

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

In Re: Penn Treaty Network America  
Insurance Company in Rehabilitation

No. 1 PEN 2009

In Re: American Network Insurance  
Company in Rehabilitation

No. 1 ANI 2009

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COMMONWEALTH COURT OF PENNSYLVANIA

**RESPONSE OF THE NATIONAL ORGANIZATION OF LIFE AND HEALTH  
INSURANCE GUARANTY ASSOCIATIONS TO HEALTH INSURERS' APPLICATION  
FOR RELIEF TO MODIFY THE PLAN TO ELIMINATE THE USE OF ESTATE  
ASSETS TO PAY "UNCOVERED BENEFITS" CLAIMS MADE UNDER POLICIES  
TERMINATED PURSUANT TO 40 P.S. §§ 221.20 and 221.21**

The National Organization of Life and Health Insurance Guaranty Associations ("NOLHGA") provides this comment in response to the Health Insurers' Application for Relief To Modify the Plan To Eliminate the Use of Estate Assets To Pay "Uncovered Benefits" Claims Made Under Policies Terminated Pursuant to 40 P.S. §§ 221.20 and 221.21 ("Application To Eliminate the Uncovered Benefits Trust"). NOLHGA offers the following information to assist the Court.

The Health Insurers' Application To Eliminate the Uncovered Benefits Trust targets one aspect of the Second Amended Plan, namely the Commissioner's proposal to establish a funded trust for policyholders who may have claims for benefits that would have been provided under their policies but which exceed guaranty association coverage limits. The Health Insurers offer an argument under 40 P.S. §§ 221.20 and 221.21 and *Warrantech Consumer Products, Inc. v. Reliance Ins. Co. in Liquidation*, 96 A.3d 346 (Pa. 2014), in support of their objection to the creation and funding of the Uncovered Benefits Trust<sup>1</sup>.

NOLHGA has not expressed an objection (based on these arguments or otherwise) specifically relating to the Uncovered Benefits Trust in its Formal Comments (even though the

<sup>1</sup> "Uncovered Benefits Trust" is the term used by the Health Insurers to have the same meaning as the terms "Penn Treaty Liquidating Trust" and "Trust" in the Second Amended Plan. We use the term "Uncovered Benefits Trust" in this Response. Other capitalized terms used but not defined herein shall have the meanings as defined in the Second Amended Plan of Rehabilitation, as filed with this Court on October 8, 2014.

guaranty associations—collectively, the largest creditors of Company B—stand to lose the most as a result of the Uncovered Benefits Trust), because NOLHGA views the Second Amended Plan as a comprehensive package as to which the Uncovered Benefits Trust is but one of multiple interrelated elements. The Rehabilitator submitted the Second Amended Plan after months of negotiations among interested parties, at the direction of this Court, to resolve concerns the interested parties had about the rehabilitation plans filed by the Rehabilitator in 2013. NOLHGA generally supports the comprehensive resolution represented by the Second Amended Plan, although NOLHGA believes that refinements to the Second Amended Plan could usefully take into account various comments that have been offered, including those of the Health Insurers. NOLHGA offers the following observations as to the Health Insurers' Application on this issue.

Extending *Warrantech* beyond the service contract reimbursement insurance policies at issue in that case could give rise to unprecedented treatment of other insurance products in a future insolvency of a Pennsylvania-domiciled insurer. The Second Amended Plan, possibly with certain refinements, could appropriately address the interests of stakeholders in this proceeding while avoiding untoward consequences of extending the *Warrantech* rationale to cases far different from the one in which it arose. For example, consider what would happen under the proposed extension of *Warrantech* to annuitants receiving life contingent payments under an annuity contract issued by a Pennsylvania domiciled insurer that is placed into liquidation. Each annuity payment due under the terms of the annuity contract after the rights fixing date would be subject to an insurance contingency—the annuitant being alive on each future date an annuity payment was due. Under an extension of *Warrantech*, any obligations due more than 30 days after liquidation and subject to an insurance contingency pursuant to the terms of the annuity contract would be terminated without value, leaving the annuitants with only guaranty association covered benefits.

Such a result would be inconsistent in NOLHGA's experience with how payout annuities have been treated in all prior insurer insolvencies – across the country. In fact, if the *Warrantech* rationale had applied to the recent liquidation of Executive Life Insurance Company of New York, annuitants across the country (including Pennsylvania residents) would have lost hundreds of millions of dollars of future life contingent annuity benefits in excess of guaranty association coverage levels. Instead, the New York court calculated—as of the New York rights fixing date—a value for all future life contingent benefits (not just a value for the benefits covered by the guaranty associations) and recognized that calculated value as a liability of the insolvent insurer. This interpretation of how a rights fixing statute should be interpreted and applied has been consistently adopted in other life insurer liquidations, including Confederation Life Insurance Company (MI), London Pacific Life Insurance Company (NC), Kentucky Central Life Insurance Company (KY), and a host of smaller life insurance company liquidations where future policy benefits for periods after a statutory rights fixing date could exceed guaranty association coverage levels. NOLHGA knows of no exception.

The Court also should consider how extending the *Warrantech* decision could falsely "cure" insurer insolvencies. The legal liability of insurers (i.e., their insurance reserves) for long-term liabilities such as life insurance and life contingent annuities is heavily weighted towards future life contingent obligations rather than past insured events. If an insurer that had issued policies or annuities with benefits far in excess of guaranty association coverage levels became insolvent (i.e., the insurance reserves for future benefits exceeded the insurer's assets), extending the *Warrantech* decision to eliminate without value all future life contingent losses under those policies in excess of guaranty association coverage levels would truncate all policyholder obligations. That could leave the policyholders with maximum guaranty association benefits that were far below what the insurer had contractually promised, eliminate all of the insurer's liability for the future life contingent policy benefits (i.e., eliminate the insurance reserves for future life

contingent benefits in excess of guaranty association limits that the insurer was required by law to recognize), and leave the insurer and its shareholders with a windfall that never would have existed if the insurer had been held responsible for honoring the contractual promises it made. While this outcome is likely impossible in these cases given the deep insolvency of the Companies, a final resolution approach that would extend the *Warrantech* rationale in a way that could eliminate the bulk of an insurer's liability under Pennsylvania's rights fixing statute is troubling. In fact, it would make Pennsylvania law governing insurers internally inconsistent—requiring insurers to establish adequate reserves for future insurance obligations but then ignoring that liability if a company becomes insolvent and is ordered liquidated—again making Pennsylvania unique in NOLHGA's experience.

NOLHGA instead encourages the Court to consider instead in its entirety the Second Amended Plan, which represents a comprehensive approach for the resolution of the pending insolvencies and could, with some refinements, appropriately address the interests of stakeholders in this proceeding while avoiding untoward consequences discussed above.

In any event, NOLHGA respectfully submits that this Court should reserve judgment on this issue until after the July hearing. The existence of the Uncovered Benefits Trust does not determine any other issue under the Second Amended Plan, but rather is an interrelated element of the Second Amended Plan. The Court is therefore entitled to and should review the Second Amended Plan in its entirety and after the benefit of full hearing before resolving this issue.

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**CERTIFICATE OF SERVICE**

I hereby certify that I am this day serving the foregoing upon the persons and in the manner indicated below, which service satisfies the requirements of the Court's December 3, 2014 Case Management Orders for Comments and Hearing on the Proposed Second Amended Plan of Rehabilitation:

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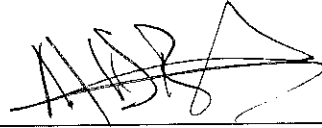
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