

**IN THE CIRCUIT COURT OF COLE COUNTY
STATE OF MISSOURI**

JOHN M. HUFF, DIRECTOR)
DEPARTMENT OF INSURANCE, FINANCIAL)
INSTITUTIONS AND PROFESSIONAL)
REGISTRATION OF THE STATE OF MISSOURI.)

Plaintiff,)

v.)

NATIONAL STATES INSURANCE COMPANY)

Defendant.)

Case No.: 10AC-CC00219

**MOTION FOR APPROVAL OF ASSUMPTION REINSURANCE
AGREEMENT AND REFORMATION OF PRODUCER AGREEMENTS**

COMES NOW John M. Huff, Director of the Missouri Department of Insurance, Financial Institutions & Professional Registration, in his capacity as Rehabilitator (“Rehabilitator”) of National States Insurance Company (“National States”), and respectfully requests that this Court enter an Order approving the Assumption and Indemnity Reinsurance Agreement (the “Assumption Agreement”), attached hereto as Exhibit A, between National States and North American Insurance Company (“North American”) and Oxford Life Insurance Company (“Oxford Life) (unless otherwise indicated, North American and Oxford Life shall be referred to collectively herein as the “Reinsurer”), and reforming the Producer Agreements between National States and the Producers who produced the Company’s Medicare Supplement insurance business. In support of this Motion, the Rehabilitator states the following:

BACKGROUND

1. On April 1, 2010, this Court granted plaintiff’s Petition for Rehabilitation, and appointed John M. Huff, the Director of the Missouri Department of Insurance, as Rehabilitator of National States.

2. After entry of the Judgment of Rehabilitation on April 1, 2010, the Rehabilitator appointed Bruce Baty to be the Special Deputy Receiver (“SDR”) for National States.

3. Under the Insurers Supervision, Rehabilitation and Liquidation Act, Mo. Rev. Stat. §§ 375.1150 *et seq.*, the Rehabilitator “may take such action as he deems necessary or appropriate to reform and revitalize the insurer.” Mo. Rev. Stat. § 375.1168.2.

4. The SDR, *inter alia*, considered the sale of what appeared to be the profitable books of business of National States, including the Medicare Supplement (“Med Supp”) block.

5. The SDR solicited offers to purchase the Med Supp block.

6. The SDR engaged Wakely Actuarial Services to complete an independent valuation of the Med Supp block and to assist in negotiating with potential bidders.

7. The SDR contacted approximately thirty insurance companies actively writing Med Supp insurance policies with financial profiles that would be acceptable to the Rehabilitator, to determine whether they would be interested in acquiring National States’ Med Supp business. As a result of those efforts, eleven companies executed non-disclosure agreements and were given access to a special extranet site to review the particulars of the Med Supp business. In July 2010, four of those companies -- including the Reinsurer -- submitted bids for the Med Supp block. The SDR determined that the preliminary bid submitted by the Reinsurer was superior to those of the other three bids, in terms of financial strength of the insurer, plans for the business and the ceding commission to be paid to the National States’ estate.

8. The bid submitted by the Reinsurer involves two of its affiliated life, accident & health insurance companies, North American and Oxford Life, with certain policies issued in

states where North American is licensed being assumed by North American, and certain policies issued in states where Oxford Life is licensed being assumed by Oxford Life.

9. For the reasons set forth below and based upon the recommendations he has received from his professional advisors, the Rehabilitator has determined that the Assumption Agreement proposed herein is in the best interests of National States, its policyholders and creditors.

SUMMARY OF THE TERMS OF THE ASSUMPTION AGREEMENT

10. The Assumption Agreement, *inter alia*, provides:

a. The transfer and assignment by novation to North American all of National States' right, title and interest in the Policies, as defined in the Assumption Agreement, issued in the states of Colorado, Illinois, Indiana, Louisiana, Maryland, Missouri, North Dakota, Minnesota, New Mexico, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Texas and Wisconsin;

b. The transfer and assignment by novation to Oxford Life all of National States' right, title and interest in the Policies, as defined in the Assumption Agreement, issued in the states of Arkansas, Arizona, Florida, Georgia, Iowa, Idaho, Kentucky, Mississippi, Montana, Nebraska, North Carolina, Nevada, South Dakota, Tennessee, Utah, Virginia, Washington and West Virginia;

c. On the Effective Date, which is September 1, 2010, the Company shall cede to the Reinsurer, and the Reinsurer shall assume from the Company on an indemnity reinsurance basis, 100% of the Policy Liabilities under all Policies which the Reinsurer has not for any reason (including the lack of any required approval or consent of a Covered Person) as of the Effective Date assumed by novation;

d. As soon as practicable after the Effective Date, the Company and the Reinsurer agree to work in a cooperative manner to effect the assumption of the Policies;

e. The Reinsurer will provide Policyholder Materials, as defined in the Assumption Agreement, to every Covered Person;

f. The Policies shall not be recaptured;

g. The Purchase Price shall be Two Million Five Hundred Thousand Dollars (\$2,500,000.00) and shall be credited to the Company as a reduction in the Settlement Amount;

h. The Settlement Amount shall equal (a) (i) the Statutory Reserves and Liabilities as of Effective Date, less (ii) the Purchase Price, less (iii) any Producer Payments paid during the period from the Effective Date to the Closing Date relating to premiums collected after the Effective Date, less (iv) the Interim Expense Fee, plus (v) the Net Cash Flow; plus (b) interest on (a) at the rate of five percent (5.00%) per annum from the Effective Date through the Closing;

i. The claim reserves will be reviewed as of January 31, 2011, or such other date as the Parties may mutually agree, at which time, if the claim reserves as of the Effective Date are found to be redundant, then the Reinsurer will pay the difference to the Company as the "Final Settlement," which shall be paid no later than thirty (30) days following the Final Settlement Date. This Final Settlement shall include interest on such amount at the rate of five percent (5.00%) per annum from the Closing Date until the amount is paid;

j. National States will provide Transition Services pursuant to the Administrative Services Agreement, attached as Exhibit A to the Assumption Agreement,

from and after the Effective Date until, at the latest, December 31, 2010. From the Effective Date of the Assumption Agreement until the Transition Date, the Reinsurer will pay Administrator an interim expense fee equal to 3% of premiums received on the Policies and 3.5% of claims incurred and paid on and after the Effective Date. The Rehabilitator and the parties believe that this fee constitutes fair and reasonable compensation to National States for the work it will perform under the Service Agreement; and

k. National States shall petition the Court for reformation of the Producer Agreements, to reduce Producer Commission Rates by twenty-five percent (25%) on all premiums collected on the Policies after the Effective Date.

11. The terms of the Assumption Agreement, including the Purchase Price and Settlement Amount were carefully analyzed and negotiated by the SDR and the parties, along with their respective outside consulting actuaries. The Rehabilitator and the parties believe that the Assumption Agreement, including the Purchase Price and Settlement Amount, in combination with the Reformation of Producer Agreements, represents a reasonable and good faith compromise of the reserve valuation, which is in the best interest of the parties, the policyholders and National States' creditors.

12. In addition, the Assumption Agreement contemplates the possibility of an increase or decrease in the above payment to the Reinsurer based on certain amounts collected and/or disbursed by National States as servicing agent for the Reinsurer during the interim period between the Effective Date and the Closing Date.

13. Pursuant to the Assumption Agreement, National States' obligations and liabilities under the Policies would terminate and end as of the Effective Date, and the Reinsurer would assume all of National States' obligations and liabilities as of the Effective Date.

14. The Assumption Agreement also contains a "cut-through" clause, which provides in part that upon entry of an order of liquidation, all Non-Novated Policies would be assumed by the Reinsurer on a direct basis, any indemnity reinsurance of such Non-Novated Policies and related liabilities thereunder by the Reinsurer shall cease, and all Policy Liabilities of National States under the Non-Novated Policies would be fully and completely discharged.

15. As noted above, the Assumption Agreement provides that the reserves supporting the business are to be transferred from the Company to the Reinsurer at closing. Although estate assets are being used to fund this transaction, the Rehabilitator believes that the net effect on remaining policyholders and other creditors will be minimal insofar as liabilities for Med Supp policies and the expenses of administration will be eliminated and in return the estate will receive a positive ceding commission.

REFORMATION OF PRODUCER AGREEMENTS

16. Shortly after assuming control of National States in April, it became apparent to the Rehabilitator that the Med Supp block was creating a surplus strain on the company. As of June 30, 2010, claim reserves for this business had to be increased by almost \$4 million, with further strengthening required as of September 1, 2010. Much of the strain can be attributed to the increased volume of business written in the last quarter of 2009 and the first quarter of 2010, but some of that strain is directly attributed to what appears to be higher-than-market producer commission rates set forth in the Producer Agreements that National States entered into with the insurance agents who produced the Med Supp business ("Producer Agreements").

17. The Producers who produced the Med Supp business for National States were paid a variety of commission rates, depending largely on the particular product sold and the state of issue. Generally, however, the rates averaged approximately 25% of premium for the first six years of the life of a policy, and 10% thereafter. The specific commission rates are set forth in Exhibit B, attached hereto. These commission rates generally are at or above the commission rates paid by other insurance companies for the same products in the same jurisdictions. *See* Examples of Commission Rates, Exhibit C.

18. Missouri law directs that the Rehabilitator “may take such action as he deems necessary or appropriate to reform and revitalize the insurer.” Mo. Rev. Stat. § 375.1168.2. Recently enacted statutes make it clear that even before the formal entry of a rehabilitation order, the Director of Insurance may require an insurer to “[r]educe general insurance and commission expenses by specified methods,” if the continued operation of that insurer might “be hazardous to its policyholders, creditors, or the general public.” Mo. Rev. Stat. § 375.539.4.

19. Here, the Rehabilitator, his staff and advisors, and the Reinsurer believe that reformation of the Producer Agreements to reduce the commission rates by 25% contributes to the profitability of the Med Supp block, permits the business to be sold to a solvent insurer and ultimately protects the Producers’ ability to collect commissions on this business now and in the future. All in all, reformation is in the best interest of National States, its policyholders and its creditors, including the Producers who will be affected by such reformation.

20. With the Court’s approval of reformation of the Producer Agreements, Producers will receive 75% of the original Producer commission rates. The Reinsurer will pay the commissions at the reformed rate from and after the Effective Date.

21. The reformed commission rates are within or above rates paid by other companies in the jurisdictions in which these Policies are in-force.

22. If the Assumption Agreement and reduction in commission rates are not approved by the Court, then the Med Supp block will remain with National States.

23. If National States is ordered into liquidation, then payments of Producer commissions would cease immediately, and the Producers would be left with a general creditor claim against an insolvent National States estate.

24. Due to the financial condition of the Company, it is questionable whether these Producers would receive any of their Producer commissions in a liquidation scenario.

25. All of the Producers affected by this proposed reformation have received or will receive notice of this Motion and will be afforded an opportunity to be heard on the Motion.

**THE ASSUMPTION AND INDEMNITY REINSURANCE AGREEMENT IS IN THE
BEST INTERESTS OF NATIONAL STATES**

26. Based upon the analysis of the terms of the Assumption Agreement, and the evaluation of the transactions as a whole by the Rehabilitator's staff and advisors, the Rehabilitator believes that the Assumption Agreement is fair and reasonable to National States, its policyholders and creditors. There are several specific advantages to National States, its policyholders and creditors arising from the consummation of the transactions contemplated by the Agreement:

a. The Med Supp block of business to be transferred pursuant to the Assumption Agreement consists of approximately 33,000 policies in 33 states.

b. North American and Oxford Life, collectively, are licensed in all states in which Policies are in-force, and pursuant to the Assumption Agreement, the Reinsurer will coinsure all policies effective September 1, 2010, and assume all policies as soon as

practicable, or on the date upon which an Order of Liquidation is entered, whichever occurs first.

c. Pursuant to the Assumption Agreement, the Reinsurer will enter into an Administrative Services Agreement with National States for a Transition Period.

d. The time and expense required for continuing to service and support the Policies would consume valuable resources and assets of National States - resources and assets that could otherwise be used to benefit National States, its policyholders and creditors. With the Court's approval of the Assumption Agreement, the Rehabilitator would be able to eliminate this administrative burden and expense.

e. Pursuant to the Assumption Agreement, the Reinsurer would become liable for agent commissions for the Med Supp block.

f. The Assumption Agreement would provide a further economic benefit to National States by conveying a ceding commission to the estate of National States, in the amount of \$2.5 million.

g. National States would receive fair and reasonable compensation for the Transition Services contemplated by the Assumption Agreement and Administrative Services Agreement.

27. As the Assumption Agreement would enable the Rehabilitator to preserve, protect and otherwise enhance the assets of National States, it is believed, and therefore averred, that the Agreement is in the best interests of National States.

WHEREFORE, the Rehabilitator respectfully request the entry of an Order, in the form submitted herewith:

1. Approving the Assumption and Indemnity Reinsurance Agreement and the Administrative Services Agreement, and the closing and implementation of the transactions contemplated thereby;

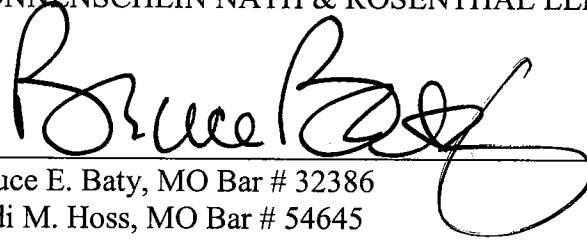
2. Reforming the Producer Agreements to reduce Producer commission rates by twenty-five percent (25%);

3. Ordering that upon the entry of an order of liquidation against National States, the cut-through clause in the Assumption Agreement will operate to transfer the Policies to the Reinsurer by novation, such that the Reinsurer shall become directly liable to the policyholders and National States will be fully and completely discharged from any and all obligations under the Policies; and

4. Affirming and approving in all respects the conduct and actions of the Rehabilitator, his SDR, employees, agents and counsel in connection with the Assumption Agreement and reformation of the Producer Agreements.

Respectfully submitted,

SONNENSCHN NATH & ROSENTHAL LLP

A handwritten signature in black ink, appearing to read "Bruce Baty", written over a horizontal line.

Bruce E. Baty, MO Bar # 32386

Jodi M. Hoss, MO Bar # 54645

Adam T. Pankratz, MO Bar # 61285

SONNENSCHN NATH & ROSENTHAL LLP

4520 Main Street, Suite 1100

Kansas City, MO 64111

(816) 460-2400 telephone

(816) 531-7545 fax

bbaty@sonnenschein.com

jhoss@sonnenschein.com

apankratz@sonnenschein.com

Attorneys for the Rehabilitator

CERTIFICATE OF SERVICE

I hereby certify that the foregoing was filed via facsimile and Federal Express with the Clerk of Court on the 28th day of September, 2010, and

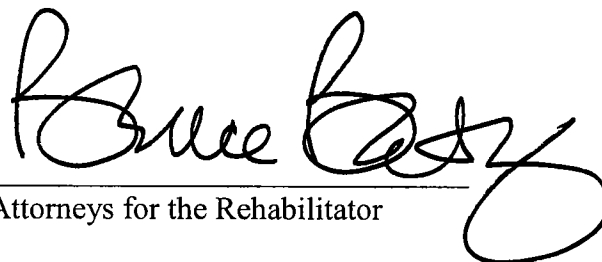
by United States postal service upon:

Diane Garber
Receivership Counsel
Missouri Department of Insurance
Financial Institutions and Professional Registration
P.O. Box 690
Jefferson City, MO 65102
Diane.Garber@insurance.mo.gov

and

as set forth in this Court's Order Prescribing Notice Requirement upon:

The Producers Listed on Exhibit D


Attorneys for the Rehabilitator