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1 SHP 2020

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

In Re: Senior Health Insurance Company of Pennsylvania (in Rehabilitation)	**:** **:** **:**	**No. 1 SHP 2020**

AMENDMENT TO THE FORMAL COMMENTS OF THE MAINE SUPERINTENDENT OF INSURANCE, THE MASSACHUSETTS COMMISSIONER OF INSURANCE, AND THE WASHINGTON INSURANCE COMMISSIONER

In accordance with the Court's Order of October 27, 2020, the intervenors Superintendent of Insurance of the State of Maine, Commissioner of Insurance of the Commonwealth of Massachusetts, and Insurance Commissioner of the State of Washington (the "State Insurance Regulators") submit this amendment to their Formal Comments filed September 15, 2020 to address material issues first raised in the Amended Plan of Rehabilitation ("Amended Plan") filed by the Pennsylvania Insurance Commissioner as Rehabilitator ("Rehabilitator") of Senior Health Insurance Company of Pennsylvania ("SHIP") on October 21, 2020.

This amendment supplements the State Insurance Regulator's Formal Comments. The State Insurance Regulators continue to assert the comments and objections in their initial Formal Comments as comments and objections to the Amended Plan, as with one exception they apply to the Amended Plan.[1]

[1] The exception is that the Amended Plan has been amended to provide that assumed business will not be treated as direct business under the Plan consistent with the State Insurance Regulators' comment on that point. *See* Amended Plan at 92.

As an initial matter, the State Insurance Regulators note that the Amended Plan does not provide, and the Rehabilitator has not otherwise provided, the analyses on which the Rehabilitator relies to contend that the Amended Plan satisfies applicable standards and is reasonably likely to succeed. The Amended Plan merely asserts that the applicable standards have been satisfied. The Rehabilitator, as the proponent of the Amended Plan, has the burden of showing that the Plan satisfies the standards for approval. *See* 40 P.S. § 221.16(d).

The State Insurance Regulators requested the analyses and reports on which the Rehabilitator relies in their initial Formal Comments, in their October 13, 2020 application, and in their November 10, 2020 renewed application for an order directing the Rehabilitator to produce the analyses and reports. The State Insurance Regulators incorporate those filings by reference and reserve their rights to address the analyses and reports when provided.

I. THE AMENDED PLAN DOES NOT SHOW THAT IT COMPLIES WITH APPLICABLE STANDARDS.

A. Constitutional Standard. As noted in the Formal Comments, a rehabilitation plan must not place policyholders in a position worse than liquidation. *See* State Insurance Regulators' Formal Comments at 7-8. The Amended Plan recognizes the constitutional standard in a new section entitled "No Worse Than Liquidation," which states that the Plan "is designed to place

policyholders in no worse a position than they would face in a liquidation of SHIP." Amended Plan at 12. *See id.* at 96.

The Amended Plan does not show that it satisfies this constitutional standard. With respect to the standard, the Plan only states that:

> Option Two will provide at least the benefit value that the Guaranty Association would provide in liquidation for every policyholder whose current policy provides benefits in excess of those limits. . . . For policyholders with current benefits below Guaranty Association limits, Option Two will provide at least the current level of benefits.

Amended Plan at 12. *See id*. at 89. This attempt to demonstrate that the standard has been met is flawed in at least three ways.

First, it appears to disregard the benefits in excess of Guaranty Association limits to which policyholders are entitled. The Rehabilitator estimates that "more than 20% of the benefits to which SHIP policyholders are expected to be entitled under current policies would exceed the statutory limits of guaranty association coverage." Amended Plan at 89-90.

Second, it also appears not to consider the premium increases contemplated by the Amended Plan. Option Two will have two effects on policyholders: it will reduce the benefits and it will increase premiums. *See* Amended Plan at 12, 20. The "no worse than liquidation" section of the Amended Plan says nothing about how the policyholders would fare in a liquidation considering benefits and premiums together.

Third, it does not appear to compare results in rehabilitation with the appropriate uniform nationwide results that would obtain in a liquidation. A liquidator takes the policies as she finds them, determines applicable benefits, and applies a uniform distribution percentage to those benefits. Thus, in liquidation, all policyholders nationwide would receive the same distribution percentage, as the statute specifically prohibits subclasses within a priority class. 40 P.S. § 221.44. The Rehabilitator, however, intends to impose different burdens on policyholders in the different States. Under the Amended Plan, "[g]enerally, policyholders whose policies were issued in states that have approved comparatively more rate increases over preceding years will face lower premium increases or benefit reductions under the Plan." Amended Plan at 17. This is a result quite different from liquidation. The Amended Plan does not provide information about the different effects on policyholders of these two approaches.

The Rehabilitator asserts that there has been "extensive analysis and discussion" (Amended Plan at 99) on which she relies. The Court should direct that it be produced so that the intervenor State Insurance Regulators and the Court can understand the Rehabilitator's analysis of contractual impairments and comparison of the results of the Amended Plan and liquidation.

B. Feasibility of the Plan. The Rehabilitator acknowledges the feasibility (likelihood of success) standard in a new section entitled "Plan Projections" stating

that "the Rehabilitator believes that, depending on policyholder elections, Phase One of the Plan could greatly reduce, if not eliminate, the Funding Gap." Amended Plan at 17 (emphasis added). (That gap is now estimated at "more than $1 billion." *Id.* at 81.) The support for this assertion consists of "some hypothetical results that could be expected from operation of the Plan as proposed." *Id.* at 17. The Amended Plan describes four scenarios, the first of which reduces the Funding Gap by "less than 50%," the second by "a bit over half the deficit," the third by "between 75% . . . and 86%," and the fourth by between 93% and 100%. *Id.* at 18.

This is far from a showing that the Amended Plan is likely to succeed, even on its own terms. In light of the Amended Plan's proposed permanent conversion of the policyholder benefits reduced by the Amended Plan into "non-insurance general creditor indebtedness," a strong showing must be made that the Amended Plan is viable. (*See* Section III below for a fuller discussion of this issue.) Instead, the Amended Plan only offers four extreme scenarios, each assuming that 100% of at least one category of policyholders will select one option. Of the four projected results, at least the first two could not reasonably be termed "success" because they will only reduce the Funding Gap by half.

To make a showing that the Amended Plan is reasonably likely to succeed, the Plan properly must include projections based on reasonably likely scenarios.

The Rehabilitator, who is familiar with SHIP's business and policyholders, must have some expectation of how policyholders will react to the Amended Plan, what mix of options they are likely to choose, and thus the scenario or scenarios that are reasonably likely to emerge. In the absence of projections concerning such scenarios, there is no basis to conclude that the Plan is reasonably likely to succeed in addressing the Funding Gap. It is not sufficient to say that the Plan creates the "possibility" of greatly reducing the Company's deficit, Amended Plan at 17, especially where the Plan will subordinate and ultimately cut off policy benefits that otherwise could be the subject of a claim in liquidation. *See id.* at 86.

C. Fairness and Equity. The Amended Plan asserts that it is "fair and equitable." Amended Plan at 96. It contends that it "addresses historically discriminatory premium rates through asset allocations . . . and through the premium rate increase structure" and that it "treats similarly situated policyholders in the same way." *Id.* at 96, 97.

Whether the Amended Plan is fair and equitable depends in great part on the definition of "similarly situated" policyholders. As described above, in a liquidation, all policyholders are treated equally in that they would receive the same *pro rata* percentage of their contractual benefits as permitted by the available assets. It appears that the Rehabilitator defines "similarly situated" based on retrospective calculations of "If Knew" premiums against those actually paid.

The Rehabilitator's approach necessarily results in policyholders in different States receiving different benefit cuts and premium increases. Indeed, that is a specifically intended result of the Amended Plan, as the Rehabilitator has expressly chosen an approach to address what she refers to as a "subsidy problem." Amended Plan at 99. This "problem," however, is a predictable and apparent consequence of the individual state rate review regime applicable to SHIP and all other national insurers writing types of insurance that are subject to state rate approval. Under this long-standing, legislatively-established regime, policyholders in different States will inevitably pay different rates and incur different loss ratios for the same coverage. The Amended Plan seeks to "fix" this perceived problem by providing for premium increases and benefit cuts premised upon calculations of "If Knew" "should have been" charged premiums. *See id.* at 29, 90, 96-97, 99.

This is not equitable, as the policyholders who will bear the brunt of the Amended Plan were not responsible for the many factors that brought SHIP to its present insolvent condition. *See* Amended Plan at 82-83. The imposition of different, and much greater, rate increases and benefit cuts in some States than in others will deprive policyholders in the burdened State of contractual benefits at a greater percentage than those in other States. All policyholders, however, are entitled to receive as much as possible of their contractual benefits. It is not

equitable to deprive some more than others, especially where the greater burdens may cause those policyholders to drop coverage altogether.

II. THE "OPT-OUT" IN THE AMENDED PLAN DOES NOT CURE THE PLAN'S DISREGARD OF OTHER STATES' RATE REVIEW STATUTES.

In their Formal Comments, the State Insurance Regulators commented that the Plan improperly seeks to override individual States' regulatory authority over premium rates to be charged to their residents. State Insurance Regulators' Formal Comments at 15-18. The State Insurance Regulators objected that the Plan's attempt to avoid state rate review exceeds the authority granted to the Rehabilitator by the rehabilitation statutes, violates the insurance statutes of the various States, is unconstitutional, and is inconsistent with comity. *Id.* at 18-27.

The Rehabilitator attempts to address these issues in the Amended Plan by adding a new "Issue-State Rate Approval" provision under which the chief regulatory official in a State may "opt-out" of the Plan's rate determination process by "withdraw[ing]" all the policies issued in the State from the rate increase determination provisions of the Plan. Amended Plan at 101. The essentials of this proposed "opt out" are:

- The chief insurance regulator of a State may advise the Rehabilitator that "his or her state elects to 'opt-out' of the rate increase component" of the Plan, in which case the policyholders in the State will not have the Plan choices. (Absent such an "opt-out," the rates will be set under the Plan in disregard of the rate review statutes.)

- The Rehabilitator then files a rate increase application with the State insurance regulator at the "If Knew Premium" level.
- The application is deemed denied if not addressed within 60 days. If the regulator approves the rate increase in full, the State is treated as having not opted-out.
- If the application is denied or granted in part, then holders of policies issued in the State have specified options. These options will be worse than the Plan options in other States. The Amended Plan states this approach "would reduce or eliminate the requirement that other policyholders subsidize the opt-out policies and provides opt-out policyholders benefits at least equal to, and in many cases exceeding, what they would have received in liquidation."

Amended Plan at 102-103. By adding this "opt-out" option, the Amended Plan purports to address the problems presented by the Plan's attempt to supersede the rate review statutes of the individual States. However, an "opt-out" does not cure the Plan's flawed concept for at least two discrete reasons.

First, there is no statutory basis for an insurance regulator to "opt-out" of a rehabilitation plan on behalf of all policyholders in a State. The Issue-State Rate Approval amendment incorrectly assumes that a state insurance regulator is authorized to act on behalf of all the policyholders in his or her State to "opt-out" of Plan rate provisions. There is no basis for that assumption. The State Insurance Regulators have objected to the Amended Plan because it seeks to displace the individual State rate review statutes that, as chief State insurance regulators, they are charged with enforcing. They are responding to the Plan's attempt to override their legislatively-granted regulatory authority over the rates applicable to residents

of their States. They are not asserting this objection as some sort of agent for the policyholders in their States, and they do not have the authority to determine on behalf of policyholders whether or not to opt-out of Plan provisions.

Second, and more fundamentally, the Issue-State Rate Approval amendment does not provide for "opt-out" State insurance regulators to actually review rates under their statutes. Instead, it attempts to coerce those regulators to approve the rates sought by the Rehabilitator. Under the amendment, if the insurance regulators do anything other than approve the Rehabilitator's requested rates in full within 60 days, then the policyholders in the State will be treated worse than the policyholders in other States. *See* Amended Plan at 102-103. The Amended Plan seeks to present the appearance of deference to State rate review statutes while in fact requiring the States to approve the requested rates, in full, on pain of punishing policyholders in the State.

This nominal deference to state statutes does not cure the violations noted in the State Insurance Regulators' Formal Comments. The rehabilitation statutes do not authorize the Rehabilitator to override the rate statutes of other States. The Amended Plan still seeks to override those rate statutes by compelling a particular result – full approval of the rate increases sought under the Plan. The Full Faith and Credit Clause of the United States Constitution requires Pennsylvania to give full credit to the rate statutes that apply in other States. The Amended Plan does

not respect those statutes but instead seeks to use them to implement the Pennsylvania Rehabilitator's view of "proper" rates by compelling "opt-out" State regulators to implement the Plan's rate increases under their own statutes. Comity requires that Pennsylvania consider and acknowledge the statutes of sister States. The Amended Plan, however, seeks to coerce those States into abdicating their statutory rate setting function in favor of Pennsylvania's views as to what rates "should be."

In sum, the Amended Plan's Issue-State Approval provision continues the Plan's effort to override other States' rate approval laws, just in the guise of an "opt-out" that compels the same result – application of the rates sought by the Rehabilitator in full and notwithstanding their differential impact across States.

III. THE AMENDED PLAN'S RESTRUCTURING AND SUBORDINATION OF THE UNFUNDED BENEFIT LIABILITY PREJUDICES POLICYHOLDERS.

The Amended Plan includes a revised "Policy Restructuring" section that now provides that the "Unfunded Benefit Liability" ("UBL") that will result from the restructuring of SHIP's policies will not have policy status. It states that the unfunded policy benefits – "the amount by which the liabilities have been reduced, *i.e.*, the UBL" – will no longer be treated as a policy obligation. Amended Plan at 86. "[T]his liability will not be an insurance obligation arising under SHIP's

policies" and "will be converted into non-insurance general creditor indebtedness." *Id*.

This "non-insurance" treatment of policy obligations prejudices policyholders in two ways in the event SHIP is ultimately liquidated. First, it will deprive the policyholders of guaranty association coverage relating to the UBL. The Amended Plan acknowledges that the policy obligations converted to "non-insurance" liability "would not constitute a contractual obligation covered by the Guaranty Associations if SHIP were liquidated." Amended Plan at 86. Second, it will deprive the policyholders of distributions from the SHIP estate on the UBL. As a non-policy obligation, the UBL will not be entitled to Class (b) policy-related priority under the insurer liquidation priority statute, 40 P.S. § 221.44.

The conversion of policy liabilities into general liabilities will have significant effects if the Amended Plan does not succeed. If SHIP is placed in liquidation, then policyholders will be entitled to the applicable guaranty association coverage and distributions from assets based upon their claims. At present, the policyholders would be entitled to guaranty association coverage and policy-level priority distributions based upon their present contractual benefits, including the UBL. Under the Policy Restructuring provision, however, the policyholders would not be entitled to guaranty association coverage or policy-level priority distributions on the UBL if SHIP were liquidated post-Plan.

There is no benefit to policyholders in having the Plan reduce SHIP's policy obligations so that policyholders will be entitled to pursue only reduced benefits in a liquidation. The Amended Plan should be revised so that the UBL remains a policy obligation eligible for guaranty association coverage and Class (b) distributions in the event of a liquidation.

IV. THE ALLEGED RISK OF "TRUNCATING" POLICY BENEFITS IS NOT AN APPROPRIATE CONSIDERATION.

The Amended Plan contains a new section concerning "Liquidation Claims In Excess of Guaranty Association Limits." Amended Plan at 89-90. In it, the Rehabilitator attempts to justify the Amended Plan by referring to an alleged risk that benefits in excess of guaranty association coverage might be cut off in liquidation. To the extent it may exist, this risk does not properly support the Plan.

The Amended Plan estimates that "more than 20%" of the benefits to which SHIP policyholders are expected to be entitled would exceed the limits of guaranty association coverage. Amended Plan at 89-90. The Rehabilitator states that she believes that applicable law would authorize her to use SHIP assets to pay part of these "uncovered benefits" in the event of a liquidation but that "some members of the insurance industry hold the opposite view." *Id.* at 90. She then cites to an unspecified proceeding that has "so far prevented" the liquidator of Penn Treaty Network America Insurance Company and American Network Insurance Company from making such payments, and she expresses concern that placing SHIP in

liquidation might result in "truncating" policy benefits to the limits of guaranty association coverage. *Id.* at 90. The Rehabilitator later cites this concern as a reason to prefer the Plan to liquidation. *Id.* at 99.

The State Insurance Regulators are not aware of any reason that the existence of guaranty association coverage should somehow limit the policy benefits that can be claimed in a liquidation. Guaranty associations exist to protect policyholders by providing continuing coverage when an insurer becomes insolvent, subject to statutory limitations. *See* National Association of Insurance Commissioners, *Life and Health Insurance Guaranty Association Model Act ("LHIGA Model Act")*, § 2; *e.g.*, 40 P.S. § 991.1701. Generally, the guaranty associations pay policy benefits within their statutory limits and in turn have a policy-level claim in the liquidation for those amounts, on which they will receive the policy-level priority percentage distribution. *See LHIGA Model Act*, § 8(K)(1) and (2); *e.g.*, 40 P.S. 991.1706(l)(1) and (2).

If the policy benefits exceed the statutory limits on guaranty association coverage, then the policyholder has a policy-level priority claim in the liquidation for that excess, and will receive the policy-level distribution percentage on that allowed excess amount. *See, e.g.*, 40 P.S. § 221.44(b). It would be perverse to hold that the existence of limited guaranty association coverage cuts off the remaining benefits that the policyholders had purchased and to which they would

otherwise be entitled. No statute requires such a result. *See* 40 P.S. § 221.36(b)(4) (requiring equality of distribution between guaranty associations and policyholder-level creditors). If the Legislature intended such a draconian effect, it would have said so expressly.

The alleged risk of "truncation" is not a proper reason to support the Amended Plan. The Plan itself cuts off benefits by restructuring the policies and converting the UBL into "non-insurance" liability that will not be paid. Amended Plan at 86. It is not equitable to support the Plan's express adverse impacts on policyholders based on an asserted concern about a potential adverse effect, especially where that concern arises from a position asserted by others that is contrary to the purposes of the guaranty association system and that the Rehabilitator herself believes to be incorrect. Amended Plan at 90.[2]

V. THE ASSERTED REASONS TO PREFER THE PLAN TO LIQUIDATION DO NOT WITHSTAND SCRUTINY.

The Amended Plan includes a new section on "Alternatives to the Plan," including a section on "Liquidation" that presents five principal reasons the Rehabilitator claims make the Amended Plan preferable to liquidation. Amended

[2] *See* Liquidator's Application for Declaration Regarding Policyholder Claims for Non-GA Policy Benefits, *In re Penn Treaty Network America Ins. Co. in Liquidation*, No. 1 PEN 2009 (Penn. Commw. Ct. filed March 20, 2019); Liquidator's Reply Memorandum in Further Support of the Application for a Declaration Regarding Policyholder Claims for Non-GA Benefits, *In re Penn Treaty Network America Ins. Co. in Liquidation*, No. 1 PEN 2009 (Penn. Commw. Ct. filed May 22, 2019).

Plan at 99. The first two concern the possibility of choice. The Plan offers policyholders some choices among combinations of benefit reductions and premium increases. It also offers policyholders who are able and willing to pay the required premium increase to choose to preserve their current coverage. If the Plan put the policyholders in at least as good a position as liquidation, these could be reasonable considerations. However, it is at best uncertain and disputed at this point whether the Plan does treat policyholders as well as liquidation. *See* Section I.A above. The other three reasons are unsupportable.

First, the Rehabilitator states that the Amended Plan would "eliminate the historical premium rate inequities and subsidies prospectively so that all policyholders would pay comparable premiums for comparable coverages." Amended Plan at 99. This is a "key goal" of the Plan. *Id.* at 90. *See id.* at 29. However, as discussed in Section I.C above, this is another way of saying that the Plan will impose greater premium increases and benefit cuts on policyholders in some states than in others. This notion of equity is inconsistent with the equality of treatment that is required in liquidation, in which liabilities are fixed at the liquidation date and distributions on all policyholder claims must receive equal percentage distributions regardless of their state of origin. *See, e.g.*, 40 P.S. § 221.20(d) (liquidation order fixes the rights and liabilities of the insurer and its

policyholders at the date the petition for liquidation is filed); 40 P.S. § 221.44 (prohibiting subclasses within statutory priority classes).

The Rehabilitator's goal of correcting what she perceives as a historical inequity does not reflect any legislatively-enacted policy. It conflicts with the express statutory policy of liquidation statutes. In the circumstances, the actual public policy as articulated in statues should control.

Second, the Rehabilitator states that the Amended Plan would avoid the truncation of policy benefits to the applicable guaranty association limit. Amended Plan at 99. As discussed in Section IV above, this "truncation" is a risk based on a legal position with which the Rehabilitator disagrees, and it is not a proper basis on which to justify the adverse impacts of the Plan on policyholders, let alone to render their treatment under the Plan superior to their treatment in liquidation.

Third, the Rehabilitator contends that in liquidation premium increases sought by guaranty associations would inure to the benefit of insurers assessed to fund the associations, not for policyholder claims, while rate increases under the Amended Plan would be used to address policyholder claims. Amended Plan at 99. This ignores the fact that the guaranty associations pay for policy benefits from their own funds derived from assessments on insurers (to the extent there is a shortfall in the insurer's assets). *See LHIGA Model Act* § 9; *e.g.*, 40 P.S. § 991.1707. They bring this new money to the table to support policyholder

benefits (subject to statutory limitations) that otherwise would be paid only in part due to the insurer's insolvency. Where the guaranty associations provide additional resources to fund policy obligations, it is reasonable (and reflects the legislative judgment) for them to collect ongoing premiums. This does not mean that money that otherwise would go to policyholders is going to insurers.

CONCLUSION

For the foregoing reasons and those stated in the State Insurance Regulators' initial Formal Comments, the Rehabilitator has not shown that the Amended Plan satisfies applicable standards. It should accordingly be disapproved. In any event (1) the Rehabilitator should be directed to provide analyses and reports to the State Insurance Regulators, (2) the Plan should be modified to protect policyholders on waiver-of-premium status, and (3) the Plan should be modified to provide that the Rehabilitator must seek approval of rate changes in each State from the insurance regulator of the State in accordance with the State's laws.

November 30, 2020

Respectfully submitted,

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/s/ Stephen G. Harvey

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PROOF OF SERVICE

I, Stephen G. Harvey, hereby certify that on November 30, 2020, I served the foregoing Amendment to the Formal Comments of the Maine Superintendent of Insurance, the Massachusetts Commissioner of Insurance, and the Washington Insurance Commissioner on all parties appearing on the Master Service List.

/s/ Stephen G. Harvey

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