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

AFFIDAVIT OF PETER A. BENGELSDORF, SPECIAL DEPUTY LIQUIDATOR, IN SUPPORT OF APPROVAL OF 2013 EMPLOYEE COMPENSATION PLANS

I, Peter A. Bengelsdorf, hereby depose and say:

1. I was appointed Special Deputy Liquidator of The Home Insurance Company ("Home"), by the Commissioner of Insurance for the State of New Hampshire, as Liquidator ("Liquidator") of the Companies. I submit this affidavit in support of the Liquidator's Motion for Approval of 2013 Compensation Plans ("Motion"). The facts and information set forth below are either within my own knowledge gained through my involvement with this matter, in which case I confirm that they are true, or are based on information provided to me by others, in which case they are true to the best of my knowledge, information and belief.

2. The Motion concerns the approval of integrated compensation plans for the employees of Home in 2013 (the "2013 Employee Compensation Plans") and a compensation and incentive/retention plan for myself as Special Deputy Liquidator. The 2013 Employee Compensation Plans consist of annual base salary programs supplemented, in certain cases, by an Annual Incentive Plan ("Annual Plan") and a Collection Incentive Plan ("Collection Plan"). Those plans are intended to reward performance and reinforce retention of essential employees in order to facilitate the successful, efficient and prompt completion of the liquidation process. The Motion reflects the recommendation of Ernst & Young LLP ("E & Y"), experienced

insurance industry compensation consultants, concerning the appropriate compensation structure for employees of Home.

3. As described in the Liquidator's reports and the Liquidator's Motion for Approval of Compensation Plans dated April 5, 2004 (concerning the 2004 compensation plans) (the "2004 Compensation Motion"), shortly after the liquidation proceeding began in June 2003, the Liquidator determined that the most efficient way to organize the liquidation process was to hire the most critical Risk Enterprise Management ("REM") employees. This permitted the Liquidator to benefit from the continued involvement of experienced employees with prior involvement with the Home runoff. The Liquidator initially hired 98 employees (93 from REM and 5 others) to handle the liquidation of Home. The liquidation is presently staffed by 63 employees, 52 of whom are located in New York City, 10 in Manchester, New Hampshire, and 1 in Atlanta, Georgia.

4. Home's liquid invested assets have increased from the day the Order of Rehabilitation was entered, approximately \$12.7 million as of March 2003, to an estimated \$1.4 billion as of September 30, 2012. (These figures include USI Re, \$222 million of Class II early access distributions to guaranty associations to date and \$48 million in Class I distributions to guaranty associations.)

5. As set forth in the 2004 Compensation Motion, the Liquidator engaged nationally recognized compensation consultants to assist in the design of employee compensation plans for 2004. The consultants had experience in the design of compensation plans for large insurers, like Home, in liquidation. They concluded that Home's base salaries were approximately at the 50^{th} percentile among comparable companies and recommended that total direct compensation (base salary and incentive bonuses) range between the 50^{th} and 75^{th} percentile.

6. To retain and compensate the necessary staff for Home, the Liquidator accordingly developed and requested approval for three integrated compensation plans for 2004: a Retention Incentive Plan for non-exempt full time employees, an Annual Incentive Plan for exempt full time employees including executives, and a Collection Incentive Plan for executives. As set forth in the 2004 Compensation Motion, the Liquidator's consultants advised that the plans represented best practices with respect to compensation in insurance company liquidations, provided competitive annual and long-term earnings opportunities, and balanced performance-based rewards with short-term and long-term retention. The individual programs were integrated across employee levels and would provide, if performance goals were met or exceeded, total direct compensation between the 50^{th} and 75^{th} percentile market levels. This was the level of compensation recommended by the Liquidator's consultants in order to retain experienced employees. The Court approved the compensation plans for 2004 by order issued April 21, 2004 and the similar 2005 compensation plans by order dated March 4, 2005.

7. After consulting with E & Y in 2006, the Liquidator proposed to eliminate the Retention Incentive Plan and continue the Annual Plan and Collection Incentive Plan on essentially the same terms as in 2005. The Court approved the 2006 Compensation Plans, including the elimination of the Retention Incentive Plan, by order dated February 8, 2006. During 2004 and 2005 the Retention Incentive Plan applied to Home's 15 non-exempt (Federal Wage and Hour Law) employees. Beginning in 2006 those employees had individual performance goals and were included in the Annual Plan. The proposed 2013 Employee Compensation Plans are based on the 2006 Compensation Plans.

8. The Liquidator seeks to continue to provide compensation consistent with best practices with respect to compensation in insurance company liquidations, provide competitive

annual and long-term earnings opportunities and balance performance-based rewards with short-term and long-term retention. The 2013 Employee Compensation Plans therefore consist of annual base salary programs supplemented, in certain cases, by the Annual Plan and the Collection Plan.

a. *Annual Plan.* This plan is designed to provide additional cash compensation based on the overall performance of Home's liquidation and the individual employee during the annual plan cycle. Fifteen full time employees as of January 1, 2013, would be eligible to participate in the Annual Plan.

i. The Annual Plan was a component of the 2004 Employee Compensation Plans. For 2011, the Liquidator proposed to reduce participation in the Annual Plan by eliminating participation for employees with base salaries less than $75,000. In lieu of the Annual Plan, up to 70% of the amount that would otherwise be paid in incentive payments to these employees was used to increase their salaries and the remainder was applied toward the annual 401(k) safe harbor contribution. This change, which did not increase total expenses, was based on the conclusion that, in the prevailing circumstances, the nature of these positions was such that the affected employees had less ability to directly affect operating results. Compensation based solely on annual salary was therefore deemed most appropriate. The court approved this change in an order dated December 30, 2010.

ii. For 2012 the Liquidator proposed to further reduce participation in the Annual Plan by eliminating participation for employees with base salary less than $150,000. This change was based on the conclusion that, in continuation of the trend underlying the 2011 changes to the Annual Plan, the nature of these positions is such that they have less ability to directly affect operating results. As a result, compensation based solely on annual salary was therefore deemed most appropriate and, in lieu of the Annual Plan the Liquidator proposed that up to 60% of the amount that would otherwise be paid in incentive payments to these employees would be used to increase their salaries and the remainder would be applied toward the annual 401(k) safe harbor contribution. The court approved this change in an order dated January 25, 2012.

iii. The Liquidator proposes to maintain in 2013 the same eligibility criteria that applied in 2012. As with the Annual Plan for preceding years, for 2013 the Liquidator would determine the annual goals, performance measures and payouts. The 2013 goals would include: operation within budget, accomplishment of enumerated claim determination processing objectives and reaching asset marshaling targets. Annual cash payments would be made after the close of the performance year (no later than March 15, 2014). If an employee voluntarily leaves or is terminated for cause, then no Annual Plan payment would be made. In the event of death, disability or an involuntary termination, the employee would be entitled to a pro rata share of any Annual Plan payment. The estimated 2013 cost for the Annual Plan is approximately \$1.17 million (compared with \$1.17 million estimated to be paid for 2012, \$1.58 million paid for 2011, \$1.73 million paid for 2010, \$1.86 million paid for 2009, \$2.29 million paid for 2008, \$2.23 million paid for 2007, \$2.28 million paid for 2006, \$2.28 million paid for 2005, and \$2.61 million paid for 2004).

b. *Collection Plan.* At the discretion of the Liquidator, the seven senior executives of Home would be eligible to participate in the Collection Plan. The Collection Plan is designed to provide focused incentives for the collection of assets, determination of claims and management of the liquidation in an efficient manner. Awards under this plan will be based on the accomplishment of annual corporate targets but may also vary, at the discretion of the

Liquidator, based on achievement of individual performance goals. The objective of the Collection Plan, through deferred compensation, is to retain senior and experienced executives as long as deemed necessary by the Liquidator. Therefore, any Collection Plan award will be deferred and funded into a trust account. The employee will actually receive those funds only upon the involuntary termination of employment other than for cause, or at the dates established by the Liquidator (e.g., an interim 40% payout at July 1, 2015 and 60% payout at July 1, 2017). If an employee voluntarily terminates or is terminated for cause, then all Collection Plan amounts are forfeited. In the event of death or disability, the Collection Plan amounts will be distributed. The estimated 2013 cost for the Collection Plan is approximately $844,809 (compared with $844,809 estimated to be paid for 2012, $895,145 paid for both 2010 and 2011, $1.06 million paid for 2009, $1.32 million paid for 2008, $1.31 million paid for 2007, $1.45 million paid for 2006, $1.51 million paid for 2005, and $1.48 million paid for 2004). This figure includes a 2012 reduction of $5,000 in Collection Plan eligibility for each of two executives whose compensation was considered to be highly competitive at the median market level.

9. The Liquidator's consultant, E & Y, advises that the 2013 Employee Compensation Plans are appropriate and consistent with general market practices and to insurance companies in liquidation. It further advises that the individual plan designs and mechanics are based upon accepted compensation practices for insurance companies in liquidation, and that the levels of pay provided by the individual plans, as well as the overall total compensation, represent market competitive compensation levels.[1]

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[1] E & Y's analysis has historically been based on national data and E & Y continues to use such data in analyzing the market competitiveness of compensation for Home's seven senior executives. For Home's remaining key employees, however, E & Y determined to analyze 2012 compensation on the basis of data for the region in which these employees work. For 2013, E & Y has continued to compare compensation for the seven senior executives to national data and compensation for the remaining key employees to regional data.

10. The cost of the estimated 2013 safe harbor contribution ($231,000) has been given consideration in determining the total 2013 compensation budget (including incentive compensation). As described in the Liquidator's reports, Home adopted a non-contributory 401(k) plan effective October 1, 2004. Further, effective January 1, 2005, Home adopted the safe harbor provision under Internal Revenue Service rules so that all employees who wish to do so may contribute the maximum amount to the 401(k) plan. The cost of adopting the safe harbor provision is three percent of employees' earnings (up to an individual employee earnings cap of $255,000). That cost has been applied to reduce the budgeted amounts for 2013 otherwise payable as compensation (including incentive compensation).

11. The Liquidator's consultant, E & Y, concludes that the overall levels of pay provided by the individual incentive plans, as well as the overall total compensation, represent market competitive compensation levels.

12. I believe that without the adoption of these plans the liquidation effort would be harmed because key employees would seek better, more long-term career opportunities elsewhere. For the reasons described above, I believe that the Plans are fair and reasonable and in the best interests of the liquidation and of the policyholders and other creditors of Home.

Signed under the penalties of perjury this 19 day of November, 2012.

Peter A. Bengelsdorf
Special Deputy Liquidator of The Home Insurance Company

STATE OF CALIFORNIA
COUNTY OF VENTURA

Subscribed and sworn to, before me, this 19 day of November, 2012.

TINA TRINH LE
COMM. #1820876
Notary Public - California
Ventura County
My Comm. Expires Nov. 27, 2012
NR01

Notary Public/Justice of the Peace