☐ EXPEDITE
☐ No Hearing Set
☑ Hearing is Set:
Date: August 26, 2011
Time:9:00 a.m.
Judge Carol Murphy

FILED
AUG 19 2011
SUPERIOR COURT
BETTY J. GOULD
THURSTON COUNTY CLERK

STATE OF WASHINGTON
THURSTON COUNTY SUPERIOR COURT

MIKE KREIDLER, INSURANCE COMMISSIONER, Petitioner, v. GREAT REPUBLIC LIFE INSURANCE COMPANY, a Domestic Insurer, Respondent	NO. 11-2-01494-8 VERIFIED PETITION OF THE INSURANCE COMMISSIONER FOR APPROVAL OF SALE OF GREAT REPUBLIC LIFE INSURANCE COMPANY AND PLAN OF REHABILITATION

I. INTRODUCTION

On July 7, 2011, this Court entered a Stipulated Order Commencing Rehabilitation Proceedings For The Purpose Of Selling a Domestic Insurer ("Rehabilitation Order"), placing Great Republic Life Insurance Company ("Great Republic") into rehabilitation proceedings pursuant to Chapters 48.31 and 48.99 RCW. The Receiver[1] by and through his attorneys of record, ROBERT M. MCKENNA, Attorney General, and MARTA U. DELEON,

[1] Throughout this petition, the term Receiver collectively refers to Mike Kreidler, Insurance Commissioner of the State of Washington and Statutory Receiver of Great Republic, James T. Odiorne, Deputy Insurance Commissioner and Court-appointed Receiver of Great Republic, and Marshall McGinnis and Ron Pastuch, court-appointed Deputy Receivers of Great Republic.

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Assistant Attorney General, respectfully files this Petition for Approval of Sale of Great Republic and Plan of Rehabilitation (the "Petition" or the "Plan").

The Receiver's first and foremost goal by law is to protect policy holders, and the proposed sale of all policies to United Security Assurance Company of Pennsylvania ("United Security"), a company with sufficient and stable capital to support the policyholders' contracts, would achieve that goal. As outlined below, the Plan calls for the approval of the sale of Great Republic's policies to United Security, to close on or before September 30, 2011. This will achieve a rehabilitation of the policies that will provide the best array of options and protection to the policyholders. To provide any potential claimants with an opportunity to object to this transaction, the Plan also calls for notice to all insureds and all potential creditors to file any non policy related claims with the Receiver on or before September 26, 2011. Finally, the Plan provides for a final hearing approving the Sale to be held on September 30, 2011.

II. OVERVIEW OF GREAT REPUBLIC

Great Republic Life Insurance Company ("Great Republic") was incorporated in 1965 as a stock life insurance company using the name Pacific Reserve Life Insurance Company. On January 1, 1968, the company name was changed to Great Republic Life Insurance Company. On March 17, 1978, Empire Insurance Agency, Inc. ("Empire"), a Washington corporation based in Seattle, acquired control of Great Republic. Empire owns all of Great Republic's common stock. Ms. Patricia Pritchett, former President of Great Republic, owns all of Empire's common stock. Great Republic remains a Washington domiciled stock life and disability insurance company.

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A. Financial Summary

Great Republic has been struggling financially for many years. Since 1998, the Office of the Insurance Commissioner ("OIC") has required Great Republic to file monthly financial reports in order to better monitor Great Republic's financial condition. As a Washington domiciled company, Great Republic has been grandfathered at a significantly lower capital and surplus requirement than the $4.8 million that is currently required for new Washington insurers. Immediately prior to being placed in receivership, Great Republic's Capital and Surplus totaled $268,792, well below the grandfathered $500,000.00 minimum required by RCW 48.05.340.

In addition, Great Republic has not sufficiently reserved for the cost of future claims under its policies. Great Republic does not have reinsurance for any of its life insurance policies. However, Great Republic does have reinsurance through United Security that covers its nursing home and long term home health care policies. Under these contracts, Great Republic cedes 50% of the risk on these policies to the reinsurer, reducing the reserves it would otherwise be required to keep. Even so, Great Republic's reserves have been declining for several years. Upon closer review of Great Republic's finances, it appears that the total assets of the company are insufficient to fully fund the policy reserves necessary to cover all claims.

In addition, Great Republic's condition is deteriorating. For the year preceding this receivership, Great Republic was losing approximately $100,000 per month. Great Republic's operating loss as of December 31, 2010 was 351% of the remaining surplus, well in excess of the percentages deemed hazardous in WAC 284-16-310(5) and (6). In fact, Great Republic has had a negative cash flow from operations in 2008, 2009, 2010, and to date in 2011. Although Great

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Republic has control of significant assets, when balanced against its claim liabilities and negative cash flow, it is apparent that Great Republic will become insolvent if its current expenses are not reduced and its reserves and capital are not improved. The Receiver has taken steps to reduce company expenses, including dismissal of several former employees. However, operational changes will not address Great Republic's more urgent need to correct its capital and surplus, and reserve deficiencies.

Insurers faced with declining reserves, negative cash flow, and inadequate capital and surplus have two principle methods for correcting these deficiencies: raising capital and raising premiums. Neither Great Republic nor Empire has been successful in raising the required capital; nor do they have sufficient assets to remedy Great Republic's financial deficiencies. Unfortunately, raising premiums alone does not guarantee sufficient income to fully fund the reserves. In this case, raising Great Republic's premiums is essential to not only restoring, but also to maintaining adequate reserves. However, when a company raises premiums, some policy holders will choose to let their coverage lapse. This is particularly true when a premium rate increase is substantial. While an insurer no longer has to reserve for a lapsed policy, the insurer also will no longer be receiving premiums. Therefore, large premium or rate increases are not likely to solve Great Republic's reserve and capitalization deficiencies. However, a sale of Great Republic's policies to an adequately capitalized insurer, coupled with an incremental premium rate increase, could cure Great Republic's deficiencies.

Fortunately, based on the Receiver's review of the books and records of Great Republic, it does not appear that there are any significant outstanding creditors whose legal interests will be impacted by a sale of the policies. Even so, the Receiver intends to provide notice to all known creditors of Great

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Republic, and publish notice for any unknown creditors, of the opportunity to file any and all claims against Great Republic, as part of these Rehabilitation Proceedings.

B. Overview Of Policies

Great Republic has a small group of life insurance policies. However, Great Republic's largest blocks of business are nursing home and long term home health care insurance. For most of Great Republic's nursing home and long term home health care policies, the policy holder pays a premium until the policy holder goes into claim status and begins receiving nursing home or long term home health care services. Policy holders are not required to pay premiums while in claim status, (i.e. while receiving benefits under their policies). Further, state laws and regulations limit an insurer's ability to unilaterally modify most of the policies offered by Great Republic.

Like other types of long term care policies, Great Republic's policies require continuously monitoring the premiums being paid by policy holders, against the company's obligations under the policies, to ensure reserves are adequate. This is especially important where the term of the contract is often years, if not decades after the initial premiums are set, and no further premiums are accrued while policy benefits are being paid. A review of Great Republic's rates, reserves, and policies, shows that most of Great Republic's long term care policies are significantly under priced. In other words, the premiums rates need to be raised in order to provide sufficient reserves to cover future claims.

The majority of Great Republic's policy holders are located in the State of Washington. Great Republic also has some remaining policies in Alaska, Arizona, Idaho, Nevada, Oregon, and Utah. Most of Great Republic's policy holders are seniors who would not qualify for life or long term care insurance if

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they were looking for policies today. Most of Great Republic's policy holders are retired and have relatively fixed incomes; therefore a sharp increase in premiums may pose a hardship on many of Great Republic's policy holders. However, losing the coverage that Great Republic's policies provide would likely be even more problematic as most of Great Republic's policy holders would not be able to find replacement coverage in the market today. A series of increases phased in over time would be in the best interests of Great Republic's policy holders, and the company. However, even if premiums were significantly increased, Great Republic would still have a statutory capital and surplus deficiency.

Based on the information the Receiver has reviewed, it is clear that unless Great Republic's policy premiums are realigned to the projected claims costs, and sold to a company with adequate capital and surplus, the company will have to be placed in liquidation, and the company's policies will be placed in the guaranty association.

III. SUMMARY OF PLAN AND SALE TRANSACTION

As mentioned above, Great Republic's premiums are insufficient to reasonably cover the costs of future claims against the policies. Therefore, a rate increase will be necessary regardless of whether the policies are sold or placed in the guaranty association. In addition, due to Great Republic's inability to replenish its deficient capital and surplus, it is imperative that the policies be placed with a properly capitalized company.

Under the proposed Rehabilitation Plan, United Security will acquire Great Republic's assets including the entire book of business, in exchange for United Security's assumption of all liabilities related to the policies. The purchase and assumption agreement proposed by United Security is contingent on regulator

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approval of the proposed rate increases developed by United Security, and approval of the acquisition by the OIC. The Receiver has reviewed the terms of the proposed Agreement, and has concluded that if the contingencies in the Agreement are satisfied, the terms provide more protection and flexibility to policy holders than they would receive if Great Republic were liquidated and its policies were assumed by the Washington Life and Disability Insurance Guaranty Association. Therefore, the Receiver's Plan, as detailed below, proposes the sale of Great Republic's policies to United Security, and adjustment of Great Republic's rates. While the Receiver does not believe there are any creditors with potential claims against Great Republic, the Plan provides notice and an opportunity to be heard to any creditors that may come forward.

A. The Purchaser

United Security, a Pennsylvania company, has been an authorized insurer since 1983. In 1997, it acquired 100% of the stock of Colonial American Life Insurance Company ("Colonial"), a Louisiana domiciled life insurance company. Colonial was later re-domesticated to Pennsylvania. In 2007, United Security's parent company, United Security Assurance, Inc., was acquired by CMS Financial Services Corp. United Security offers life, accident, and health insurance, including long term care, and long term home health care coverage. United Security is licensed to do business in Washington State.

Given the many years of experience United Security has in long term and long term home health care insurance, the Receiver is satisfied that the officers and directors of United Security have sufficient experience and expertise in these lines of insurance to ensure that the policies will be properly managed and administered. Even so, the OIC is reviewing the managing officers and directors of United Security to confirm that their significant experience in long term and

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long term home health care insurance is appropriate for Great Republic's policies. The sale is contingent on the OIC providing appropriate administrative approval of United Securities acquisition of these policies.

B. The Purchase And Assumption Agreement

Prior to being placed in receivership, Great Republic was negotiating a sale of its business to its reinsurer, United Security. On January 12, 2011, United Security and Empire entered into an option agreement that granted United Security the right to purchase Great Republic and to work with state regulators on behalf of Great Republic to correct the pricing and reserve deficiencies in Great Republic's policies. Pursuant to the option agreement between United Security and Great Republic, United Security closely reviewed all of Great Republic's financial information, particularly current premium rates and reserves, and developed a rate increase plan that would be necessary to bring the premium rates to a point where the current policies would break even for Great Republic.

Although United Security and Great Republic were not able to agree to the final terms of a sale prior to the appointment of the Receiver, United Security did sign a purchase and assumption agreement that outlined terms that would be acceptable, if approved by the Receiver and the Court. Although the agreement between United Security and Great Republic is labeled a purchase, there is no money being returned to Great Republic or Empire. Under the terms of the agreement, United Security will assume all policy liabilities. Policy liabilities are the gross liability and obligations of Great Republic, based upon or arising out of the policies, including, but not limited to, claims, losses, benefits, allocated loss adjustment expenses, guaranty association assessments, returns or refunds of premiums, and all taxes.

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In exchange for its assumption of all policy obligations, United Security will receive all the assets of Great Republic, including, but not limited to, all books, cash, securities, accounts receivable, all policies of insurance, and all rights and claims of Great Republic, but specifically excluding certificates of authority issued by any state authorizing Great Republic to transact insurance. Most importantly, all of the accounts and assets held as reserves or as capital and surplus will be transferred to United Security.

The assumption of these policies is contingent, however, on the approval by the OIC (and the insurance regulators of other states where Great Republic's policies are located) of the rate adjustments United Security has proposed on behalf of Great Republic. Because Great Republic's current rates have not been properly adjusted over time, the rates are significantly lower than are actuarially justified, and reasonably required in order to collect sufficient income to maintain the policies as an ongoing concern. However, the Receiver and United Security both realize if the rate increase that is necessary were to be implemented at once, it would likely push many policy holders to relinquish their policies. At the very least, a single large rate increase has the potential to cause a significant hardship on policy holders. Therefore, the proposed rate increases would occur incrementally over a period of five years.

Further, United Security's proposal would offer alternatives to all policy holders. United Security has agreed that all policy holders still in premium paying status, or who may return to premium paying status, will be offered a modification option that would eliminate the need for premium increases during the five year rate increase period. As a condition of approval of this Plan, United Security will be required to provide all policy holders with full disclosure of the rate increase, and modification options available to the policy holder under this

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plan, including the estimated annual rate increase for each of the five years under this Plan. This will provide policy holders with complete information concerning the financial impact of their decision.

Because of the state of Great Republic's records, it is apparent that the rates being charged to policy holders within a group do not always align with the policy forms. In some cases, the policy documents are actually missing. Although Great Republic's liabilities on these policies are not reflected in written contracts, United Security has agreed to honor the current practice regarding those policies as the actual terms of the policy.

The actuarial staff of the OIC have reviewed United Security's proposed rate plan. They agree that the rate plan proposed is reasonable, actuarially justified under RCW 48.18.110 and WAC 284-54-600 et. seq., will provide for adequate reserves, and is likely to reduce policy lapses and forfeitures. Moreover, spreading the rate increases out over five years is likely to help reduce the financial burden on policy holders who may be unable to afford a single large rate increase.

In all, the purchase and assumption agreement offered by United Security offers better options, and more protections to policy holders than would be possible if these policies are forced into liquidation. Particularly for policy holders with fixed incomes, and those who are unlikely to find or qualify for other coverage, the gradual rate increases will be less of an immediate burden, and may help reduce the forfeiture rate for these policies. In addition, these policies will be placed with a company that has significant experience and expertise in long term care insurance. This plan puts the policy holders' interests first. Although contingent on several factors beyond the Receiver's or this court's control, the contingencies outlined in this plan ensure that all policy

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holders, including those in other states, will be appropriately rated, so that appropriate reserves can be built and maintained for Great Republic's policyholders.

C. Notice To Potential Claimants

Because United Security is acquiring all assets, policies, and policy liabilities, Great Republic will have no real assets or business following the sale. To the best of the Receiver's knowledge, there are no outstanding claims, debts, judgments or liabilities owed by Great Republic that are not policy liabilities. Creditors and others that have ongoing business or contractual relationships with Great Republic have been notified of this receivership. Because this sale is part of Rehabilitation, notice to any potential creditors is not necessary under the law. However, the Receiver recognizes that the sale may, as a practical matter, impede recovery by any creditors with a claim against Great Republic. Therefore under the Plan, the Receiver will provide notice to all policy holders and potential creditors of the right to file any and all claims against Great Republic no later than September 26, 2011, and notifying them of the final hearing approving the sale on September 30, 2011, at 9:00 a.m.[2] This provides all known potential creditors with the opportunity to intervene, object to, or monitor this sale.

D. Future Business Plans for Great Republic

At or before closing, all of Great Republic's employees will have received a small severance payment pursuant to the employee manual. Two employees may become temporary employees or consultants for United Security.

After the closing, no additional payment or consideration will be made to Empire. Essentially, Great Republic will remain as a shell company. Therefore,

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[2] Although this hearing is not technically dispositive, this date has been reserved on the Court's calendar.

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once the sale is finalized, the Receiver intends to seek court approval of the surrender of all of Great Republic's certificates of authority to all issuing jurisdictions. Without policies or authority to act as an insurer, Great Republic's reserve and capital and surplus deficiencies will have been cured, and the reasons for this receivership will no longer exist. The remaining shell, and any claims that have been made by creditors, will be returned to the owners of Great Republic.

Although there will be no assets with which to pay creditors, the Plan does not prejudice the rights or likelihood of recovery for any creditors. The only viable alternative to this Plan is liquidation of the company. Without sufficient assets to cover reserves for its policyholders, and with the additional expenses of liquidating these policies, there would not be sufficient assets to pay all policyholders, let alone assets to pay any creditors with a lower priority than the policy holders. Even if there were a possibility of such funds being available, no moneys would be paid to any creditors until all policy liabilities are determined. Given the nature of Great Republic's policies, that would not likely occur for many years. Even then, moneys could only be paid after the Receiver reviews and approves (or denies) all claims by the entire class of claimants. The cost of this determination could easily exceed any small amount remaining in the receivership estate after payment of all policy claims. Most importantly, the Receiver's primary goal is protection and rehabilitation of these policies. While the Receiver must also consider other creditors, the interests of the policy holders are paramount. In liquidation, the policy holders could not have the policy modification options included in this plan. The likely result is a significant burden on the policy holders as they pay dramatically increased premiums. Given that there are no readily apparent potential creditors, the Receiver is

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confident that this Plan provides the best protection for policyholders, with the least detriment to other potential creditors.

IV. THE LEGAL STANDARD

The Insurance Commissioner as Receiver is obligated to "correct and remove the causes and conditions which made rehabilitation necessary and, if possible, to conserve and restore the company to a viable status for the benefit of the policyholders." *Kueckelhan v. Federal Old Line Ins. Co.,* 74 Wn.2d 304, 315-316, 444 P.2d 667, 674 (1968). The Receiver is afforded broad discretion in this endeavor, and the Court, in its supervisory and reviewing role, may not substitute its judgment for that of the Commissioner, and should only refuse to confirm the Receiver's actions if it is determined that he is manifestly abusing his authority and discretion or engaging in a capricious, untenable or unlawful course. In *Kueckelhan*, the Court noted:

> ...the legislature, [in enacting RCW 48.31.030(1)] in its wisdom, in its reliance upon the presumed expertise and experience of a duly elected and functioning state official, and in the public interest, vested the Commissioner with a realistic and effective control over the administration of the affairs and assets of an insurer found to be in need of rehabilitation. The authority so vested necessarily contemplates and embraces a considerable degree of independent administrative judgment and discretion to be exercised by the Commissioner if he is to carry out the responsibility and trust imposed upon him.

74 Wn.2d at 316. Moreover, the Court has determined that it should not substitute its own judgment in place of the Commissioner:

> The Commissioner holds his position as rehabilitator by force of legislative enactment, confirmed by court appointment. Consequently, the court's power of discretion, vis-à-vis the Insurance Commissioner, is curtailed by the Commissioner's statutory powers and the statutes governing the management of insurance companies and rehabilitation proceedings. (Citations omitted.)
>
> ...The court does not conduct the business of the seized company. This task is assigned by the legislature to the Insurance

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> Commissioner who acts to protect the general public, the policy holders and owners of the company, and the company itself.

Kueckelhan v. Federal Old Line Ins. Co. (Mutual), 69 Wn.2d 392, 406, 418 P.2d 443, 453 (1966).

V. CONCLUSION

The Receiver has reviewed the offer by United Security, and has determined that it is financially viable, and protective of policyholders. The current offer will achieve a rehabilitation of the policies, while providing flexibility and protection to policy holders. In light of the broad discretion of the Receiver, and absent any evidence that this discretion has been misused, the Plan is well within the discretion of the Receiver, and in the best interests of the policy holders, and Great Republic.

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VERIFICATION

I, James T. Odiorne, Court-appointed Receiver of Great Republic, am over 18 years of age and do solemnly declare and affirm that to the best of my knowledge and belief the facts recited in this Petition are true and correct.

DATED this 18th day of August, 2011.

James T. Odiorne,
Receiver for Great Republic

RESPECTFULLY SUBMITTED this 19th day of August, 2011.

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