MEMORANDU M

To: Mr. M. R. Greenberg

From: F. Douglas

Date: August 30, 2000

Re: Underwriting Mistakes/Segments producing Large Losses to DBG

Per your request yesterday, following is a list of classes of business where we have been severely hurt (either in the P&L or in our loss reserve position) due to extremely adverse results and/or poor underwriting. I include only a brief explanation of what occurred. Much more information is available if you wish to see it. In total the underwriting loss from the items listed below exceeds $2 Billion net.

Auto Warranty: Ultimate underwriting loss of roughly $320 Million. There was no basis supporting the adequacy of original rates; reinsurance "protection" had to be commuted; grossly unprofitable for most carriers who wrote it but consulting actuary said our results were the worst he had ever seen; claims originally outside our control; the Dealers/TPA's were in virtual control of the business; severe data problems prevented any ability to accurately assess the results for at least four years.

Nursing Homes: Ultimate underwriting loss in excess of $400 Million for policy years 1993-1999. Loss ratios over 400% for many years. Loss cost trends running up to 30% per year or higher for some accounts. No basis for adequacy of original rates; they proved grossly inadequate then compounded by massive adverse trend in loss costs, minimal reinsurance protection. Additional underwriting loss of about $150 Million from Physicians and Surgeons business written by Healthcare division in 1994 - 1999. Division booked to profit due to Stop Loss; staggering loss reserve deficiency has been created.

California WC (1995-99): Following open rating, rates collapsed in 1995. Our loss/LAE ratios exploded to as high as 150 in 1995-99, far worse than industry. Lack of proper rate monitoring tools prevented full understanding of deterioration in rates. Case reserve adequacy severely weakened in mid 1990's which gave the impression results not as bad as they actually were. LAE paid to paid ratios surged to 45% before being sharply reduced in 1998-2000. Underwriting losses totalled $200 Million (after discount) resulting in significant inadequacy in current loss reserves. The original actuarial projections for 1995-97 although highly unfavorable, proved to be far below the actual ultimate loss ratios.

Non-California WC – Same as California, except results deteriorated less suddenly as rate decreases occurred over three year period from 1995 to 1997. Little or no improvement occurred in 1998-1999 as rate levels remained depressed. Our results in some states were particularly disastrous, i.e. Illinois, Indiana and Texas. Loss of Unicover treaty (expected to help 1998-2000 results) caused the underwriting losses to remain net. Total underwriting loss (after discount) was about $150 Million.

Lexington International Property - The ultimate net underwriting loss will be in excess of $100 Million for this business. Results began to deteriorate in 1995 and were particularly adverse by 1997 as the loss ratios approached 200%.

AH Excess - Nursing Home Aggregates – AH had already committed to multi year aggregate covers with limits as high as $50 Million net per year with no actuarial review or signoff. We run the risk of total losses on several of these particularly Beverly. The profit center extended Beverly to a fourth year even after we advised them no aggregate cover should be offered. Efforts are now underway to commute, reinsure or cancel Beverly and possibly additional nursing home accounts. As the potential exposure is up to $250 Million or higher I strongly recommend getting off these in any way possible.

Risk Finance Credit or "Finite" Deals - Claims had provided us with loss estimates totaling up to $130 Million on 4 accounts: Team Classic Golf, Kids Mall; QCC Trust; and GE Medical Systems residual value. These deals were supposed to have virtually no risk. We have booked only a portion of these losses.

Malden Mills - This large property claim produced a net underwriting loss of roughly $117 Million. The gross loss was $295 Million and far exceeded the PML.

AIG Environmental Waste Haulers - Underwriting losses of about $70 Million were sustained on two extremely unprofitable accounts; USA Waste and Allied Waste. These accounts were severely underpriced and growing rapidly An additional underwriting loss of about $60 Million was incurred on all the smaller haulers. As you know, our Commercial Auto has been unprofitable in all divisions but was a particularly large portion of the Environmental Casualty divisions.

Lex London Thor Program – This professional liability program was reviewed by Actuarial only after it was already written. It was expected to be severely unprofitable and is currently anticipated to create a net underwriting loss of about $20 Million. Some of the loss was booked thus causing deterioration to the Lex program division, but the majority of the loss will remain as a reserve deficiency.

Division 20 Tow Truck Program – This is the poorest program from the last 5 years from Division 20. The MGA did not charge the intended rates and the program quickly grew out of control to a major loss. We believe the underwriting loss will be about $30 to $40 Million. Part of these results was booked and caused a deterioration to the Division, however much of the loss remains as a permanent reserve deficiency. The program was terminated this year.

AIG Environmental HELP Program - This small homeowners' warranty program for oil tanks produced loss ratios in the 500% range for several years and about a $50 Million loss. (This result was hidden in the overall very profitable AIG Environmental results). It took several additional years for the profit center to get completely off the business, due largely to regulatory requirements regarding non-renewals.

AMS - This is the AH Excess account you referred to which is actually an E&O exposure. The net loss is $35 Million. Like NU, there are very many large claims some of which are from accounts which probably shouldn't have been written. We can provide a list of the largest claims if you want to see them. The biggest concern to me is the Nursing Home aggregate exposure highlighted above. We are working with the profit center now to properly loss rate all aggregate exposure. We have also expressed a concern about Pharmaceutical risks where the underlying insurance is cost of defense erosive -- this caused a $50 Million loss to AH from Fen-Phen for American Home Products. We are trying to see how much of this exposure is out there.

RMG NPV deals and Buyouts - You have already seen the accounts producing adverse development to date of about $60 Million on NPV deals. Buyouts overall have shown only modest development although the Florida WC Fund and Beverly accounts produced large losses. (You have also seen the adverse results for small GL, AL and WC accounts written by Energy, Construction and Division 59).

The only Company not included in the above is NU. Obviously there are many large D&O claims, some for accounts which probably should not have been written. However the results on balance are favorable. A list of the largest D&O claims can be provided if you wish to see it. Segments of concern in NU include the Multi-Media program in Professional Liability (for which a profitability study is about to be released showing extremely adverse loss ratios), and several of the Financial Services E&O segments (Investment Counselors/Advisors) which have generated consistently unfavorable results.

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