

WHITE MOUNTAINS INSURANCE GROUP LTD
Form 10-K/A
May 13, 2003

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K/A

ý **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

For the fiscal year ended December 31, 2002

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the transition period from _____ to _____
Commission file number 1-8993

WHITE MOUNTAINS INSURANCE GROUP, LTD.

(Exact name of Registrant as specified in its charter)

Bermuda
(State or other jurisdiction of
incorporation or organization)

94-2708455
(I.R.S. Employer
Identification No.)

80 South Main Street, Hanover, New Hampshire
(Address of principal executive offices)

03755-2053
(Zip Code)

Registrant's telephone number, including area code: **(603) 640-2200**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class
Common Shares, par value \$1.00 per share

Name of each exchange on which registered
New York Stock Exchange

Securities registered pursuant to section 12(g) of the Act:

None

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

The aggregate market value of voting shares (based on the closing price of those shares listed on the New York Stock Exchange and the consideration received for those shares not listed on a national or regional exchange) held by non-affiliates of the Registrant as of May 8, 2003, was \$3,163,996,321.

As of May 8, 2003, 8,326,087 common shares, par value of \$1.00 per share ("Common Shares"), were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), relating to the Registrant's Annual General Meeting of Shareholders scheduled to be held May 19, 2003 are incorporated by reference into Part III of this Form 10-K. With the exception of the portions of the Proxy Statement specifically incorporated herein by reference, the Proxy Statement is not deemed to be filed as part of this Form 10-K.

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PART I

Item 1. Business

GENERAL

White Mountains Insurance Group, Ltd. (the "Company") was originally formed as a Delaware corporation in 1980. In October 1999, the Company completed a corporate reorganization that changed its domicile from Delaware to Bermuda (the "Redomestication"). The Company's principal businesses are conducted through its subsidiaries and affiliates in the businesses of property and casualty insurance and reinsurance. Within this report, the consolidated organization is referred to as "White Mountains". The Company's headquarters are located at Crawford House, 23 Church Street, Hamilton, Bermuda HM 11, its principal executive office is located at 80 South Main Street, Hanover, New Hampshire 03755-2053 and its registered office is located at Clarendon House, 2 Church Street, Hamilton, Bermuda HM 11.

The Company's reportable segments are OneBeacon, Reinsurance and Other Operations. The OneBeacon Insurance Group LLC family of companies are U.S.-based property and casualty insurance writers including, among several others, OneBeacon Insurance Company, Pennsylvania General Insurance Company and Camden Fire Insurance Association (collectively "OneBeacon"). OneBeacon was acquired by White Mountains from Aviva plc ("Aviva", formerly CGNU plc) on June 1, 2001 (the "Acquisition").

White Mountains' reinsurance operations are conducted primarily through Folksamerica Holding Company Inc. (together with its reinsurance subsidiary, Folksamerica Reinsurance Company, "Folksamerica"). In connection with the Acquisition, Folksamerica was contributed by the Company to OneBeacon. OneBeacon and Folksamerica are run as separate entities, with distinct operations, management and business strategies. White Mountains' reinsurance operations also include its wholly owned subsidiaries, Fund American Reinsurance Company Ltd. ("Fund American Re") and White Mountains Underwriting Limited ("WMU"), as well as its investment in Montpelier Re Holdings Ltd. ("Montpelier"), a Bermuda-domiciled reinsurance holding company. Fund American Re is commercially domiciled in Bermuda but maintains its executive office and an operating branch in Stockholm, Sweden, and operates through an additional branch in Singapore. WMU is an Ireland-domiciled consulting services provider specializing in international property excess reinsurance.

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White Mountains' other operations consist of the International American Group, Esurance Inc. ("Esurance"), the Company and the Company's intermediate holding companies. The International American Group consists of Peninsula Insurance Company ("Peninsula"), American Centennial Insurance Company ("American Centennial") and British Insurance Company of Cayman ("British Insurance Company"), which were purchased by the Company in 1999. In connection with the Acquisition, Peninsula, American Centennial and British Insurance Company were contributed by the Company to Folksamerica.

White Mountains' Operating Principles

White Mountains strives to operate within the spirit of four operating principles. These are:

Underwriting Comes First. We must respect the fundamentals of insurance. There must be a realistic expectation of underwriting profit on all business written, and demonstrated fulfillment of that expectation over time, with focused attention to the loss ratio and to the professional insurance disciplines of pricing, underwriting and claims management.

Maintain a Disciplined Balance Sheet. Insurance liabilities must always be fully recognized. Loss reserves must be solid before any other aspect of the business can be solid. Pricing, marketing and

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underwriting all depend on informed judgment of ultimate loss costs and can be managed effectively only with a disciplined balance sheet.

Invest for Total Return. White Mountains invests for the best growth in after-tax value over time whether reported as income or not and without regard to any need to report a smooth earnings stream. In addition to investing our bond portfolios for total after-tax return, that will also mean prudent investment in equities consistent with leverage and insurance risk considerations.

Think Like Owners. By taking accountability for one's actions and behaving with a sense of urgency, all employees demonstrate their stake in the business by working smarter and understanding that actions influence results. Thinking like an owner embraces all that without losing the touchstone of a capitalist enterprise.

ONEBEACON

Headquartered in Boston, Massachusetts, OneBeacon is one of the oldest property and casualty insurers in the United States, tracing its roots to 1831 and the Potomac Fire Insurance Company. OneBeacon's legacy includes being among the first to issue automobile policies, honoring claims arising from the great San Francisco earthquake and the sinking of the Titanic and insuring several U.S. presidents. During 1998, Commercial Union plc and General Accident plc, both U.K. corporations, were merged to form CGU plc. The U.S. operations of these companies, General Accident Corporation of America ("General Accident") and Commercial Union Corporation ("Commercial Union"), were merged to form CGU Corporation (the "Merger"). White Mountains agreed to purchase CGU Corporation in September of 2000, with the transaction closing on June 1, 2001. The name OneBeacon was introduced at the time of the Acquisition. OneBeacon's principal operating insurance subsidiaries are rated "A" (Excellent, the third highest of fifteen ratings) by A.M. Best, a rating agency which specializes in the insurance and reinsurance industry.

In connection with the Acquisition, Aviva caused OneBeacon to purchase reinsurance contracts with two reinsurance companies rated "AAA" (Extremely Strong, which is the highest of twenty-one ratings) by Standard & Poor's and "A++" (Superior, which is the highest of fifteen ratings) by A.M. Best: a full risk-transfer cover from National Indemnity Company ("NICO") for up to \$2.5 billion in old asbestos and environmental claims (the "NICO Cover") and an adverse development cover from General Reinsurance Corporation ("GRC") for up to \$400.0 million on additional losses occurring in accident years 2000 and prior (the "GRC Cover").

On November 1, 2001, OneBeacon transferred its regional agency business, agents and operations in 42 states and the District of Columbia to Liberty Mutual Insurance Group ("Liberty Mutual") pursuant to a renewal rights agreement (the "Renewal Rights Agreement"). This transfer amounted to approximately 45% of OneBeacon's total business. The operating results and cash flows of policies renewed from November 1, 2001 through October 31, 2003 pursuant to the Renewal Rights Agreement are shared between Liberty Mutual and OneBeacon. A reinsurance agreement pro-rates results so that OneBeacon assumed approximately two-thirds of the operating results from renewals through October 31, 2002 and assumes approximately one-third of the operating results from renewals from November 1, 2002 to October 31, 2003. Additionally, OneBeacon has the option of assuming 10% of Liberty Mutual's regional agency markets business for the years 2004 to 2006 on a *pari passu* basis with Liberty Mutual. Since entering the Renewal Rights Agreement, OneBeacon has been focused on becoming a profitable independent agency property and casualty insurance company in the Northeast and for select specialty business on a national basis.

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OneBeacon conducts its primary personal and commercial business through independent agents in two regional operations (New England and the New York/New Jersey area), a New York limited assigned distribution servicing carrier (AutoOne Insurance) and one reciprocal exchange (New Jersey Skylands Management Corporation). Agents provide value to their customers through personal

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attention, coverage expertise and an understanding of local market conditions. The regional operations target personal and commercial customers, focusing on the family account and small to mid-sized businesses. OneBeacon's objective is to underwrite only profitable business without regard to market share, premium volume or growth. In addition to these regional operations, OneBeacon is also committed to nurturing its select specialty businesses that focus on providing custom coverages to certain niche markets, including ocean marine, agricultural, professional liability and tuition reimbursement. Each specialty business has its own operations and appointed agents that target specific customer groups.

At December 31, 2002 and 2001, OneBeacon had \$15.8 billion and \$16.5 billion of total assets, respectively, and shareholder's equity of \$3.1 billion and \$3.0 billion, respectively. OneBeacon's total assets and shareholder's equity include Folksamerica and its subsidiaries and OneBeacon's investment in Montpelier, which are covered elsewhere in this report.

Property and Casualty Insurance Overview

As a property and casualty insurance company, OneBeacon writes insurance policies in exchange for premiums paid by its customers (the insured). An insurance policy is a contract between OneBeacon and the insured where OneBeacon agrees to pay for losses suffered by the insured that are covered under the contract. Such contracts often are subject to subsequent legal interpretation by courts, legislative action and arbitration. Property insurance generally covers the financial consequences of accidental losses to the insured's property, such as a home and the personal property in it, or a business' building, inventory and equipment. Casualty insurance (often referred to as liability insurance) generally covers the financial consequences of a legal liability of an individual or an organization resulting from negligent acts and omissions causing bodily injury and/or property damage to a third party. Claims on property coverage generally are reported and settled in a relatively short period of time, whereas those on casualty coverage can take years, even decades, to settle.

OneBeacon provides a variety of property and casualty insurance products to individuals (personal lines) and to businesses (commercial lines), including the following:

Automobile: consists of physical damage and liability coverage. Automobile physical damage insurance covers loss or damage to vehicles from collision, vandalism, fire, theft or other causes. Automobile liability insurance covers bodily injury of others, damage to their property and costs of legal defense resulting from a collision caused by the insured.

Commercial property: covers losses to a business' premises, inventory and equipment as a result of weather, fire, theft and other causes.

Homeowners: covers losses to an insured's home, including its contents, as a result of weather, fire, theft and other causes, and losses resulting from liability for acts of negligence by the insured or the insured's immediate family.

General liability: covers businesses for any liability resulting from bodily injury and property damage arising from its general business operations, accidents on its premises and its products manufactured or sold.

Umbrella: supplements existing insurance policies by covering losses from a broad range of insurance risks in excess of coverage provided by the primary insurance policy up to a specified limit.

Workers compensation: covers an employer's liability for injuries, disability or death of employees, without regard to fault, as prescribed by state workers compensation law and other statutes.

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Multiple peril: a package policy sold to small to mid-sized insureds or to members of trade associations or other groups that includes general liability insurance and commercial property insurance.

Inland marine: covers property that may be in transit or held by a bailee at a fixed location, movable goods that are often stored at different locations or property with an unusual antique or collector's value.

OneBeacon also provides various specialty insurance products, including the following:

Ocean marine: covers losses to an insured's vessel and/or its cargo as a result of collision, fire, piracy and other perils. Ocean marine coverages include cargo, hull, protection and indemnity, primary and excess liability, marina package, comprehensive marina liability package and yacht products.

Agricultural: a package policy providing property, liability, automobile and/or umbrella coverages for the farm and ranch marketplace.

Directors and Officers ("D&O") and professional liability: covers liability that may arise as a result of omissions, misstatements, negligence or misconduct related to business operations. OneBeacon offers D&O and professional liability products to small and middle market businesses.

Tuition reimbursement: covers tuition payments due to schools and colleges when a student is unable to complete a semester as a result of an illness, accident or certain other causes.

OneBeacon derives substantially all of its revenues from earned premiums, investment income and net gains and losses from sales of investment securities. Earned premiums represent premiums received from insureds, which are recognized as revenue over the period of time during which insurance coverage is provided (i.e., ratably over the life of the policy). A significant period of time normally elapses between the receipt of insurance premiums and the payment of insurance claims. During this time, investment income is generated, consisting primarily of interest earned on fixed maturity investments and dividends earned on equity securities. Net realized investment gains and losses result from sales of securities from OneBeacon's investment portfolio.

OneBeacon incurs a significant amount of its total expenses from policyholder losses, which are commonly referred to as "claims". In settling policyholder losses, various loss adjustment expenses ("LAE") are incurred, such as insurance adjusters' fees and litigation expenses. In addition, OneBeacon incurs policy acquisition expenses such as commissions paid to agents and premium taxes, and other expenses related to the underwriting process, including compensation and benefits for professional and clerical staff.

Underwriting profit or loss is determined by subtracting loss and LAE, policy acquisition expenses and other underwriting expenses from earned premiums. A key measure of relative underwriting performance for an insurance company is the combined ratio. An insurance company's combined ratio under accounting principles generally accepted in the United States ("GAAP") is calculated by adding the ratio of incurred loss and LAE to earned premiums (the "loss ratio") and the ratio of commissions, premium taxes and other underwriting expenses, including general and administrative expenses, to earned premiums (the "expense ratio"). When considering investment income and investment gains or losses, insurance companies operating at a combined ratio of greater than 100% can be profitable despite incurring an underwriting loss.

Lines of Business

OneBeacon writes three "core" lines of business consisting of personal and commercial lines in the Northeast and certain specialty lines on a national basis. "Non-core" lines of business include business

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For the twelve months ended December 31, 2002 and 2001, OneBeacon's net written premiums by line of business were as follows:

Net written premiums by line of business (\$ in millions)	Year Ended December 31,			
	2002		2001	
Personal	\$ 1,092.1	43%	\$ 856.9	25%
Commercial	454.6	18	678.4	20
Specialty	284.1	11	221.6	6
Non-core lines	692.0	28	1,710.0	49
Total	\$ 2,522.8	100%	\$ 3,466.9	100%

For the twelve months ended December 31, 2002 and seven months ended December 31, 2001, OneBeacon's underwriting gain (loss) by line of business were as follows:

Underwriting gain (loss) by line of business (\$ in millions)	Periods Ended December 31,	
	2002	2001
Personal	\$ 37.3	\$ (63.8)
Commercial	28.1	(200.5)
Specialty	14.3	4.8
Non-core lines	(293.1)	(417.8)
Total	\$ (213.4)	\$ (677.3)

Core Operations

Personal Lines

OneBeacon's personal lines include, among others, automobile, homeowners and Custom-Pac products (Custom-Pac products are combination policies offering home and automobile coverage with optional umbrella, boatowners and other coverages), which represented 62%, 18% and 15% of personal lines net written premium for the twelve months ended December 31, 2002. Personal lines automobile includes AutoOne Insurance and New Jersey Skylands Management Corporation.

Commercial Lines

OneBeacon's commercial lines products include, among others, multiple peril, commercial automobile and workers compensation, which represented 52%, 29% and 14% of commercial lines net written premium for the twelve months ended December 31, 2002. Nearly 90% of OneBeacon's commercial accounts are comprised of policies with an annual premium of less than \$50,000 and consist primarily of small, non-manufacturing accounts.

Specialty Lines

OneBeacon's specialty business focuses on providing custom coverages to certain niche markets, including ocean marine (offered through International Marine Underwriters, "IMU"), agricultural ("Agri"), professional liability (offered through OneBeacon Professional Partners, "OBPP") and other specialty products, such as tuition reimbursement. Each specialty business has its own operations and distribution channel that target specific customer groups. For the twelve months ended December 31,

2002, IMU, Agri, OBPP and other specialty products represented 38%, 36%, 10% and 16%, respectively, of specialty lines net written premium.

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OneBeacon's IMU unit offers insurance products which specialize in the ocean marine marketplace. IMU's products include coverage for cargo, hull, yacht, marina and primary and excess liability.

OneBeacon's Agri unit offers insurance products which focus on the farm and ranch marketplace. Agri's products include coverage for property and liability related claims, excluding crop damage claims, on dairy farms, equine farms, farm equipment dealers, orchard and garden farms. Additionally, since most farm and ranch businesses are proprietor-owned, Agri also offers personal and umbrella coverages for the farm or ranch owner as a package with its farm and ranch property and liability coverage.

OneBeacon offers D&O and professional liability insurance under the name OneBeacon Professional Partners. OneBeacon entered the D&O and professional liability market in order to capitalize on a lack of available capacity within the marketplace. Due to the potential volatility of D&O and professional liability insurance, OneBeacon selectively underwrites each policy and does not write Fortune 1000 accounts, foreign businesses or large hospitals or groups. Further, OneBeacon does not write primary coverage. Most policies attach coverage in excess of \$20 million of existing insurance and/or a deductible and have small limits of coverage, usually less than \$5 million. OBPP's liability coverages are issued on a "claims made" basis, which means insurance that covers losses reported to OBPP during the time period when a liability policy is in effect, regardless of when the event causing the claim actually occurred. As a result, the ability of an insured to report claims outside of the policy term is limited, thereby limiting the claims tail.

OneBeacon offers tuition reimbursement insurance through its subsidiary, A.W.G. Dewar, Inc. ("Dewar"). Dewar has offered tuition reimbursement insurance since 1930.

Non-Core Operations

Non-core operations are primarily from business assumed from Liberty Mutual in connection with the Renewal Rights Agreement (\$496.7 million in net written premiums for 2002). Premiums from non-core operations decreased from 49% of total premiums in 2001 to 28% of total premiums in 2002. Premiums from non-core lines will continue to diminish over the next year as OneBeacon's obligations under the Renewal Rights Agreement decrease and policies in run-off expire.

Geographic Concentration

OneBeacon's gross written premiums are derived solely from business produced in the United States. The various specialty businesses within core operations generate premiums from risks written in

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markets across the country. Personal and commercial lines business from core operations was produced in the following states:

Personal and commercial written premiums by state	Year Ended December 31,	
	2002	2001
New York(1)	48%	39%
Massachusetts	24	24
New Jersey	10	13
Maine	9	10
Connecticut	5	5
Other(2)	4	9
Total	100%	100%

(1)

Growth in written premiums in New York State from 2001 to 2002 is primarily from AutoOne Insurance. See separate discussion of AutoOne Insurance below.

(2)
Vermont, New Hampshire and Rhode Island.

Marketing

OneBeacon sells its personal and commercial lines products through select independent insurance agents. OneBeacon believes that independent agents provide complete assessments of their clients' needs, which results in appropriate coverages and prudent risk management. OneBeacon believes that independent agents will continue to be a significant force in overall industry premium production.

OneBeacon conducts its business through 11 branch offices and approximately 1,000 appointed agencies. OneBeacon's operations are located close to its agent partners and customers throughout New England, New York and New Jersey.

OneBeacon's specialty businesses are located in separate locations, logistically appropriate to their target markets. IMU is headquartered in New York City and has nine branch locations located throughout the United States. Its products are distributed through a network of select agents that specialize in the ocean marine business. Agri has centralized operations in Lenexa, Kansas and distributes its products through independent agencies. OBPP, which is located in Avon, Connecticut, distributes its products nationally through excess and surplus lines brokers. Through these specialty businesses, OneBeacon leverages its knowledge about these markets to provide products and services that are tailored to meet customer needs.

Underwriting and Pricing

OneBeacon believes that there must be a realistic expectation of underwriting profit on all business written and a demonstrated fulfillment of that expectation over time. Pricing pressures can be caused by many factors such as: (1) insurance companies selling their products at less than adequate rates, because they either underestimate ultimate claim costs or overestimate the amount of investment income and investment gains they will earn on premiums before the claims are paid; (2) lower distribution costs for insurance companies utilizing direct-response marketing methods versus marketing their products through independent agents; (3) insurance companies seeking to increase revenues and market share by reducing the price of their products beneath levels acceptable to OneBeacon; and (4) mutual insurance companies and other insurance companies who are willing to accept a lower return on equity on their insurance operations than White Mountains' management and its shareholders. Pricing levels can also be influenced by state regulation, legislation and judicial decisions.

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Following the Merger, the integration of underwriting and claims adjudication, settlement, administration, reporting and processing functions, which focused on expense savings, brought about numerous changes in business practices and philosophy, as well as in processes and systems. The operational integration of General Accident and Commercial Union (collectively, the "legacy companies") presented a challenge to OneBeacon in managing its business. It was necessary to combine the underwriting, pricing and claims recording practices of many organizations that had over time adopted differing operational methods, systems and means of coding and processing information. The integration of key data needed for financial reporting and regulatory compliance was given top priority; however, compromises were made in the integration of some additional information which limited the usefulness of certain analyses and tools used to manage and operate the business. This additional information, which included certain information relating to claim counts, insured values, exposure descriptors, risk classifications and pricing data, was often not captured fully or at all into the combined records of the legacy companies. As a result, it was difficult for OneBeacon's underwriters, claims managers and actuaries to localize sources of and causes for changes in price adequacy, underwriting quality and claims experience. As a consequence, in hindsight, prior management was slow to respond to external factors caused by market conditions and emerging claims trends in managing the business. However, the operational challenges described above did not affect in any material respect OneBeacon's ability to estimate reserves for losses and LAE in accordance with GAAP.

Subsequent to the Acquisition, White Mountains brought a new management team to OneBeacon to improve operating results in the short-term and establish practices for sustaining acceptable underwriting results going forward. White Mountains has taken significant actions with respect to OneBeacon since it completed the Acquisition including (1) shedding non-core businesses through the Liberty Mutual transaction (as described herein), (2) increasing prices, (3) reevaluating the risks, terms and conditions associated with renewing certain policies (and in appropriate cases declining to issue a renewal policy), (4) eliminating unprofitable products, accounts and agents, such as National Accounts and National Programs business, (5) improving the claims adjudication, settlement, administration and processing functions and (6) improving management information systems and deploying new technology to contribute to process improvement and overall results.

Further, as a result of the Renewal Rights Agreement, OneBeacon has focused its efforts on improving the ongoing operations in the Northeast, where it believes its agency relationships are the strongest and its historical results have been closer to profit targets. Under the terms

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of the Renewal Rights Agreement, Liberty Mutual assumed control over the underwriting and pricing of business subject to this agreement. The operating results and cash flows of policies renewed from November 1, 2001 through October 31, 2003 pursuant to the Renewal Rights Agreement are shared between Liberty Mutual and OneBeacon. A reinsurance agreement pro-rates results so that OneBeacon assumed approximately two-thirds of the operating results from renewals through October 31, 2002 and assumes approximately one-third of the operating results from renewals from November 1, 2002 to October 31, 2003. Liberty Mutual has control over a variety of factors which could impact the underwriting performance of Renewal Rights Agreement business, such as pricing adequacy, actual renewal premium volume, claims management, catastrophe exposures and other considerations. Management believes Liberty Mutual has done an acceptable job in each of these areas except for the handling of pre-November 1, 2001 claims. See "**Claims**" below for a further discussion.

Competition

Property and casualty insurance is highly competitive and extensively regulated by state insurance departments. OneBeacon competes in the United States with numerous regional and national insurance companies, most notably Travelers Insurance Group, Liberty Mutual, Selective Insurance Group, Zurich Insurance Group, Hanover Insurance Company and the Hartford Financial Services Group. It is often difficult for insurance companies to differentiate their products to consumers. The more significant

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competitive factors for most insurance products offered by OneBeacon are price, product terms and claims service. OneBeacon's underwriting principles and dedication to agency distribution are unlikely to make OneBeacon the "low cost" provider in most markets. However, as a property and casualty insurer that writes predominantly through independent agents, OneBeacon believes that most property and casualty insurance customers value the counsel of a professional independent agent and that OneBeacon's use of independent agents is a competitive advantage over direct-response writers.

Claims

Effective claims management is a critical factor in achieving satisfactory underwriting results. Claims service is the most important product differentiation that OneBeacon brings to its agents and insureds. OneBeacon's near-term staffing and systems plans have caused and will continue to cause it to spend more on administrative claims costs in order to improve the efficiency of OneBeacon's claims function and ultimately to reduce overall loss costs. Additionally, in 2002, OneBeacon implemented a new claims workstation which is expected to provide management and claims adjusters with substantially more analysis and information to facilitate decision making and reduce overall claims costs in the future.

Claims handling is located in various regional and local branch offices under the supervision of the Chief Claims Officer. OneBeacon maintains an experienced staff of appraisers, medical specialists, managers, attorneys and field adjusters strategically located throughout its operating territories. OneBeacon also maintains a special investigative unit designed to detect insurance fraud and abuse, and supports efforts by regulatory bodies and trade associations to curtail the cost of fraud.

Pursuant to the Renewal Rights Agreement, Liberty Mutual assumed control of OneBeacon's claims offices in the regions subject to the Renewal Rights Agreement and is responsible for servicing claims from the OneBeacon policies written prior to November 1, 2001, as well as policies which have renewed in those regions since that date. Service agreements were put in place in connection with the Renewal Rights Agreement, through which Liberty Mutual became a third party administrator ("TPA") for those claims. Upon review of claims information during the third and fourth quarters of 2002, OneBeacon's management determined that average paid claims in offices where Liberty was acting as a TPA were higher than expected. As a result, management has begun a process to directly handle more of those claims related to policies written prior to the Renewal Rights Agreement and expects that substantially all such claims will be handled directly by OneBeacon by the end of 2003.

OneBeacon also uses TPAs for certain other claims, especially for National Accounts and National Programs business which is in run-off. Additionally, NICO is handling the claims processing for claims ceded under the NICO Cover under a TPA agreement. OneBeacon's claims staff performs on-site claim audits of its TPA's to ensure the propriety of the controls and processes over claims serviced by the TPA on behalf of OneBeacon.

Loss and Loss Adjustment Expense Reserves

Non-Asbestos and Environmental Reserves

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OneBeacon establishes loss and LAE reserves that are estimates of amounts needed to pay claims and related expenses in the future for insured events that have already occurred. The process of estimating reserves involves a considerable degree of judgment by management and, as of any given date, is inherently uncertain.

Reserve estimates at OneBeacon are subject to additional uncertainty as a consequence of a number of factors that occurred prior to and since the Acquisition. As previously discussed, OneBeacon is the result of the merger of the U.S. operations of General Accident and Commercial Union. While relatively the same size, the legacy companies had different underwriting and claims management

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practices, which produced different business and underwriting results. The operational integration of the two companies was complex and included changes in underwriting and claims operations. Beginning in the mid-1990s, and continuing through the Merger, the subsequent operational integration of the legacy companies and the Acquisition, OneBeacon experienced an environment of significant change, both in its business and operations. Generally accepted actuarial techniques used to estimate reserves rely in large degree on projecting historical trends, such as patterns of claim development (i.e., reported claims and paid losses), into the future. Accordingly, estimating reserves becomes more uncertain if business mix, coverage limits, case reserve adequacy, claims payment rates and other factors change over time. The breadth and depth of the business and operational changes that occurred at OneBeacon (1) led to a wider range in the reserve estimates produced by a variety of actuarial loss reserving techniques, especially those that rely upon consistent claim development patterns, and (2) introduced greater complexity to the judgments required to be made by management in determining the impact of the business and operational changes on the development patterns used to estimate reserves.

Reserves are typically comprised of (1) case reserves for claims reported and (2) reserves for losses that have occurred but for which claims have not yet been reported, referred to as incurred but not reported ("IBNR") reserves, which include a provision for expected future development on case reserves. Case reserves are estimated based on the experience and knowledge of claims staff regarding the nature and potential cost of each claim and are adjusted as additional information becomes known or payments are made. IBNR reserves are regarded as the most uncertain reserve segment and are derived by subtracting paid loss and LAE and case reserves from estimates of ultimate loss and LAE. Actuaries estimate ultimate loss and LAE using various generally accepted actuarial methods applied to known losses and other relevant information. Like case reserves, IBNR reserves are adjusted as additional information becomes known or payments are made.

Ultimate loss and LAE are generally determined by extrapolation of claim emergence and settlement patterns observed in the past that can reasonably be expected to persist into the future. In forecasting ultimate loss and LAE with respect to any line of business, past experience with respect to that line of business is the primary resource, but cannot be relied upon in isolation. OneBeacon's own experience, particularly claims development experience, such as trends in case reserves, payments on and closings of claims, as well as changes in business mix and coverage limits, is the most important information for estimating its reserves. External data, available from organizations such as statistical bureaus, consulting firms and reinsurance companies, is sometimes used to supplement or corroborate OneBeacon's own experience, and can be especially useful for estimating costs of new business. For some lines of business, such as "long-tail" coverages discussed below, claims data reported in the most recent accident year is often too limited to provide a meaningful basis for analysis due to the typical delay in reporting of claims. For this type of business, OneBeacon uses a selected loss ratio method for the initial accident year or years. This is a standard and accepted actuarial reserve estimation method in these circumstances in which the loss ratio is selected based upon information used in pricing policies for that line of business, as well as any publicly available industry data, such as industry pricing, experience and trends, for that line of business.

In determining ultimate loss and LAE, the cost to indemnify claimants, provide needed legal defense and other services for insureds and administer the investigation and adjustment of claims are considered. These claim costs are influenced by many factors that change over time, such as expanded coverage definitions as a result of new court decisions, inflation in costs to repair or replace damaged property, inflation in the cost of medical services and legislated changes in statutory benefits, as well as by the particular, unique facts that pertain to each claim. As a result, the rate at which claims arose in the past and the costs to settle them may not always be representative of what will occur in the future. Often the factors influencing changes in claim costs are difficult to isolate or quantify and developments in paid and incurred losses from historical trends are frequently subject to multiple and conflicting interpretations. Changes in coverage terms or claims handling practices may also cause

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future experience and/or development patterns to vary from past. A key objective of actuaries in developing estimates of ultimate loss and LAE, and resulting IBNR reserves, is to identify aberrations and systemic changes occurring within historical experience and accurately adjust for

them so that the future can be projected reliably. Because of the factors previously discussed, this process requires the use of informed judgment.

Uncertainties in estimating ultimate loss and LAE are magnified by the time lag between when a claim actually occurs and when it is reported and settled. This time lag is sometimes referred to as the "claim-tail". The claim-tail for most property coverages is typically short (usually a few days up to a few months). The claim-tail for liability/casualty coverages, such as automobile liability, general liability, products liability, D&O, multiple peril coverage, and workers compensation, can be especially long as claims are often reported and ultimately paid or settled years, even decades, after the related loss events occur. During the long claims reporting and settlement period, additional facts regarding coverages written in prior accident years, as well as about actual claims and trends may become known and, as a result, OneBeacon may adjust its reserves. If management determines that an adjustment is appropriate, the adjustment is booked in the accounting period in which such determination is made in accordance with GAAP. Accordingly, should reserves need to be increased or decreased in the future from amounts currently established, future results of operations would be negatively or positively impacted, respectively.

Management believes that OneBeacon's loss and LAE reserves as of December 31, 2002 are reasonably stated; however, ultimate loss and LAE may deviate, perhaps materially, from the amounts currently reflected in the reserve balance. Adverse development, if any, would impact the Company's future results of operations. For a further description of the historical factors affecting OneBeacon's loss and LAE reserves prior to the Acquisition, see "Non-Asbestos and Environmental Reserves" under the caption "Loss and Loss Adjustment Expense Reserves" in the "OneBeacon" section of the business description contained within the Company's Amendment No. 3 to Form S-3 dated March 14, 2003 (the "Form S-3"). Such portion of the Form S-3 is incorporated by reference into this Form 10-K.

Asbestos and Environmental ("A&E") Reserves

OneBeacon's reserves include provisions made for claims that assert damages from A&E related exposures. Asbestos claims relate primarily to injuries asserted by those who came in contact with asbestos or products containing asbestos. Environmental claims relate primarily to pollution and related clean-up costs obligations, particularly as mandated by federal and state environmental protection agencies. In addition to the factors described above under "**Non-Asbestos and Environmental Reserves**" regarding the reserving process, OneBeacon estimates its A&E reserves based upon, among other factors, facts surrounding reported cases and exposures to claims, such as policy limits and deductibles, current law, past and projected claim activity and past settlement values for similar claims, as well as analysis of industry studies and events, such as recent settlements and asbestos-related bankruptcies.

OneBeacon's A&E losses resulted primarily from the operations of the Employers Group, an entity acquired by one of the legacy companies in 1971. These operations, including business of Employers Surplus Lines Insurance Company and Employers Liability Assurance Corporation, provided primary and excess liability insurance for commercial insureds, including Fortune 500-sized accounts, some of whom subsequently experienced claims for A&E losses. Employers Group stopped writing such coverage in 1984.

OneBeacon's liabilities for A&E losses from business underwritten in the recent past are substantially limited by the application of exclusionary clauses in the policy language that eliminated coverage of such claims. After 1987 for pollution and 1992 for asbestos, most liability policies contained industry-standard absolute exclusions of such claims. In earlier years, various exclusions were also

applied, but the wording of those exclusions was less strict and subsequent court rulings have reduced their effectiveness.

OneBeacon also incurred A&E losses via its participation in industry pools and associations. The most significant of these pools was the Excess Casualty Reinsurance Association ("ECRA"), which provided excess liability reinsurance to U.S. insurers from 1950 until the early 1980s. ECRA incurred significant liabilities for A&E, of which OneBeacon bears approximately a 4.7% share, or \$68 million at year end 2002.

More recently, since the 1990s, OneBeacon has experienced an influx of claims from commercial insureds, including many non-Fortune 500-sized accounts written during the 1970s and 1980s, who are named as defendants in asbestos lawsuits. As a number of large well-known manufacturers of asbestos and asbestos-containing products have gone into bankruptcy, plaintiffs have sought recoveries from peripheral defendants, such as installers, transporters or sellers of such products, or from owners of premises on which exposure to asbestos allegedly occurred. At December 31, 2002, 602 policyholders had asbestos related claims against OneBeacon. In 2002, 38 new insureds with such peripheral involvement presented asbestos claims under prior OneBeacon policies.

Historically, most asbestos claims have been asserted as product liability claims. Recently, insureds who have exhausted the available products liability limits of their insurance policies have sought payment for asbestos claims under the premises and operations coverage of their liability policies. It is more difficult for plaintiffs to establish losses as stemming from premises and operations exposures, which requires proof of the defendant's negligence, rather than products liability under which strict legal liability applies. Hence, there are fewer of such claims and

settlements are generally for smaller amounts. There are currently 79 active claims against OneBeacon without product liability coverage asserting operations or premises coverage.

Immediately prior to the Acquisition, Aviva caused OneBeacon to purchase a reinsurance contract with NICO for a premium of \$1.3 billion under which OneBeacon is entitled to recover from NICO up to \$2.5 billion in the future for asbestos claims arising from business written by OneBeacon in 1992 and prior, environmental claims arising from business written by OneBeacon in 1987 and prior, and certain other exposures. Under the terms of the NICO Cover, NICO receives the economic benefit of reinsurance recoverables from certain of OneBeacon's third party reinsurers in existence at the time the NICO Cover was executed ("Third Party Recoverables"). As a result, the Third Party Recoverables serve to protect the \$2.5 billion limit of NICO coverage for the benefit of OneBeacon. Third Party Recoverables are typically for the amount of loss in excess of a stated level each year. Of claim payments in the past 11 years, approximately 58% of asbestos losses and 40% of environmental losses have been recovered under the historical third party reinsurance.

For purposes of determining available reinsurance, product liability asbestos claims typically are aggregated as a single loss within each policy period. As a result, losses often exceed the threshold level under the reinsurance agreement and reinsurance recoveries are obtained. However, for claims being asserted under premises and operations coverage, the losses are generally not aggregated for purposes of determining reinsurance recoveries, so OneBeacon expects that in the future a smaller percentage of these losses will be covered as Third Party Recoverables than has been true historically of products liability asbestos losses.

The large majority of OneBeacon's third party reinsurance has been obtained from top-rated, financially strong companies. Of the Third Party Recoverables presented for recovery to date, approximately 3% has been determined to be unrecoverable due either to inability of a reinsurer to pay or to disputes with the reinsurer over the amounts due. For asbestos losses, this unrecoverable percentage has been 3.8% and for environmental losses 2.0%. Amounts uncollectible from third party reinsurers due to dispute or the reinsurers' financial inability to pay are covered by NICO under its agreement with OneBeacon.

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OneBeacon estimates that on an incurred basis it has exhausted approximately \$1,771 million of the coverage provided by NICO at December 31, 2002. Approximately \$419 million of the estimated \$1,771 million of incurred losses have been paid by NICO through December 31, 2002, with \$106.3 million paid in 2002. To the extent that actual experience differs from OneBeacon's estimate of ultimate A&E losses and Third Party Recoverables, the remaining protection under the NICO Cover may be more or less than the approximate \$729 million that OneBeacon estimates remained at December 31, 2002.

OneBeacon's reserves for A&E losses, net of Third Party Recoverables but prior to NICO recoveries, are \$1.2 billion at December 31, 2002. An industry benchmark of reserve adequacy is the "survival ratio", computed as a company's reserves divided by its historical average yearly loss payments. This ratio indicates approximately how many more years of payments the reserves can support, assuming future yearly payments are equal to historical levels. OneBeacon's survival ratio was approximately 15.7 at December 31, 2002, which was computed as the ratio of A&E reserves, net of Third Party Recoverables, of \$1.2 billion plus the remaining unused portion of the NICO Cover of \$729 million, to the average loss payments in the past three years. White Mountains believes that as a result of the NICO Cover and its historical third party reinsurance programs, OneBeacon should not experience material financial loss from old A&E exposures under current coverage interpretations and that its survival ratio compares favorably to industry survival ratios. See Note 3 to the financial statements for more information regarding White Mountains' A&E reserves.

OneBeacon's reserves for A&E losses at December 31, 2002 represent management's best estimate of its ultimate liability based on information currently available. OneBeacon believes the NICO Cover will be adequate to cover all of its A&E obligations. However, as case law expands, medical and clean-up costs increase and industry settlement practices change, OneBeacon may be subject to asbestos and environmental losses beyond currently estimated amounts. Therefore, OneBeacon cannot guarantee that its A&E loss reserves, plus the remaining coverage under the NICO Cover, will be sufficient to cover additional liability arising from any such unfavorable developments.

Construction Defect Claims

OneBeacon's general liability and multiple peril lines of business have been significantly impacted by an increasing number of construction defect claims. Construction defect is a liability allegation relating to defective work performed in the construction of structures such as apartments, condominiums, single family dwellings or other housing. Such claims seek recovery due to damage caused by alleged deficient construction techniques or workmanship. Much of the increase in claims activity has been generated by plaintiffs' lawyers who approach disgruntled homeowners, and in many cases homeowner associations with large numbers of homeowners in multi-residential complexes, about defects or other flaws in their homes. The increasing number of claims for construction defects has been experienced industry-wide beginning with increased claims relating to exposures in California. Then, as plaintiffs' lawyers organized suits in other states with high levels of

multi-residential construction, construction defect claims were reported in nearby western states, such as Colorado and Nevada, and eventually throughout the country. The reporting of such claims can be quite delayed as the statute of limitations can be up to ten years. Court decisions have expanded insurers' exposure to construction defect claims as well. For example, in 1995, California courts adopted a "continuous trigger" theory in which all insurers during the period in which the damage occurs (i.e., the entire construction period through remediation of the damage) must respond. As a result, claims may be reported more than ten years after a project has been completed as litigation can proceed for several years before an insurance company is identified as a potential contributor. Recently, claims have also emerged from parties claiming additional insured status on policies issued to other parties (e.g., such as contractors seeking coverage on a sub-contractor's policy).

A large number of construction defect claims were identified relating to coverages that OneBeacon had written in the past through Commercial Union and General Accident and their subsidiaries in California, Colorado, Nevada, Washington and Oregon. Management has sought to mitigate future construction defect risks in all states by no longer providing insurance to certain residential general contractors and sub-contractors involved in multi-habitational projects. Mitigating actions also included initiating the withdrawal from problematic sub-segments within OneBeacon's construction book of business, such as street and road construction, water, sewer and pipeline construction, and dam, waterway, railroad and subway construction. Although management has undertaken actions to mitigate future risks related to construction defect claims, management believes that the number of reported construction defect claims relating to coverages written in the past will continue to increase. In addition, in reserving for these claims, there is additional uncertainty due to the potential for further unfavorable judicial rulings and regulatory actions.

Additional Loss and Loss Adjustment Expense Information

The following information presents (1) OneBeacon's reserve development over the preceding ten years and (2) a reconciliation of reserves in accordance with accounting principles and practices prescribed or permitted by insurance authorities ("Statutory" basis) to such reserves determined in accordance with GAAP, each as prescribed by Securities Act Industry Guide No. 6.

Section I of the ten year table shows the estimated liability that was recorded at the end of each of the indicated years for all current and prior accident year unpaid losses and LAE. The liability represents the estimated amount of losses and LAE for claims that were unpaid at the balance sheet date, including IBNR reserves. In accordance with GAAP, the liability for unpaid losses and LAE is recorded in the balance sheet gross of the effects of reinsurance with an estimate of reinsurance recoverables arising from reinsurance contracts reported separately as an asset. The net balance represents the estimated amount of unpaid losses and LAE outstanding as of the balance sheet date, reduced by estimates of amounts recoverable under reinsurance contracts.

Section II shows the re-estimated amount of the previously recorded net liability as of the end of each succeeding year. Estimates of the liability for unpaid losses and LAE are increased or decreased as payments are made and more information regarding individual claims and trends, such as overall frequency and severity patterns, becomes known. Section III shows the cumulative net (deficiency)/redundancy representing the aggregate change in the liability from original balance sheet dates and the re-estimated liability through December 31, 2002. Section IV shows the re-estimated gross liability and re-estimated reinsurance recoverables through December 31, 2002. Section V shows the cumulative

amount of net losses and LAE paid relating to recorded liabilities as of the end of each succeeding year.

OneBeacon Loss and LAE(1), (3) Years Ended December 31,

(\$ in millions)	1992	1993	1994	1995	1996	1997	1998(2)	1999	2000	2001	2002
I. Liability for unpaid losses and LAE:	\$ 5,652.8	\$ 5,562.5	\$ 5,535.4	\$ 5,844.4	\$ 5,804.4	\$ 5,655.9	\$ 6,944.0	\$ 6,368.8	\$ 6,982.7	\$ 8,425.2	\$ 7,630.5
Less: reins. recoverables on unpaid losses and LAE	(1,392.6)	(1,191.6)	(1,069.8)	(1,307.4)	(1,260.4)	(1,159.2)	(1,651.9)	(1,285.6)	(1,276.4)	(3,609.7)	(3,560.6)

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OneBeacon Loss and LAE(1), (3)

Years Ended December 31,

Net balance	\$ 4,260.2	\$ 4,370.9	\$ 4,465.6	\$ 4,537.0	\$ 4,544.0	\$ 4,496.7	\$ 5,292.1	\$ 5,083.2	\$ 5,706.3	\$ 4,815.5	\$ 4,069.9
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II. Net liability re-estimated as of:

1 year later	4,365.9	4,411.5	4,494.1	4,584.7	4,627.8	5,370.1	5,305.3	5,901.2	4,815.8	4,872.9
2 years later	4,413.4	4,450.3	4,552.1	4,667.1	5,476.0	5,424.7	5,985.4	5,013.5	4,913.7	
3 years later	4,510.5	4,501.0	4,642.8	5,460.6	5,549.0	5,965.0	5,002.8	5,025.5		
4 years later	4,610.3	4,602.8	5,406.5	5,510.6	5,924.8	4,980.5	5,073.5			
5 years later	4,705.8	5,353.2	5,431.8	5,779.5	4,948.0	5,049.2				
6 years later	5,446.4	5,353.5	5,632.0	4,794.7	4,995.6					
7 years later	5,439.2	5,523.8	4,658.7	4,840.0						
8 years later	5,587.1	4,569.2	4,691.8							
9 years later	4,638.5	4,595.6								
10 years later	4,660.5									

III. Cumulative net

(deficiency)/redundancy \$	(400.3)	\$ (224.7)	\$ (226.2)	\$ (303.0)	\$ (451.6)	\$ (552.5)	\$ 218.6	\$ 57.7	\$ 792.6	\$ (57.4)	\$
Percent (deficient)/redundant	(9.4)%	(5.1)%	(5.1)%	(6.7)%	(9.9)%						