

NOLHGA JOURNAL

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

Gallanis Named NOLHGA President

On February 26, NOLHGA Chairman Doug Goto announced that Peter Gallanis, an experienced insurance receiver and guaranty law expert, had been named NOLHGA president.

Gallanis said of his appointment, "I am both deeply honored and very excited to have this opportunity to work with NOLHGA's outstanding staff, its Board of Directors, and the member associations in the coming years. NOLHGA fields a great team that will continue to deliver top-notch service to the insurance-

buying public, on a timely basis and at a minimal cost."

Gallanis currently serves as Special Deputy Receiver for the State of Illinois, a position he has held since 1995; he is also an Adjunct Professor of Insurance Law at Chicago's DePaul University College of Law. As Special Deputy, he has been responsible for all insurance insolvency matters affecting Illinois, supervising the activities of that state's receivership agency, the Office of the Special Deputy Receiver (OSD).

An attorney by training, Gallanis received a bachelor's degree from the University of Chicago in 1975 and a law degree from the University of Illinois College of Law in 1978. Upon graduation, he worked for several years in the corporate finance department of the Chicago law firm Chapman and Cutler, before moving to Chicago's Rudnick & Wolfe in 1981. He was elected to full partnership at Rudnick in 1985, where he was a member of that firm's corporate department until joining the OSD in 1992.

Mr. Gallanis has chaired the NAIC's Insolvency Subcommittee (EX5) since 1995. He has also represented Illinois as that state's representative on the Interstate Insurance Receivership Compact Commission, and has been a frequent writer and lecturer on insurance and insolvency topics, both in the United States and abroad. He has represented the

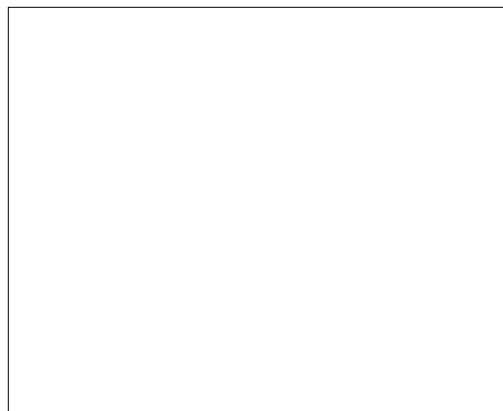
Illinois Director in the Supreme Court of Illinois and in other state and federal courts, and has filed a number of *amicus curiae* briefs with the United States Supreme Court and with other courts on insurance-related issues.

In looking ahead at the future of the guaranty system and of NOLHGA, Gallanis commented, "NOLHGA certainly will continue to provide the critical support that it has in the past when multi-state life and health carriers have encountered financial difficulties." Continued Gallanis, "But in addition, the next decade will present NOLHGA with a whole new set of challenges. The convergence of various types of financial service providers, the development of new insurance products, and innovations in health care delivery will all test the boundaries of today's life and health guaranty

system. My objective is to do everything within my power to see that NOLHGA and its constituencies meet those tests in a way that justifies continued consumer confidence in the insurance industry."

Said Gallanis of his previous experiences with NOLHGA, "During the years that I have chaired NAIC's Insolvency Subcommittee, I have had many opportunities to work with members of NOLHGA's staff and its Board of Directors. The technical expertise and professional attitude of every individual I have encountered has been truly impressive."

Gallanis will assume his new duties as NOLHGA's President on April 1, 1999. He and his wife Kathryn will relocate to the Washington, DC area later this spring. ▼



Incoming NOLHGA President Peter Gallanis

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Selection of NOLHGA President A Team Effort

On behalf of the NOLHGA Board, I was pleased and proud to announce to our membership that Peter Gallanis will join NOLHGA as our next president. I have every confidence that Peter is both immensely able and enthusiastically willing to skillfully lead NOLHGA in its role of ensuring the continuing success of the guaranty association system.

Our recently concluded selection process was indeed challenging. Many eminently qualified individuals expressed an interest in serving as NOLHGA's next leader. In reviewing the qualifications of the applicants, the entire Selection Committee was extremely impressed by the depth of talent available to the guaranty association system. These individuals and the many others who are a part of the system are the primary reason why, I believe, the system has served policyholders across the country so well.

I would also like to recognize the outstanding contribution of our Selection Committee in helping the Board reach this important decision. There are few tasks more difficult and strategically important than choosing an individual to lead an organization. All of the members of the Committee and the Board are to be commended on the open and thoughtful nature of our discussions.

I would also be remiss if I did not recognize the many individuals who made recommendations and suggestions to the committee and the Board as it undertook

this process. It is indeed gratifying to see that those involved with NOLHGA recognized the importance of this decision and provided both advice and support. The advice and support that we received was vital to our decision making process.

I would also like to commend the NOLHGA staff for continuing to provide the level of service that we have come to expect. In particular, Dick Klipstein's leadership and energy was indispensable in guiding NOLHGA during the search. On behalf of the Board, I would like to express our deepest gratitude to the NOLHGA staff, and to Dick in particular, for a job well done under difficult circumstances.

Clearly, Peter comes to NOLHGA at a time when there are many important challenges facing the guaranty association system. Legislation on Capitol Hill could dramatically alter the current guaranty system, a system that has served policyholders and the insurance industry so well. The continuing trend towards consolidation of the financial services sector will also pose new challenges for the industry.

Peter is well able to lead the system as it addresses these issues, but the support and advice of all those involved in the system will be critical as we move forward. I urge everyone to provide both Peter and the NOLHGA staff that support and advice. ▼



NOLHGA Chairman
Doug Goto

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MBL Insolvency Nears Closing

by Peter J. Marigliano

Communications Manager, NOLHGA

As the saga of Mutual Benefit Life nears its conclusion, the guaranty association system has good reason to be proud of its fine work in resolving the largest insolvency in NOLHGA history. Even with over \$5 billion in covered obligations and a projected \$1 billion shortfall, guaranty associations incurred virtually no costs, policyholders obligations were fulfilled and general creditors were almost fully paid. The resolution of the MBL insolvency in such a positive fashion shows how effective the guaranty association system can be.

Introduction

Mutual Benefit Life Insurance Company was placed in rehabilitation by the New Jersey Insurance Commissioner on July 16, 1991 to halt policyholder withdrawals prompted by credit rating downgrades related to troubled real estate investments. A Rehabilitation Plan for the company took effect on April 30, 1994, when insurance liabilities and most assets were transferred to MBL Life Assurance Corporation, previously a stock subsidiary of Mutual Benefit. The important role NOLHGA would play in the rehabilitation was recognized with two seats on the company's board of directors. Dick Klipstein, executive vice president, Insurance Services at

NOLHGA, held one of those seats.

The court-approved plan incorporated account value and certain interest rate guarantees provided by participating guaranty associations and a consortium of life companies (for unallocated contracts) and established a rehabilitation period ending December 31, 1999.

Following the state takeover of Mutual Benefit Life, an insurance industry task force estimated that MBL Life's liabilities exceeded the market value of its invested assets by at least \$1 billion.

It is important to keep in mind the situation the guaranty asso-

ciation system faced when confronted by the MBL insolvency and the \$5 billion in covered obligations resulting from the insolvency. Already that year, Executive Life had been declared insolvent and it also carried \$5 billion in obligations, only slightly less than the obligations of MBL. Additionally, there was a rash of smaller insolvencies that put additional strains on the system.

After a tumultuous period leading up to the approval of the 1994 rehabilitation plan for the company, winding down of the insolvency proceeded, buoyed by recovering asset prices, particularly in the real estate sector.

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Associations May Face New Tax Burdens

by Angela J. Franklin

Assistant Counsel, NOLHGA



The Clinton Administration's 1999 Budget Proposal, published last month, contains a provision that would tax

the investment income of all 501(c)(6) organizations, sweeping in any such association from "mom and pop" operations to multi-thousand member associations. Under the current law,

nonprofit business leagues, which include trade groups, are generally exempt from taxes on their income. Under the proposed plan, the first \$10,000 that an association earns from interest, dividends, rents, capital gains and royalties will not be taxable, but all income earned over that will be subject to the unrelated business income tax (UBIT). It has been reported that such a tax would represent \$1.44 billion raised from trade and professional associations over the next five years. The stated rationale for the proposal is to guard against tax exempt organizations engaging in activities that would constitute unfair

competition with for-profit businesses.

The budget proposal was submitted to Congress on Feb. 1, but does not yet exist in bill form. The House and Senate Budget Committees began hearings February 3, 1998 which started the process that will lead toward a final budget resolution plan. Conventional wisdom is, however, that the proposal will not be received favorably on the Hill, given that the Republican-controlled Congress is committed to tax cuts this session. Congress is obligated by law to enact a budget resolution by April 15, although this deadline is seldom

met.

As NOLHGA and the majority of its members are 501(c)(6) organizations, NOLHGA is carefully considering possible responses to the proposal on its own behalf and on behalf of its members. Chief among NOLHGA concerns are that the guaranty associations not be swept into the same category as commercial trades, as the insurance guaranty associations are more akin to public service organizations. ▼



Rating Centennial Life

by Willis B. Howard, Jr.
Senior Vice President and Actuary,
NOLHGA

In analyzing insolvencies, NOLHGA staff and consultants have developed 10 criteria for a "perfect insolvency." Unfortunately, none of the insolvencies analyzed to produce the criteria were major health insurance insolvencies, and clearly, insolvencies of companies with primarily health business are very different from those of a company with predominantly life business.

How do the differences between a health insolvency and a life/annuity insolvency affect the application of the ten-point criteria? The following rates Centennial according to the criteria.

1. Relationship

From the beginning, relationships among the receiver, NOLHGA task force and guaranty associations have been very cooperative. This relationship began before the task force was formed, with meetings among NOLHGA staff, the MPC Chair and the receiver. Relations have remained cordial and helpful. The Centennial receiver regards NOLHGA as a resource. Were it not for the strong cooperation that has existed between the receiver and the guaranty associations, a somewhat difficult situation would have become more

frustrating. With the on-going claims backlog, the relationship between the receiver and the guaranty associations in a health insurance insolvency is critical.
Score: 10

2. Good records

Financial records and data on in force coverages were adequate, but good management information on existing claim backlog, number of claims processed per week and duplicate claims filed did not exist at the beginning of the Centennial rehabilitation. To this day, this insolvency remains "information challenged." The lack of solid information on how long before a particular claim would be processed has been a continuing source of frustration for policyholders, guaranty association administrators, the task force and the receiver. The wide variety of health insurance coverages in the Centennial health block (approximately 200 policy forms, with approximately 2000 variations) has resulted in a high error rate, which slowed claim processing due to the need for review (initially) of 100 percent of claims over \$100.
Score: 5

3. Limited uncovered obligations

Centennial had only a small block of completely uncovered health business, composed of policies sold to foreign nationals. Until the last health claim is filed, we will not know how many claims may exceed individual guaranty association limits. Fewer than 50 LTD claims exceed guaranty association limits. Some of these LTD claims are

substantially over limits, and unless the estate can recover significant assets, these claimants face significant reductions in monthly payments once the guaranty association limit is reached. Nonetheless, the total uncovered liability is less than 10 percent of total obligations.
Score: 7

4. Facts and solutions are clear and agreed on

The urgent problems facing the receiver and the guaranty associations were clear, and the receiver and the task force quickly reached agreement on the solution. It was essential for guaranty associations to begin payments to LTD claimants with minimal interruption. The guaranty associations responded magnificently. Less than 15 days after the May 27 liquidation order, guaranty associations began making LTD payments. Some guaranty associations wired funds to the receiver and others sent guaranty

association checks to individual claimants. As for the Centennial health block, the need for prompt payment had to be balanced with the guaranty associations' duty to make the correct payment. This inevitably caused delay, because an initial claims audit revealed an unacceptable error rate on claims that had been processed before the liqui-

Criteria For A "Perfect" Insolvency

1. Cooperative Relationships
2. Good Records
3. Limited Uncovered Obligations
4. Facts and Solutions are Clear and Agreed On
5. Joint Solicitation/Negotiation of Reinsurance Bids with Strong Reinsurers
6. No Resistance to Order of Liquidation and Finding of Insolvency
7. Prompt Regulatory Approvals
8. Quick Closing
9. GA Obligations Fully Satisfied
10. Asset Recovery with NOLHGA Involvement

datation order. Again, the facts and solutions were clear and agreed on. Because of the extensive variety of coverages, no commercial TPA could offer a promise of

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Rating Centennial Life

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expedited claims adjudication. The receiver and the task force agreed that the best – indeed, the only – solution was for the receiver to process claims using the former Centennial claims personnel who knew the products and the system.

Score: 8

5. Joint Solicitation, negotiation of reinsurance bids with strong reinsurers

The Centennial task force and receiver have not yet begun this process, but they have jointly solicited bids and negotiated a contract for the audit of the on-benefit LTD claims. This audit has been completed, and the receiver and the task force jointly negotiated an agreement to clean up the LTD block so that it can be sold. Before the guaranty associations became involved, the receiver had negotiated an agreement with another carrier to re-write Centennial's cancelable association business. Some complications arose because not all states or all policyholders were included in the replacement offer.

Score: 7, Ongoing

6. No resistance to order of liquidation and finding of insolvency

There were no objections filed to the rehabilitator's petition for liquidation, and the liquidation order was approved from the bench the day of the hearing.

Score: 10

7. Prompt regulatory approvals

The liquidation court has promptly approved the service agreement and the early access agreement negotiated between the task force and the receiver. A final score can not yet be given, since an assumption reinsurance agreement for the LTD block and a small block of other business is still a possibility for the future.

Score: 10, Ongoing

8. Quick closing to get policyholders moved to a solid insurer

To the great frustration of policyholders, regulators, guaranty associations, the receiver and the task force, this solution, which presumes an assumption reinsurance agreement for most, if not all of, the guaranty associations' covered obligations, is simply not feasible when most of the health insurance is cancelable. Instead, individual guaranty associations must determine their notice requirements with their departments of insurance.

It has been possible in recent life and annuity insolvencies for the receiver, the guaranty associations and the selected assuming reinsurer to close a transaction within six to eight months of the liquidation order, and within less than a year of the rehabilitation order. Since most annuity and life insurance contract holders have no immediate need for their funds, absent hardship, the receiver obtains a court-approved moratorium on surrenders. This gives the guaranty associations and the receiver the breathing

room necessary to plan all the tasks required for an assumption reinsurance transaction in an orderly process.

This was not the case for Centennial. Instead, the claimants all have a perceived urgent need for payment of their claims. To accommodate the real as well as perceived need for prompt payment, claims must be sent to guaranty associations for funding in frequent small batches. Thus, instead of a single closing of an assumption reinsurance transaction, guaranty associations have had eight fundings of the Centennial health block, approximately a dozen fundings of the LTD block, and one funding of the Aegon block – all within six months of the liquidation order date. This requires a level of activity by the individual guaranty associations unprecedented in recent experience.

Score: N/A

9. GA obligations fully satisfied at closing

Those working on resolving the insolvency only wish that this were the case in Centennial! Instead, each funding, represented by a batch of LTD or medical claims to be paid, is merely a signal that we are not yet through. The backlog of claims in the Centennial health block peaked at approximately 90,000 in August. With some guaranty association cancellation decisions not yet made, as of February, we are assured of a long tail of claims, stretching more than a year beyond the liquidation order date, making satisfaction of guaranty association obligations a lengthy

process.

The differences in interpreting LTD coverage limits (present value limits versus sum of payments) will also present unique challenges.

Score: N/A

10. Asset recoveries with NOLHGA involvement

The receiver has kept the task force fully apprised of his litigation strategy with AXA Re, the former primary reinsurer of the Centennial Health block. With contractual and damages claims against AXA of \$40-\$50 million, litigation is the receiver's primary source of assets for the estate. As with other aspects of this insolvency, the receiver continues to regard NOLHGA as a resource, and has had discussions with the task force's litigation subgroup on litigation strategy.

Score: 10 on Cooperation, Too Early to Rate Results

If Centennial is a guide to future health insolvencies, it does not appear likely that a health insolvency could ever be a "perfect 10." Any large health insolvency would likely result in a variety of claim types, difficulty in calculating benefits, complexity of valuing blocks of business, and time and resource consuming efforts at processing and adjudicating claims. For these reasons, fast and efficient resolution of major health insolvencies will always be difficult. ▼



The Uniform Receivership Law: Catalyst for Legislative Activity

by Joni Forsythe

Assistant Counsel, NOLHGA



On September 14, 1998, the Interstate Insurance Receivership Commission; i.e., the

“Compact Commission” adopted proposed interstate receivership legislation. The uniform receivership law (“URL”) was the product of a two year cooperative effort by members of the Compact Commission’s Receivership Law Advisory Committee (“RLAC”), which included a broad array of representatives of receivers, regulators, guaranty associations and other industry representatives. An exposure draft of the URL was released last May for industry comment. The final draft was submitted to the Compact Commission for approval last September after multiple open drafting and comment sessions.

Background

The Interstate Compact was developed by the NAIC (Midwest Zone) and was endorsed by the National Conference of Insurance Legislators (NCOIL). The NCOIL/NAIC proposal followed efforts in the early 90’s by Congressman John Dingell (D-MI) to push for federal regulation of insurance insolvency, as well as a congressional study on the establishment of a uniform national system for insurance regulation. The Compact was

established in 1995 when compact legislation was enacted in New Hampshire and Nebraska. Illinois and California joined the Compact in January of 1996, followed by Michigan in July of 1996. New Hampshire and California subsequently withdrew from the Compact.

In drafting the URL, RLAC referred to the existing law in the compacting states, using the Michigan statute as a template for the first draft. It was not the intent of the Commission or

RLAC to radically change existing law. In fact, the URL reflects some of the NAIC Model Rehabilitation and Liquidation Act provisions. However, the URL goes beyond the NAIC Model in an effort to improve the effectiveness and efficiency of receivership proceedings, and to incorporate a balanced approach to frequently controversial issues consistent with the case law that has evolved around those issues. The URL also reflects a reorganization and of the statutory framework so as to make it more clear, consistent and readable, and to ameliorate various drafting and logistical problems which existed as a result of the piecemeal fashion in which state receivership laws have developed over the last 50 years.

Legislative initiatives

The URL is expected to be introduced in the compacting states (Michigan, Nebraska and Illinois) during the upcoming year. In addition, initiatives are underway in several states to consider modifications and/or rewrites of state receivership laws, some based on the URL, others reflecting revisions to NAIC Model provisions. It appears that much of the legislative activity has been triggered in response to the adoption of the URL by the Com-

compact Commission last fall.

In Missouri, a URL-based rewrite has been introduced as House Bill 599. House and Senate Committee

hearings on HB 599 have already begun. In Oklahoma, a bill has been proposed to substitute the URL based jurisdiction and offset provisions in the state receivership statute. In Tennessee, proposed revisions to the receivership statute have been introduced as House Bill 919 and Senate Bill 1080. We have also been told that URL based legislation is being discussed for future consideration in Idaho, Rhode Island and Mississippi.

Earlier this year, the California Liquidation Office (CLO) began an effort to have a modified version of the URL introduced in California. In response to an in-

itation from the CLO, NOLHGA attended two review sessions and provided technical comments regarding provisions affecting guaranty association interests. In more recent drafts, however, it appears that the CLO proposal has veered far away from the URL model. No final proposal has yet been introduced in California.

NOLHGA has taken no formal position with respect to the URL, but has continued to analyze and evaluate the URL from a guaranty association perspective. Similarly, while we believe that there are provisions in the URL that are very favorable to guaranty association interests, NOLHGA has remained neutral with respect to the multiple initiatives to introduce URL legislation in the various states. However, we would like to be available as a technical resource to members considering such legislation. In this regard, we would be glad to provide a copy of the URL to any of our members upon request, and to respond to any questions that you may have regarding URL provisions.

During the next few months, NOLHGA staff will be working with Legal Committee members to prepare an analysis highlighting the key provisions of the URL that affect guaranty association interests. That report will be distributed to our members in May and should serve as a useful reference for members in states where amendments to the receivership law will be introduced as legislation. ▼



MBL: A Guaranty System Success Story

MBL, *From Page 3*

Current Status

With major asset and litigation issues substantially resolved or approaching resolution, MBL Life's management and board of directors conducted a strategic analysis in 1997 of the company's post-rehabilitation options. The analysis resulted in the decision to sell MBL Life or its assets, rather than attempt a stand-alone marketplace re-entry at the end of the rehabilitation period. In the fall of 1997, efforts began to identify a buyer.

A broad auction process managed by Goldman, Sachs culminated in the July 1998 announcement of an agreement to sell MBL Life's individual life insurance and individual and group annuity businesses to affiliates of SunAmerica Inc. Also in July, 1998, the company agreed to sell its remaining interests in Mutual Benefit's corporate-owned life insurance (COLI) business to The Hartford, which first acquired an interest in that business early in the rehabilitation.

The New Jersey Superior Court overseeing the rehabilitation approved the COLI sale to The Hartford in September 1998 and that transaction closed on November 10.

The SunAmerica transaction, with the support of key policyholder groups and Mutual Benefit's general unsecured creditors, was approved by the rehabilitation court on Novem-

ber 12, 1998. The transaction closed, as expected, on December 31, 1998.

Impact of the SunAmerica Transaction

The sale to SunAmerica will result in the eventual distribution to creditors and eligible policyholders of MBL Life's "company value," representing the sale proceeds and MBL Life's total adjusted capital, net of expenses and requisite holdbacks. Company value on December 31, 1998, was determined to be \$818 million, which is to be allocated in a ratio of 70 percent to general unsecured creditors and 30 percent to policyholders who persist with SunAmerica through a vesting period ending June 30, 2003. The policyholder share of company value (except for a small amount attributable to a group of contracts that are not part of the SunAmerica transaction) was transferred to SunAmerica at the closing.

The SunAmerica transaction will also bring about an early end to the Mutual Benefit Life rehabilitation. The rehabilitation and its related policyholder restrictions will end June 30, 1999, six months earlier than the original schedule.

MBL Life is continuing to service the life insurance and annuity business purchased by SunAmerica during a six-month transition period, after which SunAmerica affiliates will fully assume the business and MBL Life will be liquidated.

Unallocated Guaranteed Investment Contracts in MBL's Separate Account are expected to be paid out in full in the second quarter of 1999, also on an accelerated schedule.

MBL Life has also negotiated or is in the process of negotiating transactions with other parties for several small blocks of business not included in the large transactions.

On January 15, 1999, MBL Life made a first distribution of \$250 million to Mutual Benefit's general unsecured creditors. A second distribution is expected on or about April 1, 1999. In total, these distributions will represent recovery of approximately 95 percent of the creditors' allowed claims. Additional smaller distributions may be possible at a later date in the liquidation process.

With only a few months left, MBL is an unmitigated triumph for the system. All the goals one hopes for in resolving an insolvency were met: policyholders were made whole and their policies transferred to a sound assuming carrier; guaranty associations recovered all of their costs; GIC holders were fully paid and general creditor obligations were almost totally fulfilled. The MBL insolvency proves the guaranty association system works, and works well. ▼

"The MBL insolvency proves the guaranty association system works, and works well."

UPCOMING EVENTS

| | |
|----------------------|---|
| April 27-28 | NOLHGA Board of Directors McLean, VA |
| May 19-21 | NOLHGA MPC Meeting Washington, DC |
| June 5-9 | NAIC Summer Meeting Kansas City, MO |
| July 28-29 | NOLHGA Board of Directors Baltimore, MD |
| August 24-26 | NOLHGA MPC Meeting Coeur d'Alene, ID |
| October 19-22 | NOLHGA Annual/MPC Meeting Indian Wells, CA |

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