

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

M. Diane Koken,
Insurance Commissioner of the
Commonwealth of Pennsylvania,
Plaintiff

v.

Reliance Insurance Company,
Defendant

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: No. 269 M.D. 2001

IN RE: Liquidator's Petition to Approve Guidelines Regarding the Direct
Payment of Reinsurance Proceeds Pursuant to 40 P.S. §221.34

APR 26 3 51 PM '02
M.D. 269

ORDER

AND NOW, this 26th day of April 2002 consideration having been given to the Petition of M. Diane Koken in her capacity as Liquidator, Reliance Insurance Company, to approve guidelines regarding the direct payment of reinsurance proceeds pursuant to 40 P.S. §221.34 (hereinafter Guidelines) said Petition is **GRANTED** as set forth below; and, the Court directs that the Liquidator shall follow and abide by said Guidelines.

FURTHER, The Guidelines attached hereto and marked as "Exhibit A", are APPROVED and are incorporated herein. Further, a reinsurer of Reliance Insurance Company ("Reliance") will not be relieved of its obligation to pay all reinsurance proceeds, without diminution, to the Liquidator unless (1) the relevant reinsurance contract contains a direct

payment provision in compliance with the requirements of 40 P.S. § 221.34, as set forth in the Guidelines; (2) the reinsurer or insured seeks in writing and obtains the written approval of the Court and the Liquidator before the reinsurer makes a direct payment to the insured; and (3) in considering any written request to pay reinsurance directly to an insured, the Liquidator shall apply the requirements of 40 P.S. § 221.34, as reflected in the Guidelines.

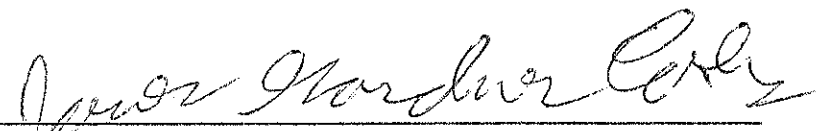
IT IS further **ORDERED** that, as a necessary condition precedent to any direct payment by a reinsurer to any Reliance insured, the reinsurer shall provide to the Liquidator a signed document evidencing (1) that the reinsurer has unequivocally undertaken a direct coverage obligation to the insured; and (2) the insured's informed consent to the reinsurer's direct coverage of the insured. Such documents shall be in a form substantially similar to Exhibits B and C to this Order, which are made a part hereof.

IT IS further **ORDERED** that, as a necessary condition precedent to any direct payment by a reinsurer to any Reliance insured, the Liquidator shall provide to the Court, for the Court's approval, a signed document evidencing (1) that the reinsurer has unequivocally undertaken a direct coverage obligation to the insured; and (2) the insured's informed consent to the reinsurer's direct coverage of the insured. Such documents shall be in a form substantially similar to Exhibits B and C to this Order, which are made a part hereof.

IT IS further **ORDERED**, pursuant to 40 P.S. §§ 221.4 and 221.5, that this Court shall retain sole and exclusive jurisdiction over, inter alia, the assets of the Reliance estate, including matters related to the direct

payment of reinsurance to Reliance insureds by Reliance's reinsurers given that said payments reduce the assets of Reliance available for distribution to all policyholders. Such sole and exclusive jurisdiction shall include any claim of injury as a result of the Liquidator's application of the Guidelines and review of the Liquidator's determination of any specific request for approval of direct payment of reinsurance proceeds under 40 P.S. § 221.34.

FURTHER, the Liquidator, through her counsel, is hereby directed to serve a copy of this order, forthwith, upon all parties listed on the master service list via U.S. mail and, where designated, fax and/or e-mail. The Liquidator, through her counsel, is directed to file with the court in the Office of the Prothonotary, 9th Floor the Widener Building, 1339 Chestnut Street, Philadelphia, PA 19107, by **3:00 p.m. April 30, 2002** an affidavit, that service, as outlined above, has been effectuated.



JAMES GARDNER COLINS, President Judge

Exhibit "A"

GUIDELINES FOR ENFORCEMENT OF 40 P.S. § 221.34

Pursuant to her authority under the Insurance Department Act of 1921, 40 P.S. § 221.1 et seq. (the "Act"), M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania, in her capacity as Liquidator ("Liquidator") of Reliance Insurance Company ("Reliance"), hereby promulgates the following Guidelines for the Enforcement of 40 P.S. § 221.34 ("Guidelines").

1. Section 221.34 of the Act, 40 P.S. § 221.34, provides:

The amount recoverable by the liquidator from reinsurers shall not be reduced as a result of delinquency proceedings, regardless of any provision in the reinsurance contract or other agreement. Payment made directly to an insured or other creditor shall not diminish the reinsurer's obligation to the insurer's estate except when the reinsurance contract provided for direct coverage of an individual named insured and the payment was made in discharge of that obligation.

Section 221.34 is applicable to all reinsurance contracts, treaties and certificates to which Reliance is presently a party.

2. All reinsurers of Reliance, which is an insurer subject to the Act, shall be obligated to remit all reinsurance proceeds to the Liquidator, without diminution, regardless of any provision in the reinsurance contract between Reliance and the reinsurer or otherwise, except as specifically provided below.

3. Where a binding written contract document creating the reinsurance relationship between Reliance and a reinsurer contains a provision relating to the direct payment of the claims of an insured by the reinsurer, and the reinsurer or insured desires that such direct payment be made by the reinsurer, the reinsurer or insured must first submit a written request to the Liquidator seeking approval of direct payment by the reinsurer.

4. In reviewing the written request, the Liquidator, or her designee, shall determine whether the following requirements are satisfied before approving the request:

a. The reinsurance contract must specifically provide for payment to an individual named insured and that insured must be identified with particularity either by name or policy number in the reinsurance contract;

b. The reinsurance contract must provide for a direct coverage obligation by the reinsurer to the insured and the payment must be made in satisfaction of that coverage obligation. The term "direct coverage" in §221.34 refers to the creation of rights in the insured to look to the reinsurer directly to satisfy coverage obligations in place of and in substitution for any obligations of Reliance to the insured and on such terms as are set forth in the policy of insurance between Reliance and the insured. The magnitude and scope of the reinsurer's direct coverage obligation to the insured shall be governed by the language of the reinsurance contract and determined by the Liquidator in considering the direct payment request, the statute and the language of the relevant reinsurance contract;

c. The payment made in "discharge" of the reinsurer's direct coverage obligation must release the insolvent insurer's estate from all liability to the insured for claims covered by the reinsurer's direct coverage obligation to the insured;

d. The reinsurer and insured seeking to utilize the direct payment provision must further comply with all other relevant contractual provisions and obligations not in conflict with Pennsylvania law, and which affect the existence or creation of a direct coverage obligation or the release of the insolvent insurer for claims covered by the reinsurer's direct coverage obligations; and,

e. Consistent with the Liquidator's obligation to protect the interests and maximize the assets of the insolvent insurer's estate, the reinsurer must (1) obtain the named insured's informed consent to the direct coverage relationship, which is in substitution for the relationship between the insured and the insolvent insurer; (2) provide evidence, in a form substantially similar to the form approved by the Court, that the reinsurer has unequivocally assumed a direct coverage obligation to the insured, that the reinsurer has complied with any other contractual provision regarding the direct payment or assumption and the reinsurer has disclosed to the insured certain consequences of consenting to the direct coverage relationship with the reinsurer, including, if applicable, the lack of guaranty association coverage in the event the reinsurer becomes insolvent and the fact that consent to direct payment from the reinsurer is a release of all

claims of the insured against the estate of Reliance relating to coverage assumed by the reinsurer; and (3) provide evidence of the insured's informed consent to the direct coverage relationship by furnishing a written consent of the named insured in a form substantially similar to the form approved by the Court. The insured or reinsurer may obtain the Court-approved forms satisfying these requirements upon request.

5. Where the reinsurance contract complies with the requirements of §221.34, as reflected in these Guidelines, and the requirements of the reinsurance contract itself are also complied with, and the reinsurer commits in writing to undertake a direct coverage obligation to the insured, in a form substantially similar to the form approved by the Court, and the insured's informed consent has been obtained by the Liquidator, the Liquidator shall submit this documentation to the Court along with the Liquidator's recommendation for approval, and the Court will respond to the Liquidator's recommendation within twenty (20) days of the date of submission, thereafter, the Liquidator will respond to the written request to approve direct payment by notifying the reinsurer and the named insured in writing that the direct payment provision is valid under Pennsylvania law and the reinsurer may, by complying with the terms of the reinsurance contract, make direct payment to the insured without incurring double liability to the Liquidator.

6. The Liquidator will further notify the reinsurer and the insured that the direct coverage relationship may be subject to regulation by the applicable state regulator in one or more states, *e.g.*, the state in which the insured resides or the state(s) in which the reinsurer seeks to pay claims directly, and that it is the reinsurer's obligation to comply with all such regulatory requirements.

7. Where the language of the reinsurance contract fails to satisfy the requirements of § 221.34 as set forth in these Guidelines or the reinsurer refuses to assume a direct coverage obligation to the insured or the reinsurer fails to obtain the insured's informed consent, the Liquidator will notify the reinsurer and the insured that the direct payment request has been denied and that direct payment of reinsurance proceeds to the insured by the reinsurer is not recognized by the Liquidator as discharging the reinsurer's obligation to pay all reinsurance proceeds to the Liquidator. The Liquidator will further notify the reinsurer and insured that any such payments are made at the reinsurer's peril and will not relieve the reinsurer of the obligation to pay the full reinsurance to the Liquidator. An insurer or reinsurer may file objections to the Liquidator's denial of a direct payment request within thirty (30) days of receipt of the notice of denial of a direct payment request, said

filing shall be made with the Court, in the Office of the Chief Clerk, 9th floor
the Widener Building, 1339 Chestnut Street, Philadelphia, PA, 19107.