

NOLHGA JOURNAL

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Huge Guaranty Association Payment Marks Beginning Of The End For Executive Life

by Angela J. Franklin
Assistant Counsel, NOLHGA

Guaranty associations on June 3 made the largest combined single payment in history when they paid more than \$862 million to Aurora National Life Assurance Company, extinguishing their obligations due in the Executive Life Insurance Company insolvency.

This "bullet payment" discharges most of the participating guaranty associations' remaining obligations for Declared Rate Contracts (DRCs) and unallocated contracts. DRCs relate principally to surrenderable life insurance policies and single-premium deferred annuities. The June 3 payment will be subject to a true-up next year and, if necessary, an additional payment will be due June 3, 1999.



The bullet payment occurred three months prior to the Sept. 3 end of the five-year moratorium period provided for in the Executive Life Rehabilitation Plan. At that time, policyholders may surrender their surrenderable contracts without penalty.

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Executive Life In Brief

Domiciled	California
Affected States	44
Conservation	April 11, 1991
Liquidation	Dec. 6, 1991
Close	Sept. 9, 1993
Assuming Carrier	Aurora National Life Assurance Company
Cause of insolvency	Asset Risk



Centennial Life Presents GA's With Multiple Challenges

by Charles T. Richardson, Baker & Daniels, and Mark H. Femal, Centennial Life Task Force Chair

The national health care debate of 1993-94 began a discussion about insurance issues that, at least on the scale the public then witnessed, had not occurred before. Since May 27, when the state court in Topeka, Kan., entered a final order of liquidation for Centennial Life Insurance Company, the guaranty system has had to tackle its own series of health insurance issues on a scale we had not seen before. Centennial Life is the first large, national health insurance insolvency in some time that presents a series of interesting challenges to the 49 affected guaranty associations. Those challenges, and the steps the guaranty system has taken to meet them, were reviewed in detail at the Aug. 20 Members' Participation Council meeting in Omaha, Neb.

Task Force and Centennial Life Receiver

Mark Femal of Wisconsin chairs NOLHGA's Centennial Life Task Force. Other task force members are Linda Becker, Kansas; Bart Boles, Texas; Andrea Bowers, South Carolina; Randy Cox, West Virginia; William Falck, Florida; and Mike Marchman, Georgia. Kansas Insurance Commissioner Kathleen Sebelius appointed Dan Watkins, a Kansas attorney and experienced receiver, as her special deputy in charge of Centennial Life. The well-regarded Kansas City law firm of Blackwell Sanders Peper Martin, led by Doug Schmidt, was named to serve as general counsel to the receiver. The staff at Centennial and the personnel at American Chambers Life Insurance Company, with which the receiver has a management services contract, have provided continuing assistance to everyone involved,

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NOLHGA Researches Methods, Legal Requirements of Institutional Memory



For some time, we have been pondering how we and our member guaranty association administrators could share, reference and reuse information which has been collected on paper since NOLHGA's inception in 1983. Indeed, the concept of "institutional memory" - essentially, records retention - has been on the radar screen for about a half-dozen years. The activity brought on by Executive Life, Confederation Life and other insolvencies, however, precluded serious consideration of this matter. In short, we were too busy fighting the battles to write and preserve our valuable history.

As the new guy on the block, I suggested to the NOLHGA Board of Directors that institutional memory needed attention. The Board, noting advances in technology and its increasing affordability, directed staff to designate institutional memory a top priority for 1998 and 1999.

Staff determined, and the Board agreed, that an electronic archive not only would help to contain and ultimately reduce costs, but would enable us to better educate our constituents and protect the organization and its members from a disaster which could damage or destroy hard copy records.

Dick Klipstein, NOLHGA's executive vice president, insurance services, formed a systems group to study methods by which to achieve institutional memory in accordance with legal requirements for document retention.

NOLHGA's legal department assisted this effort by preparing draft requirements for the retention of various categories of information.

Rather than design a proprietary system, presumably a costly and labor-intensive endeavor, the group studied several "off-the-shelf" products which could be customized for the organization. The product ultimately selected met our goals of accessibility, cost-effectiveness, ease of implementation, potential for expansion, user-friendliness and compatibility with NOLHGANet. The Board has authorized staff to proceed with the initial phase of this project and report back to the Board.

Locating and collecting electronic copies of an overwhelming amount of information promises to be an enormous task. We cannot say with certainty just how many sheets of paper insolvency and system-related information we have produced in the 15 years of NOLHGA's existence, though the number is estimated to be in the millions.

To get a handle on just how complex the task of electronic document conversion might be, staff soon will begin a study of four mid-sized insolvencies. Wading through these "test" cases, we hope, will better enable us to proceed with the remaining documents in our possession. The hard copy documents related to each will be sorted into three categories: primary secondary, and "trash."

"Primary" documents might

include assumption agreements, rehabilitation plans and other key, final documents.


"Secondary" documents could be supporting information such as task force correspondence to an affected guaranty association explaining why Solution A would be preferable to Solution B for a particular insolvency.

"Trash" would be duplicate copies of documents, old faxes that no longer are legible, and the like.

Primary documents, of course, will receive top priority in terms of electronic conversion and posting to the new system. Wading through these "test" cases, we hope, will better enable us to proceed with the remaining documents in our possession.

To insure that the project ultimately will be helpful to our members, MPC Chair Peggy Parker has named an advisory group of administrators to help shape the direction of the institutional memory project. The group includes Peter Leonard, Alaska; Jamie Kelldorf, Colorado, Montana and Wyoming; Lowell Miller, North Carolina; and Bill Callnan, Vermont.

NOLHGA is committed to the success of this project, which we hope will be of lasting benefit to our members. As always, we welcome your comments and suggestions and encourage you to share with us your experience with similar undertakings. ▼

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National Organization of Life and Health Insurance Guaranty Associations

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NOLHGA Files Amicus Briefs in Blue Cross/Blue Shield, Executive Life Insurance Company Cases

by Joni L. Forsythe
Counsel, NOLHGA

On Aug. 17, NOLHGA and the National Conference of Insurance Guaranty Funds filed a joint *amicus* brief with the West Virginia Supreme Court of Appeals in connection with litigation arising out of the liquidation of **Blue Cross/Blue Shield of West Virginia**. The state's receivership court in January, 1997, had concluded that the state statutory claims bar date applies to claims of the federal government.



In accordance with West Virginia's statutory scheme, the court assigned Class 7 priority to untimely federal claims, for payment after general creditors. It does not appear that the estate has assets sufficient to satisfy all Class 2 policyholder claims or any subordinate claims. Because BC/BS of West Virginia was licensed as a hospital service corporation and was not a member of the state life and health insurance guaranty association at the time of its liquidation, guaranty association claims priority is not at issue.

The United States took exception to the receivership court's findings, and the West Virginia Supreme Court of Appeals on Nov. 10, 1997, agreed to hear the government's petition for appeal. The issue of national

interest in this case is the applicability of the state's statutory claims bar date to claims of the federal government. Otherwise stated, are the McCarran-Ferguson protections, as construed by *Fabe* and its progeny, sufficiently broad to encompass non-priority based provisions of the state liquidation acts?

As is often the case with issues NOLHGA is asked to brief, this matter is one of first impression in most jurisdictions. Moreover, there appears to be a fair amount of dissension among courts that have addressed this issue.

The question most recently was raised - albeit in a different context - in an appeal to the 5th Circuit Court of Appeals, where the court concluded that the state liquidation act is part of the state's comprehensive statutory mechanism for regulating the business of insurance for the protection of policyholders, such that its provisions for exclusive jurisdiction are shielded from pre-emption by federal arbitration laws under the McCarran-Ferguson Act.

A petition for certiorari has been submitted to the U.S. Supreme Court in connection with the 5th Circuit Case.

Unisys - California (ELIC)

In the Unisys case, the California Court of Appeals on April 28 denied coverage under the California Life and Health

Insurance Guaranty Association Act for certain guaranteed investment contracts (GICs) issued by Executive Life Insurance Company to Unisys Corp. as investments for its employees' 401(k) plans. This ruling upholds the trial court's earlier decisions in the case. In

The Court of Appeals confirmed its earlier decision that the California statute excludes coverage for all GICs, not just those that are unallocated annuity contracts.

1996, NOLHGA appeared before the Court of Appeals to brief the coverage issues.

The plaintiffs in this case requested rehearing of the court's April 28 decision, again arguing that the GICs at issue should not be excluded from coverage under the act because they are not unallocated annuity contracts within the meaning of the California statute to the extent the contracts guaranteed annuity benefits to an individual. The Court of Appeals on May 21 denied the plaintiff's request for rehearing, confirming its earlier finding that the California statute excludes coverage for *all* GICs, not just those that are unallocated annuity contracts. See AMICUS, Page 6

With Less Than A Year And A Half To Go, How Ready Are NOLHGA And Its Member Guaranty Associations?



by Richard W. Klipstein
Executive Vice President, Insurance Services, NOLHGA

The Year 2000. It's coming and there's nothing you can do about it. Should you worry? We didn't think we had anything to worry about here at NOLHGA, but deciding to err on the side of paranoia, several months ago we began the process of determining whether our systems and programs were, in the vernacular, "year 2000 compliant."

Testing individual programs involved a lot of research and created almost as many questions as it answered: Which version of XYZ program was considered "safe?" If an older version was compliant, did that mean later versions were too? What about upgrades?

Inspecting the computers, however, required little effort, and we show you one approach on Page 7. But first you might want to know...

What's all the fuss about?

Essentially, your computer may not know that "00" means "2000" and not "1900." If an insurance company's computer, for example, reads the date as 1900, beneficiaries might not get paid because the computer thinks they haven't been born yet. Or the computer could cancel poli-

cies. I'm sure you can conceive of other disastrous results of non-compliance.

The worldwide repair bill to fix the problem is estimated to be \$300-600 billion (with perhaps 25 percent allocated toward design, another 25 percent to modifications and 50 percent to testing). Who will be compliant by Dec. 31, 1999? Experts say 80 percent of U.S. companies will be ok, compared to 65 percent of European companies and only 27 percent of the rest of the world's companies (including Japan).

NOLHGA's strategy

As mentioned, NOLHGA has begun preparations for 2000. Some programs will be updated in order to comply and others will be phased out. We've conducted both "Year 2000" and leap year tests on all personal computers. We expect that all software and hardware will be fully compliant by June, 1999. Our Board of Directors has been receiving, and will continue to receive, quarterly reports on our progress.

Guaranty association risk

We have endeavored to work with our member guaranty associations, first to make

them aware of the potential problem, and second to provide them with precautionary measures and to understand and address the problem.

At worst, the guaranty system may have to deal with insolvent insurers that experience total computer systems failure, resulting in inaccurate and/or lost data. Contract administration and claims and premium processing could come to a halt. Investment and financial accounting reporting could be inaccurate, as could payroll and actuarial calculations. Delays in assumption reinsurance arrangements create additional exposure.

To minimize guaranty association exposure, we have undertaken an inventory of insolvencies which may be associated with non-compliant, or questionably compliant, systems. Plans to deal with the problems and monitor compliance progress are being established.

What about the industry?

The life and health insurance industry, like most industries, requires the timely and accurate flow of electronic information in the forms of trades,

See YEAR 2000, Page 7

Guaranty Associations Make Huge Payment To Aurora

ELIC, from Page 1

Task Force Activities

In the coming months, the task force will concentrate on tying up loose ends in the ELIC insolvency. Through the end of the moratorium and beyond, the task force will:

- monitor the implementation of the indemnity settlement approved in March by the conservation court;
- monitor any new conservation court filings;
- coordinate responses to GIC coverage and plan challenges;
- review the administration of restructured Irreplaceable Life-6 and Irreplaceable Life-88 contracts and follow up on any remaining issues related to these contracts;
- participate in negotiations and in the implementation of the distribution of funds in the First Executive Corporation litigation trust;
- coordinate with the California Liquidation Office (CLO) and Aurora regarding any necessary amendments to the Rehabilitation Plan and Enhancement Agreement;
- evaluate the need for and the scope of an audit of Aurora;
- consider any restructuring of the ELIC Trust; and

- monitor other specific end-of-moratorium tasks to be performed by the CLO or Aurora.

Remaining Obligations

The remaining obligations of participating guaranty associations are composed primarily of non-surrenderable implied rate contracts (IRCs). These obligations are to be paid every April through declining yearly installment billings until the death of the last surviving annuitant. As of Dec. 31, 1997, these future IRC payments had a discounted present value of approximately \$806 million, representing undiscounted future payments of about \$1.6 billion. As mentioned above, in June of 1999, there may be a second additional installment billing, if needed, as a result of the tru-up of the June 3, 1998 payment.

Defeasance

Participating guaranty associations have the option of defeasing certain components of their obligations on May 30 of each year. A participating guaranty association that chooses this option first must request, not later than Dec. 31 of the prior year, a defeasance calculation pursuant to Section 5.1.4 of the Enhancement Agreement.

A participating guaranty association that defeases has no continuing obligations for installment amounts due under Section 5.1.2, but will

have continuing obligations for pre-closing lump sums provided for under Section 6.4.1, advances under Article 20, prior advances under Article 21, IL-6 guaranteed issue contracts under Article 22, IL-88 contracts under Article 23, and certain other payments specifically provided for in the Enhancement Agreement, including the tax indemnity provided to Aurora in Section 15.5 of the Enhancement Agreement.

The task force will continue proactive dealings with the issues surrounding the wind-down of the Executive Life insolvency. ▼

EXECUTIVE LIFE TASK FORCE

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Task Force, Receiver Pledge Cooperation To Resolve Centennial Life's Complex Issues

CENTENNIAL, from Page 1

helping to uncover Centennial's policy obligations and providing the administrative systems support necessary for the guaranty associations to discharge their covered obligations.

Why is Centennial Life so complex?

Centennial Life's core business was its health blocks, mainly group major medical products, which accounted for more than 90 percent of the company's premium and about 44 percent of its liabilities. The other blocks included long-term disability coverages (about 45 percent of Centennial's liabilities) and miscellaneous small coverages. A series of factors combined to make the task force's job a difficult one:

- large (more than six months' worth) health claims payment backlog, exacerbated by a complex set of health coverages and hundreds of policy variations;
- long-term disability business where the insureds were depending on monthly disability checks;
- a liquidation estate with little cash on the date of the liquidation order and no ability to pay claims;
- the complexity of Centennial's contractual arrangements and the difficulty of understanding the myriad of systems and operational aspects of the business;
- a multitude of pending serious litigation and legal disputes, including litigation with

a health reinsurer and litigation with a sister receivership in Idaho; and

- the need to analyze for the first time the legal and administrative parameters of health policy cancellation in this post-HIPAA environment.

Where do we go from here?

The contractual foundation has been laid to start meeting the needs of Centennial Life's insureds. On Aug. 20, the MPC approved two agreements with the receiver – a service agreement and an early access agreement – and authorized commencement of NOLHGA's normal opt-out process for guaranty association participation.

Under those agreements, the receiver will act as the participating associations' servicing agent and provide policy services, claims services and a variety of other functions. The

agreements should stabilize the situation for at least a year and lead the task force to short and mid-term solutions. The task force will be wrestling, block by block, with the long-term solution as the receiver's team, with guaranty association support and funding, works on the health claim backlog.

NOLHGA and its member life and health insurance guaranty associations are committed to cooperating with receivers and regulators in achieving solutions to sometimes thorny legal and financial problems that the insolvency system faces when companies go under. Fortunately with Centennial, all of the players recognized the critical need for cooperation. Much remains to be done, but the guaranty system and the receiver are united in their desire to protect policyholders as quickly, efficiently and cost-effectively as possible. ▼

NOLHGA Welcomes Requests For Amicus Participation

AMICUS, from Page 3

The plaintiff on June 5 filed a petition for review with the California Supreme Court. NOLHGA has been asked by counsel to consider filing an updated *amicus* brief in the event the California Supreme Court were to grant the plaintiff's petition for review. That petition since was denied; however, further appeal may be

forthcoming. Accordingly, NOLHGA will continue to monitor the proceedings in this case.

As in past years, NOLHGA continues to welcome requests for amicus participation in cases that involve matters of widespread importance to the guaranty system and encourages administrators and receivers to submit requests with respect to such matters. ▼

'At worst, the guaranty system may have to deal with insolvent insurers that experience total computer systems failure, resulting in inaccurate and/or lost data.'

Guaranty Associations, NOLHGA, Insurance Industry Prepare For Potential 'Year 2000' Problems

YEAR 2000, from Page 4

(stocks, bonds, options, futures), price quotations, routing buy/sell orders, and transferring securities and payments, to name a few.

It is estimated that the larger life and health insurers may be further along in diagnosing and repairing any problems associated with the advent of the millennium. Lower rated and more thinly capitalized companies may not have the resources to accomplish this in time.

The Information Services Subcommittee of the National Association of Insurance Commissioners is working with the industry to minimize disaster potential and speed compliance. The subcommittee's Year 2000 Working Group, chaired by Len Kincannon of California, is developing "Regulatory Expectations of the Industry Regarding Year 2000 Compliance" and is working to minimize duplicate compliance efforts among the states. Some states, however, while willing to work with the NAIC, understandably feel the need to protect the confidentiality of some of the information they have gathered.

Risk assessment and contingency plan

To appreciate the seriousness of the situation, one need only consider that if 95 percent of the life industry achieves compliance, 80 insurers could be NOLHGA clients. Not a settling thought! Needless to say, this could pose a considerable strain on the guaranty system and steer it through uncharted waters.

Of particular concern will be the high risk associated with insuring continuity in timely benefit payments on health insurance, disability income and on-benefit annuities.

NOLHGA has begun to assess the potential risks and the need to develop a comprehensive contingency plan to mitigate damages that are incurred by a member insurer that experiences Year 2000 failure. Short term, NOLHGA is keeping open the lines of communication with receivers, the NAIC and the ACLI. ▼

Y2K Test

1. Set the date on the computer to Dec. 31, 1999.
2. Set the time on the computer

to 11:58 pm (23 :58 hours). Turn the computer OFF.

3. Wait at least three minutes and turn the computer back on.
4. Check the date and time. It SHOULD be a minute or two past midnight on the morning of Saturday, Jan. 1, 2000. **IMPORTANT:** The year "2000" must be displayed, not just "00."
5. Execute every program to confirm normal operation.
6. Set the date and time back to the correct settings.

Leap Year Test

1. Set the date on the computer to Feb. 28, 2000.
2. Set the time to 11:58 pm. Turn the computer OFF.
3. Wait at least three minutes and turn the computer back on.
4. Check the date and time. It SHOULD be a minute or two past midnight on the morning of Feb. 29, 2000.
5. Execute every program to confirm normal operation.
6. Set the date and time back to the correct settings.
7. Repeat Steps 1 - 6, using Feb. 29, 2000 as the date in Step 1.

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1998 - 1999 CALENDAR



SEPTEMBER

13-16 NAIC Fall Meeting
New York City

OCTOBER

5 NOLHGA Board of Directors
Portland Hilton, Portland, Ore.

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

NOVEMBER

12-13 NCIGF/IAIR Workshop
Monterey, Calif.

18-20 Members' Participation Council
*Hyatt Regency Westshore,
Tampa, Fla.*

DECEMBER

5-9 NAIC Winter Meeting
Orlando, Fla.

25 Christmas Day
NOLHGA's Offices Closed

JANUARY

FEBRUARY

17-19 Members' Participation Council
Tucson East Hilton. Tucson, Ariz.

MARCH

6-10 NAIC Spring Meeting
Washington, D.C.

APRIL

22-23 NCIGF Annual Meeting
Hilton Head, S.C.

MAY

19-21 Members' Participation Council
Westin Hotel, Washington, D.C.

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