Discussed w
MRG - 11/9

Joseph H. Umansky

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TO: M. R. Greenberg
H. L Smith

RE: <u>Special Re</u>

See attached.

Joe

JHU:ge
Att.

Special Re - 2003 plan

The plan's objective is to balance the conflicting goals of (i) reducing Special Re contracts and maximizing positive cash flow, vs. (ii) minimizing the adverse development effect of commutations, and maximizing the benefits of any new contracts. The plan reduces the implied discount from $2B to $1B; the other numbers are reduced but not as significantly.

The suggested plan is:

- To commute those contracts where the adverse development implications are minimal,
- Leave older deals in place until their natural expiry because they are not subject to the same criticism (the rules and the structures were different in those years) and they generate significant investment income,
- Enter into a new 2003 DBG Aggregate Stop Loss treaty. Frank Douglas is an advocate of this step. If structured similar to the 2002 contract, it can provide immediate benefit to calendar year results. Alternatively, if over funded, it can provide dollar for dollar benefit plus offset for other deficiencies. No other treaties,
- Liquidate Capco in 2002, and
- Reduce, but not eliminate, reliance on the SICO swap (retrocession).

Points considered in developing the plan:

- Older deals that should stay in place have $600M of funds available and $700M of credit taken.
- Acceleration of commutations is possible but the cost in terms of putting up ultimate reserves is high.
- Canceling old transactions while entering into new ones is inefficient and raises red flags.
- The discount decreases $565M over the next two years due to investment income alone.
- As losses emerge for accident years 1997 – 2001 the amount of reinsurance credit taken will be reduced. (Faster payout of claims reduces ultimate recoverables.)
- None of the steps would have a negative effect on the shortfall, which approximates $100M.

The above plan reduces the discount from $2B to $1B at the end of 2004. A summary of key numbers and projections follows:

	Funds Available	Credit Taken
Balance 10/1/2002	4,330	6,350
Recoveries/commutations	(240)	(225)
Investment income	65	
Reevaluation of benefit of Aggregates		(225)
Balance, 12/31/2002	4,155	5,900
Recoveries	(525)	(525)
New 2003 contract	300	350
Reevaluation of benefit of Aggregates		(175)
Investment income	250	
Balance, 12/31/2003	4,180	5,550
Recoveries	(300)	(300)
Reevaluation of benefit of Aggregates		(100)
Investment income	250	
Balance, 12/31/2004	4,130	5,150

The contractual exposure (the difference between limit and premium) to Union Excess from the AIG contracts is $1.3B of which $650M is covered by the SICO swap. The swap has a three year term and does not react directly to the above changes. However, if the plan proceeds as forecasted, we should be able to drop the SICO limit to $400M or less.

The attached schedule shows the current status by major contract, adjusted for last week's commutations. In the fourth quarter we have/will take back $241 million, most through commutations.

Other issues:

- Newbridge securities: proposal to monitize the put and invest the proceeds to be discussed with HIS & EEM. The question: how to invest the proceeds?
- Union Excess shareholder issues.
- Union Excess operational issues – security of funds.
- Commitments to reinsurers re 2003 volume.
- Capco liquidation.

SPECIAL REINSURANCE

(in millions)

		Ultimate Loss	NPV of Ultimate	Funds Available	Over (Short)	Credit Taken
	AGGREGATE EXCESS / STOP LOSS					
1.	Aggregate Excess - 1984-1985	206	161	163	2	206
2.	Abeille - 1988 - Retrospective	352	324	324	0	352
3.	Abeille - 1991 - 10 Yr.	140	122	120	(2)	139
4.	AIGRM Stop Loss - 1994	50	43	44	1	23
5.	Division 50 - Blown Max - 1997	34	27	25	(2)	25
6.	Aggregate Loss Ratio / Excess - 1996	625	324	272	(52)	519
7.	Aggregate Loss Ratio / Excess - 1997	733	434	368	(66)	581
8.	Aggregate Loss Ratio / Excess - 1998	800	456	377	(79)	669
9.	Aggregate Loss Ratio / Excess - 1999	620	325	278	(47)	490
10.	Aggregate Loss Ratio / Excess - 2000 (B)	652	332	292	(40)	587
11.	Aggregate Loss Ratio / Excess - 2001 (B)	835	397	353	(44)	752
12.	Aggregate Loss Ratio / Excess - 2002 (B)	900	362	362	0	449
13.	DBG - Fac Obligatory - Aggregate Excess - 1999	361	219	219	0	361
14.	AIU - Aggregate Excess - 1999	30	18	18	0	30
15.	AIU - Aggregate Excess - 2000	30	17	17	0	30
16.	DBG - Aggregate Excess - 1999	60	39	39	0	60
17.	DBG - Aggregate Excess - 2000	60	33	33	0	60
18.	Foreign General Aggregate - 2000	51	30	30	0	51
19.	Foreign General Aggregate - 2001	64	36	36	0	64
20.	Foreign General Aggregate - 2002	5	5	5	0	5
21.	Personal Lines Auto Aggregate - 2000-2002	224	120	52	(68)	159
22.	DBG Divisional Stop Loss - 7/2000 (B)	200	123	123	0	150
23.	DBG Divisional Stop Loss - 1/2001 (B)	210	119	119	0	210
24.	DBG Divisional Stop Loss - 7/2001 (B)	190	118	118	0	190
25.	Starr Excess - Excess of Loss - 2001-2002	95	25	25	0	0
	Total Aggregate Excess / Stop Loss	7,527	4,209	3,812	(397)	6,162
	MISCELLANEOUS					
26.	Other - Active Contracts	58	58	139	81	26
27.	Other - Commuted & Cancelled Contracts (A)	0	0	211	211	0
	Total Miscellaneous	58	58	350	292	26
	TOTAL SPECIAL REINSURANCE	7,585	4,267	4,162	(105)	6,188

(A) Commuted & Cancelled Accounts Funds:

Global Catastrophe Cover	131
Lexington Warehouse	117
DBG Replacement Treaties	(80)
Professional Liability (NU Agg X/S)-Div 65	(3)
All Others Including Interest on Balance	46
Total Commuted & Cancelled Contracts	211

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(B) Fund is recorded as funds withheld by DBG and accrues interest