

FILED
05-23-2023
CIRCUIT COURT
DANE COUNTY, WI
2023CV001310
Honorable Stephen E
Ehlke
Branch 15

STATE OF WISCONSIN : CIRCUIT COURT : DANE COUNTY

In the Matter of the Rehabilitation of:

Wisconsin Reinsurance Corporation and 1st Auto &
Casualty Insurance Company

Case No.
Case Code: 30703

**NOTICE OF VERIFIED PETITION AND
VERIFIED PETITION FOR ORDER FOR REHABILITATION**

TO: All Interested Parties

NOTICE

PLEASE TAKE NOTICE that the Petitioner, Nathan Houdek, Commissioner of Insurance of the State of Wisconsin (the “Commissioner”), brings this Verified Petition for Order for Rehabilitation (the “Verified Petition”) before the Circuit Court of Dane County, the Hon. Stephen Ehlke, for hearing in the Dane County Courthouse, 215 South Hamilton Street, Madison, WI 53703-3285 on a date and at a time to be set by the Court. Written objections to the Verified Petition and the proposed Order for Rehabilitation, along with supporting documentation, shall be filed with the Court and served on the Commissioner, by his attorneys, James A. Friedman and Zachary P. Bemis of Godfrey & Kahn, S.C., within 28 days of the date of the Petition. The Commissioner shall file and serve any responsive pleadings by no later than 35 days from the date of the Petition.

VERIFIED PETITION

Nathan Houdek, Commissioner of Insurance of the State of Wisconsin (the “Commissioner”), hereby petitions the Court, pursuant to Wis. Stat. § 645.31, to enter an Order for Rehabilitation for Wisconsin Reinsurance Corporation (“WRC”) and 1st Auto & Casualty

Insurance Company (“1st Auto”). As grounds for this Petition, the Commissioner states as follows:

1. He is the duly appointed and confirmed Commissioner of Insurance of the State of Wisconsin, and he makes this Verified Petition as he is authorized to do, pursuant to Wis. Stat. § 645.31.

BACKGROUND

2. WRC is a Wisconsin domestic, stock, property and casualty insurance company.

3. WRC is the successor to an unincorporated association of town mutual insurers initially organized in 1942 under the name Mutual Spread Loss Association (“MSLA”). MSLA served as a reinsurance mechanism whereby each member insurer ceded excess loss risks and participated in a pooled reinsurance assumption.

4. MSLA was dissolved and WRC was incorporated as a mutual reinsurance company under the name of Mutual Spread Loss Reinsurance, Inc. (“MSLR”), effective December 15, 1972. Ownership and control of MSLR was exercised by its member town mutual insurers, and MSLR operated as a reinsurer of risks written by the member insurers.

5. Effective December 31, 1982, Wisconsin Town Mutual Reinsurance Company (“WTMRC”) was merged into MSLR. WTMRC was originally incorporated in November 1931, and at the time of its merger into MSLR, WTMRC was licensed as a town mutual reinsurer under Wis. Stat. ch. 612. The mutual reinsurer, MSLR, was the surviving entity following the 1982 merger. After the merger, MSLR changed its name to Wisconsin Reinsurance Corporation.

6. During 1990 and 1991, WRC demutualized and converted to a stock insurance company, pursuant to Wis. Stat. § 611.76. The policyholders were primarily town mutual

insurance companies, which are subject to administrative restrictions regarding permitted investments in common stock assets. To enable the conversion of WRC from a mutual to a stock company, stock was issued to town mutual insurers. The conversion was effective January 1, 1991.

7. WRC distributed 309,655 shares of Class A common capital stock at \$14.98 per share upon the effective date of the conversion. WRC is currently owned by 73 small mutual insurers domiciled in Wisconsin, Iowa, Missouri, Illinois, and Arkansas. A small number of shares are owned by 294 natural persons who purchased personal umbrella liability policies from the company in the five years before the conversion.

8. In 1991, WRC obtained capital funds of \$6,395,000 through the sale of Series A convertible preferred stock to WRC common stock shareholders, and it used the proceeds to capitalize and incorporate 1st Auto as an insurance company subsidiary. In 1997, WRC obtained an additional \$3,225,000 of capital funds from the sale of Series B cumulative preferred stock to WRC common stock shareholders.

9. WRC is licensed in Wisconsin and Iowa and is recognized as an authorized reinsurer in South Dakota, North Dakota, Missouri, Illinois, and Arkansas. WRC's primary business is the reinsurance of property and nonproperty liability risks written on a direct basis by small mutual insurance companies. The reinsurance products written by the company include pro rata quota share, surplus share, and excess of loss contracts on both property and casualty risks, as well as aggregate excess and catastrophe coverages. WRC's lines of business include fire and allied lines, homeowners, farm owners, commercial property and liability, personal umbrella policies, and earthquake.

10. WRC is integral to the functioning of the town mutual insurance companies organized under Wis. Stat. ch. 612, to which it issues reinsurance coverage. Town mutuals are subject to specific reinsurance obligations, providing protection against the risk that a significant claim or series of claims could jeopardize the solvency of the town mutual. Presently, WRC reinsures 34 Wisconsin town mutuals, 5 converted town mutuals now organized under Wis. Stat. ch. 611, and 1 small insurer that reinsures Wisconsin town mutuals against assessments to policyholders that is organized under Wis. Stat. ch. 611. As such, WRC has systemic importance to the insurance industry in Wisconsin, particularly in the rural areas and small municipalities where town mutuals operate. Outside of Wisconsin, WRC reinsures farm, town, or county mutual insurance companies as follows: Arkansas (2), Illinois (4), Iowa (1), Missouri (13), and South Dakota (2).

11. 1st Auto is a Wisconsin domiciled property and casualty insurance company and a subsidiary of WRC. 1st Auto was organized in 1991, and it commenced business on September 25, 1991.

12. 1st Auto is licensed in Wisconsin, South Dakota, Arkansas, Iowa, Illinois, and Missouri. 1st Auto's primary business includes private passenger automobile liability and physical damage insurance, personal and farm umbrella and liability insurance, and commercial automobile liability and commercial automobile physical damage insurance. The products are primarily marketed to policyholders of town mutual insurers that are reinsured by WRC.

13. 1st Auto relies heavily on WRC for reinsurance, it does not have any employees, and all operating functions are performed by WRC pursuant to intercompany service agreements. A failure of WRC, therefore, almost certainly would result in a failure of 1st Auto.

14. WRC reported assets of \$63,756,054, liabilities of \$41,455,399, and a surplus of \$22,300,655 in its December 31, 2022, financial statements. During 2022, however, WRC's surplus declined \$21,011,955, or 48.5%.

15. After the issuance of the WRC December 31, 2022 financial statements, WRC's auditors issued a Notification of Adverse Financial Condition stating that a material misstatement to the financial statements was reported to the Office of the Commissioner of Insurance. The notification stated that WRC surplus was overstated by \$6,129,097 as 1st Auto's equity should have been non-admitted under Statutory Statements of Accounting Principle No. 97 due to substantial doubt about the entity's ability to continue as a going concern. Had this been reported in the financial statements, WRC would have reported surplus of \$16,171,558.

16. As it disclosed in its Annual Statement, "Losses to surplus in the last two years resulting from severe convective storm activity in the Midwest has raised substantial doubt about the [WRC's] ability to continue as a going concern within one year following the date of the financial statements."

17. Moreover, as a result of its financial condition, WRC anticipates losing its Directors and Officers insurance coverage.

18. 1st Auto reported assets of \$24,886,701, liabilities of \$18,57,604, and surplus of \$6,129,097 in its December 31, 2022 financial statements. During 2022, 1st Auto's surplus declined \$3,525,238, or 36.5%. In the first quarter of 2023, 1st Auto's surplus declined another \$1,538,855 resulting in surplus of \$4,590,242 as of March 31, 2023.

19. As reported in its Annual Statement, 1st Auto "relies on reinsurance arrangements with its Parent, Wisconsin Reinsurance Corporation (WRC), to partially support underwriting losses associated with its personal and commercial auto business. Continued underwriting losses

caused by increasing claims costs in recent years along with losses to WRC's surplus in the last two years resulting from severe convective storm activity in the Midwest has raised substantial doubt about the Company's ability to continue as a going concern within one year following the date of the financial statements."

20. WRC and 1st Auto's bank has indicated that it no longer is interested in having them as a client and has been talking to WRC and 1st Auto about moving their business elsewhere. WRC and 1st Auto have searched for other financial institutions but due to their financial troubles they have not been successful in finding an institution that is willing to take their business.

21. In light of its financial troubles, WRC has spent several months searching for investors or other financial partners that could potentially provide financial stability to it and to 1st Auto. As these efforts have not borne fruit, the Commissioner believes that rehabilitation under Wis. Stat. ch. 645 is in the best interest of WRC, 1st Auto, their policyholders, creditors, and the public.

REHABILITATION PROCEEDING

22. The grounds for rehabilitation are as follows:

- a. WRC and 1st Auto are or are about to become insolvent [Wis. Stat. § 645.41(2)];
- b. WRC and 1st Auto are in such a condition that the further transaction of business would be hazardous, financially or otherwise, to their policyholders, their creditors, and the public [Wis. Stat. § 645.41(4)];

c. WRC and 1st Auto do not satisfy the requirements that would be applicable if they were seeking initial authorization to do an insurance business in this state [Wis. Stat. § 645.41(9)];

d. The Board of Directors of WRC consents to the rehabilitation [Wis. Stat. § 645.41(14)]; and

e. The Commissioner believes that WRC and 1st Auto may be successfully rehabilitated without any substantial increase in the risk of loss to creditors of WRC or 1st Auto or to the public [Wis. Stat. § 645.31(1)].

23. The rehabilitation of WRC and 1st Auto will maximize the recovery of, and be in the best interest of, creditors of WRC and 1st Auto.

24. The Commissioner expects to consider a variety of options to reform and revitalize WRC and 1st Auto including, but not limited to, changes to the companies' organizational structures and business models, such as transitioning to a direct writer of insurance products or to a manager of insurance companies writing direct products (including potentially the conversion of WRC to a mutual company), changes to the companies' underwriting and rating practices, and potential transactions with investors or other insurance entities.

25. WRC and 1st Auto have agreed to not object to the Commissioner having jurisdiction over any insolvency proceeding.

POWERS AND DUTIES OF REHABILITATOR; PLAN FOR REHABILITATION

26. The Commissioner hereby seeks authorization from the Court, pursuant to Wis. Stat. § 645.33(1), to appoint Justin Schrader, of Noble Consulting Services, Inc., as the Special Deputy Commissioner for purposes of overseeing the rehabilitation process. The Commissioner

requests that Mr. Schrader serve without bond. Mr. Schrader has over twenty-two years of insurance regulatory experience, specializing in areas related to financial solvency. Mr. Schrader has experience with examinations, analysis, and corporate transactions dealing with reinsurance, acquisitions, investments, and regulatory actions. Mr. Schrader has served as the Chief Financial Examiner of the Nebraska Department of Insurance for the past nine years before joining Noble Consulting Services, Inc. as the Vice President-Director of Regulatory Advisory Services. The Commissioner believes that Mr. Schrader is qualified to be Special Deputy Commissioner. Pending further notice and Court approval, Mr. Schrader will serve as Special Deputy Commissioner for this rehabilitation proceeding with compensation and reimbursement of administrative expenses paid for from the rehabilitation estate.

27. Pursuant to Wis. Stat. § 645.33(2), the Commissioner hereby also seeks authorization from the Court to coordinate and conduct business and administrative activities for WRC and to grant the Commissioner and his Special Deputy the authority to operate the company with full power authorized by that section to reform and revitalize the insurer.

28. To date, the Commissioner has a written engagement in place with Godfrey & Kahn, S.C., to act as counsel to the Rehabilitator, and the Commissioner, as Rehabilitator, anticipates utilizing various other professionals in the course of the rehabilitation of WRC and 1st Auto. Pursuant to Wis. Stat. § 645.33(3), the Commissioner, as Rehabilitator, hereby seeks authorization from the Court to continue utilizing the services of existing and additional professional consultants and experts, including incurring fees and expenses that are reasonable and necessary, provided that any such contracts shall first be disclosed for approval by the Court.

29. The Commissioner shall, within 14 days of the filing of this Verified Petition, provide notice of the Verified Petition and the proposed Order of Rehabilitation to all creditors

of WRC and 1st Auto, current in-force policyholders and insureds of WRC and 1st Auto, claimants of WRC and 1st Auto, reinsureds of WRC, individuals and entities against whom WRC or 1st Auto has or may have a claim, and all other interested parties (collectively, the “interested parties”), as follows:

a. If WRC or the Commissioner has a mailing address for the interested party, by mailing via first class mail a notice, including instructions on accessing the Verified Petition and the Proposed Order for Rehabilitation; and,

b. For all other interested parties, by publishing in newspapers likely to apprise the interested parties and by placing on the OCI’s website the Verified Petition and proposed Order for Rehabilitation.

30. The Commissioner intends to file a plan of rehabilitation within 45 days of the Court’s entry of the Order for Rehabilitation.

WHEREFORE, the Petitioner requests that the Court enter the accompanying Order for Rehabilitation.

Dated at Madison, Wisconsin, this 23rd day of May, 2023.

GODFREY & KAHN, S.C.
James A. Friedman
State Bar No.: 1020756
Zachary P. Bemis
State Bar No.: 1094291
P. O. Box 2719
Madison, WI 53701-2719
Tel: (608) 257-3911

Respectfully submitted,

GODFREY & KAHN, S.C.

By: Electronically signed by James A. Friedman
James A. Friedman
Zachary P. Bemis
Attorneys for Petitioner Nathan Houdek,
Commissioner of Insurance of the State of
Wisconsin

VERIFICATION

STATE OF WISCONSIN)
)
COUNTY OF DANE) ss.

NATHAN HOUDEK, being fully sworn on oath, deposes and states as follows:

1. I am the Commissioner of Insurance of the State of Wisconsin and verify the foregoing Petition for Order of Rehabilitation ("Petition") on its behalf.

2. I have read the Petition and, to the best of my knowledge, information and belief, it is true and correct.

[Handwritten signature of Nathan Houdek]
Nathan Houdek

Subscribed and sworn to before me
This 23 day of MAY, 2023

[Handwritten signature of Karyn C. Culver]
Print Name: KARYN C. CULVER
Notary Public, State of Wisconsin
My Commission: EXPIRES: 1-23-2026

