

**Analysis of Loss and ALAE
Reserves of The Home Insurance Company (in Liquidation)
As of December 31, 2003**

Executive Summary

February 11, 2005

Prepared for: Liquidator of The Home Insurance Company

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I. INTRODUCTION

Background

The Liquidator of The Home Insurance Company (in Liquidation) ("Home") engaged Milliman, Inc. ("Milliman") for the purpose of analyzing the loss and allocated loss adjustment expense reserves of Home as of June 30, 2003, and to roll the June 30, 2003 reserves forward to December 31, 2003. This report presents a summary of the results of our analysis.

In performing this analysis, we required a substantial amount of data, information and assistance from individuals at Home. We wish to express our appreciation for their support.

We will be available to answer questions regarding this report if authorized to do so by the Liquidator of Home.

Limitations on Use

This is a summary of Milliman's report dated February 11, 2005 ("Full Report"). This summary is prepared solely to be relied upon by Home. Milliman does not intend to benefit any third party recipient of this summary. The following additional limitations apply to the Full Report.

Milliman's work may not be provided to third parties without Milliman's prior consent, which consent may be granted conditioned on the execution by the third party of a Release Agreement. We agree that copies may be made available to the various state Guaranty Funds. We consent to such distribution as long as the report is distributed in its entirety. Milliman does not intend to benefit any third party recipient of its work product, even if Milliman consents to the release of its work product to such third party. We agree that this report may be submitted to the Merrimack County Superior Court, the High Court of Justice Chancery Division Companies Court or other such tribunals as may be necessary in connection with the liquidation of Home.

Scope of Study

The purpose of the Full Report was to present an independent actuarial evaluation of the loss and allocated loss adjustment expense reserves needed as of December 31, 2003 by Home, with

certain exclusions discussed below. For purposes of the Full Report, the project was broken down into two major components: 1) "core" reserves, and 2) reserves for asbestos and pollution (A&P).

Our review excluded all business written through the American Foreign Insurance Association (AFIA) and City International Insurance Company, Limited. Our review included other international business written by Home, including the business of Home's Canadian Branch. Our review included US International Reinsurance Company, since Home had reinsured all liabilities of US International Reinsurance Company not otherwise retroceded; however the schedules of liabilities in this Summary include the business of US International Reinsurance Company only to the extent of such obligation of Home.

Our analysis of A&P claim reserves was based on claim experience through December 31, 2003.

Our analysis of core reserves is based on claim experience through June 30, 2003. Reserves for unallocated loss adjustment expense (ULAE) were excluded from the scope of this analysis. As noted below, A&P liabilities assumed by Home were also excluded from the scope of this analysis.

For A&P liabilities, Milliman agreed to review the direct A&P liabilities of Home using ground up exposure estimates, and to consider how Home's liquidation status might affect ultimate claim costs. Exposure estimates use information about Home's individual claims and policies, and therefore produce results that are more reliable than top-down approaches that use only aggregate data. Our review was limited to business directly written by Home. There is A&P exposure that is associated with assumed reinsurance written by Home, but a review of that exposure is outside the scope of this analysis.

For the core reserves, the scope of our work consisted of an independent analysis for selected lines of business. The lines we independently reviewed are:

- Excess Lines, non-D&O claims only
- Workers' Compensation, non-Occupational Disease claims only (six groupings: Companies-handled vs. TPA-handled vs. high deductible business, and indemnity vs. medical)

- General Liability, non-High Deductible business only (three groupings: surplus lines products, other products, and non-products)

For the remaining lines of business, and for Home's obligation to USI Reinsurance Company, we reviewed Home's internal actuarial work papers for these lines for reasonableness.

Our estimates are on a net basis with regard to "other refunds" (as defined by Home) and salvage and subrogation. Losses are net of "automated deductibles" (discussed later) and recoveries from Workers' Compensation second injury funds. Our ALAE estimates are net of all deductibles and other refunds.

For Home core reserves, we developed separate estimates of the outstanding deductible amounts on large ("automated") deductible business. The "automated" deductible business generally has collateralized deductibles of \$100,000 or more. We estimated outstanding losses gross of all deductibles and then separately estimated outstanding deductible amounts on "large deductible" business. We reduced our reserve estimates to reflect these estimated outstanding amounts.

Our understanding is that Home obtained security in the form of letters of credit from its large deductible policyholders, in order to offset the associated credit risk. However, because Home is now in liquidation, the scope and impact of the large deductible credit risk has changed. In the case of claims that are paid directly by the Guaranty Fund, the Fund may often be allowed to directly bill the insured or to draw down the letter of credit in order to recover the deductible. For claims, or parts of claims, not paid by the Guaranty Fund, the insured is responsible for paying the claim and then filing a proof of claim with the Liquidator in order to apply for reimbursement. In that case, the payment to the insured is reduced by the amount of the deductible, and there is no credit risk. However, in cases where the Guaranty Fund does not pay the claim and the insured is unable to pay the claim, then Home's estate could be found to be liable and still exposed to credit risk for the deductible. Therefore, of the credit risk that formerly belonged to Home, some will belong to the Guaranty Fund, some will disappear, and some will remain with Home's estate.

Our estimates are on a net basis with regard to ceded reinsurance, except that our estimates are on a gross basis with respect to reinsurance that was commuted by Home or was recognized by

Home as "written off," in the case of insolvent reinsurers. In some cases the data provided to us, and therefore our estimates, are also gross of reinsurance ceded to certain other insolvent reinsurers, but which was not yet written off by Home. The scope of our analysis did not include investigation of the collectibility of any ceded reinsurance. The scope of our analysis also did not include investigation of the possibility of future reinsurance premium or commission adjustments (positive or negative) that might occur under the terms of reinsurance contracts as a function of the loss experience.

Our estimates are on an ultimate cost basis, not at present discounted value.

Data

The primary data and other information used in our analysis were provided to us by Home. We also relied on data from certain external sources such as the Reinsurance Association of America, A.M. Best Company, and the Environmental Protection Agency, among other sources. We have not audited or verified this data and other information. If the underlying data or information is inaccurate or incomplete, the results of our analysis may be materially distorted.

We have performed a limited review of the data used directly in our analysis for reasonableness and consistency, and have not found material defects in the data. If there are material defects in the data, it is possible that they would be uncovered by a detailed, systematic review and comparison of the data to search for data values that are questionable or relationships that are materially inconsistent. Such a review is beyond the scope of our assignment.

Variability of Results

It is important to understand that any estimate of future claim activity is necessarily subject to a substantial amount of uncertainty due to the unpredictability of changes in inflation, the legal system, and claims handling, among other variables. The estimates developed in the Full Report represent our best estimates of the future claim activity based upon claim experience through June 30, 2003 and December 31, 2003 for core reserves, and December 31, 2003 for A&P reserves. However, our best estimate is most properly viewed as the average of a wide range of possible outcomes. We consider the range of potential variability to be greater above our

estimate than below.

The uncertainty in our estimates is greater than it would otherwise be due to the liquidation of Home and the resulting involvement of state Guaranty Funds (and of insureds and their agents) in the claim handling process. In addition, Milliman did not have access to data from proof of claim filings given the claim filing deadline of June 13, 2004. Because Home is in liquidation its historical loss experience is less predictive of future claim activity, both with respect to the timing of claim reporting and claims determination, and with respect to ultimate claim sizes. We have judgmentally adjusted for these changes based on discussions with Home regarding changes in the claim handling process. However, the liquidation of Home adds an additional level of uncertainty to our estimates.

The estimates of A&P loss exposures are subject to a very high degree of uncertainty. This uncertainty stems from several factors, including a relative lack of historical data, inapplicability of standard actuarial projection techniques, and uncertainty with regard to claim costs, coverage interpretation and the judicial, statutory and regulatory provisions under which the claims may be ultimately resolved. The Asbestos and Pollution section (Section IV of the Full Report) includes optimistic but reasonable and pessimistic but reasonable estimates of the unpaid asbestos and pollution losses. Relative to the net best estimate, the optimistic/pessimistic range for Asbestos is -37% to +62%, and the range for Pollution is -23% to +43%. It should be understood that these ranges do not in any way represent the "lowest" or "highest" reserve estimates. Instead, the ranges should be interpreted as ranges of reasonable outcomes that can be expected given current information. There is no guarantee that all possible outcomes are contained within these ranges. This uncertainty of the A&P estimates is discussed further in Section IV of the Full Report.

II. SUMMARY OF RESULTS

We developed independent estimates in this analysis, or reviewed Home's reserves, for reserve components that account for about 90% of Home's total indicated reserve as of December 31, 2003.

The details underlying the estimates in the summary exhibits are provided in the Full Report.

The following tables compare Milliman's estimates of Home's gross, ceded and net outstanding losses and loss adjustment expenses to Home's indicated reserves as of December 31, 2003. The losses are shown in \$1,000's.

Estimated Total Gross * Outstanding Loss and ALAE
 As of December 31, 2003
 (Dollars in Thousands)

	(1)	(2)	(3)
	Milliman Analysis	Home Indicated Reserves	[(2)/(1)] - 1.0 Percentage Difference
Core Reserves Analyzed by Milliman			
Workers' Compensation ¹	\$675,077	\$714,704	5.9%
General Liability ²	125,203	132,896	6.1%
Excess Lines Excluding D&O	235,902	243,941	3.4%
Subtotal	\$1,036,182	\$1,091,541	5.3%
A&P Reserves Analyzed by Milliman (Direct)			
Asbestos	\$1,434,000	\$1,619,442	12.9%
Pollution	580,000	563,733	-2.8%
Subtotal	\$2,014,000	\$2,183,175	8.4%
Home Reserves That Were Reviewed by Milliman			
Workers' Compensation ¹	\$11,216	\$11,216	0.0%
General Liability ²	35,531	35,531	0.0%
Excess Lines D&O	1,064	1,064	0.0%
Auto	15,812	15,812	0.0%
Professional Liability	51,216	51,216	0.0%
Risk Management	43,214	43,214	0.0%
Small Lines	7,247	7,247	0.0%
Subtotal	\$165,300	\$165,300	0.0%
Total	\$3,215,482	\$3,440,016	7.0%
Home Reserves That Were Not Reviewed by Milliman			
Cut-Through and Omnibus	—	—	—
DES	—	\$55,320	—
Implants	—	62,017	—
Miscellaneous ³	—	232,002	—
USI Reinsurance Company	\$67,376	\$67,376	0.0%

¹ "Core Reserves" excludes Occupational Disease and Portfolio Transfers, which are included in "Reviewed by Milliman."

² "Core Reserves" includes surplus lines products, other products and non-products. "Reviewed by Milliman" includes High Deductible Business, Special Accounts and CMP Liability.

³ Includes Syndicates, facultatively assumed reinsurance written on Home policy forms with an HEC prefix (including Asbestos, DES, Agent Orange, and Pollution elements), as well as other Assumed reinsurance (including Asbestos, Pollution, and Other).

* Losses are gross with regard to reinsurance, but net with regard to salvage and subrogation, deductible recoveries, and all other refunds including those from Workers' Compensation second injury funds.

Summary of Milliman's Analysis of Loss and ALAE Reserves as of December 31, 2003

Estimated Total Ceded Outstanding Loss and ALAE
As of December 31, 2003
(Dollars in Thousands)

	(1)	(2)	(3)
	Milliman Analysis	Home Indicated Reserves	[(2)/(1)] - 1.0 Percentage Difference
Core Reserves Analyzed by Milliman			
Workers' Compensation ¹	\$125,113	\$136,671	9.2%
General Liability ²	15,216	20,426	34.2%
Excess Lines Excluding D&O	87,262	90,289	3.5%
Subtotal	<u>\$227,591</u>	<u>\$247,386</u>	8.7%
A&P Reserves Analyzed by Milliman (Direct)			
Asbestos	\$372,900	\$414,968	11.3%
Pollution	110,000	121,256	10.2%
Subtotal	<u>\$482,900</u>	<u>\$536,224</u>	11.0%
Home Reserves That Were Reviewed by Milliman			
Workers' Compensation ¹	\$907	\$907	0.0%
General Liability ²	(708)	(708)	0.0%
Excess Lines D&O	28	28	0.0%
Auto	4,902	4,902	0.0%
Professional Liability	5,305	5,305	0.0%
Risk Management	32,501	32,501	0.0%
Small Lines	3,237	3,237	0.0%
Subtotal	<u>\$46,172</u>	<u>\$46,172</u>	0.0%
Total	\$756,663	\$829,782	9.7%
Home Reserves That Were Not Reviewed by Milliman			
Cut-Through and Omnibus	—	\$356	—
DES	—	12,876	—
Implants	—	27,131	—
Miscellaneous ³	—	43,198	—
USI Reinsurance Company	\$0	\$0	—

¹ "Core Reserves" excludes Occupational Disease and Portfolio Transfers, which are included in "Reviewed by Milliman."

² "Core Reserves" includes surplus lines products, other products and non-products. "Reviewed by Milliman" includes High Deductible Business, Special Accounts and CMP Liability.

³ Includes Syndicates, facultatively assumed reinsurance written on Home policy forms with an HEC prefix (including Asbestos, DES, Agent Orange, and Pollution elements), as well as other Assumed reinsurance (including Asbestos, Pollution, and Other).

Summary of Milliman's Analysis of Loss and ALAE Reserves as of December 31, 2003

**Estimated Total Net Outstanding Loss and ALAE
As of December 31, 2003
(Dollars in Thousands)**

	(1)	(2)	(3)
	Milliman Analysis	Home Indicated Reserves	[(2)/(1)] - 1.0 Percentage Difference
Core Reserves Analyzed by Milliman			
Workers' Compensation ¹	\$549,964	\$578,033	5.1%
General Liability ²	109,987	112,470	2.3%
Excess Lines Excluding D&O	148,640	153,652	3.4%
Subtotal	<u>\$808,591</u>	<u>\$844,155</u>	<u>4.4%</u>
A&P Reserves Analyzed by Milliman (Direct)			
Asbestos	\$1,061,100	\$1,204,474	13.5%
Pollution	470,000	442,477	-5.9%
Subtotal	<u>\$1,531,100</u>	<u>\$1,646,951</u>	<u>7.6%</u>
Home Reserves That Were Reviewed by Milliman			
Workers' Compensation ¹	\$10,309	\$10,309	0.0%
General Liability ²	36,239	36,239	0.0%
Excess Lines D&O	1,036	1,036	0.0%
Auto	10,910	10,910	0.0%
Professional Liability	45,911	45,911	0.0%
Risk Management	10,713	10,713	0.0%
Small Lines	4,010	4,010	0.0%
Subtotal	<u>\$119,128</u>	<u>\$119,128</u>	<u>0.0%</u>
Total	\$2,458,819	\$2,610,234	6.2%
Home Reserves That Were Not Reviewed by Milliman			
Cut-Through and Omnibus	—	(\$356)	—
DES	—	42,444	—
Implants	—	34,886	—
Miscellaneous ³	—	\$188,804	—
USI Reinsurance Company	\$67,376	\$67,376	0.0%

¹ "Core Reserves" excludes Occupational Disease and Portfolio Transfers, which are included in "Reviewed by Milliman."

² "Core Reserves" includes surplus lines products, other products and non-products. "Reviewed by Milliman" includes High Deductible Business, Special Accounts and CMP Liability.

³ Includes Syndicates, facultatively assumed reinsurance written on Home policy forms with an HEC prefix (including Asbestos, DES, Agent Orange, and Pollution elements), as well as other Assumed reinsurance (including Asbestos, Pollution, and Other).

Asbestos and Pollution

The Milliman unpaid loss estimates for Asbestos and Pollution (A&P) have the following characteristics:

- a. They represent our best attempt at estimating ultimate loss using exposure model analysis for direct business. However, it is important to note that there is a wide range of uncertainty with respect to ultimate asbestos and pollution liabilities.
- b. The ultimate asbestos loss estimates selected by Milliman do not anticipate any federal legislative reform.
- c. The ultimate pollution loss estimates selected by Milliman:
 - Do not anticipate Superfund reform
 - Assume that there will be no savings in the claims determination process that, absent liquidation, might have been gained through the early or negotiated settlement of claims
 - Assume there will be a 25% reduction to DJ expenses as a result of the liquidation status of Home
 - Do not include a provision for Natural Resources Damage costs
 - Consider NPL and non-NPL site additions through the year 2010

The additional losses that might arise from Natural Resource Damage and sites added after the year 2010 may or may not turn out to be significant. We do not believe there is a reasonable basis for projecting such losses at this time. However, the potential for significant additional losses should be noted.

- d. The Milliman unpaid loss estimates are net of reinsurance. We have not reviewed the collectibility of Home's reinsurance. We have assumed that all ceded reinsurance is

collectible, except that our estimates are gross of reinsurance contracts that have been commuted or are with reinsurers identified as insolvent by Home. It is important to note, especially in the case of A&P losses, that reinsurance may also become uncollectible due to disputes over coverage terms and/or loss allocation. No provision is made in our estimates for uncollectible reinsurance arising out of such disputes.