

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

JOEL S. ARIO,
Insurance Commissioner of the
Commonwealth of Pennsylvania,
in his official capacity as Liquidator
of Reliance Insurance Company,

Plaintiff,

v.

RELiance INSURANCE COMPANY,

Defendant.

No. 269 M.D. 2001

RECEIVED AND FILED
COMMONWEALTH COURT
OF PA (PHILA)
2010 MAR - 8 P 2:19

IN RE: *Commutation, Settlement Agreement and Release between
Reliance Insurance Company (In Liquidation) and
Monumental Life Insurance Company*

ORDER

AND NOW, this ___ day of _____ 2010, upon consideration of the
Liquidator's Petition for Approval of the Commutation, Settlement Agreement and Release
("Settlement Agreement") between Reliance Insurance Company ("Reliance" or "Estate")
and Monumental Life Insurance Company (the "Reinsurer") submitted by the Liquidator
of Reliance Insurance Company ("Liquidator"):

The Court ACCEPTS the Liquidator's representations that the Settlement Agreement is in the best interest of the Estate, as the Settlement Agreement allows the Liquidator to terminate and commute the Reinsurance Agreements and the Estate will receive an economic benefit amounting to \$10,000,000;

Further, the Court accepts the Liquidator's representations that the Settlement Agreement is a fair and reasonable settlement of the Reinsurer's obligations to the Estate under the Reinsurance Agreements, and that the payment contemplated under the Settlement Agreement constitutes fair and reasonable value to the Estate;

Accordingly, the Court accepts the Liquidator's representations and based thereon approves the Commutation, Settlement Agreement and Release attached hereto and marked as Sealed Exhibit A.

Further, counsel for the Liquidator is directed to serve a copy of this Order upon those listed on the Master Service List and file with the Court an affidavit that service has been effectuated.

BONNIE BRIGANCE LEADBETTER
President Judge

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Reliance Insurance Company (In Liquidation) and
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**Liquidator's Petition For Approval Of
Commutation, Settlement Agreement And Release**

Petitioner Joel S. Ario, Insurance Commissioner for the Commonwealth of Pennsylvania, in his capacity as Statutory Liquidator ("Liquidator") of Reliance Insurance Company ("Reliance" or "Estate"), respectfully requests that this Court enter an Order approving the Commutation, Settlement Agreement and Release ("Settlement Agreement") between Reliance and Monumental Life Insurance Company (the "Reinsurer"). In support of this Petition, the Liquidator avers the following:

1. On October 3, 2001, this Court found Reliance insolvent and appointed the Commissioner as Liquidator of Reliance pursuant to Article V of the Insurance Department Act of 1921, 40 P.S. §221.1 et seq. ("Act"). The Act confers broad powers on the Liquidator to

marshal the assets of Reliance in order to maximize the value of the insolvent insurer's estate for eventual distribution to its policyholders and creditors.

2. The Act authorizes the Liquidator to take such actions as deemed "necessary or expedient to . . . conserve or protect [the insolvent insurer's] assets or property[.]" including the power to "compromise" claims involving assets of the insolvent insurer in order to accomplish or aid in achieving the purposes of liquidation. See 40 P.S. §221.23(6, 9, and 23).

3. Two ways in which the Liquidator "compromises" claims and "conserves" assets are through settlement of litigation or commutation of reinsurance balances owed. A commutation is a settlement agreement reached between a reinsured and its reinsurer by which the reinsurance obligation is terminated through an agreement by the reinsurer to pay funds that are both due and not yet due under the reinsurance agreement.

4. The commutation and the Settlement Agreement arose during the course of an arbitration, filed by Reliance against the Reinsurer, that had already completed a week of evidentiary hearing on threshold issues that had already been submitted to the panel for deliberation, but before the panel had announced a decision. The arbitration concerned three agreements ("Reinsurance Agreements") between Reliance and the Reinsurer which are described later in this Petition.

5. The parties expended significant time and expense prosecuting and defending the arbitration. While neither party concedes liability, the final outcome of the arbitration was not certain. Reliance staff and its counsel analyzed the potential outcomes, costs and risks of proceeding with arbitration.

6. In a mutual effort to reduce legal expenses and bring finality to both the dispute that is the subject of the arbitration and the business relationship between them, the parties

negotiated the terms of a commutation and executed the Settlement Agreement. It was the opinion of Reliance staff and their counsel that that this Settlement Agreement represented the best interests of the estate. Reliance's objective is to settle and finalize the participation of the Reinsurer with Reliance in the reinsurance agreements listed in the Settlement Agreement attached to this Petition as Sealed Exhibit A.

7. In analyzing a commutation, Reliance staff takes several steps, including the following, to ensure that the commutation is fair and reasonable to the Estate and in the best interests of its policyholders, claimants and the general public:

- (a) Reliance staff develops a complete list of reinsurance agreements to be included in the commutation;
- (b) Reinsurance accounting specialists for Reliance verify balances and reconcile differences with the reinsurer;
- (c) The Reliance claims staff reviews ceded case reserves;
- (d) Actuaries for Reliance determine the projected ultimate loss, discounted and undiscounted, taking into consideration specific contract features such as reinstatement premiums, sliding scale rates, commission adjustments and/or loss corridors¹ as well as the impact of other applicable reinsurance and off-sets;
- (e) Reliance staff and the reinsurer exchange commutation proposals and discuss justifications;

¹ A loss corridor is a mechanism contained in certain reinsurance agreements that requires the ceding insurer to be responsible for a certain amount of the ultimate net loss that is above the company's designated retention and below the designated limit, and which would otherwise be reimbursed under the reinsurance agreement. A loss corridor is usually expressed as a loss ratio percentage of the reinsurer's earned premium, or a combined ratio if the reinsurance agreement provides for a ceding commission to the company. Loss corridors are employed to mitigate the volatility of reinsurance agreements.

(f) Reliance staff evaluate the commutation proposal based on nominal results, the discounted results, the volatility and trends of the business, disputed issues, costs of litigation and any administrative savings; and

(g) Reliance staff and the reinsurer secure any required approvals.

8. The Liquidator also has established a Commutation Working Group which performs accounting and data reconciliations, actuarial analyses, and claims reviews and analyses. The Commutation Working Group is largely comprised of several key senior management employees each of whom has over 20 years of insurance and reinsurance experience.

9. The Liquidator has established a Commutation Committee, consisting of the Chief Liquidation Officer, the Liquidation Team Reinsurance Manager and the Chief Actuary, who, along with the Vice-President for Commutations and the Executive Vice-President for Reinsurance, review all commutation proposals. Any commutation in excess of \$1,000,000 must be approved by the Commutation Committee and the approval was provided in this case.

10. In addition, Reliance's independent consulting actuaries, PricewaterhouseCoopers ("PwC"), have reviewed Reliance's commutation approach both generally and with respect to certain individual transactions and have concluded that the process Reliance utilizes to estimate liabilities ceded to reinsurers is reasonable for commutation purposes.

Reinsurer's Share of the Reinsurance Agreements

11. Effective July 1, 1997 to June 30, 1998, the Reinsurer entered into a Workers' Compensation Excess Cessions Treaty ("Cessions Treaty"). Pursuant to the terms and conditions of the Cessions Treaty, Credit General Insurance Company² ("Credit General"),

² Credit General Insurance Company is an unrelated insurer in liquidation in the state of Ohio.

Reliance and other companies were each directly reinsured by the Reinsurer with respect to their own business. The Cessions Treaty was renewed for the period effective July 1, 1998 to June 30, 1999. The Cessions Treaty covered workers' compensation policies issued by Reliance, but selected and priced by a program manager, which was an affiliate of Credit General. Under the Cessions Treaty the Reinsurer is obligated to reimburse Reliance for 20% of \$2,000,000 each occurrence in excess of a minimum of \$100,000 each occurrence. The maximum amount that Reliance can recover for all losses under the Cessions Treaty for all periods is unlimited.

12. Effective July 1, 1997 to June 30, 1998, the Reinsurer entered into a Workers' Compensation Aggregate Treaty ("Agg Treaty"). Pursuant to the terms and conditions of the Agg Treaty, Credit General, Reliance and other companies were each directly reinsured by the Reinsurer with respect to their own business. The Agg Treaty was renewed for the period effective July 1, 1998 to June 30, 1999. The Agg Treaty covered workers' compensation policies issued by Reliance, but selected and priced by a program manager, which was an affiliate of Credit General. Under the Agg Treaty the Reinsurer would reimburse Reliance for 20% of "US \$3,000,000 Each Declared Programme Separately each account year in the Aggregate EXCESS OF The Annual Aggregate Attachment point, being no less than 70% of the Normal Manual Premium, any one declaration." The maximum amount that Reliance can recover for all losses under the Agg Treaty for all periods is unlimited.

13. Effective July 1, 1997 to June 30, 1998, the Reinsurer entered into a Workers' Compensation Sunrise Treaty ("Sunrise Treaty") with Reliance. The Sunrise Treaty was renewed for the period effective July 1, 1998 to June 30, 1999. The Sunrise Treaty covered workers' compensation policies issued by Reliance, but selected and priced by a program manager, which was an affiliate of Credit General. Under the Sunrise Treaty, the Reinsurer is

obligated to reimburse Reliance for 100% of \$1,000,000 each occurrence in excess of a minimum of \$100,000 each occurrence. However, the Sunrise Treaty only covered occurrences first reported to Reliance after the deadline for reporting occurrences to the Cessions Treaty had passed. The maximum amount that Reliance can recover for all losses under the Sunrise Treaty for all periods is unlimited.

Reliance's Share of the Assumed Contracts

14. Separately, Reliance reinsured the Reinsurer under certain contracts hereinafter referred to collectively as the "Assumed Contracts". Under the Assumed Contracts, Reliance reinsured the Reinsurer for 10% of the amount of losses assumed by the Reinsurer from January 1, 1997 to December 31, 1998. This includes 10% of the losses ceded by Reliance to the Reinsurer under the Reinsurance Agreements. Hence, Reliance assumed back some of the losses it ceded to the Reinsurer.

Settlement Agreement

15. During the arbitration described in paragraph 4 above, Reliance negotiated with the Reinsurer to commute its obligations under the Reinsurance Agreements for an agreed amount of \$10,000,000, which is acceptable based upon the range of values established by the Reliance actuaries. Reliance and the Reinsurer entered into the Settlement Agreement effective December 23, 2009, subject to the approval of this Court. The Settlement Agreement settles with certainty the claims against the Reinsurer for losses under the Reinsurance Agreements described in this Petition.

16. Specifically, the Settlement Agreement provides that the Reinsurer shall pay Reliance \$10,000,000 ("Commutation Amount") to commute its obligations under the Reinsurance Agreements within 10 calendar days from when the Reinsurer is notified that this

Court has approved the Settlement Agreement. The Commutation Amount was negotiated with the Reinsurer, and the Liquidator has taken the necessary steps to determine, and has concluded, that the terms of the Settlement Agreement are fair and reasonable to the Estate and in the best interests of its policyholders, claimants and the general public. See 40 P.S. §§221.1(c), 221.23(9).

17. Based on the analysis of the terms of the Settlement Agreement, and the evaluation of the transaction as a whole by the Liquidator's staff and Reliance staff members familiar with the business dealings under the Reinsurance Agreements, the Liquidator has determined that payment of the Commutation Amount by the Reinsurer is a fair and reasonable commutation of the Reinsurer's obligations to Reliance under the Reinsurance Agreements. In the event the Court does not grant the approval sought in the Petition, the Settlement Agreement will become null and void and Reliance and the Reinsurer will continue their arbitration, which is currently suspended pending the approval by the Court of the Settlement Agreement.

18. Keith Kaplan, Executive Vice President for Reinsurance at Reliance, is responsible for all facets of ceded and assumed reinsurance at Reliance including accounting, billing, claims, commutations, coverage analysis, and dispute management. He has specific knowledge regarding the risks to the Estate of attempting to collect reinsurance through billing, negotiation or the dispute resolution process. As set forth in his Confidential Affidavit (attached as "Sealed Exhibit B"), Mr. Kaplan has identified several specific advantages to the Estate arising from the consummation of the transaction memorialized in the Settlement Agreement.

19. The Settlement Agreement will further achievement of the liquidation objectives under the Act. The commutation transaction will assist the Liquidator in marshalling and maximizing Reliance's immediately available assets while minimizing any unavoidable loss to

policyholders, claimants and creditors resulting from the Reliance insolvency. See 40 P.S. §221.1(c).

(a) First, the Settlement Agreement avoids the risk that the arbitration panel might award Reliance a lesser amount than it will receive under the Settlement Agreement as well as avoiding the costs associated with the additional hearings that were scheduled.

(b) Second, the Settlement Agreement converts current and future reinsurance obligations into immediate cash for the Estate. Specifically, the Estate receives a payment of \$10,000,000 which can be invested until it is distributed.

(c) Third, the Settlement Agreement eliminates both the internal and external administrative costs associated with continued reporting and collection efforts, including legal fees.

(d) Fourth, the Settlement Agreement eliminates any potential future credit risk associated with collection of the reinsurance proceeds in the event that the Reinsurer becomes insolvent.

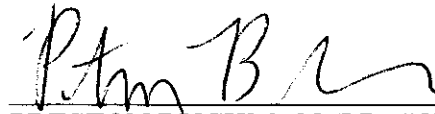
20. Under the terms of the Settlement Agreement, the Commutation will be fully consummated upon satisfaction of the following conditions:

- (a) approval of the transaction by this Court;
- (b) appropriate notice to the Reinsurer of Court approval, and
- (c) payment by the Reinsurer of \$10,000,000.

WHEREFORE, the Liquidator respectfully requests that this Court enter an Order in the form attached hereto:

- (a) Finding that the Settlement Agreement and Commutation Amount are in the best interest of the Estate;
- (b) Finding that the Settlement Agreement is a fair and reasonable settlement of the Reinsurer's obligations under the Reinsurance Agreements;
- (c) Finding the payment contemplated by the Settlement Agreement constitutes fair and reasonable value to the Estate; and
- (d) Approving the terms of the Settlement Agreement submitted as Sealed Exhibit A.

Respectfully submitted,



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Attorney for Plaintiff, Joel S. Ario, Insurance
Commissioner of the Commonwealth of
Pennsylvania, in his official capacity as Liquidator
of Reliance Insurance Company


Dated: March 8, 2010

VERIFICATION

I, David S. Brietling, Chief Liquidation Officer for Reliance Insurance Company, in liquidation, am authorized by Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania, pursuant to 40 P.S. §221.23, to act on his behalf in his capacity as the Statutory Liquidator of Reliance Insurance Company. I hereby verify that the facts set forth in the foregoing pleading are true and correct to the best of my knowledge, information and belief.

I understand that this Verification is made subject to the penalties of 18 P.S. §4904 relating to unsworn falsification to authorities.

Executed on March 8, 2010



DAVID S. BRIETLING

CERTIFICATE OF SERVICE

I, Marilyn K. Kincaid, hereby certify that on or about this day, pursuant to the Court's Order of December 12, 2008, service of the foregoing was made on the attached Master Service List through the transmission of a Notice of Filing and through posting of a true and correct copy in PDF file format on the Reliance Documents website at www.reliancedocuments.com.

Dated: March 8, 2010


MARILYN K. KINCAID

Master Service List

Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania

v.

Reliance Insurance Company

No. 269 M.D. 2001 (Commonwealth Court of Pennsylvania)

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Exhibit A

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

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v.

RELIANCE INSURANCE COMPANY,

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DOCKET NO. 269 MD 2001

IN RE: Commutation, Settlement Agreement and Release between
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SEALED EXHIBIT A TO THE PETITION FOR APPROVAL OF
COMMUTATION, SETTLEMENT AND RELEASE AGREEMENT

THIS ENVELOPE IS SEALED AND CONTAINS INFORMATION DESIGNATED
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THE COURT OR PURSUANT TO STIPULATION OF BOTH PARTIES TO THIS ACTION.

Exhibit B

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

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DOCKET NO. 269 MD 2001

IN RE: Commutation, Settlement Agreement and Release between
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**SEALED EXHIBIT B TO THE PETITION FOR APPROVAL OF
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