

PLAINTIFF'S
EXHIBIT
25

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Greenberg 19
DD 9/11/08

MEMORANDUM

To: Mr. M. R. Greenberg

October 21, 1999

From: F. Douglas

Re: Warranty - Lack of Data for Pricing and to Evaluate Profitability

Per your request attached are two reports (one for DBG, and one for Foreign Gen) outlining the data situation for each of the warranty programs.

The overall situation is extremely poor. There are only two programs where we have had good policy year data for pricing and to evaluate our ongoing profitability. These are the VISA Credit Card Program on the DBG side and the Comet (U.K.) Brown & White program on the Foreign Gen side. Both these programs have been nicely profitable. Efforts have been underway to improve the data.

Auto

You are very familiar with the situation on the Domestic Auto Warranty. The situation on the Foreign Gen side for Auto Warranty is actually worse from a data standpoint in that we have not had any credible data for pricing, nor are we getting policy year results to evaluate the profitability even in hindsight. We only have inception-to-date data, and the results appear to be clearly unprofitable for all the major auto programs. We cannot project the ultimate loss ratios due to lack of data, but our Warranty actuaries do not believe the Foreign Auto results will be as unprofitable as those on the Domestic side. The volume is smaller, and the terms are shorter so the exposure is less than what you saw in DBG. Very recently (June 1999) we obtained detail policy year statistics for Spain, and this led us to conclude the business is unprofitable (many programs now being terminated).

Brown & White and Other Warranty Programs

There is no credible policy year data for any program other than Comet in the U.K. On the DBG side, the Best Buy program is larger than all the remaining programs combined. The initial rates for Best Buy were provided by Best Buy, and we do not have policy year data. The inception-to-date results that are available do not allow us to look at the results by product but only by major product group (e.g. computers results can be seen but not laptops or other detail). On the DBG side, Best Buy and most of the other programs have very limited profit potential due to profit share agreements returning most of any profits to the insured. We generally have the downside risk with limited upside potential.

On the Foreign Gen side, Comet has been an excellent program however we are only able to keep 11% net as 89% of the business goes to the insured's captive. The remaining foreign programs do not in general appear to show profitability problems, but we cannot accurately project results for any of them without policy year data. We are also at risk if premium are being earned too quickly (which we know has happened in some countries) as this understates the loss ratio in the early years and then the true results come in later. The initial pricing of the programs is based on a process called "countrification". Under this process, Actuarial and/or the profit center calculates the indicated rates for the covered products based on any relevant data we have (e.g. the Comet program). These indicated rates are then adjusted to account for the variance in replacement part costs and wage differentials or any other factors of the country where the new program is to be implemented. It should be understood there is no actuarial signoff when such speculative assumptions are made. A major new program in Brazil is underway with rates determined by this process. Actuarial has no realistic idea what the loss ratios will be on this business. Without policy year data, we might never have a clear picture of profitability even on an overall basis, let alone for individual products. We are clearly relying on the expertise of the profit center in these cases, which basically is the entire non-Comet business around the world. Local AIU staff use policy year information generated locally, however these figures do not reconcile with financial records of AIU and are considered unreliable by actuarial.

Cc: E. G. Greenberg
J. Morrow

F H Douglas