GRC 07/11/17

THE STATE OF NEW HAMPSHIRE

MERRIMACK, SS **SUPERIOR COURT**

Docket No 03 - E - 0106
In the matter of the Liquidation of The Home Insurance Company

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AFFIDAVIT OF
GARETH HOWARD HUGHES

I, **GARETH HOWARD HUGHES,** of 1 More London Place, London SE1 2AF, United Kingdom, **MAKE OATH AND SAYS AS FOLLOWS:**

1. I am a licensed insolvency practitioner and a partner in the firm of accountants Ernst & Young LLP of the above address. I am also one of the Joint Provisional Liquidators of The Home Insurance Company, having been appointed to such office by the High Court in England and Wales on 8 May 2003. My partner Margaret Elizabeth Mills is the other Joint Provisional Liquidator who was appointed on the same date. I make this affidavit on the basis of my own knowledge, alternatively on the basis of information and documents supplied to me. To the extent that the matters to which I depose herein derive from my own personal knowledge, they are true, and to the extent that they derive from information and documents supplied to me, they are true to the best of my knowledge and belief. There is now produced to me marked "GHH1" and exhibited hereto a bundle of copy documents to which I shall refer to herein.

2. I have substantial experience in insurance insolvency matters, having been appointed by the English and/or Bermudian courts as insolvency officeholder to a member of insolvent insurers including The Bermuda Fire & Marine Insurance Company; Scan Re; Pine Top Insurance; Ocean Marine Mutual Association; Taisei Fire & Marine Insurance Company of Japan; Carolina Re and New Cap Reinsurance Company.

3. I have seen copies of certain papers filed in the New Hampshire court by Century Indemnity Company, ACE Property and Casualty Insurance Company, Pacific Employers Insurance Company and ACE American Reinsurance Company, in which those companies object to the motion of Mr Roger Sevigny, Liquidator of The Home Insurance Company, seeking approval of an agreement and compromise with AFIA Cedents. I make this affidavit in order to respond to certain of the factual assertions made by those objecting parties in their filed papers. For the sake of convenience, I shall adopt in this affidavit, save where the context otherwise requires, the same defined terms used by those parties in their Objections and Response dated 19 March 2004.

4. As Joint Provisional Liquidators of Home, Ms Mills and I were charged by the English High Court with the responsibility for safeguarding and protecting the assets of Home located in England and Wales. Since our appointment I have been working closely with the Liquidator and his staff on issues confronting the Home estate as a result of its participating in the AFIA pool. In particular, I was closely involved in negotiating the Agreement with the members of the Informal Creditors Committee which was established pursuant to the English High Court's order of appointment.

5. Since the date of our appointment we have liaised regularly with the Financial Services Authority ("FSA"), the responsible UK regulator of the financial services industry, to keep them informed of progress on the provisional liquidation. In particular, we have kept the FSA informed of the evolving proposal for dealing with the AFIA cendents' claims as envisaged in the Agreement and in the proposed scheme. Mr Sevigny and certain of his staff, as well as his advisers, have also participated in certain of these discussions with the FSA. A copy of the FSA's letter dated 26 March 2004 indicating its "non-objection" to the proposal appears at page 1 of GHH1.

6. I refer to paragraph 10 of the Objections and Response of the ACE Companies, as well as to their Memorandum in support, in which they assert that Home makes the 'false proposition that the proceeds from recoveries against Century pursuant to the Assumption Agreement constitute 'UK Assets''. They make the point that these are the only alleged 'UK Assets' alluded to in the Liquidator's Motion and they go on to assert that these could not comprise UK Assets in any event.

7. I understand that the question of 'situs' of particular assets gives rise to complex issues of fact and law. However, it is important to correct the misconception that the Liquidator cannot identify potential 'UK Assets' beyond the proceeds of the Assumption Agreement. This is not accurate. Prior to the execution of the Assumption Agreement in 1984, Home's liabilities under its AFIA policies were protected by a substantial reinsurance contract provided by BAFCO Reinsurance Company of Bermuda Limited ('BAFCO'), a Bermudian company. This reinsurance contact was first executed on 23 December 1982 and was expanded by agreements dated 23 December 1982 and February 1985 ('the BAFCO Reinsurances'). Under the BAFCO Reinsurances, as amended, BAFCO reinsured Home for its entire

inwards treaty reinsurance account for all underwriting years up to and including 1982. The cover written was for 'net losses' exceeding $95 million in aggregate. Following various name changes and mergers, BAFCO's liabilities under the BAFCO Reinsurances were apparently assumed by another Bermudian company, Century International Reinsurance Company Limited ('CIRC'). CIRC is wholly-owned by the ACE Group.

8. The ACE Group (as run-off managers of the AFIA business) estimated that, as at 31 December 2002, the gross ultimate liabilities of Home on the AFIA business stood at US$231 million. Home has calculated that, based upon these figures, Home's reinsurance claim against CIRC under the BAFCO Reinsurances would, after set-off, amount to approximately US$211 million.

9. There is a substantial 'UK nexus' between Home and CIRC; firstly, the BAFCO Reinsurances are expressed to be subject to English law and disputes are to be resolved pursuant to arbitration in England. Secondly, whilst the BAFCO Reinsurances and the indemnity provided to Home by Century under the Assumption Agreement appear to overlap to a significant extent, it is clear that historically it is the BAFCO Reinsurances which have been utilised by INA and then by ACE Group (as the new owners of INA and its successor entities) to make payments to AFIA cedents on Home's behalf.

10. By way of illustration, I attach at pages 2-3 a copy of a memorandum prepared for my staff by two individuals at ACE in England dated 5 June 2003. These individuals are called Peter Bamforth and Avtar Kalsi and they work in the Accounts department of ACE at Maidstone in Kent, England. They had been asked by my staff to prepare this memorandum as part of the cash reconciliation exercise which my staff were carrying out in conjunction with the ACE personnel in order that the Joint Provisional Liquidators could better understand how the Home's UK branch had funded its operations in the period of its stewardship by the ACE Group. It was clear from this exercise that the funds made available for funding claims payments by Home to its creditors were drawn from CIRC, were paid into England and were credited against recoveries falling due from that company under the BAFCO Reinsurances. I would draw this court's attention, in particular, to paragraph 3 (a) of that memorandum. I also attach (at page 4 of GHH1) a copy of a sheet used by ACE Accounts personnel in Maidstone to reconcile the CIRC outstanding balances under the BAFCO Reinsurances to the AFIA ledger maintained by ACE on Home's and St Paul's behalf. This shows cash received from CIRC of $1 million in January, February and May 2003, as well as pounds sterling 300,000 in January 2003. These payments were received in England.

I understand that the cash balances were not split out as between Home and St Paul at this level but both companies issued policies on the AFIA pool and both were protected by the BAFCO Reinsurances as well as by the indemnity under the Assumption Agreement.

11. ACE Group has previously asserted that Home is no longer the beneficial owner of the BAFCO Reinsurances, on the ground that they were allegedly assigned to INA in 1984 as part and parcel of the AFIA business transfer arrangements. Neither the Liquidator nor the Joint Provisional Liquidators accept this analysis, not least because Home was a signatory of the February 1985 agreement referred to in paragraph 6 above, pursuant to which the BAFCO Reinsurances were amended - i.e. after the date of their alleged "assignment" to INA. I attach at pages 5-7 of GHH1 a copy of a letter (provided to me by Jonathan Rosen, Chief Operating Officer of Home, from Home's records in New York) sent by AFIA Worldwide Insurance to the UK Department of Trade and Industry dated 28 October 1985 (this was sent at a time when the CIGNA group had assumed responsibility for running off the Home's AFIA business under the Assumption Agreement but prior to ACE's acquisition of that part of the CIGNA group). The UK Department of Trade and Industry was at that time the responsible regulator for the insurance industry in the UK. It is noteworthy that in this letter Mr White, on behalf of the CIGNA group entities then running off the Home business, makes express reference to the BAFCO Reinsurances and observes (bottom of page 1) that *'all losses of the UK Treaty Departments of Home and St Paul and certain uncollectable reinsurance is recoverable from BAFCO.'* Further, at the bottom of page 2 of that letter, Mr White goes on to observe: *'In conclusion I would suggest that the reinsurance now afforded by BAFCO under the [BAFCO Reinsurances] ... provide high quality protection for the United Kingdom Treaty Department of Home and St Paul.'*

12. I now allude to paragraphs 12 and 13 of the ACE Companies' Objection and Response and to their assertions that, first, AFIA cedents would be likely to file proofs of claim in the Home liquidation in any event and, second, the Liquidator has not substantiated his assertion that, but for the proposed scheme of arrangement contemplated by the Agreement, AFIA cedents would seek to 'wall off' the UK assets or seek to negotiate side agreements with the ACE group.

13. With respect to the first assertion, I fundamentally disagree with the ACE Companies. Several members of the Informal Creditors Committee (including Excess Insurance, Unionamerica, Equitas, Agrippina and Continental Insurance Company) have made it clear to me on a number of occasions that they would be most unlikely to prosecute proofs of claim in the New Hampshire liquidation proceeding in the absence of the Agreement (save, possibly, to the extent necessary to preserve any set-off rights which they might have), for the simple reason that they would not wish to incur the time and expense of prosecuting those claims in circumstances where they would not receive payment for their claims.

14. With respect to the second assertion, I can certainly provide substantiation. In a number of discussions which I and/or my staff have had with certain Informal Creditors Committee members (Equitas, Agrippina, Excess), those members have made it clear that they have been considering what methods may be available to them to enable them to 'cut-through' to the reinsurances provided to Home by the ACE Group or otherwise to negotiate a direct agreement with the ACE Group. In

particular, they have suggested that they might try to negotiate direct arrangements with the ACE Group whereunder the ACE Group would make payments to AFIA cedents, by-passing the Home estate in the process. Both the Liquidator and the Joint Provisional Liquidators have made it clear that we would not regard any such arrangements as legally permissible but I am nevertheless very concerned that the threat has been made. In my experience, it is very difficult in practice for insolvent insurers to pre-empt and deal with such arrangements and I understand that, certainly as a matter of English law, the legal basis for challenging this type of 'cut-through' arrangement is very far from straightforward.

15. With respect to the "walled off" liquidation issue, the Informal Creditors Committee members as a body indicated to us that they wished to investigate the question of whether there should be a separate "ring-fenced" English liquidation procedure whereunder the assets of the UK branch of Home would be ear-marked for distribution to the UK branch creditors. The legal advisers to Excess and Continental Insurance have since indicated to us that, if the scheme of arrangement envisaged by the Agreement does not proceed, they will certainly revisit this issue.

Sworn this 31st day of March 2004)

Before me NICHOLAS ANDREW THOMPSON)

Notary Public

Notary Public London England (Nicholas A. Thompson)

My Commission Expires at Death

Saville & Co.
Notaries Public
Princes House
95 Gresham Street
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THE STATE OF NEW HAMPSHIRE

MERRIMACK, SS

SUPERIOR COURT

Docket No 03 - E - 0109
In the matter of the Liquidation of The Home Insurance Company

AFFIDAVIT OF

GARETH HOWARD HUGHES

THE STATE OF NEW HAMPSHIRE

MERRIMACK, SS **SUPERIOR COURT**

Docket No 03 - E - 0106
In the matter of the Liquidation of The Home Insurance Company

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EXHIBIT "GHH1" TO THE AFFIDAVIT OF GARETH HOWARD HUGHES

This is the exhibit "GHH1" referred to in the Affidavit of **GARETH HOWARD HUGHES** sworn the 31st day of March 2004.

Before me,

Notary Public

Notary Public London England (Nicholas A. Thompson)

My Commission Expires at Death

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Notaries Public
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Financial Services Authority

Direct line: 020 7066 9660
Local fax: 020 7066 9701
Email: paul.taylor@fsa.gov.uk

FSA®

26 March 2004

G Hughes Esq
Joint Provisional Liquidator
The Home Insurance Company (UK branch)
c/o Ernst & Young LLP
1 More London Place
London
SE1 2AF

Our Ref: INSFD/non-life e/202179
AH/15SE20D

Dear Gareth

The Home Insurance Company ("the Home") (in Provisional Liquidation)

I write further to our meetings on 10 December 2003 and 24 February 2004 regarding the proposed approach in relation to the provisional liquidation of the Home's UK branch, including the proposed scheme of arrangement.

We note from our discussions and the scheme as proposed that this course of action envisages a better outcome for creditors compared with the potential availability of assets if a scheme is not approved.

On this basis, the FSA has no objections to the proposed scheme of arrangement.

Yours sincerely

D.P. Taylor

Paul Taylor
Manager: Insurance Firms Division

cc: Philip Hertz (Clifford Chance)

AFIA (REINSURANCE OPERATIONS LONDON)

BACKGROUND TO BANK BALANCES PER CASHBOOKS (G.L.)

The notes below are applicable to the attached file (BankRec@05.03peg).

Total balances per account are reconciled to AFIA bank statements on a monthly basis.

NB: Inter-branch cash transfers reflect cash transfers between branches to meet year-end solvency requirements. No physical transfer of cash takes place because the balances are held (in trust) on one bank account.

2. The Home and St. Paul split shown in the schedules attached are memorandum statements reflecting cash transactions recorded in the cashbooks and the General Ledger since 1984 (the year CIGNA purchased AFIA from the previous owners). The Trust Agreements specify that the AFIA bank balances belong to Home and/or St Paul as per the respective accounting records.

3. The following points should be noted regarding the cash transactions recorded over the last 18 years in the cashbooks and the GL:

a) Cash collected under the BAFCO reinsurance agreement, as amended, (CIRC's reinsurance of the AFIA liabilities) was posted as a matter of practicality to the Home Cashbook/GL. The reasoning behind this is that most of the losses related to the Home book (rather than the St Paul) and nearly always (if not always) CIRC provided cash as and when required to fund the Home (and the St Paul) operations. The BAFCO billings are consolidated for Home and St Paul transactions and submitted to CIRC semi-annually. No split between Home and St Paul has been made in the billings (this could be determined although it would be a difficult and onerous task given the other points noted below and the period that these transactions cover).

The question arises as to why CIRC has not paid AFIA (Home and St Paul) billings in full at the time of the billing. The background to this is that:

At times in the late 1980's AFIA UK almost ran out of cash and had no billings to draw on. CIRC, on a number of occasions, advanced AFIA (Home & St Paul branches) US$1m- 3m against future BAFCO billings.

ii. ACE (and CIGNA) has in addition provided/ contributed significant funds to both the Home and St Paul to enable the branches to remain solvent and meet regulatory solvency margins. As at December 2002 CIRC has "contributed" US$ 20.2m to the Home branch as shown in the GL. In effect the amounts have been treated as "Capital" within the accounts of the Home branch i.e. it has enabled the branch to continue to meet its UK solvency margin requirements.

b) Time deposits are posted as Home transactions, and funds are transferred to the current bank accounts as and when required. The current accounts are used to effect all payments and bank all receipts for the Home and the St Paul branches.

c) All assumed brokers' payments are strictly coded in the cashbooks/GL and the assumed ledgers to the entity that wrote the underlying policy. However, on limited occasions, where payments are due to a broker/cedant from both entities, a consolidated cheque has been raised and coded to either the Home or the St. Paul, depending on the entity settling the larger balance; a journal has subsequently been raised internally in balance sheet inter-branch accounts, transferring the appropriate settled balance to the second entity. No physical transfer of cash took place between the two entities in such circumstances as there was only one bank account.

A further complicating factor is that brokers will on occasion show the wrong entity, i.e. Home for St Paul or vice versa, on their statements. As a result broker receipts by wire transfer (direct to bank accounts) have from 1984 onwards on occasion been received into the AFIA bank account and only later has the correct entity been identified. The correcting entries have been raised in the inter-branch transfer accounts.

d) All ceded cash payments are strictly in the cashbook/GL and the ceded ledgers coded to the entity with the underlying contracts. The procedure noted in (c) above applies.

Consolidated cash receipts (i.e. combined Home and St. Paul receipts) by wire transfer have been treated in the same way as consolidated assumed receipts, i.e. often recorded to one entity and appropriate settlement transferred to the second entity through balance sheet inter-branch accounts when the correct entity has been identified.

A further complicating factor is that certain of the outwards reinsurance policies protect both the Home and the St. Paul and therefore consolidated ceded billings are sent out. Certain ceded reinsurance contracts entered into the 1970's are in the name of "AFIA and/or its Member Companies" and do not specifically mention the Home (and/or St Paul).

PJB/ AK
05 June 2003

AFIA LONDON
CIRC (BAFCO) OUTSTANDING BALANCES
MAY 2003

J/15

	Stg £ 1.0000	US$ 1.57260	Can$ 2.33445	Conv Stg As @ 5/03 rate
PER CIRC				
Balance Outstanding as agreed @ 12/02	852,479	42,129,709	0	27,642,323
Add : CIRC Statements: 2nd Half Year 2002 - booked 4/03)	184,954	7,195,359	0	4,760,408
	1,037,433	49,325,068	0	32,402,731
Cash Received				
- Jan 03	(300,000)	(1,000,000)		(935,890)
- Feb 03		(1,000,000)		(635,890)
- May 03		(1,000,000)		(635,890)
Total RO50H	737,433	46,325,068	0	30,195,062
Cash c/fwd @ 12/02	(500,000)	(29,500,000)	0	(19,258,743)
Total RO51Y	(500,000)	(29,500,000)	0	(19,258,743)
Total CIRC balance oustanding @ 5/2003	**237,433**	**16,825,068**	**0**	**10,936,319** ✓
PER GENERAL LEDGER @ 5/2003				
GL @ 5/2003 - 11500003	237,476	16,825,469	0	10,936,617
Small Diff	(43)	(401)	0	(298)
	237,433	16,825,068	0	10,936,319

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APPENDIX B

AFIA WORLDWIDE INSURANCE Chesterfield House, 26-28 Fenchurch Street, London, EC3M 3DH. Telephone: 01-626 8744, 01-626 8758 Telex No. 888880

G.R. Wilson Esq.
Department of Trade & Industry
Insurance Division 1E
Sanctuary Buildings
20 Great Smith Street
London SW1P 3DB

28th October 1985

Dear Mr Wilson,

RE: THE HOME INSURANCE COMPANY
ST. PAUL FIRE & MARINE INSURANCE COMPANY
TREATY DEPARTMENT REINSURANCE ARRANGEMENTS

At a recent meeting you requested further details of the special reinsurance arrangement covering the Treaty Departments of the London branches of The Home Insurance Company and St. Paul Fire and Marine Insurance Company in respect of the 1983 and prior underwriting years.

The reinsurance arrangements in question include those arranged with BAFCO Reinsurance Company, a company incorporated in Bermuda. Prior to the acquisition of AFIA by CIGNA Corporation, BAFCO was ultimately wholly-owned by the then members of AFIA. Since the acquisition of AFIA by CIGNA, BAFCO has ultimately been a wholly-owned subsidiary of CIGNA. BAFCO is authorised to carry on insurance business in Bermuda.

The History of the Arrangements is as follows:

In June 1981 with effect from 12th May 1981 and subsequently amended to have effect from 1st January 1981 an Excess of Loss Reinsurance Agreement was entered into whereby six specific treaties written by the Home Insurance Company were 100% retroceded to BAFCO.

In 1982 the general nature of the AFIA UK Treaty Department losses became apparent, and a Second Excess of Loss Reinsurance Agreement was entered into. In summary, subject to a retention of US$95 million, all losses of the UK Treaty Departments of Home and St. Paul and certain uncollectable reinsurance is recoverable from BAFCO.

...2/-

For BAFCO's protection the Stop Loss Agreement was entered into which provided that in so far as BAFCO's liabilities were not covered by its accumulated funds it would be reinsured without limit by all the then members of AFIA.

On acquisition of AFIA these reinsurance arrangements passed to CIGNA and for the purpose of the acquisition Stop Loss Addendum 1, the Insurance Assumption Agreement and the Quota Share Agreement were entered into. Since that time CIGNA has taken further steps to consolidate and simplify the reinsurance arrangements by the preparation and execution of the First Supplemental Excess of Loss Reinsurance Agreement and Stop Loss Addendum.

The Present Arrangements are currently:

The First and Second Excess of Loss Reinsurance Agreements have been modified by the First Supplemental Excess of Loss Reinsurance Agreement. The Stop Loss Agreement must be read in conjunction with Stop Loss Addendum 1 and, Stop Loss Addendum 2. The Insurance Assumption Agreement and Quota Share Agreement exist independently.

The Stop Loss Agreement, as amended by Stop Loss Addendum 1 and Stop Loss Addendum 2, is now between BAFCO and Insurance Company of North America, one of CIGNA's US insurance subsidiaries. As amended, the Stop Loss Agreement reinsures BAFCO for all liability under the First and Second Excess of Loss Reinsurance Agreements (as amended) in excess of an aggregate of US$50,000.

The Insurance Assumption Agreement was entered into on CIGNA's acquisition of AFIA. It provided that INA would assume as its direct obligation all insurance and reinsurance liabilities of each of the selling members of AFIA (including Home and St. Paul) arising out of the operation of AFIA. This agreement results in INA being legally obliged to stand directly behind the liabilities of the Home and St. Paul Treaty Departments whether formally reinsured with INA or not.

X

Under the Quota Share Agreement the selling AFIA members in turn reinsure INA and the other CIGNA entities for:

(a) a 90% Quota Share of US$265 million excess of US$335 million of losses of the London Treaty Department; and

(b) 50% of non-recoverable London Treaty Department reinsurance in excess of US$45.9 million.

In conclusion I would suggest that the reinsurance now afforded by BAFCO under the First Excess of Loss Reinsurance Agreement, the Second Excess of Loss Reinsurance Agreement and the First Supplemental Excess of Loss Reinsurance Agreement and supported by the Stop Loss Agreement provide high quality protection for the United Kingdom Treaty Department of Home and St. Paul.

...3/-

I hope that you now have the information which you require. If you would appreciate a meeting to clarify further the contents of this letter, I should be very happy to oblige.

I enclose the following copy documents:

(a) First Excess of Loss Reinsurance Agreement, signed on 1st and 23rd December 1982 and taking effect on 12th May 1981.

(b) Second Excess of Loss Reinsurance Agreement, signed on 1st and 23rd December 1982 and taking effect on 12th May 1982.

(c) First Supplemental Excess of Loss Reinsurance Agreement, signed on 1st February 1985 and taking effect on 1st January 1981 in respect of the First Excess of Loss Reinsurance Agreement and 12th May 1982 in respect of the Second Excess of Loss Reinsurance Agreement.

(d) Stop Loss Reinsurance Agreement, signed on various dates in 1982 and 1983 and taking effect on 30th June 1982.

(e) Addendum number 1 to the Stop Loss Agreement signed on 31st January 1983 and taking effect on 30th June 1983.

(f) Addendum number 2 to the Stop Loss Agreement, in draft, and taking effect on 30th June 1983.

(g) Insurance and Reinsurance Assumption Agreement, signed on 31st January 1984 and taking effect on that date, together with a glossary of terms used but not defined in the Agreement. ✓

(h) Quota Share Reinsurance Treaty Agreement, signed on 31st January 1984 and taking effect on 30th June 1983, together with a glossary of terms used but not defined in the Agreement. ✓

Yours sincerely,

S.D.J. White
General Manager
SW22/85/AFIA14/LP

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