



RMG CONSULTING

Claims and Risk Management Executives

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**REINSURANCE REPORT
REGARDING GROUP
December 7, 2007**

Overview of Reinsurance Assumed

writes several types of reinsurance for the Group including a Global Slip, various Facultative Certificates and the Variable Quota Share Excess and Umbrella contract. On several prior visits we have recently conducted reviews of the Quota Share and Umbrella contracts and those reports are available for review. The purpose of this audit was to gain insight into handling of long term exposure matters, including asbestos, environmental and hazardous waste among others, reinsured under Global Slip Treaty First Excess of Loss Contract.

Global Slip

Companies participate on Global Slip through (brokered through) and also participates on a direct basis. The years of involvement are from as early as 1967 through 1985. Attachment points vary and range from in excess of \$1 million to \$3 million. **Exhibit 1** attached shows the various participations of the companies. Regardless of the fact that percentage participation is relatively small, the layers of involvement are high and the attachment point low. Given the long term and high risk exposures, over multiple policy years, a significant overall dollar exposure to exists.

Pre-Audit Preparation

█████ claim personnel identified the need for an audit of this long tail book and arranged an audit to be conducted during the week following Thanksgiving (November 27 thru November 30). █████ contact responded to █████ request for the audit asking it to identify what claims it wanted to review. █████ asked for a loss run including all open and closed claims against the treaty. The response was delayed, and once received, a selection of some 95 claims from the various runs were selected. This was the normal procedure and was followed for the past two audits without incident when all but several files were available.

In this instance, however, different █████ personnel were involved and we encountered difficulties that did not appear warranted. Unbeknown to █████, approximately 2/3's of the files selected were being handled by █████ TPA, █████ in Boston. █████ refused to arrange for those files to be sent to █████ for the review. In addition, when █████ attempted to replace those files with additional matters, it was met with a similar refusal since by then the new request was within 30 days of the audit inception and too late in █████ protocol to select additional files. █████ did relent somewhat (only after having caused █████ management to become involved) and allow █████ to review one recently reported matter from another treaty that was of significant concern.

Audit

█████, who has assumed responsibility for the account, and consultant John Saulino of RMG Consulting both of whom had been involved in past audits of █████ performed the review. The files for the Global Slip were arranged and handled differently from the files we had seen on prior audits. Not only were we not previously advised that claims were handled off site █████ but these older files were created in various classifications for each of the individual accounts. The classifications included:

- Declaratory Judgment files – generally created to handle a particular litigated coverage matter.
- Coverage files – generally created to handle a matter of coverage interpretation
- Holding Files – these files were usually created to place reserves on the account for those matters which had exposure on more than one year of coverage and hence an allocation to other files and years of coverage would eventually have to be made.

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The audit revealed that notwithstanding the original purpose for which the particular file was created, files often contained aspects of other categories. For example a file earmarked as a DJ file may well have been converted to a holding file or vice versa. In some instances a file contained elements of all three categories defeating any purpose of segregation. We later learned that many files had been returned from [REDACTED] others were transferred to different handlers, and others still may have had more than one handler having responsibility for different issues within the file (DJ vs underlying claims).

Notwithstanding these impediments we were able to glean significant information from the files, albeit after having to sort through multi-volumes for each file. In total we reviewed 37 claims involving some 27 different accounts.

We identified the major exposure (loss cause) for each of the files reviewed.

- Eight (8) files were primarily environmental.
- Twenty – three (23) files revolved around the asbestos exposure
- The remaining files six (6) files involved either lead, chemical, other mass tort or a combination of exposures.

We were permitted to take copies of the “one step” adjuster file notes and make copies of significant documents we identified in the file. These will actually help identify reserving needs for more than the file selected since the information often touched on the overview of the account and not a particular claim file as one would have expected.

The database we utilized for the review was one which we had used in the past and included columns which allowed us to assess overall claim handling by [REDACTED] in several key categories (we added a column for “Allocation” in view of the type of claims we expected to encounter). The categories and results for each included the following:

Allocation Methodology / Appropriateness – [REDACTED] follows a pro-rata philosophy in addressing the needs of allocation and we found a consistent approach without apparent regard to reinsurance. The “Holding files” showed increases and decreases (presumably when monies were transferred to other files for different years of exposure) which was confirmed by notes, but we most often could not see the transaction detail since it may have involved a file for the same account which was not selected. We did request certain copy work included spreadsheets which may assist us in verifying same as well as identifying potential ACR needs.

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Coverage application – It is evident that senior and well qualified staff is assigned the handling of these long term high risk exposures involving significant coverage problems. We noticed coverage counsel involvement when necessary and the opinions and direction were appropriate. Coverage was usually referred to the [REDACTED] firm and while they appeared expensive, they were competent and responsive based on the files we reviewed. We found [REDACTED] **95% compliant** with the identification and handling of coverage.

Timely Reserving – Given [REDACTED] situation we expected and found certain needs for improvement. They were found to have reacted to reserving needs timely and **sufficiently in 79%** of the matters reviewed. In certain cases a request for a higher more appropriate reserve was made, but a lesser amount authorized. Additionally, since the file we reviewed was thought to have been a claim specific matter, but in effect was something different, reserves in general could not be fully and accurately assessed. Refer to specific examples and comments in our review data base.

Supervision – The files showed the involvement of managers and other levels of hierarchy in the oversight of the claims. Directors and even General Counsel were found to have made comments and offer suggestions or were even directing certain portions of files involving Declaratory Judgments or serious coverage matters. We found that **84% of the files had appropriate oversight.**

Settlement Negotiations – We found that [REDACTED] was fairly aggressive in attempting to resolve matters. Given that these are usually long term high exposure matters, this is a positive sign. We were advised later by Senior Management that they try to take advantage of the general perception (and reality) of the [REDACTED] [REDACTED] faces and have been able to realize some attractive results. We confirmed [REDACTED] issues [REDACTED] including policy buy outs or at least elimination of certain classes of exposure for example all asbestos related claims. Separate counsel is often retained to assist in assessing buy-out potential. We found positive attention to settlement considerations in **89%** of the claims reviewed.

Technical Claim Management – We found that a number of files were not properly documented and this may well have been caused by the fact that the documents may have been contained in a companion (or “master”) file for the same account. See also the mixing of coverage, DJ and holding files as noted above. Nonetheless, we found an overall rating of 81% in this area with the technical issues of the file addressed either by the technician, counsel as necessary, or both.

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Reporting to [REDACTED] – In view of [REDACTED] file set up procedures, reporting to the reinsurer on a file basis is not significant. As will be discussed later in this report, [REDACTED] should rearrange its handling of files under the Global Slip from an individual file basis to an account basis. Identifying the exposures for the account, assessing these individual exposures and years of coverage involved and placing reserves on each year of coverage, will allow for a more accurate assessment of the exposure faced by the reinsured.

Preparation and Wrap-Up

In view of the impediments we found, it was decided to stop auditing the remaining pulled files (6 precautionary matters) and concentrate the afternoon of Thursday Nov 29th on preparing documents and summaries of our findings which would enable us to make a presentation at the wrap-up the following day. Our intent was to:

- Clearly communicate [REDACTED] needs in the conduct of an audit
- Highlight the impediments and disconnect we encountered in that effort.
- Propose ways in which to best accomplish the objective through positive suggestions.
- Gain [REDACTED] agreement with and commitment to the above.

The audit wrap up meeting was held on Friday November 30th and attended by [REDACTED] and John Saulino on behalf of [REDACTED] and [REDACTED] Reinsurance Counsel and [REDACTED] Vice President Reinsurance on behalf of [REDACTED].

We explained at the outset that we were disappointed in [REDACTED]'s response and cooperation in preparation for the audit and in meeting the needs of [REDACTED]. While at first [REDACTED] was defensive, once we made a full explanation, these individuals realized that the protocols enacted by the staff with whom we dealt were overly restrictive, and that in essence, [REDACTED] had acted inappropriately. They were apologetic and cooperative and became active listeners to our needs.

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████████ admitted that one of the impediments to resolving the issues was that we had been dealing with lower level personnel who were “following their marching orders”. ██████████ who would normally have been involved, and who would have made the necessary audit changes to our reasonable requests, was out ill during the early part of the audit. Both she and ██████████ readily agreed that the ██████████ staff should have explained how the long term exposures which we were attempting to review under the Global Slip differed from those files we had reviewed in the past. Picking a random sample from a loss run, as would have been usual practice, would not result in what we were looking for. Moreover, since many of the individual working files involving long term exposure matters were handled in ██████████ by ██████████, none would be available for the review.

████████ management agreed to speak with the staff at the conclusion of our meeting so that there would be a clear understanding of the “full and open” communication and cooperation between ceding company and reinsurer that we explained was necessary under the contract as well as usual custom and practice.

█ Requests

Once these barriers were removed, the meeting became even more productive. We suggested the following for █ handling and selection of claims involved in the Global Slip and sought █ concurrence:

- Handling claims under a macro view examining the book of business and then drilling down to the specific exposures under the treaty and years at risk
- Audit preparation would therefore include:

1. Requesting loss runs for all business applicable to the treaty on an account basis including open and closed identifying the incurred on the account in total broken down by loss, expense and total incurred.

2. Requesting █, prior to the audit, to provide copies of all Large Loss Runs and Significant Claim Reports generated by the account. In addition, █ requested that █ provide to it █'s claim organization information as well as any administration / handling information so that it might better understand and communicate with management and staff responsible.

3. Based on the information requested, █ would be in a better position to request the accounts for review focusing on the exposure by annual year, aggregate or class of business / exposure class e.g. asbestos, hazardous waste, etc.

4. █ would then bring with them a one page summary of information on the general exposures e.g. █ asbestos as well as █ other exposures and what █'s needs were for the scheduled audit. This would also allow an outside auditor not handling the files a better overview of █ objectives.

█ Responses

█ agreed to █ general conclusions regarding the macro and account approach to handling as the best means to handle the exposures and they also committed █ to do so, but only within the confines of their ability and other internal procedures as discussed below:

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1. [REDACTED] advises that it does not have the current ability in their system (and not likely to generate enhancements thereto) in order to identify business which falls within the Global Slip or any other reinsurance program. The trigger for reinsurance recognition is generated by the claim handler, who, after recognizing exposure, generates a Large Loss and the review of applicable reinsurance. It is only after reinsurance on a particular file is identified that the Reinsurance system can make identification of its applicability. The corresponding reserve on the file then triggers whether the amount is a precautionary or reserve specific reporting against the potential contract.

2. Nevertheless, loss runs can be identified for the treaty and, if insured name is available should be reportable by account. If a Large Loss had not previously been forwarded, [REDACTED] agreed to send those with the earliest request prior to any audit. However, where Large Losses had been sent previously, it felt it would be overly burdensome for them to have to go back to the underlying claim file to retrieve reports that had been previously forwarded. [REDACTED] also agreed to make [REDACTED] claim management staff available to [REDACTED] so that [REDACTED] organizational and administrative handling information might be available to [REDACTED] for future audits as [REDACTED] had requested.

3. [REDACTED] should identify those matters which have been previously reported and indicate if a Large Loss or Significant Claim Report had been generated. If not request same and [REDACTED] will provide same if available. To the extent that underlying working files which demonstrate actual claim handling are necessary, [REDACTED] will make those files available as well.

4. [REDACTED] will continue to allow its reinsurers the ability to take copies of the "One Step" adjuster notes as well as copies of any file materials. The only exception being copies of any documents relating to an *open and pending* Declaratory Judgment Action. For these files, the reinsurer can review all materials, but only take notes on the information, but not make copies of any materials therein. Kemper's reasoning is that the documents relating to their internal litigated coverage position are confidential and they do not want those positions to fall into any potential adversary's hands.

5. It was suggested that [REDACTED] request another audit date so that scheduling could take place. The Second Quarter 2008 is targeted by mutual agreement.

6. Finally, [REDACTED] management agreed to discuss [REDACTED] needs and requests with their staff so that they can comply with the spirit as well as the terms of the

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reinsurance contract. [REDACTED] also offered that [REDACTED] contact her directly if, in future dealings, it was not satisfied with the cooperation it was afforded.

Remarks and Recommendations

After having reviewed this report, [REDACTED] management should confirm its understandings via written communication to [REDACTED] Management summarizing its understanding of the issues and agreed upon results. Assuming the general tenor of the understandings is mutual and confirmed, it appears the audit and follow up meeting with the cede was largely beneficial.

While [REDACTED] may not have had the opportunity to review all of the files it desired, in the bigger picture, it accomplished a significantly more valuable objective. For the first time in three recent visits, [REDACTED] was able to communicate to the ceding company its objectives in partnering with it to understand and manage a difficult portfolio.

[REDACTED] understands that [REDACTED] is probably its largest reinsurer and clearly its most responsive. Impediments in reporting and timely payment have been almost always the result of new procedures and personnel with the broker [REDACTED]. A recent payment made by [REDACTED] that could not be located by [REDACTED] was found by them in the wrong file and they apologized for any inadvertent follow up inquiries.

[REDACTED] has a difficult task in collecting reinsurance. [REDACTED] offered that approximately [REDACTED] in reinsurance recovery was outstanding. Apparently only one case [REDACTED] and that was recently reported and poorly handled by the broker. It is certainly in [REDACTED] interest to make every effort to accede to [REDACTED] reasonable requests and the message has apparently been delivered and understood.

Once protocols have been agreed, [REDACTED] should schedule another audit review so that it is not precluded from a reasonable time frame. [REDACTED] advises that requests for audits from other reinsurers continue to be scheduled and only one reinsurer can be accommodated at a time.

Should [REDACTED] have any questions or concerns as a result of this report, I am available to discuss them with it. Thank you for allowing RMG Consulting to have been of service.

Sincerely,

NAME
Principal

Attachment

Exhibit 1

Global Slip First Excess Layer

<u>COMPANY</u>	<u>TREATY NUMBER</u>	<u>INCEPTION/EXPIRATION</u>	<u>PERCENTAGE PARTICIPATION</u>	<u>TREATY LAYER</u>
[REDACTED]	[REDACTED]	7/1/67-7/1/68	0.5	10 MIL X 1 MIL
		7/1/68-7/1/69	0.5	10 MIL X 1 MIL
		7/1/69-7/1/70	0.5	8.75 MIL X 1.25 MIL
		7/1/70-7/1/71	0.75	8.75 MIL X 1.25 MIL
		7/1/71-7/1/72	0.75	8.75 MIL X 1.25 MIL
		7/1/72-7/1/73	0.75	8.5 MIL X 1.5 MIL
		7/1/73-7/1/74	0.75	8.5 MIL X 1.5 MIL
		7/1/74-7/1/75	0.75	8.5 MIL X 1.5 MIL
		7/1/75-7/1/76	0.75	8.25 MIL X 1.75 MIL
		7/1/76-7/1/77	0.75	8 MIL X 2 MIL
		7/1/77-7/1/78	0.75	8 MIL X 2 MIL
		7/1/78-7/1/79	0.75	8 MIL X 2.5 MIL
		7/1/79-7/1/80	0.75	8 MIL X 2.5 MIL
		7/1/80-7/1/81	0.75	8 MIL X 2.5 MIL
		7/1/81-7/1/82	0.5	11 MIL X 3 MIL
		7/1/82-7/1/83	0.5	11 MIL X 3 MIL
		7/1/83-7/1/84	0.5	11 MIL X 3 MIL
7/1/84-7/1/85	0.5	11 MIL X 3 MIL		
[REDACTED]	[REDACTED]	1/1/71-1/1/72	2	8.75 MIL X 1.25 MIL
[REDACTED]	[REDACTED]	7/1/76-7/1/77	0.5	8 MIL X 2 MIL
		7/1/77-7/1/78	0.5	8 MIL X 2 MIL
		7/1/78-7/1/79	0.5	8 MIL X 2.5 MIL
		7/1/79-7/1/80	0.5	8 MIL X 2.5 MIL
		7/1/80-7/1/81	0.5	8 MIL X 2.5 MIL
		7/1/81-7/1/82	0.5	11 MIL X 3 MIL
		7/1/82-7/1/83	0.5	11 MIL X 3 MIL
		7/1/83-7/1/84	0.5	11 MIL X 3 MIL
		7/1/84-7/1/85	0.5	11 MIL X 3 MIL
[REDACTED]	[REDACTED]	7/1/76-7/1/77	1	8 MIL X 2 MIL
		7/1/77-7/1/78	6	8 MIL X 2 MIL
		7/1/78-7/1/79	6	8 MIL X 2.5 MIL
		7/1/79-7/1/80	6	8 MIL X 2.5 MIL
		7/1/80-7/1/81	6	8 MIL X 2.5 MIL
		7/1/81-7/1/82	6	11 MIL X 3 MIL
		7/1/82-7/1/83	6	11 MIL X 3 MIL
		7/1/83-7/1/84	6	11 MIL X 3 MIL
7/1/84-7/1/85	6	11 MIL X 3 MIL		