers ranked by the signs of their environmental and asbestos exposures.

Even at the time of the proposed transaction, and according to Towers Watson's work, OneBeacon Insurance Group appeared to be under-reserved. OneBeacon Insurance Group discloses A&E reserves close with respect to the insurance before which ultimately affects the length of cover, and in 2012 of $1.162 billion. The range of Towers Watson as of that date is from a low of $9.949 billion, a midpoint of $1.239 billion and a high of $1.59 billion. So the carried reserves were significantly below even the midpoint of the Towers Watson range as of that date.

Secondly, on a net basis, net prospective reinsurance, but without giving effect to length of cover, net reserves at 12/31/12 were $0.728 billion and the range of the Towers Watson was $0.707 on the low end, $0.849 on the midpoint and $1.045 on the high point. So on net basis, they were barely above the low end of the range.

I won't torture you by going through the same disclosures on the non-NICO book, but they're even worse. And they're disclosed in the 10K of OneBeacon Insurance Group at the time of March 31. The carried reserves on the non-NICO book were below the low end of the Towers Watson range, and there was an immediate reserve strengthening that brought it above the low end, but nowhere near the midpoint.

Again with respect to Towers Watson's actuaries, there are serious concerns and flaws in their report from my perspective. First of all, they say that it's suitable for financial reporting contexts. Financial reporting --- I come at this as an accountant --- looks at financial reporting not in materiality and in particular from a prospect of users, of stockholders taking the financial statements as a whole. The situation at hand, however, is not ongoing, growing from some financial reporting. It is a risk transfer of --- a final transfer, I might add, for policyholders whose counterparty will now be in all but name a completely different economic animal to the one they had. So financial reporting context, to my mind, does not give the kind of assurance that is needed by policyholders who have a material financial asset tied up with a completely different counterparty as a result of this transaction.

I will move through these points quickly, but again, explored at interminable length in my report. But I have concerns about the discount rate that they used and the unchallenged use of the equity returns as completed by White Mountain. I also am concerned that in the high scenario, they use high inflation and higher discount rates, because the two things really have nothing to do with each other. Inflation in the mass tort context and the environmental context really has nothing to do with inflation in the general economy.

I have concerns that Towers Watson notes that change in organization for the non-NICO case department, which is now moved to a so-called settlement solvency and I view that as a euphemism. And they don't really know whether payoff patterns are going to continue in the future as they have in the past, because that is a material change.

In their asbestos estimates, they rely

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

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

BRIEF INTERRUPTION

OFF RECORD DISCUSSION

MR. TERRELL:

And OneBeacon's own work was done in

2010. So 2010 work, internal OneBeacon ceded reinsurance relied on entirely by Towers Watson does not satisfy me that that asset is flexible. And I'm not talking about in terms of credit, and no reinsurance is littered with insolvency far worse than on the direct side. I'm talking about the estimates that they make, especially reinsurance.

And again, my experience of sitting through weekly large and complex claim committee meetings at Zurich and the Home Insurance Company only would look at reinsurance for every one of the claims for which we're given authority tells me that there's a high degree of judgment that goes into interpreting the various coverage positions that may influence the flexibility of the insurance, not because of credit, but because of the position. And the joke goes, if you think direct insurance is tough to collect, try collecting reinsurance.

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

On the environmental, they assume that the payoff pattern is going to be based on their industry experience. But they know it already in the roll forward period that they got it wrong, and they have to change it by $10 million because there have been a couple of large environmental settlements, even in this very short roll forward period. And the other particular concern I have is that there is no allowance at all for other new mass torts.

And while they have --- I have somewhat sarcastically said they've so much of their work by looking entirely in the rear view mirror. In this case they have ignored history, because what we know is that new mass torts do emerge on a regular basis, all sorts of pharmaceuticals. I've testified in many of these. Agent Orange, Fen Pen, breast implants, tainted blood and various kinds of construction defects, vibrations, hearing loss. I mean, there's all sorts.

There are masses of mass torts that have emerged over the time periods. And to make zero allowance for that, to my mind, is just unacceptable. In their central estimate, and that's March 31, 2013, they had $153 million for this --- for other mass torts, that's known other mass torts, not unknown ones. And even doubling that would put this new entity out of capital, just on that one assumption alone.

Moving on to the really fun part now, the Towers Watson stochastic model. Everybody loves an actuary, don't they? And every problem with the first Towers Watson report on the loss reserves impacts the stochastic model as well. I'm very concerned that RRC has not had the opportunity to really delve into the mysteries of the proprietary and confidential model, and that is unacceptable to me.

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

Secondly, the assumption about medical inflation, future asbestos being offset by the aging claimant population has no resemblance to reality on the ground. For start, there's no linkage between asbestos claim settlements and medical inflation. It's a function of economics and it's a function of anticipated trial verdicts.

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

Multi-generational claims. Many claims are coming from children of the originally exposed defendants. Asbestos dust falling off overalls while daddy's getting changed after work type thing. We are hearing from leading pulmonologists and asbestos medicine conferences who are telling us about exciting new breakthroughs in medical science that allow detection of mesothelioma several years earlier than is current. Right now there's about 18 months between diagnosis and death. That's going to be moved up by a couple of years and add a couple of years of expensive medical intervention.

And finally, there's a --- many of my

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

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

I'll say a couple words about RRC. And first of all, I do very much appreciate the engagement of RRC, who are engaged by the Department on behalf of policyholders and they are on our team. But their independence is of limited value. They've undertaken no independent review of the underlying data and financial assumptions. They discussed and they questioned and they met and had conference calls. I mean, great. That's helpful, but they haven't done any real independent work digging into this problem on behalf of policyholders.

Nevertheless, they do share many of our concerns. They many times emphasize the inherent uncertainties of forecasts, and they in particular share our concern about the payoff pattern under the NICO cover, and also this rather robust --- to quote them, robust investment yield on assets. And they note that if either of those assumptions is invalid, then the transaction potentially fails and more assets will be needed.

Their report on the stochastic modeling also raises significant concerns, again about the difficulty about forecasting eventual costs. They note the significant risks were not contemplated in the stochastic model. They emphasize the uncertainty about A&E reserves in the investment strategy and note that the 15 percent investment in equities is down from a high wire of 46 percent. And the fact that it even gets disclosed in this pro forma financial statement in this model for the future with even at one time contemplated 46-percent equity investment is staggeringly alarming to me.

As I said, the reality on the ground is that there is no end in sight. Mesothelioma cases are not declining according to the epidemiological and demographic survey that was taken by Nicholson and Selikoff in the 1970s, which have informed pretty much all forecasters of asbestos. And what we're seeing is that mesothelioma claims should have peaked some years ago. But for many, many different companies, they are just stable or increasing. Secondly, values for mesothelioma are increasing. Defense costs are as high as ever. New companies are being targeted, multi-generational claims and early diagnosis, as I mentioned earlier.

Moving on to the projected balance sheet, which will be in my opinion undercapitalized. I've often asked for explanation as to why these deferred tax assets has been recognized as an admitted asset on the opening balance sheet and written off the next day. I don't count it as far as I'm concerned. But adjusting for that, they have about a surplus of $127 million, which should be contrasted with OneBeacon Insurance Company's December 31 surplus of $866 million and put in the context of $983 million being upstreamed from OneBeacon Insurance Company to the group over the last five years. Clearly this revisation has been contemplated for a long time.

Adjusting for that deferred tax asset in this case this case caps the ratio at opening is 215 percent. I'm noting, sir, your comments about there being negative --- no leeway for a runoff company on that leeway close to the authorized control level. Nevertheless, on any sense it's a small margin for error. And some form of regulatory involvement, even if it is not authorized control, is around the corner, to my mind, based on that opening balance sheet. And I don't think that's what anyone wants. I don't think regulators approve transactions in these kinds of circumstances because they want to be supervising something very soon. Regulators to some extent have no choice but to get involved in these situations, but this is a situation where that's not a regulatory imperative right now.

Net opening reserves, net opening loss reserves. This is for full book, net of reinsurance is $156.5 million. If you look at the combined NICO and non-NICO central estimates of Towers Watson, just add them together, you get $2.15 million, and the highest mix around $2.8 million. How do you get from $2.1 billion to $156 million? One's a big number; relatively one's a small number. And there are a lot of sets.

One, there's not adequacy and I spouted

off a lot, and other people will, about the inherent --- the massive inherent uncertainty about reserve adequacy. Secondly, we have to do a roll forward. And we've noted already problems in the roll forward, and secondly, that one is getting out of date day by day.

Thirdly, the diversification --- diversification adjustment. Well, what does that mean? It means risk does not add up in a linear fashion. As I said in my report, it's not raining everywhere all the time. So you have to allow for the fact that this doesn't add up at all. And that's fine, I don't dispute it. But as Towers Watson said, and RRC concurred, that is a matter of significant professional judgment.

Ceded reinsurance. I won't even say how inadequate the work is on ceded reinsurance. But proactive reinsurance, actually in that opening reserve there's nothing, not a nickel, for the NICO coverages, the A&E. That's all completely out of the bus reserves because they are within the retroactive reinsurance cover. And when you look at the size of the gross risks in the A&E, whatever it is going on there, the potential of A&E to actually creep onto that balance sheet is, in my mind, a lot more likely than Counsel for OneBeacon would have us believe. And as they said in their response to the people who I'm speaking on behalf of today, they view a 25 percent deterioration of A&E reserves to be highly unlikely. And I think I've given plenty of analysis already today as to why that's really quite likely.

And finally, a time value of money. And time value of money, for one, discounting reserves is not allowed under statutory or Generally Accepted Accounting Principles, except for Workmen's Compensation. So discounting any kind of asbestos and environmental is a very imprudent technique. Maybe you could argue it from an economic point of view, but in terms of regulatory analysis, a higher standard is required. And they've used speculative and optimistic analysis based on a unsupported future return on investments. And for this transaction to succeed or fail based on investment performance is putting a lot of risk on the policyholders.

They go on to tell us --- and this really, really amazes me. But surplus notes for start, why should this entity be burdened with interest bearing surplus notes? Why should this entity have to be paying interest? Capital should be sufficient from the get-go, but they have forecasted they will start repaying surplus notes in 2018, just four years out into a massive decade runoff. And the settlement strategy, we've seen net reserves of $156.5 million, which are full cost to half in just 30 months and to quarter three years after that.

I mean, for start, it's unrealistic. You can't run off a book of business. But secondly, what it tells us is this so-called settlement strategy that has already been identified by Towers Watson, that it is expected that that will continue under the Armor Group, which is going to be not so much about paying valid claims as they've told you, it's going to be about commutations. And that is the first play in the runoff playbook. Commutations, finality, that's what we want.

But you compare this to the robust yield they're expecting on their assets, and that is why we want you to see that projecting the risk based capital ratios are going to hugely increase in the first few years, because what they're projecting is that these reserves will be paid off very quickly and in the meantime they will enjoy returns. But that's not believable assumptions.

Counsel for OneBeacon had offered no plausible justification for this deal. They talk about complicated accounting and reporting. I mean, are we supposed to shed a tear for that? And distraction from the poor business. And we heard from the CFO this morning. He gave us two reasons why this was good for policyholders. It allows management to focus exclusively on managing the ongoing business. I mean, whoopee. What about policyholders?

And secondly, it will be economically neutral. I'm sorry, I'm looking at the wrong page here. So we heard management. We've heard secondly, runoff liabilities will be separate from the ongoing liabilities. That's really not an offset. As we know, the volatility on the books that will be transferred is tremendous because we're talking about emerging claims on policies that were written decades ago. The specialty business of OneBeacon Insurance Group is a short tail book. And there is a particular uncertainty, nothing approaching uncertainty on the long tail book. And to say that policyholders will now be insulated from the ongoing liabilities is just --- it's cynical.

MR. JOHNSON:

Do you have much longer?

MR. TERRELL:

The financial --- huh?

MR. JOHNSON:

Because you're coming up to your half an hour here.

MR. TERRELL:

Okay. Can I have two more minutes?

MR. JOHNSON:

Two more minutes, fine.

MR. TERRELL:

Thank you. The financial condition of Armor cannot compare. Very limited data made available that the 2011 financial statements in the record tells of an equity of about $6 million and they made a loss in 2011 of $0.3 million. So we're substituting the mighty resources of OneBeacon Insurance Group for something that has a meager set of financial assembly.

We heard from their CFO this morning they have access to all kinds of capital. Well, very interesting when it wasn't explained to us what capital they have available to us and why that's going to be a benefit for policyholders. In my report I explain why the economics and motivations are different in runoff, and I have that from firsthand experience of working on the Home runoff and also from dealing on the other side of the table with Equitas and Kemper and many others.

So finally, I would just say today if they are so confident in the sophistication of their actuarial analysis and their financial projections, they should put their money where their mouth is. And as Mr. Stockman said, if these reserve deterioration was so unlikely, get an access policy to sit above the NICO cover. Should be pretty cheap. I'm sure they can convince Mr. Buffett that this is very small and should be cheap.

Secondly, the INA transaction. I recently gave a credit opinion on that. The transaction actually succeeded. Century Indemnity is part of Ace, so they're certainly intertwined. Beyond the $25 million surplus, they have plenty of other funds or assets that are off balance sheets that would give them potential plan and other covers.

Thirdly, protection for policyholders along the lines of the Royal transaction and Arrowood. And finally, you can achieve all of management's goals without doing a spinoff of this at all. You can restructure this within OneBeacon Insurance Group and have focused management and some installation of the two sides of the business. It doesn't have to be a spinoff at all. And with that, I will rest my case.

MR. JOHNSON:

Okay. Well, within your oral and in your written remarks, there is a lot of issues you've raised that the Applicant and --- the Seller and the Applicant will have to be responding to, because there's a lot of points. So we'll make sure that the Applicant --- I think the Applicant sent a letter, or the Seller sent a letter. His Counsel did the other day saying they will respond to the report subsequent to the hearing. So you make a lot of good --- you make a lot of points that they need to respond to.

I will say on a couple points, though, that I just want to ---. You say it's summarily been dismissed. Just so you understand how it works. We have to give all interested parties due process. Including the Applicant and the Seller here, so ---.

MR. TERRELL:

I speak somewhat into a passion, but ---.

MR. JOHNSON:

That's fine. I just want to get the record straight and you have to --- you know.

MR. TERRELL:

On the face of it, to my mind, this doesn't even come close.

MR. JOHNSON:

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

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

MR. TERRELL:

Understood.

MR. JOHNSON:

I thought you did, but I just wanted to make the record straight on those three points. Other than that, the Applicant and the Seller will be responding to your numerous issues that you've laid out in front of us today. And we appreciate that as trying to be unbiased regulators in this.

So we're going to take a lunch break now 'til 1:30. And then we'll start with --- Brian will come up next when we get back at 1:30. So thank you.

SHORT BREAK TAKEN

MR. JOHNSON:

Good afternoon. We'll continue the public informational hearing with additional public comment. And we'll start with Brian.

ATTORNEY SCARBROUGH:

Good afternoon. My name is Brian Scarbrough. I'm an attorney at Jenner & Block and I am here today on behalf of Olin Corporation. Olin is a OneBeacon policyholder and Olin previously submitted a petition to intervene in this proceeding and proposed transaction, and Olin also submitted written comments last week as well. And Olin had a number --- like other policyholders who petitioned to intervene, Olin had a number of procedural and substantive issues and objections, and those are laid out in its petition and the comments it submitted last week. And by participating today, Olin doesn't waive any of those objections or petitions.

MR. JOHNSON:

We've been waiting for that. Where was that earlier? Been waiting all day for that comment.

ATTORNEY DAUBERT:

We're not going to assume anyone has waived anything.

MR. JOHNSON:

Yes, thank you.

ATTORNEY SCARBROUGH:

Thank you. I don't anticipate to take nearly the 30 minutes here.

ATTORNEY DAUBERT:

Thank you.

ATTORNEY SCARBROUGH:

These will be brief remarks, so I want to make two points that Olin in particular has regarding this --- concerns that Olin has regarding the proposed transaction here. And they're points that Olin feels strongly about and strongly urges the Department to consider these.

The first point is a jury verdict that Olin obtained against OneBeacon last November 2013 in Federal Court in New York. Olin obtained a jury verdict against OneBeacon in a environmental coverage case regarding five environmental sites. That judgment --- well, that litigation remains pending in part to enter a judgment based on that jury verdict. And Olin claims that that verdict could result in a judgment exceeding $60 million and potentially material more than $60 million.

In addition, Olin has claims pending against OneBeacon as to the same five environmental sites, claims under Massachusetts General Law, Chapter 93(a) regarding claims handling and other issues. Those are set to be tried beginning December 1st, 2014, in the same federal court. And if Olin's successful on those claims, that could result in treble damages, so a total judgment could exceed $180 million and may materially exceed that amount.

So Olin's concern is what account OneBeacon's taken of that, that jury verdict and potential judgment, both in setting its reserves. Olin has no idea how that's factored into OneBeacon's reserves, if there's a specific case reserve set for this claim or not, and what information OneBeacon's given to you, the Department, to evaluate --- help evaluate the proposed transaction and the adequacy of OneBeacon's reserves, particularly in this situation. This could be pollution related environmental clause.

So if the proposed transaction were approved, Olin's fears that it will be --- when it comes time to enforce its judgment, it will have to turn to Armor. And the fear is that Armor will not have sufficient capital to pay what could be a fairly substantial, multi-million dollar --- hundreds of million dollar judgment.

Another concern that's been raised by the policyholders that Olin also has is, as pointed out by RRC, in $10 million pollution reserve increase that OneBeacon took and the nine months ended in September 2013. That's not Olin related to our knowledge, and it's a sizeable increase, eight to ten percent over OneBeacon's central reserve estimates. Now Olin has a jury verdict that could well result in judgment many times that $10 million, and it has concerns that nothing's been disclosed --- or to the public about how OneBeacon has factored in that central judgment.

The second point I wanted to make briefly was the impact of new legal developments or judicial precedents on the adequacy of setting reserves, particularly in this case, environmental and pollution reserves. So Olin's been in coverage litigation for a long time in New York and OneBeacon's been part of that for quite a while. Olin has obtained some favorable rulings recently, again --- recently on a general liability policy language, including language that shows up in OneBeacon policies that OneBeacon issued full. In particular, the rulings both from a federal court in New York, the Southern District of New York, and affirmed by the United States Court of Appeals through the Second Circuit deals with a provision that, for shorthand, is offering for to ask a continuing coverage provision.

And very, very briefly, what this --- what these rulings permit Olin to do is when it's seeking coverage, for example, property damage from environmental losses from pollution or contamination, it can seek coverage not only for property damage that took place in the actual policy year that that insurer issued the policy for, but also property damage that continued on after the policy period into later years and sort of sweep that back into the policy year that was issued.

It's important, vis à vis OneBeacon,

because OneBeacon issued to Olin several general liability policies, accepting a very low excess player in the 1970 year with no pollution exclusions. And policies issued to Olin in later years do have pollution exclusions. So what the continuing coverage provision permits Olin to do is to seek coverage from OneBeacon not just for property damage that happened in 1970, but also that continued in the years and decades, even multiple decades after 1970. And that's materially an increase in OneBeacon's exposure and liability pool.

That's a new development that happened in the past couple years, and that's something that we hadn't seen before in the case law. And it raises concerns with Olin because there's no indication what consideration OneBeacon's taken of that in setting its reserves or what it's disclosed to you in terms of evaluating the adequacy of its reserves.

That's the type of new legal development that RRC has said and they reiterated today, and Towers Watson has said, make it extremely hard to adequately set reserves for these types of claims. And it's something that should seriously be --- we submit should be seriously looked at and considered in evaluating OneBeacon's reserves here. And it's not just an Olin issue. This continuing coverage provision language is standard form language, at least in the '60s and '70s in general liability policies. So there could well be many other policyholder --- OneBeacon policyholders that have this language.

And it raises an issue with us on what account OneBeacon's taken not just of their increased liability exposure to Olin, but to actually hundreds of other policyholders that have that and what it's presented to you, the Department. So Olin, along with a lot of other policyholders, doesn't want to find out for the first time, if this transaction's approved, that OneBeacon did not adequately take account of this new legal development and doesn't have the reserves adequately set when it comes time to pay these sorts of claims.

So those are the two points I wanted to make. I hope you will seriously consider both of those and that you will seriously evaluate the petitions we filed and the written submissions we made. And thank you for the opportunity to speak.

MR. JOHNSON:

Thank you.

ATTORNEY DAUBERT:

Thank you.

MR. JOHNSON:

Gary Fergus?

ATTORNEY FERGUS:

Thank you. My name is Gary Fergus, Attorney. I'm appointed by the Court in the Northern District of California to represent the retired Honorable Charles Renfrew. He's a former --- he's retired, former United States District Court Judge, and the former Deputy Attorney General of the United States. He has been appointed by that Court to represent future claimants in the Plant bankruptcy. In the Plant bankruptcy, OneBeacon companies insured Plant during key years, '65 to '73, with primary insurance policies, with high levels of coverage.

Now, I will join in the comments made by previous policyholder speakers, and perhaps I'll plead to take up the rest of the time of the prior speaker so that I can have more than my 30 minutes, but ---

ATTORNEY DAUBERT:

No, no, no.

ATTORNEY FERGUS:

--- perhaps not.

MR. JOHNSON:

No, we got to be fair.

ATTORNEY FERGUS:

One of the things that I expected to hear and hoped to hear today in the testimony from the expert witnesses is that we have done this before, we know how to get the reserves correct, we've done it right. In fact, we have over-reserved using our models, and in fact, there was too much money put aside. But that's not what we heard today. In fact, what we heard is ---. Well, you'd think OneBeacon --- very experienced insurance company. You would think they would put a stake in the ground and say, we have a reasonable belief that our estimate of the reserves, that there's no possibility that it might --- the statutory language is might --- the financial condition might adversely impact policyholders.

But they didn't say that today. They didn't say it to the SEC. They said, we cannot do it and we think there's a really good chance we'll go through our reserves and we will go through our assets. So they hired Towers Watson. Towers Watson came in and they said very clearly that they cannot tell you that that standard has been met. They cannot say that the reserves will be adequate.

What they can say is they have done 10,000 iterations based on their models using their proprietary software. So Towers Watson has not been able to give that opinion. RRC came in and they say, we cannot give you the estimate. We cannot tell you, and in fact, there are significant risks that there will not be enough money.

Now, interestingly enough, Towers Watson, in the insight report that was described as of the end of 2012 --- it's on their website. They went through very clearly and said, guess what? The industry has been under-reserving continuously and that it is intuitively unreasonable to believe that they're adequately reserved. Now I'm speaking in very general terms.

And so what so we have? We have a very detailed analysis that is done with proprietary software and RRC has said, we've looked at it actuarially and we think that those are reasonable assumptions. I call that black box reasonableness. Because if you look at it --- and that is the only thing --- I believe Deputy Commissioner Johnson, you said earlier, there's inherent risk, we all know that, we deal with it and that's why they did 10,000, 10,000 various iterations.

The fundamental problem, though is when you look at the evidence in this case. There is significant evidence that every single time it's been wrong when there's inherent wrong, and it's always been wrong the same way, under-reserved. And so now you get to the question, well, okay, Towers Watson is --- they're very good actuaries, they have excellent credentials, they've done all these scientific things.

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

So one of the things that we found when we go through the report, we find that there is an analysis that's done that's called bootstrapping. Now, when I was a young lawyer, that was an argument you would make to a court when you have nothing else. I'm very pleased that it's now become part of the professional literature in the actuarial field and can be used. But that is what is being done.

And in particular, the --- it is not clear what epidemiological model that Towers Watson was using. If they were using Nicholson or Nicholson

KPMG, the epidemiological studies from the 1980s, it's well-known there were two fundamental flaws at least. One was the mortality tables they used at the time turned out not to be true. People are living longer. So that has to be taken into account. Second, it didn't take into account non-occupational exposures, the third wave.

I call your attention to Exhibit Two of the materials I submitted and I also brought. These were submitted yesterday electronically, but I also brought hard copies for anyone who wants them. But if you look at the report in Mealy's of --- it's basically a survey of the actuarial evidence. It says, actuarially we are guessing and underestimating the actual liability of what it is.

All right. So where are we? Where does that leave us with this black box reasonableness? Well, OneBeacon can't tell you. Towers can't tell you. RRC can't tell you. What Towers can say is we did 10,000, but you don't know where they started. You don't know --- if you start a journey in the wrong place and you do 10,000 variations on it, that is a problem, especially in a public process. There should be no black box reasonableness for the Commission to make a decision as important in this case as it is to all the policyholders, in particular, the 7,000 people that my client is a fiduciary for. It's going to be looking for these policies.

And so if what's going to be said --- because ultimately what OneBeacon is looking for is the --- and when I say stamp of approval, I mean after all of your process and everything is done, if you were to approve this, they got the stamp of approval from the Commission. It's no longer their problem; it's now onto Armor, thank you very much and we're off and running. But the policyholders and the individuals who were damaged, they don't have that option.

And so it seems to me that in terms of the question well, what about the status quo? Well, the status quo is where we are, and we're stuck with it. And if they run out of money, if they do various things, then that's OneBeacon and that's what they do. And they have the consequences of that. But to basically give them a get out of the asbestos and get out of the pollution card free, as they say it's economically neutral, we do not believe is appropriate.

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

Given the uncertainties that are all well-known, I suggest to you that there are --- well, first of all, this application as it is currently structured should be denied. But there is --- but there are alternatives, some of which have been described by other policyholders, to basically say if this is really right, let's have some clawback, let's have some skin in the game for OneBeacon as to what is in fact in this black box.

Now, one of the things that was described in the public report is, well, we did some adjustments for inflation, consumer price adjustments, medical inflation, and then there's something that says litigiousness. It's a black box; you don't know what it is. You don't know how it was. You don't know what bootstrapping was done to the model, the underlying model that's being used by Towers to predict what are the reserves that are going to be needed. It's very clear. They say it many places and so does RRC. The data they're relying upon is the historical data for OneBeacon. It does not take into account the other variables, the changes in mortalities, the changes in by-standards, women being exposed more, children being exposed more through secondary exposures of people who worked there.

So where does that leave us? We are in a situation where there are 10,000 models that were run reasonably through the standards of actuaries, and from that there are these other reasonable things done, but they're all based on black box reasonableness. Because one of the things that it would seem to me that you would want to do, is you'd want to be able to say, all right, let's try this model. Let's throw in a new mortality table, see what happens when you run one of those. Let's increase the population. Let's see how that actual model is dealing with the real life things that we are saying.

Now another example. Johns-Manville went through bankruptcy. There was a prediction as to how many future claims there were going to be. It was done by a gentleman by the name of Stollard. They went out, they were paying 100 cents on the dollar. They lasted, as I recall, about two years and they completely underestimated the liability. They redid it, they went down to a very low percentage, they redid it again and each time they've done it they've gotten it wrong. That's the largest asbestos manufacturer and installer there ever was.

And guess what? Towers Watson has been retained by the Manville Trust, because what's happened in the last two calendar years is the Manville Trust has run out of money. They stopped paying claims partway through the year because they have a cap on how much they can spend in a particular year. They've had to reduce the payment percentage that they pay to people, because they got it wrong.

So now they have hired Towers Watson in the fall of last year and in the January report, financial report from the trust, they say they're still working. Okay. So that's a real live, you know, put your money where your mouth is example that Towers Watson's going to have to get it right if in fact they're doing the estimating and they are the ones who are going to determine whether or not in fact the Manville Trust is going to be able to pay the claims throughout the whole year. Well, they haven't done that.

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

So I go back to the might. Question is whether or not the financial condition of Armor might adversely impact the policyholder, or it might not be beneficial to them. Well, here's what RRC says. However, there are significant risks, some contemplated in the stochastic modeling and some not contemplated, that could result in the exhaustion of the runoff companies' assets before all claims were paid.

Significant risks that could result. In my book, that's might. The statute doesn't say reasonably likely, more probable than not, clear and convincing evidence. The statute says might. I say, that satisfies your standard that there is evidence from your own expert that the financial condition of Armor, if this transaction goes forward, might adversely affect policyholders.

Second, they say, we are unable to predict the future of A&E losses. But if history is any guide, it would be prudent to expect further adverse development. If in fact there is a third wave of asbestos claims, this might well be considered a change in litigation environment not explicitly incorporated in the modeling. I submit that equals might. We're not talking about speculation. We're talking about what has happened with the development of medical and through litigation, and what's now known by science about exposure to asbestos.

One thing the Commission might consider doing is waiting. See what happens when Towers Watson does their estimate for the Manville Trust and see if the Manville Trust actually is able to rely on that estimate and pay claims all through the years. That'd be the real world litmus test. But there are other conditions, I think, that if you were all inclined to grant this, that need to be done, significantly more assets, more skin in the game to protect the policyholders in order to meet that statutory standard. Do you have any questions? Thank you for your time.

MR. JOHNSON:

Thank you.

ATTORNEY FERGUS:

Would you like the hard copies?

MR. JOHNSON:

Yeah.

ATTORNEY DAUBERT:

Thank you.

MR. JOHNSON:

Thank you.

MS. RANKIN:

Thank you.

MR. JOHNSON:

Okay. Dan? Dan Healy?

ATTORNEY HEALY:

We've prepared some slides that I was going to put up, but if you'd like me to hand them out, we can do that.

MR. JOHNSON:

Yes.

ATTORNEY DAUBERT:

Absolutely.

MR. JOHNSON:

Uh-huh (yes).

OFF RECORD DISCUSSION

MR. JOHNSON:

If you could at least --- the Seller and the Applicant get one, too, at least at a minimum.

ATTORNEY HEALY:

Okay. My name is Dan Healy and I'm here from Anderson Kill. I have with me --- well, with my colleague, Alexander Hardiman, also from Anderson Kill, and next to me is Allan Kauffman from FTI Consulting. He's an actuary there and has been involved previously as the actuary in the Equitas transaction.

Thank you for the opportunity to present public comments today. I appreciate the fact that you pointed out; there's no waiver this morning, so I won't have to go through that. But the short statement is I'm here on behalf of Colgate Palmolive and we do not consider this to be a substitute for the motion and we maintain our rights.

I'll preface my comments today by stating that the full information concerning this transaction has not been made available. And so while we will present information to the best of our ability, our ability is necessarily limited by the fact that we do not have all of the information that we believe is relevant and needed for policyholders to figure out what is really happening here and to assess the Towers Watson and RRC reports, as well as the other information that's been filed by the Applicants.

And the information isn't just missing from the Towers Watson report and the RRC report. There hasn't been full information provided on the transaction details. There's not full information provided about all of the reinsurance. There are other documents in the file to the Department that have been marked as confidential. And as has been covered by many of the other speakers today, the Towers Watson reports --- report and summary and the RRC reports are made based on RRC admitting that it didn't have the information that Towers Watson had in order to perform any sort of independent analysis.

As you may be aware, Colgate Palmolive did actually seek a number of those documents through a Right to Know law request and was able to obtain some of them, but not all of them. Essentially OneBeacon and Armor have been very careful and very aggressive in defending the confidentiality of their information they do not want policyholders to know what it is. We think that's somewhat telling in this circumstance where they are trying to say that this is actually to the benefit of their policyholders. From the information we do have and that has been made available, all indications are that the proposed acquisition that we're here about today is not in the benefit --- is not in the best interest of the policyholders and will not be to the benefit of policyholders.

Now, since I think I'm the last speaker, I'll try not to repeat too much of what's already been covered, but to touch on what we think it is important and get to what we can offer that might be slightly different from the prior speakers. We think the key issue is there are obvious causes for concern, even on this complete record, are that the runoff companies are undercapitalized, they lack adequate reinsurance and that these are going to be runoff companies, and that leaves Armor as the backstop.

And we haven't heard anyone today even attempt to argue that Armor will have the financial ability to make up the gap or to cover what everyone sees will be the failure of these runoff companies in the future. And we also haven't heard anyone say that these companies aren't going to fail in the future. What we really think is that issue here is how soon it's going to be. And that's based, again, just on the incomplete record. We assume that if we had more information, then that would probably paint a bleaker picture for these runoff companies.

So in some ways I'll try and use the slides; hopefully it makes it, if nothing else, slightly more interesting. But if we turn to the first slide titled proposed acquisition, I don't think there are any new surprises there. We think that this proposed acquisition that's going to transfer not only traditional commercial lines, but as we've heard a lot about today, asbestos and environmental exposures is not in the best interest of policyholders and is going to set up these runoff companies to fail in the future. Basically these companies will be left, as I stated, undercapitalized.

Given that, we don't think that the proposed acquisition should be approved, because under the sections of the Pennsylvania statute that the Department is required to look at, this is not going to be in the best interests of policyholders. It also is going to create financial instability for these companies. I don't think OneBeacon can credibly argue based on the information that's available that that is not the case. And I'll try and go through some of that information today and lay out why we think that it is clearly against the interest of the policyholders.

In looking at this, one of the things we noticed is that there is not very much analysis of the likelihood of non-payment of coverage. We think that's a major issue for policyholders, and what we haven't heard a lot about is what is the likelihood that these companies won't be able to pay, that they won't be able to pay on time. We heard earlier the definitions of failure --- I think it was the speaker from RRC --- as being zero assets, as being nothing. And you yourself were talking about the one dollar. Hopefully what we're not talking about, though, is whether or not this will result in there being one dollar left, even if that's not technically a failure.

Now, the last thing is that this proposed transaction as is, we believe would not only increase the likelihood of the Department having to stay involved with these companies in regulatory oversight rule, but that it might be --- lead to a need for immediate intervention. And we think that sort of highlights the level of the problem presented by this transaction.

Turn to the fifth page, slide. We believe that as proposed, this transaction will leave the runoff companies significantly less likely to be able to pay coverage on a timely basis. And paying on a timely basis is very important. Even Travelers in their submission to the Department stated that Armor has a reputation for not paying on time, and that in doing so it's actually been found to be in bad faith, and that that causes material consequences for other insurance companies, let alone the actual policyholders.

And so setting up a system where whether or not they've reached a technical failure, but that there is an inability to pay timely the claims that are --- or we can all just say the claims that are agreed to be payable, is a major shortcoming. And even if that isn't 30 years out, that's significantly sooner --- which we believe it is based on just the limited available information --- then this is certainly not an issue for policyholders and will lead to significant harm to policyholders.

Now here in the second bullet point, you'll see at least $200 million of additional capital. Again, and I know I've been harping on it, but that's based on incomplete information. We're not offering that as an absolute number. We see that number as probably a four based on the amount of information we have so far. We think that without at least that much more money in, based on the limited amount of information from the Towers Watson report, these companies are going to be in need of immediate regulatory oversight. They're going to fall below the company action level. And the issues that may result from the timing --- I'm sorry, the issues that may result from the lack of capital and lack of reinsurance that will affect the ability to pay timely will be in the very near future.

Now, part of this is that the reinsurance sources that have been referenced by OneBeacon and Armor are basically insufficient. And the NICO cover has been sort of a focus and it's becoming more of a focus, particularly with comments today. And it is simply insufficient to cover what the projected losses will be. And so we'll go through that in a little bit more detail, but that doesn't save it. And again, it doesn't make up the gap and shortfall this will have in capitalization.

And again, because at this point in time, OneBeacon is looking to get rid of the runoff companies and be completely separated from them, that means it's going to be left to Armor which no one has said will ever have the ability to pay this. And from the financial records and information, they don't. They wouldn't be able to make up the shortfall.

And so to the extent that down the road we'd have some other sort of hearing or proceeding before this Department, OneBeacon, I'm sure, would take the position that if this transaction goes through, they're not going to be part of it, unless there's something that's done today or as part of this acquisition, to make sure that they are part of that. And since they have the capital that's necessary and no one's sitting there saying, oh, we have to get rid of these companies because we lack capital, I think that's an important consideration for the Department.

Now, turn to the next slide, which should be here somewhat. Further reasons why we believe that the proposed acquisition should not be approved is that there are major shortcomings to the Towers Watson report. It's not just simply, oh, we don't have the information they had. From our review of their reports, we believe there are major shortcomings.

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

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

So summarizing some of the issues here before we move on to more actuarial information. Even assuming the facts as presented are all the facts, then already we know they need significant more capital. We put the number at $200 million worth of more capital in order to be secure and to be adequately capitalized to move forward. You might say, where did we pull that number from? And we do have a reasoned approach.

Basically, the Towers Watson report, Potomac, which is just one of the runoff companies, had an authorized control of $116 million. That's

OneBeacon's number; that's not our number. So if we just work off of the NAIC Model Act, which says two times that, and they have --- the amount would be $232 million.

Now, from Towers Watson's own report, it puts the entire group of runoff companies --- not just Potomac, the entire group of runoff companies, which should have a number even higher than $232 million, at $161.5 million. And that's where we get the conclusion that hey, from day one we're going to have a problem with these companies. And that's not like a couple million dollars. That's a pretty significant gap. So we think that is quite problematic, and that's based on the Towers Watson report and limited information we have. So without additional capital, we think that this is certainly not in the interest of policyholders. We would like to have that money paid and paid on time.

Also, we'll go through a chart in a few moments, but if you look at other insurance companies that have a ratio of capital to the gross liabilities, or the losses and the LAIE that are similar to what's presented in the Towers Watson report for these runoff companies, a number of them are under Department supervision already or have a grievance that are with a larger insurance company structure that has adequate capital. That is the only reason they're not being subject to Department oversight. Obviously one of the things that's come up today is the Century Indemnity Company, and that would be a good example.

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

Also, if we step back a little bit and sort of look at the overall picture in terms of the most up-to-date information, prior to the information we have today, we have a number of steps whereby OneBeacon systematically removed the capital from these runoff companies. And several of the speakers referred to some of these transactions and transfers of money between OneBeacon companies, and I --- we have --- Colgate Palmolive in its prior submissions has seen a number of these, and I'm not going to belabor you with all of them today.

But there are some pretty significant transfers. One of the ones that has been raised a number of times by different policyholders is the extraordinary distribution of $146 million upstream to non-runoff companies. There are other transactions where dividends were paid by runoff companies upstream to non-runoff companies in the amounts of $65 million and --- I think there's another one for $40 million, there's another one for $25 million. And you can run through these; it's in the financial documents, it's been documented in submissions before the Department.

The point is that during the course of 2012, there were a lot of these transfers where basically cash and real assets and securities in non-affiliated companies were being removed or sold by and then cash being removed from the runoff companies. In return, the runoff companies largely got stock in affiliated companies, meaning the runoff companies. And one of the more significant transfers is the --- a specialty transfer where it's basically holding roughly a billion dollars, I believe most of this involves.

Again, this is in the financial statements, this is public information. And that's going to retransfer back if this proposed acquisition goes through. It's not going to be one of the runoff companies. I haven't sat down and done the exact math, but that's the majority, I believe, of the assets that are being held right now and it's going --- it's not going to be part of the runoff companies.

So what we have is over the course of 2012 we have runoff companies being depleted for capital. And so looking at all of the steps of this, which I think is appropriate, that leads to many of the problems that we see today, these companies being undercapitalized. And one telling point is that I think both OBIC and OBA, all of the securities that they held in non-affiliated companies beginning of 2012 --- they did not hold anymore at the end of 2012. So they basically liquidated all of those positions and only were holding affiliates.

Now, turning to slide nine, again, we do not believe that the proposed acquisition should be approved as it stands. And we were looking to the Towers Watson and RRC reports to answer the questions that we had pointed out in prior filings. We haven't seen those answers, and that's a major concern to us.

And one of the key points, though, is that really from a review of the Towers Watson report

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

I've gone through, again, some of the systematic depletion of these runoff companies that we highlight on ten. But this was in the base of statements from OneBeacon to the Department, where they said, quote, OBIG is confident and has determined that the acquired companies' or runoff companies' liabilities through sophisticated and ongoing actuarial reviews. And further, in 2012, despite the fact that they state that they've got it all figured out, they experienced over $24 million in unfavorable losses. And so we think that their statements shouldn't necessarily be taken at face value, that there should be testament of this. And that's why we were looking to the Towers Watson report for answers, and unfortunately, we're not finding them there.

And again, turning to the next page, there's really no evidence of reinsurance that would be sufficient to close the gap here, financial gap. So that goes back to --- this is sort of getting to the end of my first couple points where we have undercapitalized companies and we have --- well, we've heard a lot today about how volatile and problematic predicting asbestos and environmental liabilities can be. And we've heard that over time they've largely grown and become more of a problem, and that is consistent with the fact that they shouldn't be taking capital out of these companies, leaving them with insufficient reinsurance and then transferring them to a company that doesn't have the capital to support runoff companies, which would be Potomac, which would be carrying these asbestos and environmental liabilities.

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

So there's been no opinion on the fairness to policyholders, but also, they don't really talk about the applicable actuarial standards from ---. And because of that, the conclusions they reach aren't necessarily tied to questions that we believe the Department needs to answer. They've reached some conclusions, which is that fair and reasonable things have been done, but they haven't really talked about why, what the effect on policyholders will be and a number of other questions the Department needs to answer.

So again, we've been talking --- I mentioned already that we're concerned about the timely payments. Neither one of the reports provides any information that will help the Department assess whether or not these runoff companies will be able to pay claims on a timely basis. And here we mention technical insolvency, which really gets into the timely question, but I think it's also just somewhat commonsense that if what they're looking at is when you hit zero, then there may be technical insolvency well before they ever get to the point that they're calling failure. And regulatory action doesn't equate until we get to the zero point, in terms of ---. And the reason for that is because we need to protect the policyholders and be involved in the management of a company that doesn't have enough capital.

So turn to the next slide. To summarize with regard to inadequate surplus, which is an issue here, we have a number of things I've covered, but they all go to whether or not these companies have adequate surplus, which is a major issue in looking at the appropriateness of the proposed acquisition. And Potomac alone would be subject to regulatory action. We think the other companies would as well. And they can't maintain their surplus in a RBC risk-based capital threshold, which is problematic to say the least.

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

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

And we prepared a chart of some of these similar --- similarly situated types of insurance companies. And the first column there that's in blue is for the runoff companies, and it sets forth a number of figures that are all straight from the Towers Watson report. These are not our figures. And you can see there that it has the gross loss as a million in reserve at $1.185 billion. And under it you have the surplus at the $161.5 million figure that I mentioned earlier.

And so below that you have the various ratios. And if you look at those ratios and you go across, we've highlighted the ratios in red that we think are most relevant. And under there, as I mentioned before, the first one as you go across the page is Century Indemnity, which you mentioned earlier as well. And then there you have the entire restructuring that's had to take place. And that is under Department supervision and has been subject to regulatory action. And in place there is the dividend retention fund, which we don't have here and it hasn't been proposed.

And so even though that's similarly situated, what they really have is a tie-in where they do have access to additional capital. And beyond that, you mentioned earlier that you were involved in this directly and you asked about additional capital being added. And you probably have a more myriad of facts than I do, but it's my understanding that over the years --- well, starting initially and then subsequently about $475 million has been included that was additional capital. That's from financial statements that we've been able to find. So again, that's another situation where there's been additional capital provided. But we distinguish it from the proposed acquisition that we have before us today.

We can move on to the next column. This is a company that's in Rhode Island, the Caseatmen (phonetic) Insurance Company, and that has ratios that are --- has an 85 percent ratio of committed assets of costs recoverable. Again, it's subject to Department supervision and they are still under the supervision. And I think they have $8.1 million surplus. So --- and they've been under supervision since 2008.

Also, the two other columns with the red ratios there, the AIG column with National Union, based on their public filings, AIG provides an unconditional capital maintenance agreement whereby it's going to keep the companies bundled. So even though that's not under regulatory supervision and it's not subject to regulatory action at this time, because it has basically an unconditional guarantee from its parent company, AIG, which again, we don't have being proposed here.

And then the last one there, which is the Indemnity Insurance Company of North America. That has an agreement whereby there's a 100 percent reinsurance agreement in place from Ace Pioneer ---

Ace INA. Again, that distinguishes it from the proposed acquisition we have right now. Before you had mentioned are there different ways that we might be able to address some of the problems raised by this proposed acquisition. We think these are real life examples ways in which those problems have been addressed. Notably, they all involve the company that's in the shoes of OneBeacon to remain involved in the companies, the runoff companies going forward.

Now, the numbers that we just ran through and that are on that chart, like I said, were out of the Towers Watson report. And so that's just taking those numbers, which we're not necessarily saying we agree with and we're saying actually we think are probably worse. But if we look at why the Towers Watson report may not have arrived at the right conclusions to its model, there are some things that we believe that they should have done and didn't. As I mentioned before, Towers Watson tested cash as its model and did not test capital requirements. We think that that would have been the norm, to test more than simply one model.

They also failed to perform stress testing, preferred stress testing and sensitivity tests. And this is a somewhat larger conceptual issue, which is it carries to what it is they're looking for. And again, this goes back to the definition of failure that I mentioned in the beginning. What they were looking for is whether or not there are assets, one dollar meaning there are assets. They weren't looking at, at what point is this beginning to fail? What's causing it to fail? What are the points at which we need to really look at, because they will be problems in the future, or at least the most likely problem in the future?

And by failing to perform these types of tests, they can tell them that they simply don't know. They don't know either. If they do know, they haven't disclosed it. And so we think that the failure on Towers Watson's part to perform these types of tests leaves a big gap. And as the Department can see, we're trying to figure out the answers to these questions because we think it would be something necessary for you to have access to look at.

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

And this falls as part of what we would consider to be the industry standards for figuring out what would really be the situation with these runoff companies, what would be their ability to succeed and for how long. The industry standards, IRMA and ORSA, do call for multiple forms of modeling. And here we have essentially a single form of modeling. And as we understand it based on the report, without having access to information underlying the report, it was performed on just take the low, central and high. And they just took the central and used that to do the stochastic modeling. And that was performed on just the lognormal slope, if you will.

And so they took one set of information, and that's what they ran through the software 10,000 times. And again, software performs these tests. And so while they may have performed 10,000 different scenarios, it's based on one set of inputs. And your testing's only going to be as good as your inputs. I mean, if you only put in one set of inputs, then that necessarily drives the results on those 10,000 scenarios.

And we think it would have been much

more prudent, if not necessary, to perhaps try some different inputs to find out what might cause major changes since the inputs are based on the assumptions that we've been hearing about today, in that a number of policyholders have expressed real concern today, because a number of those assumptions have been drawn in OneBeacon's favor. They're not necessarily the type of assumptions that we would draw, particularly because we're dealing with here the asbestos and environmental type of liability where no one is sitting here saying it's very easy to predict and you don't have to worry; you can just go with your one set of assumptions and not worry about if your modeling is going to come out okay. We're hearing various different people say that's not the case. These are difficult to do. There are no rote assumptions. You have to rely on the historical data, but after all, you're making projections. So why wouldn't you want to try to run as many different models as you can reasonably perceive in the time to look at? Here we just have one and we think that's insufficient.

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

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

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

And here we have on the next slide then here, that RRC --- Towers make judgmental adjustments to interest rates, equity returns and A&E defaults, and all such adjustments were not unreasonable; they were adding somewhat to the riskiness of the model results. So you have a single model being run and you have --- they're filled with assumptions that essentially make it risky. And we think that, again, is insufficient and that the Department is entitled to more information to make this decision. The policyholders are entitled to more information to find out what this really will involve.

And because the information that the Towers Watson report is based on has been kept from us, people like Mr. Kauffman can't perform the types of modeling for his own actuarial report to figure out what the real answers are. And that goes to the prejudice to policyholders, which is we can't even figure this out. We can't --- we don't have the information we need if we wanted to say fine, we'll do it. We can't. It's not been provided to us. We've gone through a Right to Know appeal and gotten as much information as we could, but OneBeacon and Armor don't want to provide the information to us.

And RRC concludes that the runoff companies are likely to meet the obligations, but under considerable stress. Considerable stress is not defined, and given the problems I've already gone through with the modeling and the fact that RRC itself admits that it didn't have the information to really test or perform any independent analysis on the Towers Watson report, it's pretty difficult to determine what it is they mean that the current companies are likely to meet their obligations, because I'm not sure that Armor really knows either.

And I covered this before, but we'd like to see the up-to-date reserve data and claim information used, because why wouldn't you want to look at the best information you can get? We haven't heard any real reason why we can't do that.

We think all of this is very relevant, not only under the standards that you have to consider, but because as policyholders, obviously a number of different companies have broken up. But this is something that's very important to them that these liabilities --- these insurance policies are very important to them. And we think it's due the consideration by the Department.

Earlier --- actually in your opening remarks, I believe you had asked about whether or not people had questions. So if you don't mind Mr. Kauffman come up with a couple of questions that we think would be appropriate to have answered as part of the process.

MR. JOHNSON:

Could you state your name and your affiliation?

MR. KAUFMAN:

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

Secondly, with respect to the model in capital adequacy, it appears that the model is done as if zero capital is the cutoff point. So that's to kind of confirm what might be obvious. And that's important because both the number of insolvencies and the timing of insolvencies would depend on the capital standard. And in terms of what we've said about the amount of additional capital that's needed, that's key to say, well, maybe they ought to have at least the company actual capital.

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

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

And finally, what is the basis for effectively --- not quite concluding, but suggesting that a 12 and a half percent --- that a 12 percent failure rate is good enough? If anything, I know about good enough from insurance subs they require much higher safety levels of that risk-based capital, company action level, individual line of business, risk charges are calibrated to roughly 12 percent. And that's the company action level for just those factors, the overall risk-based capital aims for company action level to be safer than that. So 12 percent for table one is not in any standard I know of a safe level of --- a safe measure of failure rate.

So the specific question is, is it really based just on cash? Is there no capital adequacy testing in the model and what basis, if any, is there for a presumption created that 12 percent is safe enough? And I'm sure through counsel we'll have other questions.

ATTORNEY HEALY:

That's all I have for now.

MR. JOHNSON:

Okay. Well, I think --- just a couple of points to clear the record always. One is, just so everybody's aware of --- I think you are but it never comes out here --- Potomac's already in an action level today. So just remember, again, my points that the RBC level does given the commissioner flexibility and runoff companies that are property and casualty to be in mandatory control level if it's under the supervision of the insurance commissioner. And

Potomac's already in an action level, so it's not like this is like newsworthy. So just put ---.

Two, again, as I mentioned before, we mentioned it a number --- is that Century Indemnity had a lot of conditions in its order. Those conditions gave us additional oversight. So if you believe we may be --- again, as I said earlier, we may be going down a path to approve. Certainly you believe conditions would help your clients. You should comment on what conditions would help your clients for us to consider. That's if we go down that road.

So I bring that up again because Century Indemnity's class A example of there's like 30, 35 conditions within that order that gives us additional oversight of the runoff of these --- of Century Indemnity. And I will say Century Indemnity --- just to clarify because obviously I was involved in the transaction. In the letter --- who signed it from Anderson Kill? This is the Jerry Goldman letter of July 18. It says, notably the Department has required Century to be guaranteed by Ace.

I just want to make the record clear here while we're together and you brought it up, that's not the case. What's in place is an excess of loss treaty of $800 million between Century Indemnity and the active United States insurance companies, the active pool companies in the United States. It is capped at $800 million, and then we have the dividend retention fund of $50 million. So there is $850 million, of which some of that $800 million at this point, I think 200 --- I just looked at it yesterday. $220 million of the $800 has been used up so far of the XOL. So just to be clear, Ace has not done a blanket guarantee.

I will say you are correct on the AIG, that they do have a parental capital maintenance agreement. That's true. We don't have anything like that --- we don't have that type of guarantee set up within the Century Indemnity transaction, just to make clear.

ATTORNEY HEALY:

Okay. So just to quickly respond to your prior comment about Potomac already seen at the action level, it's OneBeacon and Armor, though, that have asked for this transaction to be approved by the Department despite the fact that Potomac is already in a company action level and it's their burden to establish why that is something you should approve.

MR. JOHNSON:

Okay. Thank you. So we're down to William. Was anything not covered you may want to make some remarks?

ATTORNEY GREANEY:

Five minutes.

MR. JOHNSON:

That's fine.

ATTORNEY GREANEY:

Guarantee. I never really met a lawyer who actually ---.

MR. JOHNSON:

Yeah, right. No, I haven't, so ---.

ATTORNEY GREANEY:

I actually just wanted to respond to a couple of questions that you had earlier, Mr. Johnson. One is you asked about other runoffs that failed. I think your point was to say Home was back in the '90s when things were done differently and we --- the regulatory community has learned a lot. And I grant all that is true. But I mean --- and I --- we can probably provide you with a more complete list. I assume you were focused on this side of the Atlantic, because obviously across ---

MR. JOHNSON:

Yes.

ATTORNEY GREANEY:

--- the pond ---

ATTORNEY DAUBERT:

We are.

ATTORNEY GREANEY:

--- you've got a lot of runoff failures ---

MR. JOHNSON:

Correct.

ATTORNEY GREANEY:

--- because they're relatively unregulated and poorly capitalized. And they're even more without arrangement. Over here, I mean, a fairly I think spectacular example of a recent runoff failure is Kemper. They went into runoff in 2003, 2004 to most people's considerable surprise. I actually had an advance awareness that that was coming because of a particularly meddlesome asbestos account that they had and wanted to deal with. But most people were quite surprised by it, and by '05, '06 that beautiful building they had with the golf course out in Long Grove that used to be a beehive of activity, there were 100 people remaining there. And they struggled around in runoff for the next maybe nine years. And then in 2013, you know, they went into liquidation, which is going to take literally years to play out.

So there are --- another impending, unfortunately, runoff casualty is probably going to be Arrowood. And to be fair to the Delaware Insurance Department, he didn't have a whole lot of leverage, because there you had a very different situation. You had a UK parent company that basically got sick and tired of dealing with the U.S. legal system and said, we're getting out of the United States, not just GL, but everything. We're out of here. And when you don't have a parent organization that's committed to the U.S. market, no regulator can insist on the sun, the moon and the stars.

So I think the Delaware Department did about the best it could by insisting that they forgive indebtedness to the runoff entities. And I think it was close to a $300 million capital infusion, submitting the jurisdiction and establishing a claims monitor. That being said, if you take a look at the capital debasement that's occurred since 2006 with Arrowood, it's very difficult to look at that entity and think that it's really long for this world. It's pretty much limping along.

And I'd also point out that the damage --- you also asked another question, why is the status quo better? On the ground level, the damage that is done by runoff entities is very significant. I cannot tell you how many times I have negotiated coverage in place arrangements, both in and out of litigation, with a bunch of insurers to resolve asbestos claims on a long term prospective basis with everybody picking up a share, including the policyholder, just to get it done, just to get it done, only to have Arrowood and --- or Kemper come in at the last minute and say, we don't do that anymore, we don't do coverage in place arrangements. We want to buy out on the cheap, cents on the dollar or we're not going to --- we're just going to throw a monkey wrench in the whole gear. Those of us who have dealt with runoff companies, they see that every day.

And you mentioned Travelers getting hammered in the press. But let's talk about Travelers. That's a good example of an active underwriter committed to the U.S. market that aggressively managed and controlled it's A&E exposure for that very reason. They input Travelers Indemnity in their runoff. Hartford, they set up the Heritage Group, but they didn't put Hartford Accident and Indemnity into runoff. Why? Because they are committed to the U.S. market, the property casualty side of the market. They bit the bullet, they repeatedly raised their reserves and increased them over time. They aggressively did commutations for fair value, they aggressively entered into coverage in place arrangements.

And I have no brief for Travelers and Hartford. I litigate against them all the time. But there's a huge difference in the way they behave as active ongoing underwriters and what a runoff entity does, which they don't --- they don't proactively work to really resolve coverage litigation. They effectively invite or engender coverage litigation because it puts things on hold for a long period of time while they work to commute reinsurance and raise cash and generate investment returns and do the sort of things that runoff companies do.

So the problem that Travelers and Hartford and Liberty have is that as hard as they have worked to manage and reduce their A&E liability, they've been hit with third and fourth generation claims which is all new policies and exposures, which would put them in difficult straights again. But it's not like they haven't done a good job of managing their exposure or been unfair across the board to policyholders.

And in terms of Ace, the --- Ace is an example of a parent, and you mentioned the controls that you placed on them, which God knows, those are a lot better than what's being proposed over here, which is a walk-away, complete disassociation with the legacy business. They go in one direction, the runoff rump operation remains with a thinly capitalized ownership structure that's not going to infuse any capital if the actuaries are wrong.

And the reason that they're wrong is not because they're good at --- bad at math. It's because a lot of what goes into estimating asbestos and mass tort liabilities has more to do with social science and human psychology than it does with algorithms. So if they're wrong, if the mathematicians and actuaries are wrong, we're left without any source of capital infusion, meaning you won't get it from OneBeacon because they'll be long gone. And it's quite clear from Armor Group's balance sheet that they won't be in a position to do it.

So with the Ace transaction, not only did we have the dividend retention plan, $2.5 billion retroactive reinsurance and $800 million excess of loss arrangement that you spoke about, we also had an insurance company that was concerned about the severe reputational consequences of not permitting Century to fail. I mean, the same policyholders that buy D&O coverage or Bermuda form coverage from Ace today, also bought coverage from I&A and have legacy liabilities. Ace can't afford to have Century fail.

But in the OneBeacon situation, not only would there be no residual capital infusion protection in the event that the actuaries got it wrong, but you'll basically have a group of legacy policyholders like the ones I represent, P&G, ITT, United Technologies and others, who don't buy --- buys sort of middle market specialty coverages that OneBeacon sees itself as offering in the future.

So it's for those reasons that we really hope --- and I take you --- I take your point that you want specifics. I think there are some specifics in the Terrell report. We'd be happy to provide more, but what I'm --- my clients at least are looking for is some residual protections. Because we just don't share the optimism fundamentally that Towers Watson does. And RRC is not optimistic; let's call it like it is. They're --- they said, well, it's standard actuarial methodology, but I mean, they're not standing behind this report as a completely accurate projection of what we're going to see in the future.

So we're just looking for residual protections. That's the long and short of it. Thank you.

MR. JOHNSON:

Thank you.

ATTORNEY DAUBERT:

Thank you.

MR. JOHNSON:

We're going to take a 15-minute break so we can huddle and determine whether we want to ask some questions before we go through the rest of the agenda. So we'll be back at 3:10.

SHORT BREAK TAKEN

MR. JOHNSON:

We'll get started again. I only really have one question, though I have some additional comments. And I think Brad, you want to come up just for ---? And certainly as we talked about, you can supplement this with additional information subsequent to this. But I don't remember if there was something in the Form A or not --- you had talked about in your remarks that you believe you're going to have an expense savings in running this compared to the expense load that OneBeacon currently has.

MR. HUNTINGTON:

Correct.

MR. JOHNSON:

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

MR. HUNTINGTON:

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

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

ATTORNEY DAUBERT:

I think we're asking for specifics of where your claims of cost savings are coming from.

MR. HUNTINGTON:

It can be significant. We'll put some rough numbers that I think will help the Department get an understanding of the potential.

MR. JOHNSON:

Okay. If you would do so.

MR. HUNTINGTON:

Okay.

MR. JOHNSON:

Okay. That's it. Thank you.

MR. HUNTINGTON:

Thank you.

MR. JOHNSON:

Why we decided not to ask anymore additional questions is we believe that today the public has put a lot of questions and comments on the record, that I don't think we have the time today orally off the cuff, so to speak, to get into kind of responses --- the kind of responses as a regulator I'd like to see, real analytics around a response. So that's why I'm not going to ask any more questions.

But what I'm going to task again, as I did at the beginning, that all the comments of the ---

of the public commenters need to be appropriately addressed by the Applicant if it's a question concerning the Applicant, or the Seller, if it's concerning the Seller. We will have --- we are targeting to have the transcript of this up on our website next Thursday, the 31st of July. I'm sure everybody took a lot of notes also, but you'll have the transcript to review and go through.

But really, there's a lot of information that the public has brought forth today that really needs specific kind of thoughtful, analytical response to from either the Applicant and/or the Seller. And certainly, if the public has even more questions or thoughts, there'll be more time, as I'll get into in my closing remarks, to add to the record about this transaction in the public comment period that I'll get into shortly when we close.

So just --- I don't think --- otherwise I think any questions that we ask today would be not really effective answers, because this was a lot of very detailed kind of comments and questions from the presenters today, from the public presenters.

So with that, I will give an opportunity if the commenters, any commenters want to add any additional comments. Very short, but you've heard from other commenters. I'll give you your opportunity if you have a few minutes that you want to add anything else to the record before we close down the hearing.

ATTORNEY STOCKMAN:

Mr. Johnson, I just have about one minute's worth of comments. Should I just stand here and deliver them?

MR. JOHNSON:

Sure.

ATTORNEY STOCKMAN:

And they really are addressed to the point you raised in response to my comments, which is an important one, which is that this case turns on uncertainty. But it's not so much as to whether they're uncertainty. Of course there is. Rather, it's who should bear the risk of that uncertainty.

My clients, who bought broad, general or umbrella liability coverage, purchased something that was intentionally designed to give them certainty in an uncertain world. They paid a sum certain in return for a promise that Commercial Union companies would cover unexpected liabilities that happened to be asserted against them. That quasi-fiduciary nature of that obligation is why the Department even regulates this sort of stuff in the first place.

Now, my clients can't get complete certainty now. No one can, but we submit that the risk of that uncertainty should fall upon the insurer and not upon the policyholder who paid a premium to shift the risk to a company who is by definition a professional taker of risks. At a minimum, our clients deserve better than the chances of success or failure that appear to be faked into the transaction as it's now structured.

We would ask the Department to ensure that there's sufficient assets available to give policyholders what they bought. And we would also ask the Department to enable policyholders to make their own calculations as to what that level of assets should be and to appropriately offer our views to the Department based on a complete base of knowledge.

In making that core determination, whether the proposed transaction accurately accounts for the future uncertainty associated with asbestos and environmental liabilities, our best basis now for predicting what's likely to happen in the future is of course what's happened in the past. While it's cliché to say that those who forget the past are doomed to repeat it, that cliché like most clichés has a core of truth. And the industry's track record in the context of asbestos and environmental reserve estimation is frankly not encouraging.

So we would ask the Department to keep these transactions in --- or concepts in mind in deciding whether to permit this transaction to move forward at all, or if it does elect to have the transaction move forward, in deciding what conditions are appropriate to protect the policyholders. Thank you again for the opportunity to speak.

MR. JOHNSON:

Any other public commenters want to add anything at this point?

Seeing none, does either the Seller or Applicant want to have any closing remarks at all, or any of your representatives?

MR. MCDONOUGH:

I would like --- excuse me. I would like to make a ---

MR. JOHNSON:

Sure.

MR. MCDONOUGH:

--- comment.

MR. JOHNSON:

Come on up.

MR. MCDONOUGH:

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

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

I suggest this is a false premise. In the event the transaction is approved, in the rare scenarios where the company runs out of assets before it has paid its last dollar of claims, it is not likely to reach that eventuality for 20 or 30 years or more, as demonstrated in the stochastic modeling completed by Towers Watson. During that period, the capital needs of OneBeacon's ongoing business will be subject to exposures and business contingencies that cannot be predicted with any degree of certainty.

We submit that assuming the transaction is not approved, whether OneBeacon will have the resources or the intention to add additional capital to a runoff subsidiary 20 or 30 years from now provides less certainty to policyholders than the certainty provided by the significant asset transfer and the dedicated management provided for in the proposed transaction. While in the absence of this transaction it would certainly continue to be the intention of the current OneBeacon management team to manage the business in such a way that capital never becomes an issue, that was also the intention of the management team of every insurance company in the past that has gone from a viable ongoing enterprise to a company headed toward insolvency, and we all know that could happen very quickly.

In addition, the current OneBeacon management team is not likely to be in place 20 years from now. My point is that even with no transaction, there is simply no guarantee of solvency indefinitely, or in this case, over a 20 to 30-year period or to ultimately a 70-year period that takes us to the ultimate resolution of the claims, as the risk factors in the 10K of every public property casualty insurance company very clearly spells out.

If on the other hand the transaction is approved, what we believe is clear from the Towers Watson stochastic modeling is that the transferring companies are adequately and appropriately capitalized in the context of a very wide distribution of potential outcomes, and they would immunized going forward from any of the risks of the ongoing company, both those relating to the current business and those relating to any business that they undertake in the future. In addition, the proposed transaction has the benefits associated with transferring the ownership and management responsibilities of the runoff liabilities to dedicated runoff specialists.

Thank you again for the opportunity to speak.

MR. JOHNSON:

Thank you. Is there anybody, since this 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.

Court Reporter