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NOLHGA JOURNAL

A PUBLICATION OF THE NATIONAL ORGANIZATION OF LIFE AND HEALTH INSURANCE GUARANTY ASSOCIATIONS

NOLHGA, Receivers Partner To Protect Covered Policyholders

Last May, NOLHGA and the American Council of Life Insurance presented a paper on the history of the guaranty system to the 135th meeting of the Association of Life Insurance Counsel. Prepared at the suggestion of NOLHGA secretary William A. Wilson, the paper was co-authored by Anthony R. Buonaguro, NOLHGA's executive vice president and general counsel, and Jana Lee Pruitt, senior counsel at the ACLI. What follows is an excerpt from Chapter Six, "*The System Reaches Maturity: Post-Executive Life to Present*," which describes the evolution of the working relationship between NOLHGA and receivers.

Several insolvencies are notable if nothing else because of the positive manner with which the assistance of the task force was welcomed by the receiver. Two were in Georgia (Old Colony Life Insurance Company and Coastal States Life Insurance Company), one was in Pennsylvania (Summit National Life Insurance Company) and the other really was a trio of insolvent affiliated companies handled jointly in Alabama and Indiana (Alabama Life Insurance Company, American Educators Life Insurance Company and Consolidated National Life Insurance Company). In fact, things went so smoothly in Coastal States, Summit and the Alabama/Indiana cases that transactions with assuming carriers were closed within one year of takedown and NOLHGA involvement. It seemed that where the receivers and the guaranty system were successful in establishing a "partnering" relation at the outset, policyholders would be the ultimate beneficiaries.

The concept of partnering is best explained as a process whereby the receiver and the guaranty system each see mutual benefit in conducting the insolvency in a good faith spirit of cooperation. In the case of the guaranty system, it cannot do its job in continuing insurance for covered policyholders without the statutory power of the receiver. By the same token, the receiver needs guaranty system funds to do his or her job in fulfilling fiduciary duties to policyholders. The receiver is well-advised to recognize that, other than for assuming

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In this issue

Guaranty Associations Play Vital Role In Liquidating Estate Assets

by Frank O'Loughlin, Joel Glover and Brian Spano
Rothgerber, Appel, Powers & Johnson

Guaranty Associations as Creditors of the Estate

Two separate but complementary processes impact life and health insurance guaranty associations in multi-state insolvencies. First and foremost, guaranty associations are concerned with identifying and quantifying policyholder liabilities - the "liabilities side." From a timing standpoint, the initial concern for the associations is to ensure that policyholders receive continuing coverage in accordance with their individual state associations' acts. The continuing coverage typically is accomplished through an assumption reinsurance transaction with a healthy insurance company, negotiated and coordinated by NOLHGA.

Second, consistent with providing continuing coverage for policyholders, the guaranty associations become creditors of the estate through subrogation, assignment and specific statutory reference.

Guaranty associations, therefore, have a vested interest in maximizing their recovery of estate assets. The associations almost

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President's Column

'Cooperation' Resonates Throughout System, Journal

As you read through this edition of this spring edition of the NOLHGA *Journal*, you might notice that the word - indeed, the concept - "cooperation" appears on nearly every page. This is intentional. While we have always advocated cooperation between and among NOLHGA, its member life and health insurance guaranty associations, insurance commissioners, the receivership community and other constituencies, we're about to embark on a no-holds-barred campaign to reinforce our commitment to work together for the benefit of U.S. policyholders.

Recently I sent a letter to the nation's insurance commissioners, reminding them of the guaranty associations' desire to intervene early in the event of a life or health insurance company insolvency. Early intervention, we believe, is the key to the speedy and successful resolution of insolvencies, enabling us to fulfill our statutory obligation to provide coverage for policyholders of these failed companies. But to be invited early to the table, we recognize that we must continue our efforts to build and maintain excellent working relationships.

With that in mind, I have asked the commissioners if they would be willing to meet with me, other key NOLHGA staff, the domestic administrator and his or her board chair, if available, for a short time in conjunction with the quarterly NAIC meetings. This will give me an opportunity, having only been president for a short while, to introduce myself, and will give everyone present the opportunity to address issues of mutual concern, air any grievances, and reaffirm our intent to make the guaranty system even more efficient, economical and responsive.

In this issue, you will read an excerpt from "*NOLHGA and the Evolution of the State Guaranty Association System*" which clearly illustrates the benefits to be derived for all interested parties when cooperation prevails. And an article on NOLHGA's role in liquidating assets illustrates how values can be maximized when receivers and guaranty associations work together.

As always, I welcome your comments and suggestions - about cooperation or anything else. Communication precedes cooperation, and my door is always open. Please feel free to write to me at NOLHGA, or call me at 703/787-4116.

I look forward to seeing many of you in Salt Lake City this week. I welcome the opportunity to exchange information and revitalize our cooperative efforts.

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National Organization of Life and Health Insurance Guaranty Associations

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ASSETS, *from Page 1*

Receivers, Associations Solve Asset Problems Together

always constitute the largest creditor of any insolvent estate. In many life insurance company insolvencies, the combined claims of the guaranty associations equal in excess of 90 percent of the claims of policyholder level creditors. Therefore, of every dollar to be paid to creditors (after payment of administrative expenses), more than 90 cents is owed to the guaranty associations.

Guaranty associations, like other creditors, have a direct financial interest in assisting the insolvent insurer's estate in maximizing recoveries through the marshalling and sale of estate assets. Unlike other creditors, however, the guaranty associations also have express statutory authority to provide advice and assistance to receivers through a variety of means ranging from providing experts, to purchasing and owning assets, to appearing or intervening in legal matters. Just as NOLHGA provides critical assistance on the liabilities side, it provides crucial coordination and negotiation for the guaranty associations when dealing with assets.

This article focuses on various methods by which the guaranty associations and NOLHGA can assist receivers in maximizing the value of estate assets that are liquidated for the benefit of creditors. Every example discussed has had been utilized by receivers and guaranty associations in one form or another. We are confident that receivers and guaranty associations, working together, can identify many more methods by which their cooperation can result in increased and expedited recoveries for all creditors.

Sale of Non-Liquid Assets

Disposing of non-liquid assets can be problematic in many insolvencies, particularly where those assets are speculative, difficult to value or require several years before any value will be realized. To complicate matters, many times an insolvent estate has assets which might be worth very little in a fire sale, but have the potential to generate substantial value if sold over time. There are several mechanisms by which guaranty associations can assist receivers in resolving some of these problems.

First, offering the assets to bidders in connection with an assumption reinsurance transaction generates several appraisals at little or no cost to the estate. As part of any bid package distributed by the guaranty associations, bidders can be invited to bid upon estate assets they would be willing to accept as part of the transfer. With their due diligence, bidders typically indicate the value which they place on certain assets. Even if some of the assets are not transferred as part of the assumption reinsurance transaction, the estimates serve to provide guidance and protection for receivers in their efforts to liquidate the assets.

Second, guaranty associations can retain consultants to provide additional asset valuation. If the review confirms the original value attributed to the asset, it provides additional protection to the estate. If the valuation differs, it provides advance notice that other factors should be considered in valuing the assets. Regardless, the receiver benefits from the information. The consultants also can provide access to alternative buyers or markets.

Third, guaranty associations can act as a bidder or purchaser of the assets. In those instances, the associations can make a bid and establish a floor price or value for the assets. This approach can increase the other bids and force a purchaser to pay a value which the majority of the estate's creditors considers reasonable.

Pursuit of Litigation

In many insolvencies, potential causes of action may be the only remaining assets of

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carriers, it is only the guaranty system that puts in new money to fund the necessary assumption transactions and that it makes the most sense to include in the plan for the estate an agreed-upon method for weaving in guaranty association coverage. The concept of partnering needs to be a two-way street to work well.

Anthony R. Buonaguro
Co-author

This probably was recognized on some level back in the early days of Executive Life. What was missing then, but clearly emerging by 1994, was the ability of the system to sell the partnering idea to receivers more effectively through firmness, conviction and good cheer rather than through confrontation. The job clearly was made easier because of the improvements to system credibility implemented beginning in 1992.

Having said that, we should highlight three insolvencies where the partnering idea caught on comparatively late in the process. Put another way, there were big problems in relations with receivers in the beginning. In each case a key reason may have been the firm conviction of the receiver that the company could be rehabilitated and returned to the marketplace instead of being liquidated, while the guaranty system thought the handwriting on the wall clearly indicated otherwise.

> The receiver invited other parties to submit competing plans...

Perhaps the most dramatic of these was **Pacific Standard Life Insurance Company (PSLIC)**, a California company which actually had been placed in rehabilitation in 1989. This was before the creation of the California Life and Health Insurance Guarantee Association, so about 40 percent of the company's liabilities were uncovered.

Nothing much happened until 1992, when the receiver attempted to convince the guaranty system that it should contribute $50 million to the company in exchange for a court order that the payment would be deemed to extinguish its statutory obligations. If the system refused the offer, the receiver would impose a rehabilitation plan on policyholders with an unprecedented eight to 10-year moratorium period and oppose any court order of liquidation which could trigger the associations. If ancillary receiverships were initiated in other states to trigger the associations, the receiver would refuse to recognize subrogation claims. The receiver's confrontational proposal was turned down.

Bart A. Boles, *Chair*
PSLIC Task Force

Without a liquidation order, it was unlikely that payment of any funds would be lawful. Besides, the receiver would be putting the money to use to benefit uncovered policyholders as well as the covered ones and a long moratorium of four years still would be necessary. When the receiver submitted his long lock-in rehabilitation play for court approval, he invited other parties to submit competing plans. This gave the task force, chaired by Bart Boles of Texas, the opening it needed. It was given a scant six weeks to produce.

In what must go down as one of the most effective strategies ever implemented in so short a time period, the task force, chaired by Bart Boles of Texas, found Hartford Life Insurance Company to assume the business. Policies would be restructured to provide a package of benefits of greater value to policyholders than the receiver's plan. Affected guaranty associations clearly would be triggered and would be given the option to provide additional benefits on an individual basis if they felt it necessary to offset particular benefit limitations contained in the restructured contracts.

At first, the receiver rejected the NOLHGA plan and the task force girded up for a contested court battle. But harmony prevailed in the end, when shortly before the hearing, the receiver conceded that the NOLHGA plan was a good one. At the hearing, the receiver withdrew his own plan and testified in support of the NOLHGA plan. Relations between the receiver and the system mostly were cordial after that.

> The initial obstacle involved negotiation of a confidentiality agreement...

The second case in this triad was **Kentucky Central Life Insurance Company**, a 1993 insolvency. Here, the receiver strongly resisted the efforts of the task force, chaired by John Colpean of Michigan, to get involved in the early stages. The initial obstacle involved negotiation of a confidentiality agreement which the receiver insisted that NOLHGA sign. The proffered agreement would have sharply reduced the ability of the task force to give necessary information to all affected associations, thereby undercutting NOLHGA's fundamental role to facilitate the sharing of information. Even after a satisfactory compromise was reached, information regarding the framework of a possible plan still was hard to come by.

John C. Colpean, *Chair*
KCL Task Force

Without NOLHGA's participation, the receiver negotiated, executed and filed in court a rehabilitation plan that called for transfer of the policies to Jefferson-Pilot Life Insurance Company. Although an order of liquidation was to be sought, it was to be without a finding of insolvency, thereby warding off guaranty association triggering in most states. It was the view of the task force that it was not right to sit still, since several features of the plan did not adequately reflect contract guarantees.

These were mainly in the areas of minimum crediting rates, maximum cost-of-insurance charges and annuitization and

policy loan rights. In addition, the plan called for an unacceptable five-year moratorium.

The task force's reaction was two-fold. Over the Kentucky commissioner's objections, NOLHGA, along with the Illinois and Texas guaranty associations, intervened successfully in the court proceedings, setting aside concerns about jurisdictional issues in light of the real emergency that was unfolding. The Texas commissioner also intervened. In addition, the task force began to develop its own "safety net" alternative to the plan which would correct the perceived deficiencies in the receiver's plan.

The safety net, once unveiled to the receiver and Jefferson-Pilot, was the master stroke that finally broke the logjam. They quickly realized the receiver's plan would be significantly less attractive than NOLHGA's to many policyholders. The receiver's plan essentially was dead on arrival. The NOLHGA safety net was incorporated into the receiver's plan as an enhancement for those policyholders who opted in, through the mechanic of a "shadow account" to be tracked by the assuming carrier.

Through the shadow account, a floor for policyholder account values and contract rights was established. The plan was so ingenious that it drew effusive praise not only from the Texas commissioner but also from a special group set up at the NAIC to monitor the insolvency.

Relations between the guaranty system and the Kentucky receivership since then have been harmonious, despite their chilly beginnings.

> The plan called for the establishment of a co-managed liquidating trust...

The third insolvency is **National Heritage Life Insurance Company**, a Delaware-domiciled, Florida-based company taken down in 1994. More than 95 percent of the company's liabilities were covered. The condition of its assets was so abysmal that the required up-front association funding exceeded an eye-popping $400 million! "National Heritage" thus is the surprising answer to the trivia question: "After Executive Life, what has been the most expensive insolvency in the history of the guaranty system?"

The task force, chaired by Dan Orth of Illinois, faced a simply stated problem: How could it influence a receiver unrealistically focused on twin beliefs that the company needed to be rehabilitated in order to preserve the value of tax carry forwards and that a rehabilitation plan was possible despite the massive size of the asset shortfall? Regulatory members of an NAIC Insolvency Task Force also were concerned as the case dragged on for almost two years with no end in sight. Eventually, the task force was able to approach the receiver with a pre-packaged liquidation plan which called for the takeover of most policies by a blue-chip name, Metropolitan Life Insurance Company. This was an offer even this receiver could not refuse!

Daniel A. Orth III, Chair
NHL Task Force

Jana Lee Pruitt
Co-author

Because of the large amounts and importance of the troubled illiquid assets, a central feature of the National Heritage plan called for the establishment of a full-fledged, co-managed liquidating trust. Its structure was deliberately patterned after the ELIC liquidation trusts, except that the receiver was entitled to appoint two of the three trustees and NOLHGA just one. The trust represents one of the best examples of a recent trend in the system's design of insolvency transactions: An effective asset recovery strategy should be in the forefront of negotiations from the beginning, and should be a central feature of a task force's overall program rather than a mere bargaining chip.

There was an interesting sidelight to this insolvency. The association most affected, dollarwise, was Texas. In order to fund its huge obligations, it was able to close a unique transaction. For a long time, many associations have had bank lines of credit. NOLHGA itself secured one in 1995. But these have almost always tended to be arrangements with one local bank. In National Heritage, the Texas association, using Chase Bank in New York City, put together (without involvement by the task force or NOLHGA) a syndicated lending arrangement primarily with overseas banks, at a favorable interest rate. Association financial credibility had come a long way since Guarantee Security Life!

> Cooperation with receivers should always be a primary objective...

The lessons of Pacific Standard, Kentucky Central and National Heritage? Cooperation with receivers should always be a primary objective. Sometimes, however, the system should draw a line in the sand marking the right thing to do for covered policyholders and make certain that receivers are aware of the line's position. Once an understanding is achieved, there is no reason to fear lasting impairment of the relationship. ▼

To obtain a copy of "*NOLHGA and the Evolution of the State Guaranty Association System*," please call NOLHGA at 703/481-5206 and ask for the Law Department.

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Franklin D. O'Loughlin

significant value. Just as the guaranty associations can be of assistance in the sale of non-liquid assets, they can be of enormous assistance in pursuing litigation. One of the first steps in involving guaranty associations is to develop a comprehensive joint litigation agreement addressing issues of privilege and confidentiality as well as acknowledging that conflicts in other areas may develop.

The extent of involvement by the guaranty associations will vary depending on the particular insolvency and the causes of action. In some instances, the guaranty associations may provide advice or expertise regarding certain issues specific to the litigation, such as damages. As well, the guaranty associations can be of great assistance in evaluating settlement proposals, particularly since they will be the creditor most significantly affected by any settlement.

In addition to a supporting role, guaranty associations can, in appropriate circumstances, pursue claims as a joint plaintiff with the estate. This approach can have substantial advantages for the estate as far as savings in fees and expenses. Also, this cooperative approach presents a united front and reminds the court and the defendants that real money was lost and that the creditors want their money back.

Other Methods of Liquidating Assets

The guaranty associations have provided significant assistance in the development of alternative strategies and vehicles by which assets may be liquidated. The increased recoveries resulting from these guaranty association contributions benefit all creditors, not just the guaranty associations. In this regard, the guaranty associations have assisted in the development and operation of various trusts which may liquidate long-term assets and pursue causes of action.

Trusts have proven particularly beneficial in providing viable alternatives to fire sales by creating a mechanism to manage and liquidate the assets over a period of years.

Assistance in Winding Down an Insolvency

Through cooperative efforts on the liabilities and asset sides, the guaranty associations can provide substantial assistance to receivers in winding down an insolvent estate. Lifke all creditors, the guaranty associations have an interest in seeing the assets liquidated for as much money as possible, as soon as possible, with the proceeds distributed shortly thereafter.

The involvement of the guaranty associations can provide substantial administrative efficiencies and thus, accelerate the completion of an insolvency. For example, the guaranty associations typically replace tens of thousands of creditors (i.e, the policyholders) with a few creditors (themselves). The estate stands to realize administrative savings because it is dealing with a handful of creditors instead of thousands of creditors.

In addition, the guaranty associations can facilitate and accelerate asset liquidation and distribution. Many states authorize or require distribution of available assets to the associations on an early-access basis. Again, the result should be administrative savings and should accelerate the completion of the liquidation and the accompanying distribution to all creditors.

Conclusion

Guaranty associations can be a valuable resource to receivers in dealing with both assets and liabilities of an insolvent insurer. The guaranty associations typically are the largest creditor of the estate and have express statutory authority to provide assistance. The cooperation of the receiver and the associations can result in enhanced recoveries for all creditors through realization of efficiencies and the maximization of estate assets. The extent of guaranty association involvement is dynamic and should improve the liquidation of an insurer for the benefit of all creditors. ▼

The authors are attorneys with the law firm of Rothgerber, Appel, Powers & Johnson in Denver. They are counsel to NOLHGA in connection with several insolvencies and to three guaranty associations - Colorado, Montana and Wyoming.

DOUGLAS C. FURLONG, EXECUTIVE DIRECTOR
New Jersey Life and Health Insurance Guaranty Association

Mr. Furlong is executive director of the New Jersey guaranty association. Prior to this post, he was employed by the Home Life Insurance Company for eight years, most recently as vice president of accounting operations. Mr. Furlong came to the insurance industry from the international accounting firm of Deloitte, Haskins & Sells (now Deloitte & Touche), where he was a financial services specialist. He received his B.S. from Bucknell University and his M.B.A. from Seton Hall University.

FRANK GARTLAND, PRESIDENT
Ohio Life and Health Insurance Guaranty Corporation

Mr. Gartland is president of the Ohio guaranty association and is former chairman of the Members' Participation Council, a position he held for three years. Before joining the Ohio association, he was the executive vice president of operations and general counsel of the Pharmacists Mutual Insurance Company and the Pharmacists Life Insurance Company from 1981-1988. Mr. Gartland received his B.S. from the University of Kentucky's College of Pharmacy and his J.D. degree from the university's College of Law.

JAMES W. RHODES, LEGAL COUNSEL
Oklahoma Life and Health Insurance Guaranty Association

Mr. Rhodes is a partner in the Oklahoma City law firm of Kerr, Irvine, Rhodes & Ables and serves as general counsel and assistant administrator of the Oklahoma guaranty association. He has written several articles on the guaranty system and the law of insurer insolvency, some of which have appeared in various editions of the NOLHGA Journal. Mr. Rhodes is a graduate of Wesleyan University in Middletown, Conn., and of the University of Oklahoma Law School.

MARGARET M. PARKER, EXECUTIVE DIRECTOR
Virginia Life, Accident and Sickness Insurance Guaranty Association

Ms. Parker has been executive director of the Virginia guaranty association since 1992. Last October, she was named to succeed Frank Gartland as chairman of the Members' Participation Council. Prior to joining the guaranty association, Ms. Parker spent 24 years with The Life Insurance Company of Virginia and at the time she left, was director - government relations and also supervised the corporate secretarial functions for Life of Virginia and its 10 affiliated companies. Ms. Parker, a graduate of the University of Richmond, lobbied insurance issues at the Virginia General Assembly for 15 years.

Mark your calendars...

The **Seventh Annual NOLHGA Legal Seminar** will be held July 23-24 at the Reno Hilton (Airport) Hotel in Reno, Nev. An agenda, meeting information and other materials will be distributed in May.

NOLHGA's **15th Annual Meeting** will be held Oct. 5-7 in Portland, Ore. Invitations and materials will be distributed in July.

1998 CALENDAR

NOLHGA

MARCH

14-18 NAIC Spring Meeting
Salt Lake City

APRIL

23 NOLHGA Board of Directors
Milwaukee

23-24 NCIGF Annual Meeting
Washington, D.C.

MAY

12 Joint NOLHGA / NCIGF Legal Committees
St. Louis

JUNE

1-3 Members' Participation Council
Portland, Maine

20-24 NAIC Summer Meeting
Boston

JULY

21-22 NOLHGA Board of Directors
Jackson Hole, Wyo.

23-24 NOLHGA Legal Seminar
Reno, Nev.

AUGUST

19-21 Members' Participation Council
Omaha, Neb.

SEPTEMBER

13-16 NAIC Fall Meeting
New York City

OCTOBER

5 NOLHGA Board of Directors and Legal Committee
Portland, Ore.

5-7 NOLHGA's 15th Annual Meeting
Portland, Ore.

NOVEMBER

18-20 Members' Participation Council
Tampa, Fla.

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