

**DEPARTMENT OF INSURANCE
CONSERVATION & LIQUIDATION OFFICE**

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**REQUEST FOR PROPOSALS**

To: Parties Interested in Financial Participation in a Superior National Insurance Companies Rehabilitation Plan

Re: General Statement of Objectives and Terms of the Development of a Rehabilitation Plan for the Superior National Companies

Date: May 3, 2000

1. In General

On March 6, 2000, Chuck Quackenbush, Insurance Commissioner for the State of California, was appointed Conservator (the "Conservator") for four California domiciled insurance companies: The Superior National Insurance Company ("SNIC"), California Compensation Insurance Company ("CALCOMP"), Combined Benefits Insurance Company ("CBIC") and Superior Pacific Casualty Company ("SPCC") (collectively, the "Superior National Companies" or the "Companies"). It is currently anticipated that New York domiciled Commercial Compensation Insurance Company ("CCIC") will be merged into a fifth California domiciled affiliate of the Companies and the merged company will then join the group of conserved companies and would be included in the definition of the "Companies." Until the date of the conservation proceedings, the Companies functioned as subsidiaries of the Business Insurance Group, Inc. ("BIG"), itself a wholly owned subsidiary of Superior National Insurance Group, Inc. ("SNIG"). On the same date the Conservator appointed a Deputy Conservator of the Companies, Richard G. Krenz, Esq., Special Deputy Insurance Commissioner and Chief of Operations of the Conservation & Liquidation Office of the California Department of Insurance (the "CLO").

This Request for Proposals ("RFP") and the responses thereto, arise out of and are a part of four judicial conservation proceedings for the Companies, which the Conservator expects to have administratively consolidated into Case No. BS 061974, entitled Insurance Commissioner of the State of California v. The Superior National Insurance Company, California Compensation Insurance Company, Combined Benefits Insurance Company and Superior Pacific Casualty Company, filed in the Superior Court of the State of California for the County of Los Angeles (the "Court").

The Conservator has determined that rehabilitation of the Companies' insurance businesses is feasible and should be accomplished in the shortest time reasonably possible. In furtherance of the development of a Rehabilitation Plan, the Conservator has set forth a process to reach an Agreement in Principle to sell certain assets and transfer certain liabilities of the Companies and provide for retroactive reinsurance on existing insurance liabilities of the Companies. The Conservator requests that parties make proposals for the

rehabilitation of the Company in accordance with the structure contemplated by the Request for Proposal as outlined herein.

This RFP will outline the Rehabilitation Plan as contemplated for the Companies by the Conservator and describe the manner in which interested parties may make proposals to participate in such a plan.

2. Goals of the Rehabilitation Plan

The goals of the rehabilitation effort require a carefully crafted approach to realize the most value for the Companies' policyholders, creditors and shareholders while also protecting the interests of those professionals and staff providing service to the Companies:

- (a) The first goal of the Rehabilitation Plan is to obtain the best possible protection of the policyholders of the Companies.
- (b) The Rehabilitation Plan should also, to the greatest extent possible provide for the maintenance of the continued employment of those professionals and staff providing service to the Companies and preserve those operations located in the State of California and elsewhere.
- (c) The Companies have certain claimants whose claims, if proven, would be general creditor claims. After the policyholders are protected, the Rehabilitation Plan should, to the greatest extent possible, protect the rights of this class of creditors.
- (d) The Rehabilitation Plan should, to the greatest extent possible, appropriately protect all other constituent groups. Shareholders in an insurance company have rights subordinate to policyholder and general creditor rights. The Rehabilitation Plan should ensure that whatever assets remain following full policyholder and creditor protection are returned to the shareholders.
- (e) Through year-end 1998, the Companies' statutory financial statements showed a surplus as regards policyholders. The statutory statements for the Companies as of December 31, 1999 are still in the process of being prepared and will be made available to interested parties as part of the process. These statements may show a deficit as regards policyholders for some or all of the Companies. The conservation effort has revealed facts that suggest that a careful examination of the Companies' actual financial condition is warranted. The Rehabilitation Plan should be structured to function successfully even if the Companies' financial condition proves worse than current projections.
- (f) The obligation of the California Insurance Guarantee Association ("CIGA") under California Insurance Code sections 1063, et. seq., is to provide protection for covered claims of California policyholders in the event of the entry of a formal order of liquidation and a judicial finding of insolvency. The Rehabilitation Plan should, to the extent possible, minimize the net exposure to CIGA and, as applicable, any other guaranty funds (collectively, the "Guarantee Funds") should a liquidation become necessary.
- (g) The Conservator may also establish other criteria and goals for this process as he determines are appropriate.

3. How the Proposed Rehabilitation Plan Would Work

The Rehabilitation Plan for the Companies ultimately will proceed under the rehabilitation and liquidation statutes of the State of California (California Insurance Code sections 1010, et. seq.). Generally speaking, the Rehabilitation Plan will consist of the transfer of new and renewal business and certain assets and liabilities of the Companies to a successful party participating in the process outlined herein. This transfer may include, among other things, the customer lists, historical data, independent agency network, and to the greatest extent possible, both the leases for the existing facilities and equipment, including information systems, used by the Companies and the professionals and staff engaged in the provision of services to the Companies. Additionally all premium and associated liabilities for policies written by the Companies on or after April 5, 2000 will be transferred. After the transfer, the historical and in-force insurance liabilities along with assets to support these liabilities will remain in the Companies and be put into runoff. Notwithstanding the above, the Conservator will also consider any proposals to purchase the equity of one or more of the Companies.

As part of any response to this RFP, interested parties should include in their proposals a Third Party Administration (“TPA”) term sheet to administer, under the supervision of the CLO, the claims runoff associated with the historical and in-force liabilities to be retained by the Companies. With respect to this TPA, the Conservator will give preference to those plans that include the utilization of those persons associated with SNIG’s subsidiaries that are currently providing services to the Companies. It is expected that the ultimate negotiated TPA agreement will include appropriate incentives to insure that the policyholder claims will be processed in a manner congruent with the goals of the rehabilitation.

After the transfer contemplated above, the Companies will not write new and renewal business, except in instances where the equity of one or more of the Companies has been purchased. The historical and in-force liabilities will be run off pursuant to the TPA agreement and any surplus in the Companies left after the payment of all policyholder claims and creditor claims, will belong to the shareholders of SNIG.

This RFP is also intended to serve notice that the Companies are seeking retroactive protection on their loss and allocated loss adjustment expense reserves for all policies written prior to April 5, 2000. This protection could take the form of a retroactive or assumption reinsurance contract, which attaches above, at or below current reserves, or a loss portfolio transfer.

As discussed further in Section 4 below, during the interim period prior to adoption of a plan of rehabilitation, the Conservator has caused and intends to cause the Companies to enter into one or more interim reinsurance agreements designed to maximize policyholder safety. This reinsurance would be reinsurance of policy liabilities of the Companies on new and renewal policies incepted after the Conservation but before the final adoption and implementation of the Rehabilitation Plan, and would contain cut-through endorsements permitting direct access to the reinsurer by policyholders in the event of the Companies’ liquidation and insolvency. Interim cut-through reinsurance shall be subject to recapture by the Companies and cession to the successful participant upon adoption of the Rehabilitation Plan, less a risk charge to the interim reinsurer. The successful proposal must assume this reinsurance, ab initio, as a part of the overall transaction.

It is anticipated that any retroactive reinsurance together with the assets of the Companies will not be sufficient to cover all liabilities of the Companies. This will then necessitate the Guarantee Funds to cover the remaining liabilities of the Companies upon the entry of a liquidation order with a finding of insolvency. Minimization of the Guarantee Funds’ liability and postponement of any involvement by the Guarantee Funds in the payment of claims liability will be important criteria in evaluating any retroactive reinsurance proposal.

4. Current Status of the Conservation

On April 5, 2000, the Conservator entered into an Interim Cut-Through Reinsurance Agreement (No. SC-LMC 00-001) (“Cut-Through Agreement”) with Lumbermans Mutual Casualty Company, a member of The Kemper Companies (“Kemper”), to provide “cut-through” reinsurance such as is discussed above. Kemper will be permitted to submit a further proposal in accordance with this RFP and the provisions of the Cut-Through Agreement. The terms of this reinsurance may affect the process outlined in this memorandum. Interested parties are strongly advised to review the terms of the Cut-Through Agreement as part of their due diligence review of the Companies

5. Structure and Types of Proposals

It is currently contemplated that the Conservator will entertain two types of proposals:

- A) Proposals to purchase the assets chosen for transfer, and assumption of liabilities, and provide services to administer the orderly run off of the existing policyholder claims retained by the Companies.
- B) Proposals to provide retroactive reinsurance on existing insurance liabilities of the Companies.

Interested Parties may submit proposals in either category A or category B, or both. An important consideration in choosing a successful proposal for either A or B will be the financial strength rating of the party submitting the proposal. Other criteria are as contained in this memorandum, however, if two proposals are equal, the Conservator has indicated a preference to accept a proposal which encompasses both A and B above.

6. Outline of the Process for Submitting Proposals

- a) Interested parties should contact the Conservator’s financial advisor, Marsh & McLennan Securities (“MMSC”) and indicate whether they are interested in a purchase of assets, the provision of retroactive reinsurance, or both. Specifically, interested parties should contact MMSC Associate Geoffrey S. Sweitzer at 212-345-2785. Interested parties will be asked to enter into an appropriate confidentiality agreement covering proprietary information regarding the Companies obtained in the due diligence process, and a disclaimer agreement with the Companies independent actuaries (the Companies’ actuaries).
- b) To be considered, all interested parties must also provide a detailed written disclosure to the Conservator’s representatives disclosing i) details regarding all investors, principals, shareholders of and advisors to the interested party; ii) the source and amount of any investment capital; and iii) whether any further principals or consultants may be added to the proposed transaction. In addition, all interested parties must provide a written statement of the proposed management team to be used after the transaction and provide a written agreement not to contact agents or insureds of the Companies without written permission of the Conservator.

- c) Upon execution of the confidentiality agreement and the disclaimer agreement, interested parties will receive a Confidential Information Memorandum (“CIM”) describing the process and the Companies, the most recent annual statutory statements of the Companies, and an actuarial review of the Companies’ reserves as well as certain underlying data supporting the actuarial review. The information provided and/or the content of a confidentiality agreement may differ depending on what role the interested party has indicated it would like to pursue.
- d) Interested parties will be asked to submit a non-binding indication of interest that includes a potential price for the transfer of the selected assets and liabilities of the Companies or the premium to provide retroactive reinsurance to the Companies. Such non-binding indication of interest may take the form of a range of values and should include any material conditions the interested party would place on the acquisition or provision of retroactive reinsurance. The indication of interest must contain a purchase price or applicable reinsurance premium and a detailed description of the proposed transaction structure, including the form of consideration. If more than one transaction structure is proposed, a purchase price for each transaction structure must be identified.
- e) The indication of interest must also disclose the principal terms (by term sheet) of the proposed purchase contract. Any regulatory issues that would need to be resolved in connection with a successful closing plus any consents the interested party may require and the timetable therefor must also be clearly addressed. Indications should state whether or not the ultimate offer would be subject to the ability to obtain financing. Strong preference will be given to proposals that are not contingent to obtaining financing. Any indication of interest that contains provisions that would vary (including as to the consideration offered) depending upon the terms of another potential purchaser’s indication (including the consideration offered) or external or future conditions will not be considered. Any interested party should also include a demonstration that it has the experience and financial strength to operate a carrier writing workers’ compensation and property and casualty business in California and elsewhere; has a management team with sufficient character, expertise and experience to satisfy the Conservator; and has sufficient commitment and ability to adhere to the goals set out in Section 2.
- f) The Conservator will review all indications of interest submitted by interested parties, and some of the interested parties may be selected to attend management presentations and visit the Data Room, discussed in Section 7 below, after the Conservator and his advisor have reviewed the indications. Interested parties that have been selected by the Conservator to visit the Data Room will be given access to the Companies’ records and materials prepared by the Companies as well as their independent actuaries, independent auditors and the outside legal advisors during the Data Room portion of their visit.
- g) Following the management presentation and visit to the Data Room, interested parties will be asked to submit a formal, binding and irrevocable offer for purchasing the assets and the associated liabilities or providing reinsurance, or both. Additional guidelines and procedures will be distributed at that time.
- h) The Conservator reserves the right to modify these instructions and procedures at any time and reserves the right to reject any and all proposals without providing any reason if such proposals are, at the sole discretion of the Conservator, determined to be unsatisfactory.
- i) At the conclusion of the process outlined above, which, by order of the Court must be no later than June 30, 2000, unless extended by the Court, the Conservator will enter into an agreement with the successful interested party or parties and submit that agreement to the Court for approval and authority to enter into a transaction or transactions. At that time, it is anticipated that the Court will conduct an overbid process as required by law, at the conclusion of which the Conservator will make a recommendation to the Court that

it select and approve the proposal that the Conservator determines to be in the best interests of the beneficiaries of the Companies. To the extent that the Court conducts an overbid process, the Conservator will request that the Court only permit participation by those parties who submit good faith proposals in response to this RFP.

7. Data Room

The Conservator has established a Data Room at the Companies' premises in Calabasas, California into which relevant data, documents and other information have been and will continue to be placed in order to permit qualified interested parties to have access to such items in order to determine whether to formulate a proposal to participate in the rehabilitation of the Companies.

Access to the Data Room shall be provided at such times and on such dates to be determined by the Conservator based upon the number of interested parties and the space and time demands. Any copies made of documents in the Data Room (to the extent that copying is permitted) will be made at the expense of the interested party, and all copies taken from the Data Room must be returned or destroyed at the request of the Conservator upon completion of the selection process. Additional procedures with respect to the Data Room may also be utilized at the Conservator's sole discretion.

8. Non-Conforming Proposals:

Experience in other rehabilitations has suggested that the Rehabilitation Plan structure described above is the most feasible and the most likely structure to accommodate and preserve the rights of the various interested parties, including the policyholders, the general creditors and the shareholder.

Proposals that do not conform to the structure referred to herein may be made, but shall be deemed non-conforming proposals. The fact that a proposal is, in the Conservator's sole opinion, materially non-conforming may be grounds for rejection on that basis alone; however, the Conservator reserves the right to accept a non-conforming proposal. Further, the Conservator reserves the right to reject all proposals in the event he determines none are acceptable.

Interested parties may make joint proposals provided they collectively submit a single, unified proposal.

9. Deadlines and Contacts for Interested Parties:

All proposals must be delivered to the Conservator no later than 4:00 p.m. PST, June 1, 2000 at the offices of the Companies at 26541 Agoura Road, Calabasas, CA 91302 or by facsimile transmission at (818) 871-0515 or such other location as shall be determined by the Conservator.

Late proposals will be accepted only at the sole discretion of the Conservator. All proposals are submitted in confidence and "under seal." The terms and conditions of proposals will not be disclosed prior to the Conservator's selection of the preferred proposal. Thereafter, the Conservator will announce the selected proposal and will file appropriate papers with the Court to provide for a judicially supervised overbid process and/or such other proceedings as the Conservator, in his sole discretion, deems reasonable and necessary to implement the Rehabilitation Plan.