THE STATE OF NEW HAMPSHIRE

MERRIMACK, SS **SUPERIOR COURT**

Docket No. 03-E-0106

In the Matter of the Liquidation of
The Home Insurance Company

LIQUIDATOR'S MOTION FOR APPROVAL OF FOURTH REVISED INVESTMENT GUIDELINES

Roger A. Sevigny, Insurance Commissioner for the State of New Hampshire, as Liquidator ("Liquidator") of The Home Insurance Company ("Home"), hereby moves that the Court enter an order approving revised investment guidelines for Home to permit investment in certain municipal obligations and to increase the percentages of the portfolio that may be held in certain corporate obligations. The proposed fourth revised statement of investment policy ("Fourth Revised Investment Guidelines") is attached hereto as Exhibit 1 and a markup showing the changes from the Third Revised Investment Guidelines is attached as Exhibit 2. As reasons therefor, the Liquidator states as follows:

1. Background. Home's investment portfolio has been managed pursuant to investment guidelines since the beginning of the liquidation proceeding in June 2003. The original investment guidelines were summarized in the statement of investment policy attached as Exhibit A to the Liquidator's Third Report dated September 12, 2003. The Liquidator entered into an Asset Management Agreement dated June 2, 2004 with Conning Asset Management Company ("Conning"), which was approved by the Court on July 6, 2004. The Asset Management Agreement included as Schedule 1 investment guidelines to govern Conning's management of the longer-term portion of Home's portfolio. Affidavit of Peter A. Bengelsdorf,

Special Deputy Liquidator, in Support of Motion for Approval of Fourth Revised Investment Guidelines ("Bengelsdorf Aff.") ¶ 2.

2. As explained in the Liquidator's Motion for Approval of Revised Investment Guidelines dated January 27, 2005, those guidelines proved too restrictive given the size of Home's portfolio. The Liquidator accordingly sought approval of the Revised Investment Guidelines that allowed Conning to make larger investments in individual issues, while maintaining the conservative nature of the investment policy. Those Revised Investment Guidelines were approved by the Court on February 17, 2005. Bengelsdorf Aff. ¶ 3.

3. In light of the increasing differential between the investment returns on U.S. government obligations and on other obligations, the Liquidator moved for approval of the Second Revised Investment Guidelines that increased the percentage of the portfolio that could be invested in investment grade corporate obligations on April 8, 2008. The Court approved the Second Revised Investment Guidelines on April 30, 2008. Bengelsdorf Aff. ¶ 4.

4. The uncertain investment environment in recent years, the limited opportunities for investments in "investment grade" corporate obligations, together with the maturation of investments made in the earlier years of the liquidation, caused the portfolio's average maturity to decrease in 2012 and Conning to recommend some investment in "high yield" corporation obligations as well as an increase in the percentage of the portfolio that may be invested in obligations rated BBB (S&P) or Baa (Moody's). The Liquidator moved on March 29, 2012 for approval of the Third Revised Investment Guidelines which reflected these recommendations. The Court approved the Third Revised Investment Guidelines on May 10, 2012. Bengelsdorf Aff. ¶ 5.

5. <u>The Current Circumstances</u>. Yields on United States obligations are presently at historical lows. This low yield environment has changed the valuation relationship between tax exempt municipal bonds, Treasuries, and corporate obligations. ("Municipal bonds" mean the marketable debt instruments of the States, their agencies and political subdivisions.) Generally, due to investor demand for tax exempt income, municipal bonds have produced lower yields than taxable fixed income assets such as Treasuries and corporate obligations. However, municipal bonds in the 5 to 15 year maturity range (attractive to Home due to its expected distributions to creditors) are presently available at prices that produce yields exceeding those on Treasuries. Indeed, some high grade municipal issues are trading at yield levels close to A-rated industrial corporate obligations. The present low yield on Treasuries means that returns on Treasuries are now substantially lower than those on many high quality corporate obligations, reducing the desirability of weighting Home's portfolio towards United States obligations. Bengelsdorf Aff., ¶ 6.

6. <u>Limitations of the Third Revised Investment Guidelines</u>. The Third Revised Investment Guidelines, like the previous investment guidelines, do not include municipal bonds as an asset class that may be included in the portfolio. This omission was premised on the fact that Home, being insolvent, is not in a position to enjoy the tax advantages that have historically caused yields on municipal bonds to be lower than yields on Treasuries and other fixed income assets. It was assumed that municipal bond yields would continue to be lower than those on Treasuries so it was not contemplated that there would be an economic advantage to investing in tax exempt obligations issued by states, their political subdivisions, and their agencies. The present low yield environment, however, has disproven that assumption and the yields on certain high quality municipal bonds exceed those on Treasuries and approach those on A-rated

industrial corporate obligations. The low yield environment has also reduced the desirability of holding large portions of the portfolio in United States obligations. However, the Third Revised Investment Guidelines preclude investments in municipal bonds and limit Home's investment in the principal alternative asset class, corporate obligations, to 55% of the portfolio. Bengelsdorf Aff., ¶ 7.

7. The proposed changes to the Third Revised Investment Guidelines. The Liquidator proposes to permit investment of Home assets in certain high quality municipal bonds. Conning believes that, in the present low yield environment, investing in high grade municipal bonds offers the opportunity to diversify portfolio credit risk, maintain or improve overall credit ratings, and achieve yields in excess of those available on Treasuries. See August 13, 2012 letter from Conning attached hereto as Exhibit 3. Conning also notes that municipal bonds have historically lower default rates than AAA-rated corporate bonds, that municipal bonds have historically shown lower market price volatility, and that municipal bonds have the potential for better market price returns as interest rates rise back towards more historical valuations. Exhibit 3; Bengelsdorf Aff. ¶ 8.

8. The Liquidator also proposes to raise the present cap on investments in corporate obligations from 55% to 65% of the portfolio. The Liquidator does not propose increasing the single issuer exposure limits. Conning believes that such an increase in overall exposure, in the context of a highly diversified portfolio, will provide better earnings potential without materially adding to overall portfolio risk. Such adjustments in investment limitations by asset class are merited by the significant changes in investment yields on fixed income investments in the years since 2003. Exhibit 3; Bengelsdorf Aff., ¶ 9.

9. Regarding the cumulative impact of these proposed changes, Conning believes that the overall credit risk of the portfolio operating within the parameters of the proposed Fourth Revised Investment Guidelines will actually be lower than that of the portfolio under the Third Revised Investment Guidelines. Bengelsdorf Aff. ¶ 10. See Exhibits 1-3.

10. The Fourth Revised Investment Guidelines. The proposed Fourth Revised Investment Guidelines reflect the recommended changes. First, those Guidelines establish municipal bonds as an asset class in which up to 25% of Home's portfolio could be invested. Guidelines for municipal bonds, proposed on the basis of Conning's recommendation, include minimum issuer credit ratings of A3 (Moody's) and A- (S&P), unless an issuer is not rated but is "escrowed to maturity" and backed by United States obligations; a minimum average municipal portfolio rating of Aa3 (Moody's) and AA- (S&P); maximum exposure to any state, including all its agencies and political subdivisions, of 1.9% of the total portfolio; exposure to an individual issuer of .5% of the total portfolio; a maximum final maturity of 15 years from the date of purchase; and, average effective maturities of 10 years or less. Second, the proposed Fourth Revised Investment Guidelines permit up to 65% of the portfolio to be allocated to corporate obligations. Guidelines regarding limits on individual corporate issue exposure and the rating of the assets to be included in the portfolio remain unchanged. See Exhibit 1; Bengelsdorf Aff. ¶ 11.

11. The revisions sought in the Fourth Revised Investment Guidelines are intended to permit the Liquidator to prudently limit the reduction in investment income arising from the present low yield interest environment, and the Liquidator believes that the revisions and the Fourth Revised Investment Guidelines as a whole are consistent with a prudent and reasonably conservative investment policy. See Bengelsdorf Aff. ¶ 12.

12. For the reasons described above, the Liquidator submits that the Fourth Revised Investment Guidelines are fair and reasonable and in the best interest of the liquidation and the policyholders and other creditors of Home. See Bengelsdorf Aff. ¶ 13. The Fourth Revised Investment Guidelines are consistent with the Liquidator's authority under paragraphs (f) and (h) of the Order of Liquidation entered June 13, 2003, to administer and invest assets under the orders of the Court and under RSA 402-C:25, VI to "do such other acts as are necessary or expedient to collect, conserve or protect [the insurer's] assets or property."

WHEREFORE, the Liquidator respectfully requests that the Court grant this motion, enter an order in the form submitted herewith approving the Fourth Revised Investment Guidelines, and grant such other and further relief as justice may require.

Respectfully submitted,

ROGER A. SEVIGNY, INSURANCE COMMISSIONER OF THE STATE OF NEW HAMPSHIRE, SOLELY AS LIQUIDATOR OF THE HOME INSURANCE COMPANY,

By his attorneys,
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August 16, 2012

Certificate of Service

I hereby certify that a copy of the foregoing Liquidator's Motion for Approval of Fourth Revised Investment Guidelines, the supporting Affidavit of Peter A. Bengelsdorf, and the Proposed Order, were sent, this 16th day of August, 2012, by first class mail, postage prepaid to all persons on the attached service list.

J. David Leslie

THE STATE OF NEW HAMPSHIRE

MERRIMACK, SS. SUPERIOR COURT

In the Matter of the Liquidation of
The Home Insurance Company
Docket No. 03-E-0106

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Exhibit 1

Fourth Revised Statement of Investment Policy
Home Insurance Company (in liquidation)

I. Investment Objective

To maintain a portfolio of high quality, readily marketable investments that protects and enhances the assets of The Home Insurance Company, in Liquidation ("the Company"). The portfolio should produce a high level of investment income over a multiple year time horizon in accordance with expected liability payouts, and otherwise support the objectives of the Liquidator, consistent with safety and preservation of capital.

II. Investment Responsibility

The Special Deputy Liquidator and the Chief Financial Officer shall be responsible for the selection of investments and for their purchase or sale within the authority delegated to them by the Liquidator. They may seek investment advice from professional investment advisers outside the Company.

The Chief Financial Officer shall be responsible for periodic estimates and evaluation of the cash flow needs of the Company and the amounts available for investment.

III. Qualifications of Investment Policy

Those responsible for the Company's investment program shall invest only in bonds and fixed income securities and shall, at all times, observe the General Guide to Maximum Commitment Size as stated in the Policy summary, attached hereto and made a part hereof, which supplements the following guidelines:

1. Only Ba3 (Moody's), Double B- (S&P), or higher rated bonds, which are readily marketable, will be purchased for all asset classes except municipal bonds as discussed in (4) below.

2. Mortgage backed securities will exclude derivatives such as inverse floating rates and interest only tranches.

3. Asset backed securities will exclude franchise loan and equipment trust certificates transactions.

4. Only municipal bonds with issuer credit ratings of A3 (Moody's) or A- (S&P) will be purchased and the minimum average credit rating for the municipal portfolio shall be no lower than Aa3 (Moody's) or AA- (S&P). If insured, the issuer must have a minimum underlying rating of A3

(Moody's) or A- (S&P). "Escrowed to maturity" issues backed by Treasuries and not rated are permitted. Final maturity of municipal bonds shall not exceed 15 years from purchase date and the average effective maturity date of the municipal portfolio shall not exceed 10 years.

5. Only commercial paper with a Moody's Rating of P-1 or S&P Rating of A-1, which are readily marketable, will be purchased.

6. The Company may invest excess case required for operating purposes in overnight "Sweep Accounts" provided by its bank. These accounts utilize repurchase agreements which must have collateral consisting of full faith agencies, and be collateralized at approximately 101% of market value.

7. The investment portfolio shall reflect a maturity policy consistent with the cash flow needs of the Company.

Fourth Revised Statement of Investment Policy
Home Insurance Company (in liquidation)

General Guide to Maximum Commitment Size (1)

	Percentage of total portfolio (2)
Maximum asset allocation for a single issuer:	
• US Government and US Government Agency Obligations	No limit
• Corporate Bonds, Asset Backed, Mortgage Backed and Commercial Mortgage Backed (CMBS) (3):	
Triple A (S&P) or Aaa (Moody's)	2.50%
Double A (S&P) or Aa (Moody's)	2.00%
Single A (S&P) or A (Moody's)	1.25%
Triple B (S&P) or Baa (Moody's)	.50% (4)
Double B (S&P) or Ba (Moody's)	.25% (4)
• Municipal Bonds	.50% (5)
• Commercial Paper – Prime Moody's Rating of P-1 and S&P rating of A-1	2.50%
• Certificates of Deposit	2.50%
Maximum asset allocation for an asset class:	
• US Government and US Government Agency Obligations	No limit
• Corporate	65.0%
• Mortgage Backed	25.0%
• Commercial Mortgage Backed (CMBS)	5.0%
• Asset Backed	25.0%
• Municipal Bonds	25.0%
• Commercial Paper – Prime Moody's Rating of P-1 and S&P rating of A-1	No limit
• Certificates of Deposit	No limit

(1) The guidelines are based on percentages of the portfolio and there may be a requirement to sell investments if the portfolio size decreases. In such circumstances, those responsible for selling investments will have 90 days to bring the portfolio into compliance with the guidelines.
(2) Portfolio size is based on market value at prior month end.
(3) The asset allocation will be based on the lower of the S&P or Moody's rating.
(4) No more than 10% of the total portfolio may be invested in Triple B and Double B (S&P) or Baa and Ba (Moody's) securities, provided, however, that the aggregate market value of BB and Ba securities shall not exceed 4% of the total market value.
(5) The maximum exposure to a single state (including all its agencies and political subdivisions) shall not exceed 1.9% of the total portfolio.

Exhibit 2

~~Third~~Fourth Revised Statement of Investment Policy
Home Insurance Company (in liquidation)

I. Investment Objective

To maintain a portfolio of high quality, readily marketable investments that protects and enhances the assets of The Home Insurance Company, in Liquidation ("the Company"). The portfolio should produce a high level of investment income over a multiple year time horizon in accordance with expected liability payouts, and otherwise support the objectives of the Liquidator, consistent with safety and preservation of capital.

II. Investment Responsibility

The Special Deputy Liquidator and the Chief Financial Officer shall be responsible for the selection of investments and for their purchase or sale within the authority delegated to them by the Liquidator. They may seek investment advice from professional investment advisers outside the Company.

The Chief Financial Officer shall be responsible for periodic estimates and evaluation of the cash flow needs of the Company and the amounts available for investment.

III. Qualifications of Investment Policy

Those responsible for the Company's investment program shall invest only in bonds and fixed income securities and shall, at all times, observe the General Guide to Maximum Commitment Size as stated in the Policy summary, attached hereto and made a part hereof, which supplements the following guidelines:

1. Only Ba3 (Moody's), Double B- (S&P), or higher rated bonds, which are readily marketable, will be purchased for all asset classes except municipal bonds as discussed in (4) below.

2. Mortgage backed securities will exclude derivatives such as inverse floating rates and interest only tranches.

3. Asset backed securities will exclude franchise loan and equipment trust certificates transactions.

4. Only municipal bonds with issuer credit ratings of A3 (Moody's) or A- (S&P) will be purchased and the minimum average credit rating for the municipal portfolio shall be no lower than Aa3 (Moody's) or AA- (S&P).

If insured, the issuer must have a minimum underlying rating of A3 (Moody's) or A- (S&P). "Escrowed to maturity" issues backed by Treasuries and not rated are permitted. Final maturity of municipal bonds shall not exceed 15 years from purchase date and the average effective maturity date of the municipal portfolio shall not exceed 10 years.

~~4.~~5. Only commercial paper with a Moody's Rating of P-1 or S&P Rating of A-1, which are readily marketable, will be purchased.

~~5.~~6. The Company may invest excess case required for operating purposes in overnight "Sweep Accounts" provided by its bank. These accounts utilize repurchase agreements which must have collateral consisting of full faith agencies, and be collateralized at approximately 101% of market value.

~~6.~~7. The investment portfolio shall reflect a maturity policy consistent with the cash flow needs of the Company.

~~Third~~Fourth Revised Statement of Investment Policy
Home Insurance Company (in liquidation)

General Guide to Maximum Commitment Size (1)

	Percentage of total portfolio (2)
Maximum asset allocation for a single issuer:	
• US Government and US Government Agency Obligations	No limit
• Corporate Bonds, Asset Backed, Mortgage Backed and Commercial Mortgage Backed (CMBS) (3):	
Triple A (S&P) or Aaa (Moody's)	2.50%
Double A (S&P) or Aa (Moody's)	2.00%
Single A (S&P) or A (Moody's)	1.25%
Triple B (S&P) or Baa (Moody's)	.50% (4)
Double B (S&P) or Ba (Moody's)	.25% (4)
• Municipal Bonds	.50% (5)
• Commercial Paper – Prime Moody's Rating of P-1 and S&P rating of A-1	2.50%
• Certificates of Deposit	2.50%
Maximum asset allocation for an asset class:	
• US Government and US Government Agency Obligations	No limit
• Corporate	65.0%
• Mortgage Backed	25.0%
• Commercial Mortgage Backed (CMBS)	5.0%
• Asset Backed	25.0%
• Municipal Bonds	25.0%
• Commercial Paper – Prime Moody's Rating of P-1 and S&P rating of A-1	No limit
• Certificates of Deposit	No limit

(1) The guidelines are based on percentages of the portfolio and there may be a requirement to sell investments if the portfolio size decreases. In such circumstances, those responsible for selling investments will have 90 days to bring the portfolio into compliance with the guidelines.
(2) Portfolio size is based on market value at prior month end.
(3) The asset allocation will be based on the lower of the S&P or Moody's rating.
(4) No more than 10% of the total portfolio may be invested in Triple B and Double B (S&P) or Baa and Ba (Moody's) securities, provided, however, that the aggregate market value of BB and Ba securities shall not exceed 4% of the total market value.
~~(4)~~(5) The maximum exposure to a single state (including all its agencies and political subdivisions) shall not exceed 1.9% of the total portfolio.

Exhibit 3

CONNING

Paul J. Sellier
Director

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August 13, 2012

Mr. Peter Bengelsdorf , Special Deputy Liquidator
Mr. Arthur Wilson, Chief Financial Officer
The Home Insurance Company, in Liquidation
61 Broadway
New York, NY 10006

Gentlemen,

Pursuant to recent discussions regarding Investment Guidelines, Conning recommends an amendment to include (1) municipal bonds as an approved asset class, and (2) an increase in the allocation to the corporate sector from the existing maximum 55% to 65%.

Include Municipals as an Approved Asset Class
The present guidelines exclude investing in municipal bonds primarily because the Company cannot fully utilize tax advantaged income. Taxable municipal bonds also are not permitted investments.

The low yield environment has changed the valuation relationship between tax exempt municipals, Treasurys and corporates. Municipals in the 5 to 15 year maturity range are trading at historically "cheap" levels and high quality municipal yields generally exceed Treasury yields. Certain high grade municipal issues are trading at yield levels close to single-A rated industrial corporates. These conditions provide a unique opportunity to further diversify credit risk and maintain or improve overall credit ratings.

We have discussed the technical and fundamental factors leading to our recommendation. We believe the investment parameters listed below are appropriate given our deep understanding of management's risk preferences and tolerances, which are to maintain a prudent and reasonably conservative investment policy.

	Total Portfolio
Maximum allocation to sector	25.0%
Maximum exposure to any state including all political subdivisions	1.9%
Maximum exposure to any single issuer	0.5%
Issuer minimum credit rating of A3 by Moody's and A- by S&P	
If insured, issuer must have minimum underlying rating of A3/A-	
Escrowed to maturity issues backed by Treasurys and not rated are permitted.	
Minimum average credit rating of Aa3/AA-	
Final maturity not to exceed 15 years from purchase date, average effective maturity not to exceed 10 years.	
All holdings must be in compliance with applicable regulations.	

A few final points of importance:

Investment grade municipal bonds (AAA – BBB rated) historically have a lower default rate than AAA-rated corporate bonds.

Municipal bonds generally exhibit lower market price volatility compared to taxable securities of similar structure and maturity due to their tax exempt nature (commonly referred to as tax-adjusted effective duration). For example, a 10 year maturity municipal bond is expected to exhibit market price performance more in line with a 7 year maturity Treasury bond. This is true when interest rates both rise and fall.

Municipal bonds in the 5 – 15 year maturity range have the potential for better market price returns as interest rates rise and the sector moves back to more historical valuations. While no guarantee, this could be a powerful offset to rising interest rates.

Current market conditions present an opportunity where investment grade municipal bonds trade at market yields in excess of 100% of Treasury yields. Additionally, and despite the proposal to increase the corporate allocation limit to 65% as discussed below, the portfolio can benefit by gaining improved overall diversification without compromising gross investment income to any material degree. We believe overall credit risk will actually be reduced when operating within the risk parameters outlined in this letter.

I should note that Conning has been involved in the municipal market for the past four decades. Each of our fundamental credit, qualitative analysis, trading and portfolio management groups average over 20 years of direct municipal bond market experience. We currently manage approximately $10 billion of municipal holdings, of which substantially all are integrated with taxable bond portfolios.

<u>Increase Corporate Maximum Exposure to 65% of Portfolio Holdings</u>
Current guidelines cap corporate exposure at 55%. We believe raising the cap to 65% is reasonable and prudent. Management continues to have a strong objective to maximize investment income consistent with the overall goal of maintaining a reasonably conservative investment policy. The low yield environment continues to present challenges and adjustments in investment limitations by asset class are merited by the significant changes in investment yields on fixed income investments in the years since 2003.

We do not propose an increase to single issuer exposure limits. We continue to believe a highly diversified portfolio is a strong mitigant to overall credit risk. We simply believe the ability to own a greater percentage of corporate bonds can provide better earnings potential without materially adding to overall portfolio risk.

We are happy to review any of these recommendations in greater detail, as you may require.

Sincerely,

Paul J. Sellier
Director – Portfolio Management
Conning and Company/Conning, Inc.