

MEMORANDUM

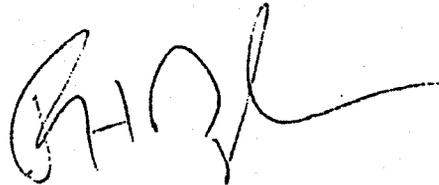
To: Mr. M. R. Greenberg
From: F. Douglas
Date: March 17, 1998
Re: Warranty - Your Call Yesterday

Actuarial has questioned both the relatively low profit potential (due to profit sharing agreements) and the high risk of loss (due to lack of credible data for pricing, and also the long tail for some products such as new car warranties) for several years now. I am not aware of anything new that should be regarded as a "surprise" as we have known and reported about these issues for at least two years. Attached are several of the notes, along with responses from the Warranty profit center that outline these very concerns. These notes make it obvious that profit center management and senior management were aware of the problems, and I believe they have been attempting to resolve them.

The only thing "new" I heard yesterday was that Ted Heller had released some inception-to-date results to Evan Greenberg showing a \$39 Million Stat Loss for the Warranty divisions (attached as Exhibit 1). The results Heller produced should not be viewed as our actual results for several reasons. First, they are gross of reinsurance, and reinsurance is extremely material. Second, expenses are written off immediately whereas the premium takes years to earn for this business - Stat P&L must be GAAP adjusted to be meaningful. Third, Heller's figures are incomplete - they actually exclude the worst deal (GE office equipment). Jay Morrow, our senior actuary for Warranty, has calculated the actual inception-to-date net results for the automobile warranty business (Exhibit 2). These are the figures that should be focused on as they tie exactly to what has actually been booked. Note there is actually an underwriting profit for this business as of 12/31/97. The actual concern with Warranty is that these results are not necessarily indicative of the ultimate results since the adequacy of the unearned premium reserve is unknown (particularly for new car warranties). Additionally, the bulk loss reserve for late processing of claims is probably about \$6 Million short, which by itself offsets the underwriting profit booked to date. We can replicate Exhibit 2 for Brown and White business if you are interested.

Although Actuarial has continually expressed concerns about this business, it is not clear that underwriting losses should be expected on the division's active business. Hence we are still booking this business at the acceptable results you have been seeing. It has not been our policy in recent years to book losses until it is clear that a profit center is unprofitable. There is business written by other profit centers which is much more obviously unprofitable than Warranty.

FHD:ms
Att.
WarrantyMRG



Cc: Messrs. E. G. Greenberg
T. R. Tizzio