IN THE COMMONWEALTH COURT OF PENNSYLVANIA

JOEL ARIO, **INSURANCE COMMISSIONER OF THE** **COMMONWEALTH OF PENNSYLVANIA,**	:	
Plaintiff	:	
v.	:	**No. 4 M.D. 2009**
AMERICAN NETWORK **INSURANCE COMPANY**	:	
Defendant	:	

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

INTRODUCTION

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

FACTUAL BACKGROUND

Information about the business and operations of ANIC and its parent company, Penn Treaty Network American Insurance Company ("PTNA"), 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's 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 ANIC's much larger number of Oldco policies. Furthermore, it has been determined that the Newco business is not as profitable as was previously believed.

ANIC as of December 31, 2008 had a reported total statutory capital and surplus of $4.8 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, ANIC's total statutory capital and surplus would be negative by approximately $45 million.

Even under optimistic projections, for premiums to be sufficient to support the coverage provided and for ANIC to be able to eventually become solvent, ANIC would need either aggregate premium rate increases on its Oldco policies of 82% approved and in effect by July 2010 or aggregate premium rate increases on those policies of 16% by July 2010 plus additional rate increases after that of 70% 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 in the required time period. The Rehabilitator has also evaluated the effects of such premium increases of over 80% on ANIC 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. ANIC Is Insolvent.

The actuarial analyses and financial data and analyses submitted by the Rehabilitator demonstrate that ANIC is insolvent. Although ANIC 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.

Although ANIC reported capital and surplus of $4.8 million as of December 31, 2008, the Rehabilitator's actuaries, following evaluation of ANIC's claims experience, have concluded that ANIC's liabilities as of 2009 in fact exceed its admitted assets by approximately $45 million.

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

Keeping ANIC in rehabilitation will cause substantial losses to policyholders which can be reduced and, in some cases avoided, in liquidation. ANIC if it remains in rehabilitation, even if it could raise rates by 70% over the next ten years, will exhaust its assets in 2042 and will leave over $100 million of remaining policyholder liabilities.

Given ANIC's insolvency, the best protection for ANIC's policyholders is coverage by the guaranty associations. ANIC's policyholders are eligible for guaranty association coverage. Most of ANIC's policyholders cannot exceed the guaranty coverage in their state and will suffer no loss at all if the guaranty associations' obligations are triggered. Indeed, over 27% of ANIC's policyholders reside in New Jersey and because ANIC, unlike PTNA, is licensed in New Jersey, they will be covered by New Jersey's guaranty association with no coverage limits. N.J. Stat. Ann. §17B:32A-3. 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. 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 ANIC. In addition, guaranty association coverage will pay claims when they occur, without waiting years for distributions from ANIC's estate.

To access the guaranty association coverage essential to protect ANIC's policyholders, an order placing ANIC in liquidation will be needed, in addition to a finding of insolvency, because states in which ANIC policyholders reside will not provide guaranty association coverage without a liquidation order. States where large numbers of ANIC policyholders reside, such as New Jersey and Kansas, will provide guaranty association coverage to ANIC insureds only where there is an order of liquidation or the insurer is failing to pay claims. N.J. Stat. Ann.

§17B:32A-4, §17B:32A-7; Kan. State Ann. §40-3005(f), (g), §40-3008. In Colorado and Florida, where significant numbers of ANIC policyholders reside, guaranty association coverage is allowed only where there is an order of liquidation. Colo. Rev. Stat. § 10-20-108(2) (providing guaranty association coverage only where insurer is an "insolvent insurer"); Colo. Rev. Stat. § 10-20-103(7) (defining "insolvent insurer" as requiring 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).

In addition, continuation of the rehabilitation will give preferential treatment to some claimants and will deplete ANIC's estate of funds needed to pay policyholder claims. ANIC, while in rehabilitation, continues paying claims in full. Indeed, keeping ANIC 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 ANIC in rehabilitation requires continued payment of premium taxes. Unless this Court allows their suspension, payment of agent commissions will deplete ANIC's estate at the rate of almost $2.5 million per year. Draining ANIC of those funds when ANIC does not have sufficient funds to pay all policyholder claims in full substantially increases the risk of loss to ANIC's policyholders.

C. Further Efforts To Rehabilitate ANIC Would Be Futile.

The Rehabilitator has evaluated actuarial projections for the ANIC 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 ANIC 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 ANIC.

The Rehabilitator has also considered the rate increases which would be required to restore ANIC to solvency and whether such rate increases could be obtained. Because the premiums on ANIC's Oldco policies are insufficient to support the coverage they provide, rate increases totaling over 80% would be required for ANIC's policies to be economically viable. Moreover, aggregate rate increases of at least 16% would have to be obtained so promptly as to be effective by July 2010. There is no realistic likelihood of obtaining rate increases both of that magnitude and within that time frame.

In addition, imposing sudden increases of this magnitude on policyholders is not in the best interest of ANIC's policyholders. The average age of ANIC's Oldco policyholders is 74 Increasing premiums on such policyholders by more than 80% would impose a tremendous burden on them which cannot be justified given that guaranty association coverage will provide significant protection to ANIC's policyholders in liquidation.

CONCLUSION

For the foregoing reasons, the Rehabilitator respectfully requests that this Court enter the attached Order placing American Network 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 American Network Insurance Company by U.S. First-Class Mail as follows:

Emile G. Ilchuk
1069 Seventh Street
North Catasauqua, PA 18032-2214

Peter M. Ross
726 Bent Lane
Newark, DE 19711

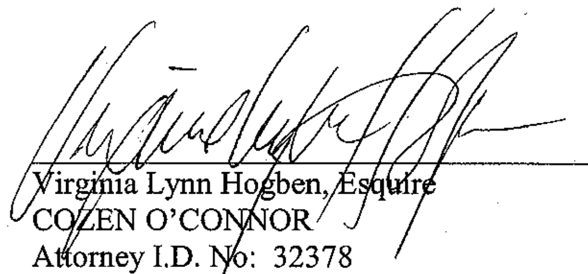
Eugene J. Woznicki
4629 Firestone Drive
Frisco, TX 75034

Cameron B. Waite
2055 Miller Rd.
Pennsburg, PA 18073

Stephen R. La Pierre
1636 N. Cedar Crest Boulevard
#107
Allentown, PA 18104

On this date, I also served a Notice of Filing of the Rehabilitator's Petition for Liquidation of American Network 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.



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