SUMMER 1998 VOL. IV NO. 3

Pacific Standard Ends With $85 Million Trust Distribution

by Bart A. Boles
LaShelle, Coffman & Boles

The rehabilitation plan the guaranty associations developed for Pacific Standard Life Insurance Company culminated May 11, 1998, with a trust distribution in excess of $85 million. This event marks the successful end of a plan in which the associations employed revolutionary techniques and firm determination to enlist the support and cooperation of the California insurance commissioner.

Late in 1992, then California commissioner John Garamendi approached the guaranty associations with the opportunity to participate in a rehabilitation plan he was proposing for PSLIC. The plan entailed an eight-year workout of the troubled asset portfolio with only one source of additional funds - a $50-80 million unrestricted "bullet" payment from the guaranty associations.

In exchange for these contributions, the commissioner would seek a court order declaring that the associations had fulfilled their obligations to policyholders. Ultimately, the associations refused the commissioner's request for funds after learning that their contributions would be used as general PSLIC assets to support all policyholders - significant because about 40 percent of the company's policyholders were not eligible for guaranty association coverage because the company's conservation pre-dated the creation of the California guaranty association.

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

NOLHGA's Amicus Involvement Increases During Past Year

by Joni L. Forsythe
Counsel, NOLHGA

During the past year NOLHGA's involvement as an amicus curiae in appellate litigation has hit an all-time high. In fact, during the last eight months alone, the organization has received five requests for amicus briefs on issues of national importance to the guaranty system. Upon receipt, all such requests are submitted to the Amicus Subgroup of NOLHGA's Legal Committee for consideration.

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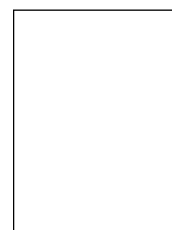
Since November of 1997, NOLHGA has filed *amicus* briefs in three cases for which the range of issues has included coverage limitations, guaranty association priority, opt-in challenges (including jurisdictional challenges) and federal claim priority. The organization received two additional requests in May which are under consideration. An overview of the aforementioned three cases is presented in this article.

Northwestern Security Life Insurance Company

In November, 1997, NOLHGA and the National Conference of Insurance Guaranty Funds filed a joint *amicus* brief with the U.S. Court of Appeals for the Fourth Circuit in connection with litigation arising out of the liquidation of Northwestern Security Life Insurance Company, a North Carolina insurer. This case was initiated by the North Carolina liquidator who, in the aftermath of the Fabe decision, sought a refund of certain alternative minimum income taxes previously paid to the federal government as priority claims against the estate.


Joni L. Forsythe

At trial, the government argued that the taxes at issue were administrative expenses of the estate and thus entitled to administrative priority under the state statute. They also challenged the validity of the state priority scheme on the grounds that it provided payment of employee and guaranty association claims at a priority higher than that of federal income tax claims, and further argued that the offending provisions were not "severable" (i.e., the entire statute must fall).

The trial court agreed that the taxes at issue were administrative expenses entitled to administrative priority and ruled in favor of the federal government.

See AMICUS, *Page 6*

President's Column

The Challenge of Change

With all that has transpired recently in the insurance and financial services industries, we had little difficulty this year in selecting a theme for our 15th Annual Meeting. "The Challenge of Change" is significant for all of us as we approach a new millenium. Business, technology, markets...all change and evolve with almost dizzying speed and present challenges - and opportunities - for everyone.

Though we're not yet sure what bearing the mergers of life insurance and financial services companies will have on the insurance industry and the guaranty system, we can comfortably predict that the rules will change. If a behemoth such as the new Citigroup were to fail, who would protect the company's life and health insurance policyholders? The FDIC? The life and health insurance guaranty associations? Some other as yet unnamed institution?

These very questions are being studied by a myriad of groups, including the National Association of Insurance Commissioners, the state life and health insurance guaranty system, and legislators. Whatever the outcome, however, I assure you that NOLHGA's member guaranty associations remain committed to the protection of the nation's policyholders and will do everything in their power to ensure that the standard we've set over the years will not be diminished.

Our annual meeting this year will be held Oct. 5-7 in Portland, Ore. We are working on assembling panels and programs, comprised of knowledgeable and respected industry individuals, who will explain the changes and challenges that lie ahead and offer suggestions on how we might prepare for them.

Leonard D. Schaeffer, chairman and CEO of Wellpoint Health Networks Inc., who transformed a financially troubled Blue Cross plan into a national health care power, will address the changes awaiting NOLHGA and its member guaranty associations and constituent companies as health care coverage evolves.

Charlie McDowell, a well-known political commentator, will join us at an Oct. 6 luncheon to give us his perspective on changes in the political landscape. Mr. McDowell drew raves reviews when he joined us at our annual meeting in Baltimore in 1996.

We also have invited Oregon **Gov. John A. Kitzhaber,** a physician familiar with both insurance and health issues. We eagerly await confirmation from the governor's office that he will be able to join us.

Invitations and other annual meeting materials will be sent in July to our members, their boards, insurance commissioners, regulators and receivers, and other industry executives. If you have not previously received an invitation but would like to be included in our mailing list, please call us at NOLHGA0, 703/481-5206. I hope to see all of you in Portland and share with you the challenge of change. ▼

Brian J. Donnelly

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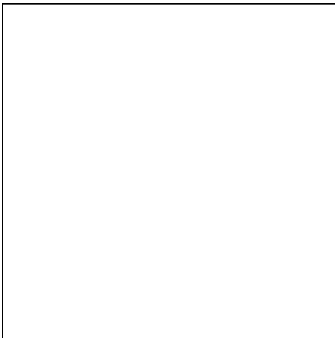


Lunch with

Alessandro Iuppa

Maine Superintendent of Insurance

Alessandro Iuppa, Maine's superintendent of insurance, addressed guaranty association administrators at a June 1 Members' Participation Council luncheon in Portland, Maine. A former Nevada commissioner who has had hands-on experience with a number of insolvencies, the superintendent said he believes life and health insurance insolvencies have declined in recent years for a number of reasons:

- the NAIC's accreditation program, which has fostered consistency in the application of state laws;
- the advances in technology for regulators;
- the increase in resources provided for financial analysts, including databases and software, which have enhanced analysis; and
- the role of the state life and health insurance guaranty associations, which have provided another set of "eyes and ears" for the regulators.

The superintendent also touched on three issues of grave importance to the life and health insurance industry in general add to the state life and health insurance guaranty system in particular.

"Y2K"

Superintendent Iuppa labeled the so-called "Year 200 Problem" a "serious issue." In 1997, he said, the National Association of Insurance Commissioners' Information Services Committee directed staff to determine Year 2000 compliance among member companies.

The survey prepared by the staff would determine companies' impetus to take action and their degree of readiness About 3,700 companies, representing 75 percent of premium, received the survey. Between 1,400 and 1,500 responded. Most said that they would be compliant by Dec. 31, 1998; the rest said they expected compliance by Dec. 31, 1999.

The survey also indicated that the larger companies are doing the most to ensure compliance and are sharing their experience and information with smaller companies. There is some concern, however, about the smallest of companies reaching an acceptable level of compliance.

H.R. 10

The legislation purports to "enhance competition in the financial services industry by providing a prudential framework for the affiliation of banks, securities firms, and other financial service providers, and for other purposes." Superintendent Iuppa said that while some modernization is appropriate, it shouldn't be done at the expense of state law and authority.

He called Sec. 104 of the bill, which deals with state preemption issues, the "most onerous." The House leadership, he said, postponed ruling on it and tried to revise it. Senate hearings are scheduled for mid-June as the *Journal* goes to press.

The superintendent said the language of H.R. 10 raises several questions and concerns:

1. Would an insurance company be considered a "financial holding company," over which the Federal Reserve has authority?

2. What does "consult" mean when the bill says that the Fed must "consult" with state regulators when taking action against insurance affiliates?

3. As Sec 104 is written, it has broad preemption potential, which could impact the state regulation of underwriting activities.

4. With respect to the redomestication of mutual companies, what authority would the ceding state have?

5. And finally, would H.R 10 create an unlevel playing field? For example, some companies are affiliated with financial institutions and some are not. Those that are would have different capital and surplus requirements, which could lead to litigation.

Managed Care

The superintendent said that his primary concern about managed care is a safety net for policyholders. "There doesn't seem to be one," he said. the state life and health insurance guaranty associations share Superintendent Iuppa's concern. ▼

PSLIC, *from Page 1*

The commissioner continued to develop his rehabilitation plan without the guaranty associations. Under the plan the commisisoner eventually submitted to the court for approval, the PSLIC policyholders would have the opportunity to opt out of the plan in exchange for a payment of approximately 70 percent of their cash surrender value.

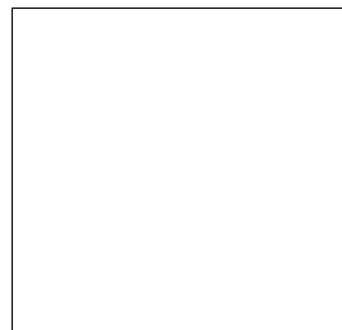
The policyholders who elected to participate in the plan would have their policies restructured to include an initial moratorium charge of 30 percent on surrenders. The moratorium would decrease incrementally over the eight-year plan period. During the eight years, policyholders would receive a 4 percent interest crediting rate on account values. The commissioner notified the guaranty associations that he considered his plan to provide full benefits to policyholders and thus would not honor any association's claim based on payment of contract benefits.

Several aspects of the commissioner's plan caused the guaranty associations concern. The lengthy moratorium period, high moratorium charges and low interest crediting rates almost would assuredly be found unacceptable by state regulators and pressure would mount to activate the guaranty associations. Moreover, the plan did not recognize the statutory subrogation rights of the associations, nor did it contain a definitive procedure for maximizing the value of PSLIC's assets.

The commissioner filed his plan with the conservation court on March 15, 1993, initiating an eight-week overbid process during which competing plans could be filed for the court's consideration. The NOLHGA PSLIC Task Force, along with Hartford Life Insurance Company, began to develop an alternative rehabilitation plan that would fulfill guaranty association obligations while adhering to statutory coverage provisions, maximize the value of PSLIC's assets, shorten the moratorium period and improve policyholder benefits.

This plan, submitted April 17, 1993, to the court and the California insurance commissioner, involved the creation of an asset liquidation trust to maximize the value of PSLIC's illiquid assets, through an orderly liquidation, over a three to four-year period. Policyholders would be given the opportunity to opt out of the plan and receive a cash payment equal to 77 percent of their cash surrender value.

Those electing to participate in the plan would have their policies restructured to include a four percent interest crediting rate for the four-year moratorium period, prohibition of total surrenders in the first year, moratorium charges beginning at 12 percent in year two and decreasing over the remaining moratorium period, and a market value adjustment for annuities to allow for higher interest to be credited after the moratorium period. The plan also called for guaranty associations to provide additional benefits should the restructured terms of the policies not meet the associations' statutory obligations. After restructuring, Hartford Life would assume the policies.

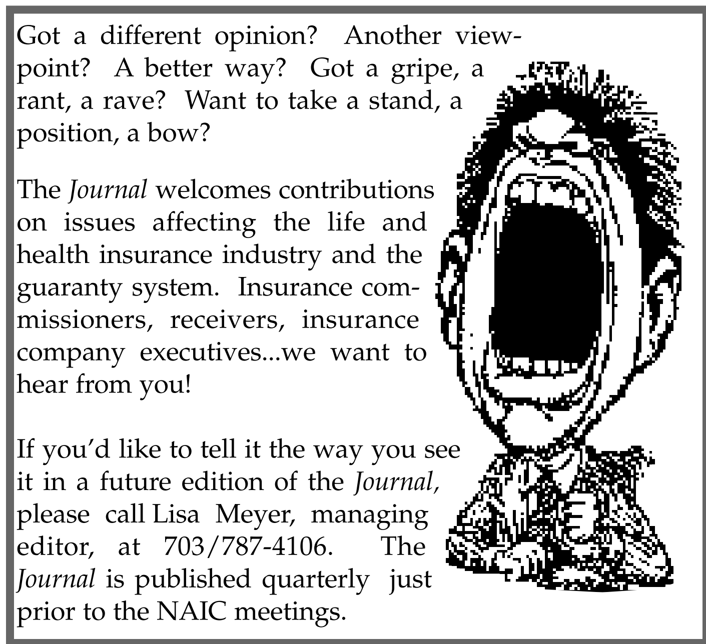


Bart A. Boles, *Chair*
PSLIC Task Force

Although another bid was submitted to the court - in addition to the commissioner's own- the commissioner agreed in June, 1993 to support the NOLHGA/Hartford plan and recommend to the court that it be adopted. Following two days of hearings, the court ruled in favor of the NOLHGA/Hartford plan.

The plan closed on May 11, 1994, following a lengthy delay due to an appeal mounted by PSLIC's equity holder. Approximately 9,000 policyholders elected to opt out of the plan, but 51,000 chose to participate, and their contracts - worth about $400 million - were transferred to Hartford. The guaranty associations funded nearly $27 million of the assets transferred to Hartford; another $320 million came from PSLIC's liquid estate assets.

The PSLIC estate retained $71 million, which allowed for the continued administration of the estate, payment of opt-out claims and prosecution of litigation against various parties responsible for the insolvency.



Got a different opinion? Another viewpoint? A better way? Got a gripe, a rant, a rave? Want to take a stand, a position, a bow?

The *Journal* welcomes contributions on issues affecting the life and health insurance industry and the guaranty system. Insurance commissioners, receivers, insurance company executives...we want to hear from you!

If you'd like to tell it the way you see it in a future edition of the *Journal*, please call Lisa Meyer, managing editor, at 703/787-4106. The *Journal* is published quarterly just prior to the NAIC meetings.

ngths To Design Beneficial Plan For PSLIC's Policyholders

The rehabilitation plan produced benefits - to both the policyholders and the guaranty associations - that would not have been realized under the commissioner's original plan. First, the funding the associations provided was reduced by the projected value that would be realized by the assets in the liquidation trust. The associations provided a guarantee for additional funding should that value not be attained. Although liquidation trusts had been employed previously, this was the first time the guaranty associations provided net funding rather than gross funding with an anticipation of future recoveries. This was an essential plan element, as several of the associations had expressed assessment capacity concerns.

The introduction of Hartford as the assuming insurer provided a much needed sense of security for beleagured policyholders, additional value through the enhancement they paid into the transferred policies, and the ability for policyholders to receive market interest rates at the conclusion of the four-year moratorium period.

Finally, the associations were assured that their statutory provisions would be applied. Specifically, their funding would benefit only the covered policyholders.

All parties were committed to ensuring the success of the plan. Hartford administered hardship requests and processed post-closing data. The commissioner actively pursued litigation against wrongdoers, ultimately resulting in $4 million in recoveries, and resolved an Internal Revenue Service claim relating to Internal Revenue Code Section 7702. As trustee, he also was responsible for liquidating problematic assets in the trust.

The surrender rate and amount of complaints received were less than anticipated, due in large part to Hartford's excellent stewardship. The commissioner's effectiveness in recovering assets and resolving tax claims resulted in a final trust distribution beyond what had been projected. Finally, the guaranty associations played a large role in maintaining the parties' focus on the overall objective of the rehabilitation plan.

It is important to reflect on the reasons for the successes in the PSLIC insolvency. Too often, plan implementation is more difficult than necessary because the parties do not cooperate. Pacific Standard had all the makings of a contentious insolvency, especially since the guaranty associations refused the commissioner's original plan and instead offered their own. Why, then, did all the pieces fall into place?

The answer lies in the ability of the three parties - Hartford, the commissioner, and the guaranty associations - to put aside any differences and concentrate their efforts on the primary goal: that of providing policyholders with the best available benefits. The plan incorporated three parties' strengths and was mindful of their limitations. Further, the parties remained flexible throughout, enhancing the cooperative atmosphere. The spirit of cooperation permitted everyone to focus on the big picture and not waste time pursuing individual victories. ▼

The PSLIC Task Force, along with Hartford Life, began to develop an alternative rehabilitation plan that would fulfill guaranty association obligations while adhering to statutory provisions, maximize the value of PSLIC's assets, shorten the moratorium period and improve policyholder benefits.

PSLIC Task Force

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Bart A. Boles is a partner at the Austin, Texas firm of LaShelle, Coffman & Boles, Ltd. The firm is under contract to administer the Texas Life, Accident, Health & Hospital Service Insurance Guaranty Association and also performs administrative duties for other guaranty associations.

John Finston, a managing partner with the Portland, Ore., office of LeBoeuf, Lamb, Greene and MacRae, contributed to this article. Mr. Finston is the PSLIC Task Force's legal counsel and project manager.

AMICUS, *from Page 1*

On appeal, the liquidator challenged the trial court's treatment of the taxes as administrative expenses, The government's challenges to the validity and severability of the state priority statute also were briefed on appeal and submitted to the court for consideration. While the trial court had not addressed these latter issues, NOLHGA and NCIGF were very concerned that the issues might be either decided by the court on appeal, or remanded for decision by the trial court.

The issue of guaranty association priority was briefed with great success by NOLHGA and NCIGF in the Boozell case (Northern District of Illinois) earlier in 1997. With the consent of the liquidator, the organizations collaborated on a protective brief rebutting the government's challenges to the state priority statute.

At the Jan. 28 hearing, NOLHGA and NCIGF, through counsel, argued vehemently against the appellate court reaching these issues without the benefit of a fully developed record. On April 16, the Court of Appeals affirmed the trial court's treatment of the taxes as expenses of the estate entitled to administrative priority under the state priority statute. No further appeal has been filed.

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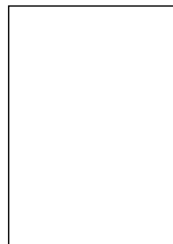
Tony Buonaguro Moves To Met Life, Is Succeeded By Bill O'Sullivan



Anthony R. Buonaguro, NOLHGA's executive vice president and general counsel, leaves NOLHGA June 26 to assume the post of vice president of business development at Metropolitan Life Insurance Company in New York City.

During his five years as general counsel at NOLHGA, Mr. Buonaguro had primary responsibility for resolving the Executive Life Insurance Company and Confederation Life Insurance Company insolvencies, two mega-failures with a host of complex legal issues. During the early days of ELIC, he was appointed a special deputy insurance commissioner of the state of California and a trustee of the company's liquidation trusts.

He also assisted in the creation of the NOLHGA Legal Committee and contributed to the Guaranty Association Model Act Amendments program, which the NAIC adopted last year. Mr. Buonaguro also represented NOLHGA to the International Association of Insurance Receivers and the Receivership Law Advisory Committee of the Interstate Receivership Compact. In 1997, he co-authored with Jana Lee Pruitt of the American Council of Life Insurance a history of NOLHGA and the state guaranty system.

"I'm very happy to be going to a company such as MetLife, which has had a long history of strong support for the state guaranty system," Mr. Buonaguro said. "It's an attractive notion to trim staff in the states and at NOLHGA when times are good. It takes vision to resist that temptation and prepare instead for when times are bad. I want my friends in the guaranty system and in the receivers' fraternity to rest assured that, as a member of the industry, I will do the best I can to maintain a strong state system and national organization to handle the next round of insolvencies."

Effective June 1, **William P. O'Sullivan,** formerly NOLHGA's vice president and deputy general counsel, became senior vice president and general counsel. Mr. O'Sullivan was corporate counsel at KTI Holdings, Inc., in New Jersey, before joining NOLHGA in January, 1985. He also had been assistant general counsel at Prudential Capital Corporation, a subsidiary of the Prudential Insurance Company of America. Mr. O'Sullivan has been instrumental in the guaranty associations' efforts to recover assets from insolvent estates.

AMICUS, *from preceeding page*

Bank of Mississippi

In response to a request by the Mississippi Life and Health Insurance Guaranty Association, NOLHGA in February filed an *amicus* brief with the Mississippi Supreme Court in the matter of Bank of Mississippi v. Mississippi Guaranty Association. The bank, as trustee of a pension plan liquidating trust, seeks reversal of the trial court's ruling denying coverage based on the Pension Benefit Guaranty Corporation (PBGC) exclusion in Mississippi's guaranty act. The act expressly excludes coverage for any unallocated contract issued to employee benefit plans otherwise protected by the PBGC.

The trustee argues that the pension plan, although eligible for PBGC coverage, was **not** protected by the PBGC because no PBGC payments were made since the plan's assets exceeded the amount of benefits guaranteed at the distribution date.

Also, the trustee argues that the exclusion does not apply to contracts purchased prior to the 1990 enactment of the PBGC exclusion, and that any retroactive application violates the Contract Clauses of the U.S. and Mississippi Constitutions.

The trial court, rejecting the plan's arguments, found that the plan paid termination insurance benefits within the PBGC's statutory limits. The court further concluded that the guaranty association law in effect at the time of the insolvency governs the association's obligations regardless of when the contracts were purchased, and that there can be no contracts clause violation since the association's obligations are purely statutory. The Mississippi Supreme Court on Feb. 25 granted NOLHGA's motion to file its amicus brief. No hearing has been scheduled.

ELIC - Claim of Fara Furhmann

In December, 1997, NOLHGA filed an amicus brief with the Wisconsin Court of Appeals in the matter of Fuhrmann v. Wisconsin Insurance Security Fund. The claimant, a Wisconsin resident, opted into the ELIC Enhancement Plan and challenged the plan on the grounds that she received less than 100 percent of her structured settlement annuity benefits. She sought additional recoveries from the Wisconsin guaranty association under Wisconsin law (as opposed to California - the state of the contract owner's residence and the state whose law was used in computing her benefits under the plan).

The Wisconsin Liquidation Court denied the claimant's challenge to the Enhancement Agreement and rejected her demand for class certification. On appeal, she argued that her election to opt into the plan was induced by fraud, because her attorney purportedly was advised by someone in the insurance commissioner's office to submit Ms. Fuhrmann's election form with a cover letter challenging the selection of California - rather than Wisconsin - as the relevant state for determination of her benefits under the plan.

In connection with the appeal, the Wisconsin guaranty association requested that NOLHGA submit an amicus brief addressing the claimant's various challenges to the plan. the brief noted the claimant's challenges based on lack of consideration, statutory coverage under Wisconsin law, and various misstatements regarding key terms of the Enhancement Agreement. The brief also provided background and context for the court to consider in connection with the policy implications at issue.

The Wisconsin Court of Appeals on April 30 affirmed the circuit court's decision denying Ms. Fuhrmann's claim. The court held that by opting into the plan, she submitted to the jurisdiction of the California liquidation court, and that the liquidation court's decision approving the plan was entitled to full faith and credit. the court also concluded that the Wisconsin guaranty association acted within in its statutory authority when it entered into the participation agreement, and that the association had satisfied its funding obligations under the plan. Because Ms. Fuhrmann failed to raise the fraud allegation in trial court proceedings, the appeals court declined to address that issue. They released the guaranty association from further obligations and concluded that Ms. Fuhrmann was bound by her election. ▼

In the next edition of the NOLHGA *Journal* (Fall 1998):

Ms. Forsythe will will review the insolvencies which prompted the two most recent *amicus* requestsand will update readers on their status.

1998 - 1999 CALENDAR

JULY		**AUGUST**		**SEPTEMBER**	
21	Audit and Finance Committees *Jackson Hole, Wyo.*	19-21	Members' Participation Council *Omaha, Neb.*	13-16	NAIC Fall Meeting *New York City*
22	NOLHGA Board of Directors *Jackson Hole, Wyo.*				
23-24	NOLHGA Legal Seminar *Reno, Nev.*				

OCTOBER		**NOVEMBER**		**DECEMBER**	
5	NOLHGA Board of Directors *Portland, Ore.*	18-20	Members' Participation Council *Tampa, Fla.*	5-9	NAIC Winter Meeting *Orlando, Fla.*
5-7	NOLHGA's 15th Annual Meeting *Portland, Ore.*			25	Christmas Day *NOLHGA's Offices Closed*

JANUARY		**FEBRUARY**		**MARCH**	
		17-19	Members' Participation Council *Tucson, Ariz.*	6-10	NAIC Spring Meeting *Washington, D.C.*

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