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By FedEx and Email

October 16, 2014

Stephen J. Johnson, CPA.
Deputy Insurance Commissioner
Pennsylvania Insurance Department
Bureau of Company Licensing and Financial Analysis
1345 Strawberry Square
Harrisburg, PA 17120

Attn: Steven L. Yerger (syerger@pa.gov)

Re: Application for Approval to Acquire Control of OneBeacon Insurance Company and Potomac Insurance Company, 43 Pa. Bull. 1157 (Feb. 23, 2013) - Reply In Support of Petition to Intervene by Colgate-Palmolive Company

Dear Mr. Johnson:

As its further public comment,¹ Colgate-Palmolive Company ("Colgate"), through its attorneys, submits this letter in support of its petition to intervene and in opposition to the approval of the proposed acquisition in which OneBeacon Insurance Group LLC ("OBIG") and Armour Group Holdings, Ltd. ("Armour") (collectively the "Applicants") propose an acquisition of OneBeacon Insurance Company's ("OBIC"), OneBeacon America Insurance Company's ("OBA"), and Potomac Insurance Company's ("Potomac") (collectively the "Run-Off Companies") run-off risks by Trebuchet US Holdings, Inc., a subsidiary of Bermuda-domiciled and Bermuda-incorporated Armour (the "Proposed Acquisition").

In response to the numerous parties' questions raised at the public comment session held by the Department on July 23, 2014, the Applicants and their agents, Towers Watson, have submitted responses to the questions. Many of their responses rely on technicalities or perceived errors in the form of the question to avoid answering the question.

¹ Colgate does not consider this letter, or any other submission, presentation or appearance it has made or was made on its behalf, to be an adequate substitution for its request to intervene in the Proposed Acquisition and it maintains that its petition to intervene should be granted.

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The responses by Applicants and Towers Watson leave unanswered questions raised at the hearing and raise other significant questions. Most importantly, the responses do not explain why the Department, or any policyholder, could confidently expect that the Run-Off Companies will have the ability to pay claims on a timely basis even over the short term.

The Applicants' statements, and those of Towers Watson and RRC, to the Department in written submissions before and after the Hearing and at the Hearing on July 23, 2014 have made clear that the Proposed Acquisition should not be approved under 40 P.S. § 991.1402(f). The Proposed Acquisition is, among other things: a) not in the interest of policyholders, and b) will leave the Run-Off Companies financially unstable. Even the incomplete facts the Applicants have provided make clear that the Proposed Acquisition is contrary to the interests of policyholders and would leave the Run-Off Companies in a financial condition which would require immediate Department regulatory oversight.

The Proposed Acquisition ***does not*** leave the Run-Off companies in the same position as they are today, let alone as they were in 2009 when OBIG began the restructuring. The transaction would significantly alter the *status quo*² and leave the Run-Off Companies at unreasonable risk of being unable to pay claims on a timely basis going forward – even assuming the expected claims are properly predicted. The expected timeframe within which timely payment would be interrupted is estimated to be eight years. This means the risk of failure is not a long term issue, as erroneously presented by OBIG, but is an issue that could be expected to arise within eight years after the Proposed Transaction.

One of the ways in which the extraordinary increase in risk of failure rises as compared with the *status quo* is because the Proposed Acquisition will remove approximately \$1 billion from the Runoff Companies at "closing." (See Applicants' "Exhibit:Restructure"; see also OBIC Annual Statements for the years 2011 and 2012, Schedule D-Part 4.) Indeed, OneBeacon has systematically been removing capital and assets from the Runoff Companies since at least as early as 2009 and spent 2012 removing hundreds of millions of dollars of assets from those companies, just before submitting the request to approve the sale of those companies. As compared with the *status quo*, the Run-Off Companies will lack approximately \$1.5 billion³ in real assets that could have been used to assure payment of claims. The Runoff Companies policyholders also lose any possible protection from OBIG. No one has claimed that

² December 2009 when OBIG reports that it began the structuring.

³ The \$1.5 billion includes a dividend paid by OBIC to OBIG of \$50 million on December 18, 2009. Since the status quo is as of December 31, 2009, the status quo has already been lowered by this \$50 million reduction in capital. OBIC 2009-2012 Annual Statements, Note 10.

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Armour would be willing to provide financial support, and it does not have the capacity to do so.

The Towers Watson report, and the RRC report that is wholly based on the Towers Watson report, do not support for the Applicants' position. To the contrary, those reports raise numerous questions regarding the Proposed Acquisition. For example, even taken at face value, the reports show that Proposed Transaction fails all reasonable standards of financial security for an insurance company. Colgate, through Mr. Kaufman, at the July 23 Hearing asked TW, RRC and OBIG to explain the basis for believing the 12% failure rate indicated by TW is appropriate. TW replied that that considering that issue was "not our job." There was silence from the applicant and RRC. There is no basis for believing the 12% failure rate is appropriate.

Looking beyond their face value, the RRC and Towers Watson reports are premised on unsupported assumptions, and contain numerous caveats on which the Applicants rely as purported support for their arguments that the Proposed Acquisition is good for policyholders. These caveats only further undermine the conclusions RRC's and Towers Watson's respective reports draw. Review of the information used by Towers Watson is critical to determining whether the Proposed Acquisition maintains the *status quo*, which it does not appear to do, based on all available information.

Colgate and other interested parties have been told to rely on RRC for assurance that the Towers Watson work is appropriate, but months after the RRC work is supposed finished RRC is still learning. For example, RRC's most recent public comment implies that RRC only recently learned about sensitivity tests prepared by Towers Watson, and may still not know about all of the Towers Watson work. (RRC letter page 2) Moreover, in the recent RRC comments show how RRC as apologist rather than a source of robust challenge to Towers Watson. RRC says "we asked Towers to run the model with asset yields slightly lower than their baseline scenario." (Emphasis added). Is RRC concerned the model 'break' if a reasonable range of rates of return were tested. (RRC letter at page 2.) Mr. Kaufman in his supplemental report explains how RRC's analysis of the Towers Watson variability work is inadequate. (FTI Supplemental Submission dated October 16, 2014 at 3-5.)

The Applicants have clearly not supported their case for approval. The Proposed Transaction including the Ancillary Transactions should be disapproved.

However, the Department has asked that Colgate and other Interveners provide their input as to what the *status quo* is and what are the conditions the Department should consider including in any approval. Accordingly, the requirements that Colgate asks the Department to place on the Proposed Acquisition directly address how to maintain the *status quo*. As set forth in the accompanying report drafted by Allan Kaufman, an actuary with FTI, those requirements are:

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- Additional⁴ capital of **\$530 million**;⁵ or
- Additional⁶ retroactive reinsurance of **\$1.6 billion**;⁷ and/or
- Financial guarantees⁸ from OBIG.

See FTI Submission authored by Allan Kaufman dated October 16, 2014 ("FTI Submission") at 8.

The purpose of these specific remedies is to require OneBeacon to provide the Run-Off Companies with sufficient capital or reinsurance to maintain at least the *status quo* level of security for Run-Off Companies. Alternatively, Colgate asks that OBIG be required to guarantee the payment of any covered claims that the Run-Off Companies are financially unable to pay. Based even on just the limited information provided by the Applicants, it appears that OBIG conducted a systematic de-capitalization of the Run-Off Companies that has left them with inadequate capital to provide reasonable security for payment of the claims levels anticipated by OneBeacon or the higher level by Towers Watson. Of course, the policyholders, including Colgate, predict the claims will be even higher than predicted by OneBeacon and Towers Watson.

The Department's assessment of the status quo must consider the situation as early as December 2009. Applicant's argument that OneBeacon has no obligation to fund any of its subsidiaries is an oversimplification. (Applicants' 8/12/14 Ltr. at 53). It asks the Department to ignore the facts, which include that, since 2009 and with added

⁴ A total of \$660 million of capital after reserves are stated at Towers Watson's central estimate.

⁵ The increased initial capitalization could be achieved through an infusion of cash, secured by surplus notes or otherwise. For example, the SPA contemplated that, if required by the Department, additional surplus notes up to 50% of OBIG capital and surplus could be provided by OBIG. (Cumulative Log, Document 079 (Amendment 1 to Form A, Exhibit SPA – A3, p. 1).

⁶ Beyond that currently provided by National Indemnity Company ("NICO") and General Reinsurance Corporation ("GenRe").

⁷ Capital earns interest to support potential claims, while reinsurance does not. Therefore, the reinsurance equivalent to \$100 of capital is more than \$100. Refer to Section B for further discussion of that equivalence.

⁸ Analogous to AIG's unconditional capital maintenance agreements with its insurance subsidiaries, or a dividend retention plan such as that between Century Indemnity Company and INA Financial Corporation. (AIG 2013 Form 10-K, p. 132; 2013 Century Indemnity Company Annual Statement, p. 14.18.) These might be triggered to the extent that cash is required or in the event that the Runoff Companies' surplus falls below a specified threshold such as the risk-based capital Company Action Level, or Authorized Control Level, as further explained in Footnotes 28 and 43 of the accompanying FTI Submission.

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intensity in 2012, OBIG systematically transferred the most valuable assets out of the Run-Off Companies to itself or its subsidiaries without transferring anything close to equivalent value to the Runoff Companies. (7/23/14 Hearing Tr. 170-172.) The Applicants cannot credibly contend that OBIG can completely ignore the Run-Off Companies' corporate integrity for years and then insist that the mere fact that the Run-Off Companies are separate corporate entities now entitles OBIG to ignore the financial plight that it created for those companies without any recourse. In this regard, the Department should not provide a stamp of approval for such conduct or fail to realize that the *status quo* should be determined by the status of the Run-Off Companies in 2009 before OBIG systematically began depleting their assets.⁹

At the public comment hearing, the Department asked for information about other run-off scenarios. OBIG provided a short list referencing certain run-off companies. FTI created the chart in the accompanying submission which compares 23 other transactions that involved run-off companies. (FTI Submission at 16.) Those comparatives demonstrate – through actual transactions – that the Proposed Acquisition is underfunded. Those transactions demonstrate that the indicated additional capital of \$530 million for the runoff companies is reasonable. This additional capital amount is significant, and Colgate believes it highlights OneBeacon's strategy in approaching the Proposed Transaction: to transfer companies from which it already has removed all value, save for the barest minimum, with little regard to the legitimate interests of its policyholders.

FTI reached further conclusions based on the available information that undermine OBIG's assertions based on mis-use of the Towers Watson's report and further demonstrate that the Proposed Transaction should not be approved. FTI's conclusions include:

FTI's Conclusion 1

Compared to the *status quo*, the Proposed Transaction will significantly diminish the Run-Off Companies' available Financial Capacity to fully pay the valid claims of Colgate and other policyholders on a timely basis. Indeed, additional capital of **\$530 million** or additional retroactive reinsurance of **\$1.6 billion** is required to establish the Run-Off Companies with the same Financial Capacity as the *status quo*.¹⁰

⁹ Although not entirely clear, it appears that RRC's report wrongly accepts the Applicant's presumption that the *status quo* or "as is" status of the Runoff Companies should be based on the already depleted remains of the Run-Off Companies as of the date the instant Form A was filed. (RRC 10/2/14 Ltr.)

¹⁰ The *status quo* is as of December 2009 when OBIG reports that it began the restructuring.

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FTI's Conclusion 2

Compared to other run-off transactions, the Proposed Transaction is among the most poorly capitalized and therefore presents a high level of risk to the Run-Off Companies' policyholders. The additional capital required to establish the Run-Off Companies with the same Financial Capacity as other recent run-off companies is the amount in Conclusion 1.

As demonstrated in the accompanying report signed by Allan Kaufman, the comparative run-off transactions illustrate how significantly undercapitalized the Run-Off Companies will be if the Proposed Acquisition is approved. (FTI Submission at 16.) Those companies, adjusted to the size of the run-off company, indicated weighted average and median increases in capital levels of \$643 million and \$723 million, respectively. (*Id.* at 14.) These would be in addition to the \$161 million in the Proposed Transaction. Thus, the comparatives further demonstrate that at least \$530 million needs to be added to the Run-Off Companies by OneBeacon prior to closing the Proposed Acquisition.

Towers Watson 'brushed off' the similar, albeit less complete set of comparatives presented by Colgate at the July 23rd hearing. Towers Watson stated that "Slide 9" of Colgate's comments at the June 23rd hearing did not establish that the Run-Off Companies are undercapitalized and that Mr. Kaufman "did not make these points in his testimony." (Towers Watson 8/11/14 Ltr. at 17.) Towers Watson's statements completely ignore the conclusions that Colgate and Mr. Kaufman presented at the hearing, the other slides in the presentation at the hearing and the explanations provided in Colgate's filings prior to the hearing. To the extent there was any doubt at the hearing, Mr. Kaufman has used those comparatives and believes they provide valid and useful information for the Department on the degree to which the Proposed Transaction is undercapitalized. Towers Watson knows that a 12% failure rate is high and should not be surprised that the Proposed Transaction looks undercapitalized compared to other runoffs.

FTI's Conclusion 3

OBIG has used the Towers Watson Stochastic Report to assert that no reason exists to believe that additional capital might be required, or that timely payment to the Run-Off Companies' policyholders would be at risk for the next 20-30 years.¹¹ But the Towers Watson Stochastic Report does not consider, let alone reach a conclusion as to

¹¹ Cumulative Log, Document 105 (Hearing Transcript, 208:24-209:20).

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when claim payments will be interrupted by Technical Insolvency.¹² That time appears to be in **eight** years, rather than 20-30 years, based on the available information.¹³

Towers Watson refers to "scope limitations" when it refuses to consider the time within which the Run-Off Companies will know they can no longer pay claims. (Towers Watson 8/11/14 Ltr. at 16.) As stated at the public comment hearing and in FTI's preliminary report, Towers Watson only considered a "failure" as when the Run-Off Companies had zero remaining dollars to pay claims.

All that the Applicants have said in defense of this approach is that RRC found the Towers Watson approach to be an acceptable actuarial methodology. (Applicant's 8/12/14 Ltr. at 51-52.) However, RRC did not express a view that OBIGs misuse of the Towers Watson payment timing was appropriate and did not express a view that Towers Watson properly applied the methodology to reach an accurate conclusion. (RRC 10/2/2014 Ltr. at 3.) The silence on these issues essentially admits that FTI's analysis is correct: the Runoff Companies will reach technical insolvency years before they reach Towers Watson's "failure" point and, thus, the "no problems for 20-30-year view offered by OBIG is not the correct baseline for the Department's analysis of the Proposed Acquisition.

Applicant has remained silent about any rationale for misusing the Towers Watson payment timing information, because there is no rationale. The available evidence submitted by FTI demonstrates that the Proposed Transaction will not leave the Run-Off Companies financially stable by industry standards, and the Applicants are unable to provide convincingly evidence to the contrary, through their experts or otherwise.

¹² Towers Watson uses the term "Success/Failure" to refer to the time at which assets are fully depleted, *i.e.*, by analogy, when OBIG checks are returned for insufficient funds. (Cumulative Log, Document 080 (TW Stochastic Report, Table 1, p. 5.)) The time at which payments would be interrupted is no later than the time at which it would be recognized that the Runoff Companies' assets would not be adequate to pay all valid policyholders claims in full. As used herein, the term "Technical Insolvency" refers to the time when assets would not be sufficient to pay for estimated liabilities.

¹³ The most RRC could say in defense of Towers Watson's report is that Towers Watson tried to test the "known unknowns." But it appears that, instead, Towers Watson actually tested "some extremely high A&E losses" and found that such scenarios would cause "failure" of the post-transaction Runoff Companies. RRC discounts this finding by stating that the "as is" Run-Off Companies would suffer the same failure. The statement ignores the fact that the "as is" Run-Off Companies were already capital-depleted from OneBeacon transfer activities in 2012 and before. (RRC 10/2/14 Ltr. at 2.) In other words, to the limited extent Towers Watson did consider the known unknowns, such variables did cause a higher failure rate. Nonetheless, Towers Watson did not carry the analysis any further.

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Colgate and FTI are interested in what response, if any, is provided to the Department's recent request for analyses of the failure rate and what the analysis will show about timing of failures using alternative definitions. (Department's 10/6/14 Ltr. at 3.)

FTI's Conclusion 4

Towers Watson's indicated it predicts 12% chance that "invested assets be inadequate to cover all claims" is a higher failure rate than accepted industry risk standards.

Towers Watson refuses to offer any opinion on the riskiness of the failure rate it provides. (Towers Watson 8/11/14 Ltr. at 18, 22.) Mr. Kaufman's analysis in the accompanying FTI Submission sets forth how the 12% failure rate indicated by Towers Watson falls well short of the insurance industry's standards. (FTI Submission at 24226.) That failure rate would place the Run-Off Companies in the least secure 3% of insurance companies. The Applicants have failed to explain why such a failure rate is appropriate in light of their assertion that the Proposed Acquisition is to the benefit of policyholders.

FTI's Conclusion 5

As stated at the public comment hearing and in FTI's preliminary report, Towers Watson and the Applicants do not take into account a number of risks that can be anticipated, but are not measurable without balance sheet projections.

Towers Watson did not prepare balance sheet projections as part of its Stochastic Report and therefore important issues that affect the Payment Failure Rate are not taken into account. For example, some of the features not reflected in the Towers Watson stochastic modeling that could only increase the Payment Failure Rate are:

- (a) the high rate of return produced by the equity investment strategy will not be achievable in all scenarios;
- (b) there is no allowance for any minimum capital; and,
- (c) Towers Watson fails to consider that Technical Insolvency will increase the projected number of failures above its otherwise indicated 12%..

Additionally, in certain scenarios Towers Watson presumes Department authorization for special practices, including discounting the Run-Off Companies' loss reserves and the ability to pay claims in the normal course despite capital being only \$1 above Technical Insolvency. (*Id.* 28-30.)

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These issues should be considered in any reasonable assessment of the risk created by the Proposed Acquisition. The Applicants and Towers Watson, however, have failed to consider these risks and Towers Watson already has, or likely would, claim a number of them are outside of its scope of analysis.

The Department has now asked OBIG to provide an analysis including information that makes it possible to prepare balance sheet projections (Department October 6 letter, item 13). The Department should, require that the new analysis consider these well-known risks that would have a material effect on the Run-Off Companies.

It is particularly important that the Department require such analyses here, as Colgate, FTI and numerous other interested parties and policyholders have made clear, the Applicants are unwilling to provide the information needed for anyone else to perform an analysis of any of the risks. The only available information is incomplete. Therefore it is necessary to require the Applicants to provide the information or to perform an analysis acceptable to the Department and the policyholders.

FTI's Conclusion 6

FTI points out that OBIG has not arranged replies to several questions from the July 22, 2014 Hearing.

FTI's Conclusion 7

The foregoing Conclusions rely on accepting Towers Watson's Payment Failure Rate. In light of all of the risks and information ignored or not included in the scope of Towers Watson's report, however, proper consideration of issues not considered by Towers Watson will show that the indicated failure rate is higher than 12%. Accordingly, further analyses are required to determine an accurate failure rate that reflects the actual risks.

In sum, Towers Watson's report was of limited value. As mentioned above, Towers Watson avoided analyzing certain issues related to its work and readily claims that response to substantive inquiries concerning whether the Proposed Acquisition should not be approved. Towers Watson often explains that other analyses were "outside its scope." (Towers Watson 8/11/14 Ltr. at 16-19.) Thus, Towers Watson relies on the "outside its scope" rationale.

Other Issues that Remained Unanswered or Explained

The Applicant's similarly refuse to provide certain needed information. Towers Watson is unwilling to offer any analysis of the effect of the Proposed Acquisition on policyholders, why it is unwilling to perform any test of capital requirements (instead of

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purely a cash model), why it did not test surplus adequacy in their cash model, and why it did not test whether well-known IRMA and ORSA industry standards would be met. (*Id.* 16-20.) Towers Watson provided the same purported rationale in response to Mr. Kaufman's questions about why Towers Watson used the failure definition it used, why Towers Watson used the central estimates it used, and why it did not opine as to the appropriateness of the success/failure rate. (*Id.* at 21-22.)

For example, Colgate and the Department raised the potential need for immediate regulatory oversight. RRC states that ORSA applies to the needed level of capital, but states that thousands of Towers Watson's scenarios involved faster or higher claim payments than Towers Watson's unknown "central estimate," and that "[m]ost of these worse-than-average scenarios do not result in failure." (*Id.* at 3.) RRC's response ignores that it is critical to know when such scenarios would leave the Run-Off Companies technically insolvent. In fact, RRC's response goes even further by stating that the scenarios "do not" result in failure, despite the fact that even Towers Watson states that failure is imminent. The question is not if the Run-Off Companies will fail, just when they will fail. (Towers Watson 8/11/14 Ltr. at 17 (admitting that it places the "failure rate" under its own definition at just under 10% in 30 years.)

As explained above, Towers Watson also narrowly responded to questions posed at the hearing (*e.g.*, by limiting its response to the words on a slide, instead of the entire presentation, let alone filings by Colgate in this proceeding, which plainly support the points Colgate and Allan Kaufman and Colgate made.)

CONCLUSION

The Applicants have failed to provide the information needed to analyze the Proposed Acquisition, as discussed above and in the accompanying FTI submission. Accordingly, Colgate respectfully requests that the Department:

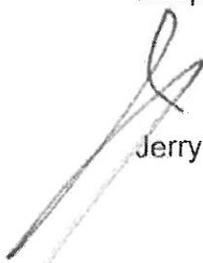
- a) require OneBeacon to make public and provide to the Department the details of the many transactions used to de-capitalize the Run-Off Companies, including any restructuring transactions undertaken in anticipation of the Proposed Acquisition, any intercompany transfers effectuated in anticipation of the Proposed Acquisition, any transactions involving a transfer of any assets out of the Run-Off Companies, and documentation of the current financial status of those companies; Including, but not limited to, Board minutes and reports to the Boards of OBIG subsidiaries authorizing these transfers.
- b) Require the Applicants to make public and provide to the Department copies of all relevant reinsurance agreements, whether provided by affiliates or third parties;

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- c) Permit Colgate to intervene in this proceeding; and
- d) Deny the Applicants' request to execute the Proposed Acquisition or, if the Proposed Acquisition is approved, require that OBIG provide:
 - i) Additional capital of **\$530 million**; and/or
 - ii) Additional retroactive reinsurance of **\$1.6 billion**; and/or
 - iii) Financial guarantees from the OBIG.

Respectfully submitted,



Jerry S. Goldman

JSG/hs

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