



May 9, 2017

Ladies and Gentlemen:

Thank you for the interest you have expressed in entering into a potential transaction with Public Service Insurance Company, in Rehabilitation (“PSIC” or the “Estate”). In our role as financial advisor to the Rehabilitator (defined below) of PSIC, Griffin Financial Group, LLC (“Griffin” or “we”) will serve as the exclusive point of contact for parties interested in entering into a potential transaction.

The purpose of this letter is to provide you with (i) an overview and the background of the proposed transaction, (ii) the phases comprising the transaction process and (iii) instructions for submitting a preliminary, non-binding indication of interest for the potential transaction.

Griffin will contact each party to review this process letter and the enclosed bid form.

Timing

- *Preliminary, non-binding indications of interest are due at 5 PM (EST) on May 19, 2017 (the “Bid Date”).*
- *Griffin will advise those parties that have been chosen to participate in Phase II on or around May 24, 2017.*
- *Phase II bids are due on or before June 23, 2017.*
- *The successful bidder will be contacted by Griffin on or before July 1, 2017.*

Background and Transaction Overview

- On March 16, 2017, PSIC was placed into rehabilitation by order (the “Rehabilitation Order”) of the Circuit Court of Cook County, Illinois (the “Supervising Court”) pursuant to Article XIII of the Illinois Insurance Code (the “Rehabilitation”), and the Director of the Illinois Department of Insurance was affirmed as PSIC’s statutory rehabilitator (the “Rehabilitator”).
- To facilitate PSIC’s orderly Rehabilitation and to protect the interests of PSIC policyholders and other creditors of the Estate, the Rehabilitator seeks to transfer certain of PSIC’s insurance policies, risks, obligations and rights associated with accident years 2013 and prior, 2016 and 2017 (collectively, the “Covered Policies”)¹ to an assuming counterparty

¹ Covered Policies Covered Policies include (i) policies written by PSIC in accident years 2013 and prior, 2016 and 2017, and (ii) business written by PSIC’s wholly-owned subsidiary, Western Select Insurance Company (“WSIC”), and assumed by PSIC under a 90% quota share agreement (“QSA”). With the express exception of the 90% QSA with WSIC, “Covered Policies” do not include PSIC’s “Assumed Reinsurance” business and participation in Pools and Associations.



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(“Assuming Counterparty”) by way of an assumption and assignment agreement that includes a novation (the “Novation Transaction”).

- *The Novation Transaction will not be in effect unless approved by the Supervising Court. The Rehabilitator intends to seek approval of the Novation Transaction contemporaneously with her seeking Supervising Court approval of a Plan of Rehabilitation for PSIC. When implementing a plan of rehabilitation, the Supervising Court’s authority includes the approval of the modification of contractual rights.² The Rehabilitator will seek the novation of policyholder rights in connection with an assumption and assignment agreement.*
- *If all or a portion of the Covered Policies are not legally transferred to the Assuming Counterparty by novation (the “Rejected Policies”), the Rejected Policies (and related insurance liabilities) will be 100% reinsured by the Assuming Counterparty in accordance with the provisions of the assumption and assignment agreement for the Novation Transaction.*
- In the Novation Transaction, the Rehabilitator seeks to transfer (i) PSIC’s Loss and ALAE reserves related to the Covered Policies, and (ii) a negotiated portion of PSIC’s investment securities and certain other assets.
- It is intended that the Assuming Counterparty will have the benefit of inuring reinsurance, including the Munich Reinsurance America, Inc. (“Munich”) \$60 million limit adverse development cover reinsuring accident years 2013 and prior (the “Munich ADC”).³
 - *In connection with reserve strengthening at year end, PSIC reached the attachment point and penetrated the Munich ADC by approximately \$680,000, leaving approximately \$59.3 million of reinsurance under the Munich ADC for the benefit of an Assuming Counterparty.⁴*
- The Assuming Counterparty will have first dollar exposure for the run-off of accident years 2016 and 2017 policies and claims.

² The Rehabilitator will also be asking the Supervising Court to modify certain rights of Surplus Note Holders and an Assuming Counterparty will not be required to assume PSIC’s outstanding surplus notes.

³ To the extent the approval of any inuring reinsurer is required, the Rehabilitator will assist the Assuming Counterparty in obtaining such approvals.

⁴ Please note that (i) the sublimit for “Assumed Reinsurance” has been exhausted, so such business will be borne by PSIC, (ii) losses associated with “Pools & Associations” will be borne by PSIC and will not be subject to the Munich ADC, and (iii) the Munich ADC provides that Munich’s consent is required if claims handling of policies (subject to the Munich ADC) will be transferred from PSIC to any third party.



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- *Accident years 2016 and 2017 premium written consists primarily of specialty program and homeowners business which has historically experienced loss ratios of ~ 60% or less.*
- *Premium earned was ~\$77.3 million in 2016 and \$7.0 million in 2017 for the three month period ending on March 31, 2017.*
- Pursuant to the authority set forth in Paragraph (3) of the Rehabilitation Order, the Rehabilitator plans to cancel all of PSIC's in-force policies effective June 30, 2017 (unless they expire earlier on their own terms).

Transaction Process

Phase I

In Phase I, which is currently in process, each party is entitled to:

- Access and review PSIC's electronic data room. *If you have not already done so, please provide us with a detailed due diligence request list or a list of diligence items currently outstanding; and*
- Calls with Griffin to seek clarification of information contained in the data room and to discuss the Transaction Process.

Phase I will conclude on the Bid Date.

Phase II will commence after the Bid Date (see page 4).

Phase I Bid Instructions:

On behalf of the Rehabilitator, we invite you to submit a preliminary, non-binding indication of interest to enter into the Novation Transaction. **As part of your indication of interest, please submit the following on or before 5 PM (EST) on the Bid Date:**

- A fully completed non-binding bid form (the "Bid Form"), a copy of which is attached to this process letter; and
- Such other documents or information that you believe to be relevant to the evaluation of your indication of interest.

Parties that do not complete the Bid Form and address the points outlined therein may be asked to complete the missing information and resubmit their indication of interest. Please ***deliver all preliminary indications of interest to Jeff Harenza, Danielle Kauffman and Richard Piscella***



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(contact information on Page 6) on or prior to 5 PM (EST) on the Bid Date. Late submissions will not be considered.

Shortly after the completion of Phase I, Griffin will notify all parties that have completed and submitted Bid Forms as to whether they will be invited to participate in Phase II.

Phase II

During Phase II, each party (and its respective advisors) will be provided access to:

- PSIC's claim files;
- PSIC's management team, actuaries and other advisors to assist you in the completion of your due diligence review; and
- Calls with Griffin to seek clarification of information contained in the data room and to discuss final bids.

During Phase II, at the Rehabilitator's discretion, prospective Assuming Counterparties will be supplied with drafts of, or term sheets for, both an assumption and assignment agreement and novation agreement, specifying the terms and conditions upon which the Rehabilitator intends close the Novation Transaction – other than price. Changes that a potential Assuming Counterparty proposes to make to the proposed draft agreements or term sheets should be submitted prior to, or simultaneous with, the submission of a definitive proposal and will be taken into account in evaluating the totality of the proposal.

In assessing the qualifications of the parties that desire to participate in Phase II and submit formal proposals, the Rehabilitator and her advisors will consider the value levels and other factors indicated in the preliminary proposals, as well as the Rehabilitator's perception of your ability to complete a Novation Transaction which will satisfy the Rehabilitator's timing objectives and such other matters as she considers appropriate at the time. The Rehabilitator seeks to enter into a definitive agreement for the Novation Transaction on or around July 1, 2017. The Rehabilitator shall have no obligation to any party to state any reasons for declining consideration of a bid by any party.

Miscellaneous

The Rehabilitator reserves the right in her sole discretion to, at any time and without prior notice, (i) reject any, or all, indications of interest, or Phase II bids, at any time without assigning any reasons therefor, (ii) negotiate exclusively with one or more prospective Assuming Counterparties, (iii) change, modify or terminate the process for the Novation Transaction and (iv) withdraw the solicitation of proposals to, and terminate discussions with, any or all prospective Assuming Counterparties. Neither the Rehabilitator nor her advisors will have any liability to any prospective Assuming Counterparty as a result of the rejection of any indication of interest, any information or



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materials furnished, made available or transmitted to such Assuming Counterparty, the acceptance of another indication of interest or with respect to any of the foregoing.

We may seek clarification of your indication of interest or Phase II bid from you at any time, and failure to respond is cause for rejection. Clarification is not an opportunity to materially change your indication of interest or Phase II bid.

The Rehabilitator may enter into a definitive agreement with any prospective Assuming Counterparty without prior notice. Neither the Rehabilitator nor the Estate or their respective advisors will have any liability or obligations to any prospective Assuming Counterparty with respect to any Novation Transaction involving PSIC until such Assuming Counterparty has entered into a definitive agreement relating to the Novation Transaction, and following such time the only obligations of PSIC will be those set forth in the definitive agreement.

The Rehabilitator reserves the right to amend or supplement any written material furnished or information orally transmitted to a prospective Assuming Counterparty, and the Rehabilitator's interpretation of the provisions of any written material furnished or information orally transmitted to a prospective Assuming Counterparty shall be final and binding on all parties. The existence and content of this letter is subject to, and this letter does not modify any provision of, the confidentiality agreement executed by you.

The Rehabilitator may consider any factor she chooses in selecting one proposal over another and expressly reserves the right, in her sole discretion, at any time, and without stating a reason therefor, to terminate discussions or negotiations with any or all parties, to negotiate directly with any party or parties with respect to a Novation Transaction, reject any or all proposals and to change the process outlined above without sending a notice to a prospective Assuming Counterparty of such change. None of the Rehabilitator, the Estate, or Griffin will have any liability or obligation to any prospective Assuming Counterparty as a result of the rejection of any preliminary or final offer or the acceptance of another prospective Assuming Counterparty's offer.

All communications or inquiries relating to a Novation Transaction should be directed to Griffin. **Under no circumstances should you contact the Rehabilitator, the Office of the Special Deputy Receiver, or PSIC or any of their employees or consultants other than as arranged in advance by Griffin. Violation of this prohibition shall be grounds for disqualification.**

It is the Rehabilitator's policy not to contract with any person or entity that is in violation of the laws of the State of Illinois or is barred from contracting with the Illinois Department of Insurance, under Illinois Public Act 095-0971, or otherwise. Parties submitting bids in either Phase must be in compliance with Illinois law.



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On behalf of the Rehabilitator, we thank you for your interest in the potential Novation Transaction. If you have any questions regarding the foregoing, please feel free to contact us.

Very truly yours,

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Non-Binding Bid Form

Please input responses in the boxes below that are highlighted in grey and underlined in red.

1. Novation Transaction Structure. Are you willing to enter into a Novation Transaction substantially as described on pages 1-3 of the process letter? (YES) or (NO)

2. The Assuming Entity. The name of the legal entity that will accept the transfer of the Covered Policies (the “Assuming Entity”).
 - Assuming Entity is domiciled in the state / commonwealth of in the U.S.
 - If the Assuming Entity is not domiciled in the U.S., the country of domicile is .
 - The Assuming Entity is licensed (and in good standing) in states in the U.S.
 - If the Assuming Entity is not licensed and in good standing in all 50 states, please list the states in which the Assuming Entity is not licensed or in good standing on Schedule 1 attached hereto.
 - The Assuming Entity has statutory capital and surplus of \$ at 12/31/2016 and \$ at 3/31/2017.

3. Consolidated Group. The name of the consolidated group that owns the Assuming Entity is (the “Group”).
 - The Group is domiciled in the country of .
 - The Group had consolidated capital and surplus of \$ at 12/31/2016 and \$ at 3/31/2017.

4. Credit Ratings and Key Ratios. The Group and the Assuming Entity’s respective credit ratings and key ratios are as follows:

	Assuming Entity	Group
<u>Credit Ratings</u>		
AM Best (FSR)	<u> </u>	<u> </u>
AM Best (ICR)	<u> </u>	<u> </u>
S&P	<u> </u>	<u> </u>

Moody's	_____	_____
Fitch	_____	_____
Other	_____	_____
<u>Key Ratios</u>		
AM Best BCAR	_____	_____
RBC Ratio	_____	_____

- Is the Assuming Entity or the Group subject to any regulatory orders, actions or similar agreements? (YES) or (NO)
 - If YES, please describe on Schedule 2 attached hereto.

5. Schedule of Liabilities Subject to the Novation Transaction.

	(A) Actual 12/31/2016	(B) Forecast 6/30/2017	(C) "Liabilities to be Assumed"
Loss and ALAE Reserves	\$179,409,800	\$166,638,000	\$166,638,000
Total Liabilities Subject to Novation Transaction	\$179,409,800	\$166,638,000	\$166,638,000

- Will you assume all of the \$166,638,000 of liabilities referenced in the chart (Column C) above (that relate to the Covered Policies) as of the Novation Transaction's closing date? (YES) or (NO)
 - If NO, please indicate the amount of "Liabilities to be Assumed" that you are willing to assume in the blank set forth right: \$_____.
 - The amount of liabilities assumed in the Novation Transaction is referred to as "Total Liabilities Assumed."

6. Transferred Assets. The tables below contain Primary and Secondary Assets that are available to be transferred to an Assuming Entity in the Novation Transaction.

- **Primary Assets.** In Chart 1 below entitled "Primary Assets", please insert in Column D, the dollar amount for each asset that you seek to be transferred to you in the Novation Transaction ("Total Transferred Primary Assets"). *Please note that "Unencumbered Bonds/Cash Equivalents" is the only asset that may be "bid" (in Column D) in-whole or in-part.*

- **Secondary Assets**. In Chart 2 below entitled “Secondary Assets”, please insert (i) in Column D, the dollar amount (PSIC’s carrying amount) for each asset that you seek to be transferred to you in the Novation Transaction, and (ii) in Column E, the value (greater or less than carrying value) that you ascribe to each asset that you seek to be transferred to you in the Novation Transaction (“Total Adjusted Value of Transferred Secondary Assets”).
- ***Total Transferred Primary Assets plus Total Adjusted Value of Transferred Secondary Assets (together, the “Total Value of Assets Transferred”) should not exceed “Liabilities to be Assumed” that you provided in paragraph 5 of this Bid Form.***
 - *Please note that no asset may be divided and “bid” in part, except for “Unencumbered Bonds/Cash Equivalents” (reflected in Chart 1: Primary Assets below) which may be “bid” in-whole or in-part.*
- ***The Rehabilitator will look favorably upon, and ascribe significant weight to, bids (i) in which “Total Value of Assets Transferred” are less than “Total Liabilities Assumed”, (ii) that substitute Secondary Assets for Primary Assets, and/or (iii) that maximize the amount of Unencumbered Bonds/Cash Equivalents available to the Estate post Novation Transaction.***

Chart 1: Primary Assets				
	(A) Primary Assets at 12/31/2016	(B) Primary Assets at 6/30/2017⁽¹⁾	(C) Maximum Primary Assets Available for Novation Transaction 6/30/2017⁽¹⁾	(D) Transferred Primary Assets 7/1/2017
Bonds Pledged To State Insurance Departments ⁽²⁾	\$94,403,156	\$94,403,156	\$94,403,156	\$94,403,156
Bonds Pledged To State National	\$5,403,321	\$5,403,321	\$5,403,321	\$ _____
Unencumbered Bonds/Cash Equivalents ⁽³⁾	\$80,137,946	\$61,195,607	\$44,300,000	\$ _____
Mortgage Loans On Real Estate ⁽⁴⁾	\$9,575,000	\$9,575,000	\$9,575,000	\$ _____
Prudential Insurance Co. Surplus Note	\$1,259,416	\$1,259,416	\$1,259,416	\$ _____
Common Stock of Western Select ⁽⁵⁾	\$15,043,765	\$15,043,765	\$15,043,765	\$ _____
Total Transferred Primary Assets				\$ _____

(1) Based on internally prepared forecast provided by PSIC

(2) The significant majority of state deposits held are invested in high grade corporate bonds. The average weighted yield of this portfolio is~2.9%

(3) If an Assuming Entity seeks to acquire Western Select Insurance Company (“**WSIC**”) (see footnote 5 below), the maximum amount of Unencumbered bonds (column C above) available for transfer in the Novation Transaction will be reduced to \$28.7 million.

(4) PSIC’s mortgage loans are performing and none were in default at 12/31/2016 or at 3/31/2017.

(5) WSIC is a wholly-owned subsidiary of PSIC and has \$15.6 million of unencumbered liquid securities and no liabilities. WSIC is not in rehabilitation, but the Rehabilitator desires, but is not obligated or required, to sell WSIC. If an Assuming Entity desires to acquire WSIC, the proposed purchase price should be inserted in the table above and such purchase price should be deemed assets transferred in the Novation Transaction. If an Assuming Counterparty agrees to acquire WSIC, the maximum amount of Unencumbered bonds (column C above) available for transfer in the Novation Transaction will be reduced, on a dollar for dollar basis, by WSIC’s policyholder surplus (\$15.6 million) to \$28.7 million.

Chart 2: Secondary Assets					
	(A)	(B)	(C)	(D)	(E)
	Carrying Value of Secondary Assets at 12/31/2016	Carrying Value of Secondary Assets at 6/30/2017⁽¹⁾	Carrying Value of Secondary Assets Available for Novation Transaction 6/30/2017⁽¹⁾	Carrying Value of Transferred Secondary Assets 7/1/2017	Total Adjusted Value of Transferred Secondary Assets 7/1/2017
Reinsurance Recoverables	\$22,823,967	\$12,972,000	\$12,972,000	\$ _____	\$ _____
Saybrook Corporate Opportunity Fund- Private Equity, Mezzanine	\$3,213,917	\$3,213,917	\$3,213,917	\$ _____	\$ _____
Scof Side II Pocket Fund Private Equity, Mezzanine	\$3,196,041	\$3,196,041	\$3,196,041	\$ _____	\$ _____
Rd Legal Funding Partners; Hedge Fund- Multi-Strategy	\$1,112,523	\$1,112,523	\$1,112,523	\$ _____	\$ _____
Muirfield Value Partners Portfolio B; Hedge Fund- Multi-Strategy	\$237,499	\$237,499	\$237,499	\$ _____	\$ _____
Muirfield Value Partners Portfolio B; Hedge Fund- Multi-Strategy	\$25,604	\$25,604	\$25,604	\$ _____	\$ _____
Culpepper State National; Private Equity	\$3,363,508	\$3,363,508	\$3,363,508	\$ _____	\$ _____
Colony Distressed Credit And Special Situations Fund	\$3,823,728	\$3,823,728	\$3,823,728	\$ _____	\$ _____
Total Value of Transferred Secondary Assets				\$ _____	\$ _____

(1) Based on internally prepared forecast provided by PSIC

Total Transferred Primary Assets (From Chart 1, Column D, above in this Paragraph 6)	\$ _____
Total Adjusted Value of Transferred Secondary Assets (From Chart 2, Column E, above in this Paragraph 6)	\$ _____
Total Value of Assets Transferred	\$ _____

7. Relevant Experience. On Schedule 3 attached hereto, please separately describe the breadth and depth of the Assuming Entity's (and Group's) claim handling abilities and experience in administering claims in run-off.

- The Assuming Entity and Group has _____ U.S.-based claim handling employees.
 - _____ claims administered annually totaling \$ _____ across _____ lines of business.

8. In connection with the Novation Transaction, do you:

- Desire to hire members of PSIC's claims staff? _____ (YES) or _____ (NO)
- Seek to acquire PSIC's claims systems, IT systems or related infrastructure? _____ (YES) or _____ (NO)
 - If you answered YES to either of the foregoing questions, please provide additional detail on Schedule 4

9. Regulatory Approval. Do you anticipate that you will need regulatory approval to complete the Novation Transaction? _____ (YES) or _____ (NO)

- If you answered YES, please describe below the regulatory approvals required to complete the Novation Transaction.

10. Board, Shareholder or Other Approval. Briefly describe any board, shareholder or other approvals (and the timing thereof) required to enter into a definitive agreement for the Novation Transaction.

[Redacted area]

11. Joint Bids. Please indicate whether you plan on partnering with any other party. (YES) or (NO)

- If YES, please identify such third party and describe the status of your discussions with such third party.

[Redacted area]

12. Contact Information. On Schedule 5, please provide (i) names, telephone numbers and email addresses of appropriate persons which can be contacted in case clarification of your proposal is required and (ii) the identity of your advisors.

Schedule 1

STATES NOT LICENSED OR IN GOOD STANDING

Schedule 2

REGULATORY ORDERS

Schedule 3
TRANSACTION EXPERIENCE

Schedule 4
CLAIMS STAFF; SYSTEMS

Schedule 5
CONTACT INFORMATION