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All's Well That Ends Well For Mid-Continent's Policyholders

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With relatively little fanfare and no opposition, Mid-Continent Life Insurance Company's insurance business — amounting to nearly one-half billion dollars in life and health insurance reserves — was transferred to American Fidelity Insurance Company in an assumption reinsurance transaction on December 18, 2000. The closing of the transaction brought certainty and protection to Mid-Continent's 128,000 policyholders without the need for financial support from the guaranty system, and for all intents and purposes concluded the nearly 4 year receivership saga for the troubled Oklahoma based insurer.

The harmonious manner in which the closing took place belies the strife and conflict that often surrounded this case and the serious challenges the Oklahoma Insurance Department faced in seeking to protect Mid-Continent's policyholders from a potential meltdown of the company. Oklahoma Insurance Commissioner Carroll Fisher and his staff are to be commended for their hard work and persistency in obtaining a positive result for Mid-Continent's policyholders. Given the circumstances they inherited upon taking office two years ago and the substantial challenges that subsequently surfaced, the result can best be characterized by the Shakespearean proverb that "all is well that ends well." However, even Shakespeare would have to acknowledge that good endings should not be taken for granted and that there is value in understanding the challenges that were faced and how the good ending was achieved. This article will briefly chronicle the key challenges of the Mid-Continent case and how the case ultimately was resolved with favorable results.

Receivership Ordered

On April 14, 1997, then Oklahoma Insurance Commissioner John P. Crawford requested and was granted an ex- parte temporary receivership order for Mid-Continent Life Insurance Company. This order resulted in insurance department personnel assuming operational control of the insurer. The principal reason for the order related to allegations that Mid-Continent's statutory reserves on its "extra-life" insurance policies, the company's best selling product, were understated by at least $125 million and that the company had willfully violated Oklahoma law by misrepresenting and making false advertisements in connection with the sale of the extra-life policies.

At a subsequent show cause hearing before the Oklahoma District Court, Mid-Continent's sole stockholder, Florida Progress Corporation, vigorously contested the receivership order to no avail, and the Oklahoma District Court entered a permanent order naming Commissioner Crawford receiver for the company. Thus began a nearly two year odyssey of acrimony and litigation between the Oklahoma Insurance Department and Florida Progress Corporation. During this period, the Department filed a lawsuit against Florida Progress and its officers and directors seeking damages relating to the alleged misconduct with respect to the marketing of the extra-life policies. The Commissioner's objective was to obtain a recovery large enough to make up the deficiency in Mid-Continent's statutory reserves, which, according to later Department calculations, was about $400 million. Florida Progress, for its part, vigorously contested the receivership order at the appellate court level hoping to regain control of its wholly-owned subsidiary. At one point, Mid-Continent's embattled parent sought to have Commissioner Crawford disqualified as receiver because he had formerly served as a consulting actuary for the insurer.

The entrenched "winner take all" attitude of the principal

See *MCL*, Page 4

In This Edition

President's Column

How Strong A Safety Net? A Closer Look

In my Spring, 2000 column, I touched upon what was then speculation about the expansion of federal financial services regulation to the insurance arena, and particularly to receivership administration and the provision of a "safety net" for insurance consumers. I stated then that the measuring stick for any proposed alternative system of consumer insolvency protection inevitably would be the recent performance of NOLHGA's member associations.

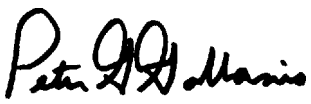
In the time that has since passed, the topic of federal insurance regulation has only become more prominent. One trade group, the American Bankers Association - Insurance Association (ABA-IA), unveiled a legislative proposal for optional federal chartering of insurers this past December. The ACLI also is taking a hard look at the pluses and minuses of an optional federal chartering approach, and is preparing draft legislation that may be exposed later this year.

In anticipation of the forthcoming public policy debate over the nature of the consumer safety net in a world that may include optional federal chartering, NOLHGA's Emerging Issues Committee (Chaired by Wilson D. ("Dave") Perry and comprising GA and NOLHGA Board members, GA Administrators, and a NOLHGA consultant) spent much of last year considering that issue. The Committee's efforts are likely now to prove of great value.

The Committee began by identifying the cardinal principles that must be served by any system of "safety net" protection for life and health insurance consumers. In the Committee's view, such a system must (1) effectively protect policyholders; (2) be cost effective; (3) be responsive and flexible; (4) provide appropriate input from the insurance industry; (5) provide for an appropriate sharing of the burdens of insolvencies; (6) permit involvement by the guaranty provider in the conduct of the receivership; (7) assess costs to the industry fairly; and (8) minimize moral hazard.

The Committee postulated that any federal legislation enabling optional federal chartering likely would result in a unitary guaranty system - one system that would cover both state-chartered and federally-chartered insurers, rather than separate state and federal guaranty systems. The Committee further assumed that the resulting unitary system likely would take one of three forms - a federal agency structure somewhat analogous to the FDIC; a single self-regulatory organization essentially operating outside of government but overseen by insurance regulators; or a slightly modified version of the current nationwide organization of individual state associations whose members (the state Guaranty Associations that, together, are NOLHGA) would cover federally chartered insurers writing in their states just as they now cover "foreign" insurers.

The Committee then assessed the projected performance of each of the three possible types of systems in light of the cardinal principles that should be served by such a system. The Committee's analysis was objective, thorough, detailed, and



complex, and cannot be fully set forth in the space available. However, the Committee concluded that the cardinal "safety net" principals, in general, would be better served by extension of the current system to include federally-chartered insurers than by either of the other two alternative systems.

That conclusion was not surprising to me. I say that not because the Committee members all contribute to the current system. Committee member Art Dummer and Chairman Perry were representative of the entire Committee in their insistence that the group's analysis be done objectively, without fear or favor, and so it was. Rather, I find the conclusion unsurprising because the nature of the current system is not accidental - far from it. Our system is the result of a couple of decades in which the experi-

See *President*, Page 7

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Issues In Litigation: Discovery of Electronic Information

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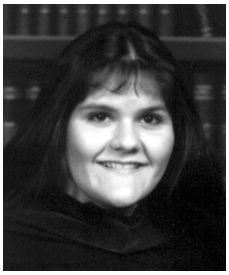

Over the course of recent years, organizations and individuals have continued to move towards conducting their business and communications electronically. As a result, more and more information is created, retained and stored electronically every year. In fact, recent studies suggest that up to 95% of information being generated today exists in electronic form. Much of that information may exist only in electronic form, as may be the case with e-mail communications, databases, electronic worksheets, file links, etc. Given this reality, discovery of electronic records has increasingly come to be recognized by the courts as a practical necessity in litigation.

While the case law is still evolving , the trend appears to be moving in the direction of allowing increasingly expansive electronic discovery and, where appropriate, imposing sanctions on parties that fail to preserve electronic evidence. In addition, the courts may impose preservation orders requiring a discovery target to take affirmative measures to prevent against loss of electronic records, and in extreme cases, may even order a party to turn over its computer hard drives for duplication as a means for preventing the loss of electronic data. A party that is well informed about its information systems, how they operate and how the components interrelate will be better positioned to avoid such a drastic result.

The focus on electronic document discovery in recent years has led to a proliferation of forensic software systems that allow electronic information to be captured, restored, preserved, processed and converted to searchable format. In fact, an entire industry of forensic computer consultants has emerged to provide high tech litigation support for discovery of electronic documents.

What does all of this mean for those on the receiving end of a subpoena seeking the product of electronic information? As a starting point, it means that parties need to understand what types of electronic documents they have that might be responsive to a discovery request, where those documents are located (e.g., hard drives, network servers, back-up, voicemail, e-mail, disks, CDs, laptops, etc.) and how to preserve them. The better the information systems are understood, the more likely a party will be able to avoid the pitfalls of lost or damaged data, and the easier it will be to negotiate a reasonable approach to satisfying the production request while minimizing disruption to daily operations. For many organizations, this will require a strategic teaming of litigation counsel with information technology experts familiar with their systems in order to develop and implement effective procedures for identifying, collecting, preserving and producing responsive documents.

What is a Document?

For discovery purposes, a document can be many things. It can be paper, a photograph, video images, microfilm, recordings, and electronic data of all types, including e-mail, voicemail or any other information contained in any data storage medium. The focus of this article is computer based electronic data, which includes active files as well as other types of information stored on a computer system. Active files are those files that are readily accessible to the user on hard drives, disks, CDs or local area networks. In addition to the active files, computers generate and store a lot of other information, some of which is readily accessible to the user (such as embedded data and file statistics, also referred to as metadata), and some of which may be recoverable only through the use of computer forensics software (such as file clones, residual data or fragmented files).

Embedded data can include file links, hidden text, comments, attachments, etc. This data is part of the active file, but may only be accessible when the document is viewed in electronic form. It may also include a history of revisions or redactions to the document recoverable through forensic software applications.

Metadata, as it is frequently called, refers generally to information about a document that is automatically collected and stored as a function of the software used to create the document. Depending on the type of software being used, metadata may include information regarding authorship, creation and modification dates, document type, size and location, number of revisions, print status, editing time and last access. It may also include embedded data that has been manually entered by a user, including routing instructions or comments. Most users may not even know this type of information exists. Nevertheless, it is user accessible in many applications (under "file / properties" on the toolbar in Microsoft Office applications) and can therefore be viewed by anyone who reviews documents through those applications. Metadata that is not user

See *Discovery*, Page 5

Mid-Continent Life Ends Well

MCL, From Page 1

parties appeared to destine the case for a long and expensive court battle. All that seemingly changed on November 3, 1998 when Carroll Fisher defeated John Crawford's bid to be re-elected as Oklahoma Insurance Commissioner. Shortly after taking office in January 1999, Commissioner Fisher stated his intent to resolve both the Florida Progress litigation and Mid-Continent's problems on a commercial basis. While the new Commissioner's approach seemed to make good sense from a business perspective, making peace was not going to be easy given the filing of a class action lawsuit on behalf of Mid-Continent's policyholders which sought damages against Florida Progress and others in connection with the sale of the extra-life policies. The class action lawyers were dogged pursuers of Florida Progress and as a consequence were critical and distrustful of Commissioner Fisher's decision to make peace with Mid-Continent's parent company. These attorneys would eventually file an appearance in the Mid-Continent receivership proceedings and provide determined opposition to the Commissioner's initial efforts to resolve the Mid-Continent case.

Undeterred by this opposition, Commissioner Fisher proceeded with his objective to resolve Mid-Continent's woes on a commercial basis. He filed a motion to stay the receiver's lawsuit against Florida Progress and sought a negotiated resolution of the case. He also instituted an RFP process seeking proposals from third parties to acquire Mid-Continent's insurance business, and retained an investment banking firm to assist with the review of those proposals. This process resulted in 10 proposals being submitted to the Commissioner in June 1999. After considering the proposals, the Commissioner chose the proposal of Life Investors Insurance Company of America and undertook to negotiate a definitive assumption agreement with that party and a settlement with Florida Progress.

> " It really is about being persistent and keeping one's focus on the most important objective in receivership proceedings...protecting the policyholders."

However, the class action attorneys and four parties that had submitted competing proposals for Mid-Continent's business formed an informal "alliance" to oppose the Commissioner's plan. Among other objections, the opposing parties claimed that the Commissioners' RFP process was unfair and did not result in the best result for policyholders, and that he was settling with Florida Progress too cheaply. As a result of the vigorous opposition presented by these parties, there were numerous receivership court filings and hearings which eventually resulted in the court ordering the Commissioner to hold a second RFP process to allow the disappointed proposers another opportunity to compete for Mid-Continent's business. The "second round" of proposals was completed in June of 2000 and resulted in American Fidelity, a highly rated company based in Oklahoma City, offering a substantially better proposal than Life Investors or any of the other proposers. American Fidelity not only offered policyholders substantially greater guarantees on their premium payments than the closest competitor but it also agreed to preserve the jobs of Mid-Continent's Oklahoma based employees. In a testament to his objective desire to protect the policyholders, Commissioner Fisher quickly seized upon the better offer presented by American Fidelity and recommended that the court accept it. He also realized that the policyholders fortunes should not be held hostage to the Florida Progress dispute and negotiated an assumption agreement with American Fidelity that did not require a Florida Progress settlement contribution.

In a last gasp effort to prevail, the remaining proposers (other than Life Investors, which withdrew from the process) mounted an opposition to the American Fidelity deal in conjunction with the would-be class action plaintiffs who were concerned the proposal would somehow take Florida Progress off the hook. However, this opposition could not hold up against the clearly superior American Fidelity proposal and the Commissioner's well thought out game plan for obtaining court approval. The opposition eventually melted away and the Oklahoma District Court approved the Commissioner's plan to transfer Mid-Continent's business to American Fidelity. Subsequently, negotiations between the class action attorneys and Florida Progress resulted in a $17.5 million settlement — $7.5 million more than under the Commissioner's original proposed deal.

So what lessons can be taken from the Mid-Continent case? Perhaps the old adage about when life deals you lemons you should make lemonade is a good fit. However, the real lesson of this case is a bit deeper. It really is about being persistent and keeping one's focus on the most important objective in receivership proceedings, which is, of course, protecting the policyholders. In this instance, notwithstanding the many obstacles, challenges and setbacks, the Commissioner kept his focus on that objective and as a result, "all is well that ends well" for the former policyholders of Mid-Continent.

Managing the Brave New World of Electronic Discovery

Discovery, From Page 3

accessible in its native application may still be recoverable with the aid of computer forensics software.

Residual data, sometimes called document clones or footprints, is another form of electronic data that is generated automatically by the computer as a result of systems back-up, auto-save and other similar functions built into software applications. Residual data is also generated when a document is deleted. Although a deleted document may no longer be accessible to the user, it remains on the hard drive or server until it is overwritten, and may very well be recoverable, even if fragmented (partially overwritten), by someone with computer forensics experience and conversion software. The only way to determine if a file has been overwritten is to attempt recovery through conversion software. The end result is that documents that have been deleted may not really be gone, and may be recoverable from back-up or hard drive imaging in the context of discovery. Residual data may also exist for documents that were printed, even if they were never saved.

Data Loss/Preventive Measures

One of the many challenges of working with electronic data is that it is easy to alter or destroy, and is more susceptible to inadvertent destruction or alteration than a piece of paper in a file. For this reason, parties must be extremely careful about how electronic documents are collected, preserved and produced. One potential pitfall in this regard is the auto delete feature commonly found in e-mail applications. This feature, unless turned off, automatically deletes e-mail from a user's in-box or out-box after a predetermined number of days. Once deleted, that e-mail may or may not be recoverable from back-up or from residual data. In any event, recovery efforts could be very expensive, time consuming, potentially invasive, and may require the assistance of a computer forensics expert.

There are also many lesser known hazards lurking in the path of the unwary. In fact, simply opening a document for review on the computer screen or printing the document for review in paper form, may change certain soft field data on the face of that document (such as date codes). It may also cause an update to the metadata (e.g., last revision date) suggesting that the document has been recently altered. Similarly, saving a document to a disk or to a segregated file for review and production may have the same effect.

Residual data is even more unstable and at risk for inadvertent loss or destruction. Every time a computer is turned on, it destroys some residual data since the computer will use memory to go through the rebooting process, during which it randomly overwrites available space. Similarly, information is overwritten and lost when disks or back-up tapes are reused/recycled. Although this may not be problematic in most routine discovery requests, it could have serious consequences to a party that has been ordered to preserve such data.

In the event a preservation order has been entered requiring preservation of this type of data, the party will need to formulate a strategy and procedures to be followed to ensure compliance with that order, and should consider seeking court approval of those procedures. Some basic preventive measures that can be taken immediately to preserve electronic data include notice to users advising against deleting or saving over documents that may be responsive to the request, turning off any auto delete functions contained within the software applications being used, and putting an end to the reuse of disks or back-up tapes that may contain responsive documents. In addition, responsive documents and files may be copied to segregated files, disks, CDs or a stand alone hard drive for preservation, review and production, though it is important that the documents are copied and not saved since saving a document alters the soft field data and metadata relating to that document.

The preservation and recovery of residual data contained on a computer hard drive is more complicated and invasive, and would likely require duplication of the target computer hard drive. This process can capture and preserve without altering all active, deleted and fragmented files as well as file statistics and embedded data. It generally requires an expert and can cost upward of $1200 per computer.

The Need for a Reasoned Approach.

One thing is clear. There is an immeasurable amount of information that is potentially available on computer systems. Enough, in fact, to bury a party in obscure data and distract the focus from the real issues in the litigation. Parties should resist any temptation to blindly pursue electronic data simply because the technology allowing them to do so exists. Instead, parties should be encouraged to take a reasoned approach to discovery, and to carefully consider what types of data are likely to have any relevance to the issues in the case before charging forward with broad scale discovery of electronic information that will be expensive, time consuming and burdensome to capture, preserve and produce, and which may have little or no bearing on the issues in the case.

Conversely, parties receiving a request for electronic records should attempt to negotiate reasonable procedures for responding to requests that will preserve target data without subjecting them to unnecessary burden or expense. To the extent parties are unable to reach agreement on these issues, they may have to seek court intervention to establish reasonable parameters for discovery that are commensurate with the needs in the case.

NOLHGA Website Upgraded: Access Opened to Insurance Departments, Public

by Peter J. Marigliano
Manager of Communications, NOLHGA

The carnage in the dotcom industry, as evidenced by the precipitous decline of the NASDAQ, shows no sign of abating. Website after website promising to change the way we buy just about everything actually sold us nothing. Content sites that relied on banner advertising for revenue are in many cases worthless. While the gloom among the instant dotcom millionaires is palpable, at least one website is experiencing growth. NOLHGA's website at www.NOLHGA.com has opened a number of portions of its previously "members only" site to the industry, public and to insurance department personnel.

The public section of NOLHGA's website is a basic resource targeted to consumers, insurance agents, and industry personnel. It contains basic information about NOLHGA, "What Happens When an Insurer Becomes Insolvent" and the frequently requested state-by-state liability limits and coverage provisions. In addition, NOLHGA makes available its annual insolvency cost information for download. The insolvency cost information is frequently requested by company personnel and assists them in preparing their estimated annual assessments.

A new, password-protected, restricted access section of the website has been made available to insurance department personnel. This area provides personnel with access to a variety of NOLHGA documents including back issues of the NOLHGA Journal, a host of industry links and other information about insurer insolvencies and their resolution.

The confidential area of the site is limited to NOLHGA members, the NOLHGA Board of Directors, state guaranty association board members and other individuals on a case-by case basis. This area of the site contains a broad range of documents, including back issues of the Weekly Wire, minutes from various NOLHGA meetings, MPC Status reports, membership directories and Committee rosters, and a number of operational documents.

The website will be further upgraded later this year so that each state guaranty association, if it so chooses, can utilize a NOLHGA-developed template with the basic guaranty association law provisions for each state and contact information. This information will be posted in the public area of the site and visitors will be directed to click on their state of residence for further information.

For further information about the NOLHGA website, or to request a password, please contact Pete Marigliano at pmarigliano@nolhga.com.

How Strong A Safety Net?

President, From Page 2

ence gleaned in multiple insolvencies has convinced our system's participants and the constituents they serve of the wisdom of performing our mission in certain ways.

The methodologies we employ - from avenues for association, regulatory, and industry input; to the procedures we use to reach collective decisions; to approaches in engaging and supervising consultants; to the ways the system's costs are shared, to the ways in which we deal with receivers and others - these are all drawn from our set of experiences on how best to protect policyholders; how best to achieve results cost-effectively; how best to allocate the burdens of an insolvency, and so on regarding the "cardinal virtues" of an insolvency safety net. Experience is the toughest teacher. Like all experiential learning, the learning in our system involved a lot of trial, and undoubtedly error. But for those who are willing to examine the current system and what it now accomplishes, the results are impressive.

For that reason, I am astonished by the misunderstandings I sometimes hear about today's guaranty system. One such instance occurred at the December 2000 forum in Washington, D.C. sponsored by the American Enterprise Institute (AEI), at which the first draft of the ABA-IA legislative proposal for optional federal chartering of insurers was unveiled. As to the ABA-IA proposal, for now I note only that it clearly reflects much hard work by its proponents, and understandably reflects a banking industry perspective of regulation and insolvency. In that regard, the ABA-IA's first draft contemplates performance of the guaranty function by an FDIC-style governmental bureau. In itself, that is not surprising.

However, one participant in the panel discussion convened by the AEI opined that consumers would like an FDIC-modeled approach to the insurance guaranty function because, in that panelist's view, the current system has inadequate financial capacity, employs too many people, and habitually "... (P)revents consumers from having access to their money for six or seven years."

A fair view of the current system reveals the inaccuracies in that perspective. The aggregate annual capacity of the life and health guaranty system for 1999 (the amount that could be assessed from the individual guaranty associations' member companies) exceeded $5.1 billion, whereas the greatest annual amount that the system has ever been required to pay - even in the dark days of the early '90s, when the real estate and junk bond markets helped precipitate numerous insolvencies - was about $900 million. Aggregate annual assessments have been much lower in recent years, dropping well below $150 million in 1999. Clearly, the system has significantly more than adequate capacity to do its job.

On the issue of system staffing, the current life and health system, including NOLHGA staff, employs fewer than approximately 100 individuals nationwide, and this small group manages to provide an effective safety net for all life and health policyholders across the country. By contrast, we are advised that the FDIC has a staff of approximately 7,000 employees. Granted, the mission of the FDIC is different in various ways from that of NOLHGA and its members, but it is hard not to marvel at how much the current system accomplishes with such lean staffing.

Finally, on the issue of policyholder access to account values: when major national life and health insolvencies first began to take place, with Baldwin United in the '80s, and several other large companies shortly after 1990, the current system as we now know it, was not yet in place. The last of the fifty-two guaranty associations (including Puerto Rico and the District of Columbia) was established only as recently as 1992, and neither the receivers nor the guaranty associations had before them a "playbook" on how to resolve the multiple large-company insolvencies of the early '90s. (In many respects, the situation compared to that of the multiple bank failures in the early Depression years.) At that time, some in both the receivership and guaranty association communities believed that the asset value inherent in the books of business of failing insurers could only be preserved through the imposition of lengthy moratoria on cash surrenders and withdrawals. That, again, was reminiscent of how bank failures were handled before the FDIC had achieved a track record and settled on its own "playbook." Even with these "startup" challenges, the vast majority of covered policyholders from the early '90s got access to all or most of their current account values much sooner than "six or seven years" into a liquidation.

The world is different today. Now, the national life and health guaranty system has established a proven track record. In recent years, more than 90 percent of policyholder obligations were paid in full through the operations of the guaranty associations. Based on that track record, concerns over the "run on the bank" phenomenon have lessened, and receivers and Guaranty Associations now endeavor to provide full access to policyholder account values in the early days of an insolvency. Given the records that sometimes exist in a failed insurer, it is still difficult sometimes to identify immediately the precise account value for a given policyholder - and it always will be, regardless of who performs the receivership and guaranty functions, because insurance commitments are intrinsically much more complex than bank accounts. Nonetheless, concerns about extended account moratoria are greatly exaggerated.

The public debate over optional federal chartering for insurers and the optimal way to perform the insurance guaranty function will continue to develop for months, and perhaps years. As I suggested a year ago, the burden rests with proponents of any new system to demonstrate how their proposal would do a better job of serving consumers and taxpayers than does the current system. That is a substantial burden. ▼

UPCOMING EVENTS

May 9-11	**NOLHGA MPC Meeting**	**Providence, RI**
May 15-16	**NOLHGA Board of Directors' Meeting**	**Chicago, IL**
June 9-13	**NAIC Summer Meeting**	**San Francisco, CA**
July 12-13	**NOLHGA Legal Seminar**	**New York, NY**
August 7-8	**NOLHGA Board of Directors' Meeting**	**Seattle, WA**
August 20-22	**NOLHGA MPC Meeting**	**Denver, CO**

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