IN THE COMMONWEALTH COURT OF PENNSYLVANIA

JOEL ARIO, **INSURANCE COMMISSIONER OF THE** **COMMONWEALTH OF PENNSYLVANIA,**	:	
Plaintiff	:	
v.	:	**No. 5 M.D. 2009**
PENN TREATY NETWORK AMERICA **INSURANCE COMPANY**	:	
Defendant	:	

MEMORANDUM OF LAW IN SUPPORT
OF THE REHABILITATOR'S AMENDED PETITION FOR
LIQUIDATION OF PENN TREATY NETWORK AMERICA INSURANCE COMPANY

INTRODUCTION

Joel Ario, Insurance Commissioner of the Commonwealth of Pennsylvania, in his capacity as Statutory Rehabilitator of Penn Treaty Network America Insurance Company ("PTNA") submits this Memorandum of Law in Support of his Amended Petition for Liquidation of PTNA.

FACTUAL BACKGROUND

Information about the business and operations of PTNA and its subsidiary, American Network Insurance Company ("ANIC"), is contained in the Preliminary Report filed with this Court on April 6, 2009. As is set forth in the Rehabilitator's Preliminary Report, PTNA and ANIC(collectively, the "Companies") are Pennsylvania domiciled stock insurance companies licensed to issue annuities and life accident and health insurance policies. PTNA is a wholly owned subsidiary of Penn Treaty American Corporation ("PTAC"), a publicly traded holding company. ANIC is a wholly owned subsidiary of PTNA. ANIC has a wholly owned subsidiary, American Independent Network Insurance Company of New York. The bulk of PTNA and ANIC's business has been long term care ("LTC") insurance. As of December 31, 2008,

approximately 97.7% of the Companies' total annualized premium in-force was from LTC policies, 2.2% was from Medicare supplement policies and 0.1% was from other insurance.

LTC policies are guaranteed renewable as long as the policyholder continues paying the premiums. Premium rates are established at the time the policy is first purchased. Rates may not be increased for an individual policyholder based on changed conditions including increasing age or declining health, but the policies do permit rate increases, subject to regulatory approval / disapproval, if actuarially supported and increased for all policyholders insured under the same policy form. The LTC policies are categorized and monitored by the Companies as two groups of business: 1) policies written before 2002 ("Oldco") and 2) policies written after February 12, 2002 ("Newco"). As of the end of 2000, PTNA's adjusted capital and surplus was below the Regulatory Action Level and PTNA was required to file a Corrective Action Plan ("CAP") with the Pennsylvania Insurance Department. The Companies suspended sale of new policies in 2001 and did not resume selling new policies until after the CAP was approved by the Insurance Department on February 12, 2002. The Oldco policies now represent approximately 81% of the Companies' LTC business and the Newco policies approximately 19%.

The premiums on the Oldco policies, written before the Companies' suspension of business 2001, have proven to be significantly lower than is necessary to provide adequate reserves for the coverage provided by those policies. While some rate increase requests by the Companies have been allowed by some states, many have not been approved and the premiums on the Oldco polices remain inadequate to support the coverage under these policies. Although the Newco policies' premiums appear adequate, the profitability of the policies is uncertain and the amount of Newco business is insufficient to stand alone as viable business or support PTNA's much larger number of Oldco policies. Furthermore, it has been determined that the Newco business is not as profitable as was previously believed.

PTNA as of December 31, 2008 had a reported negative total statutory capital and surplus of $224 million. Further study and analysis of the Companies' claims experience since the Rehabilitation Order has shown that claims are more frequent and of longer duration than was previously believed. It is the conclusion of the Rehabilitator's actuarial firm, Milliman, that as of 2009, if appropriate reserves were held, PTNA's total statutory capital and surplus would be negative by more than $1.3 billion.

Accordingly, even under optimistic projections, for premiums to be sufficient to support the coverage provided and for PTNA to be able to eventually become solvent, PTNA would need either aggregate premium rate increases on PTNA's Oldco policies of 160% approved and in effect by July 2010 or aggregate premium rate increases on those policies of 76% by July 2010 plus additional rate increases after that of 60% over ten years. The Rehabilitator's employees and experts have analyzed the regulatory environment and the feasibility of obtaining such rate increases and have concluded that there is no reasonable likelihood that rate increases of this magnitude could be obtained, let alone be obtained in the required time period. The Rehabilitator has also evaluated the effects of such premium increases of over 100% on PTNA policyholders and has concluded that such increases would be more harmful to policyholders than liquidation.

ARGUMENT

Protection of policyholders is the fundamental priority of the Insurance Department Act, both in insurer rehabilitation proceedings and in liquidations. Foster v. Mutual Fire, Marine & Inland Insurance Co., 531 Pa. 598, 624-25, 614 A.2d 1086, 1100 (1992); Grode v. Mutual Fire, Marine & Inland Insurance Co., 572 A.2d 798, 801 n. 5, 807 (Pa. Cmwlth. 1990), aff'd in relevant part sub nom Foster v. Mutual Fire, Marine & Inland Insurance Co., 531 Pa. 598, 614 A.2d 1086 (1992).

> If, after all, insurance is to perform its function of risk assumption and distribution of loss, then those statutes which govern it must first protect the insuring public, particularly in situations where the insurer becomes incapable of covering the risks it contracted to assume. Rehabilitation and liquidation are of vital importance to the consumer, who relies in the first place on the industry itself and then on its regulators for protection.

Foster v. Mutual Fire, 531 Pa. at 624-25, 614 A.2d at 1100 (quoting Grode v. Mutual Fire); see also Grode v. Mutual Fire, 572 A.2d at 801 n.5 ("the equitable purpose of rehabilitation and liquidation is to protect first of all consumers of insurance") (emphasis in original).

Where the Rehabilitator seeks to place an insurer which is under rehabilitation into liquidation, conversion to a liquidation must be granted where the Rehabilitator demonstrates a) that the insurer is insolvent and b) shows that there is reasonable cause to believe either (i) that continued rehabilitation efforts would "substantially increase the risk of loss to creditors, policy and certificate holders, or the public" or (ii) that continued rehabilitation efforts "would be futile." Koken v. Legion Insurance Co., 831 A.2d 1196, 1230, 1243-44, 1246 (Pa. Cmwlth. 2003), aff'd sub nom. Koken v. Villanova Insurance Co., 583 Pa. 400, 878 A.2d 51 (2005); 40 P.S. §221.18(a).

A. PTNA Is Insolvent.

The actuarial analyses and financial data and analyses submitted by the Rehabilitator amply demonstrate that PTNA is insolvent. Although PTNA is presently able to pay its obligations as they come due, an insurer which is timely paying its obligations when due is insolvent and may be placed in liquidation where its liabilities together with the capital and surplus required by law exceed its admitted assets. Sheppard v. Old Heritage Mutual Insurance Co., 405 A.2d 1325, 1329, 1336 (Pa. Cmwlth. 1979); 40 P.S. § 221.3.

PTNA as of December 31, 2008 reported a negative total statutory capital and surplus of $224 million and was therefore insolvent. In fact, with proper reserving for future policyholder claims, PTNA's insolvency is far greater. The Rehabilitator's actuaries, following evaluation of

PTNA's claims experience, have concluded that PTNA's liabilities as of 2009 exceed its admitted assets by in excess of $1.3 billion.

B. Further Efforts At Rehabilitation Would Substantially Increase The Risk Of Loss To Policyholders.

Keeping PTNA in rehabilitation will cause substantial losses to policyholders which can be reduced and, in some cases avoided, in liquidation. PTNA if it remains in rehabilitation, even if it could raise rates by 60% over the next ten years, will exhaust its assets in 2025 and will leave over $2.1 billion of remaining policyholder liabilities.

Given PTNA's insolvency, the best protection for PTNA's policyholders is coverage by the guaranty associations. PTNA's policyholders are eligible for guaranty association coverage. The majority of PTNA's policyholders cannot exceed the guaranty coverage in their state and will suffer no loss at all if the guaranty associations' obligations are triggered. (7/23/09 Milliman Report Ex. 1.) Even among the policyholders who can exceed their guaranty association coverage, most will in fact not exceed their guaranty association limit and will therefore suffer no loss. (7/23/09 Milliman Report Ex. 1).[1] Those policyholders whose losses exceed guaranty association coverage will still be far better off with guaranty association coverage because they will receive 100% of the portion of their claim up to the guaranty association limit without reduction by the pro rata percentage at which Class B claims are paid by PTNA. In addition, guaranty association coverage will pay claims when they occur, without waiting years for distributions from PTNA's estate.

To access the guaranty association coverage essential to protect PTNA's policyholders, an order placing PTNA in liquidation will be needed, in addition to a finding of insolvency,

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[1] While Milliman has concluded since its July report that PTNA's claim frequency and duration are worse than previously understood and the percentage of policyholders likely to exceed guaranty association coverage may therefore have increased from the 7% to 10% in that report, the conclusion that most policyholders will not in fact exceed their guaranty association coverage remains unchanged.

because states in which PTNA policyholders reside will not provide guaranty association coverage without a liquidation order. In Florida, a state where over 14% of PTNA's policyholders reside, guaranty association coverage for policyholders of out-of-state insurers such as PTNA is allowed only where there is an order of liquidation. Fla. Stat. Ann. §631.717 (providing guaranty association coverage for policyholders of a non-Florida insurers only where the insurer is an "insolvent insurer"); Fl. Stat. Ann. §631.714 (defining "insolvent insurer" as requiring entry of an order of liquidation). Other states where large numbers of PTNA policyholders reside, such as California, North Carolina and Texas, will provide guaranty association coverage to PTNA insureds only where there is an order of liquidation or the insurer is failing to pay claims. Cal. Ins. Code §1067.04(f), (h), §1067.07; N.C. Gen. Stat. §58-62-16(8), (9), §58-62-36; Tex. Ins. Code §463.003 (5), (6), §463.252.

In addition, continuation of the rehabilitation will give preferential treatment to some claimants and will deplete PTNA's estate of millions of dollars needed to pay policyholder claims. PTNA, while in rehabilitation, continues paying claims in full. Indeed, keeping PTNA in rehabilitation and reducing payments to policyholders would make policyholders worse off than in liquidation, where they would have guaranty association coverage. Continued payments in full give early claimants preferential treatment over later claimants. Moreover, keeping PTNA in rehabilitation requires payment of millions in premium taxes per year. Unless this Court allows their suspension, payment of agent commissions will deplete PTNA's estate at the rate of almost $2 million per month. Draining PTNA of millions per year when PTNA does not have sufficient funds to pay all policyholder claims in full substantially increases the risk of loss to PTNA's policyholders.

C. Further Efforts To Rehabilitate PTNA Would Be Futile.

The Rehabilitator has evaluated actuarial projections for the PTNA policies and the premiums on those policies, and the premiums are far less than is needed to provide adequate reserves for the policies. The Rehabilitator has explored numerous possible rehabilitation strategies, including sale of PTNA and transfer of all or a portion of its assets or business to another insurer. There are no solvent insurers who will assume this coverage on any terms that would be as favorable to policyholders as the guaranty association coverage in liquidation. The Rehabilitator has also considered alternatives involving new capital or reinsurance and has determined that no such alternatives are available given the financial condition and performance of PTNA.

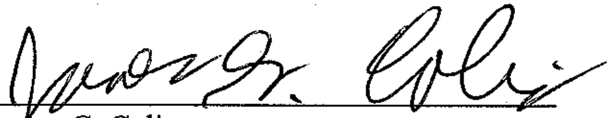
The Rehabilitator has also considered the rate increases which would be required to restore PTNA to solvency and whether such rate increases could be obtained. Because the premiums on PTNA's Oldco policies are insufficient to support the coverage they provide, rate increases totaling well over 100% would be required for PTNA's policies to be economically viable. Moreover, rate increases of at least 76% would have to be obtained so promptly as to be effective by July 2010. There is no realistic likelihood of obtaining such rate increases of that magnitude or in that time frame.

In addition, imposing sudden increases of this magnitude on policyholders is not in the best interest of PTNA's policyholders. The average age of PTNA's Oldco policyholders is 77 and the average LTC premium is over $2000. Doubling of such premiums on such policyholders would impose a tremendous burden on them which cannot be justified given that guaranty association coverage will provide significant protection to PTNA's policyholders in liquidation.

CONCLUSION

For the foregoing reasons, the Rehabilitator respectfully requests that this Court enter the attached Order placing Penn Treaty Network America Insurance Company in liquidation.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I, Virginia Lynn Hogben, hereby certify that on October 23, 2009 I served the foregoing Amended Petition for Liquidation, Exhibits A and B thereto and supporting Memorandum of Law on the directors of Penn Treaty Network America Insurance Company by U.S. First-Class Mail as follows:

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On this date, I also served a Notice of Filing of the Rehabilitator's Amended Petition for Liquidation of Penn Treaty Network America Insurance Company on all parties listed on the Master Service List by electronic mail or facsimile, or by U.S. Mail where no electronic mail address or facsimile number was available. Copies of the Amended Petition for Liquidation, Exhibits A and B and supporting Memorandum of Law were served on this date on the Intervenors as follows:

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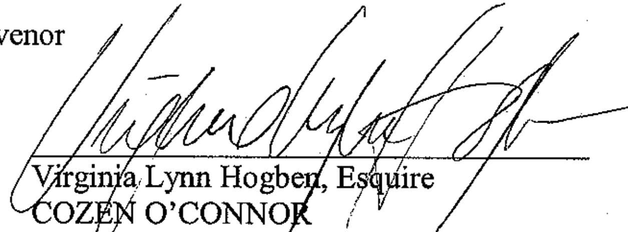

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