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NOLHGA JOURNAL

Mission Accomplished: National Heritage Trust Closes

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Recently, the National Heritage Life Insurance Company ("NHL") Trust was brought to a successful completion. This article provides an overview of the background, structure and operations of the Trust, the Trust distributions and a discussion of why the Trust was successful.

The NHL insolvency presented one of the largest shortfalls in assets in recent history. The guaranty associations provided funding in excess of $400 million for policyholders, without contribution of any estate assets. Initially, NHL had clear title to practically no assets. Through extensive legal efforts, the Receiver was able to correct many of the documentation problems and secure title to approximately $162 million in assets, in addition to realizing substantial litigation recoveries. However, at the time the guaranty associations provided coverage for policyholders, no money was available in NHL assets to provide coverage for policyholders and a number of uncertainties existed with respect to the amount of assets that would ever be available for distribution.

> There was a "Significant concern that, even after NHL secured title to these assets, the rapid sale of NHL's remaining assets would further increase the loss suffered by all creditors."

These dire financial conditions were due in large part to the enormity of the looting at NHL, which was discussed in detail in the Summer 2000 article of the NOLHGA Journal. As reported in that article, some of the convictions and sentences included: Sholam Weiss, sentenced to 845 years with a fine of $123 million and restitution of $125 million; Jan Starr, sentenced to 87 months in prison and $70 million in restitution; Jan Schneiderman, sentenced to 294 months in prison and $101,746,119 in restitution; Michael Blutrich, Lyle Pheffer and Patrick Smythe, each sentenced to 25 years in prison and $82 million in restitution. The required restitution from those individuals alone exceeds $540 million.

In addition to the amount of the shortfall, NHL's assets were not liquid. Many of the assets were mortgage loan portfolios acquired through the Resolution Trust Company ("RTC"). Well over half of these loans were in default.

The Asset Question

The NHL Receiver and the NOLHGA Task Force for NHL recognized the significant concern that, even after NHL secured title to these assets, the rapid sale of NHL's remaining assets would further increase the loss suffered by all creditors. To address that problem, the Receiver and the Task Force cooperated in developing a Liquidation Trust that would utilize professionals experienced in working out troubled asset portfolios over a period of three to five years. The Trust provided for the guaranty associations to play a more active role in the asset management and liquidation of NHL's assets by permitting the guaranty associations to appoint one of the three Trustees.

In order to achieve a return in excess of the market value, the Trustees had their work cut out for them. The Trustees faced a number of problems which would be anticipated in seeking to liquidate assets of any insurer that had been the victim of looting to the extent suffered by NHL. At the beginning, the Trustees found little or no organization of the assets, due in part, to the disarray of NHL's files. There was a backlog of decisions to be made on various assets, which was complicated by poor recordkeeping and administrative problems. Also of concern, was a lack of documentation pertaining to title on some assets.

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President's Column

The LaShelle Legacy

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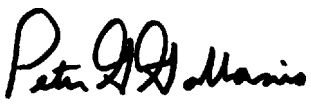
We encounter "dueling theories" in virtually every walk of life. Some examples are heredity vs. environment; free will vs. predestination; and the desirability of the designated hitter vs. the contention that pitchers should hit. One such debate thrives in the field of history. On one side is the "great man" theory - the view that history is largely the story of the efforts and achievements of significant individuals. This view is countered with the notion that history largely reflects the impersonal results of economic and social forces that are unaffected by the individual actors who may chance then to be on stage. Sometimes the latter view is referred to as the "dead hand" perspective.

Count me in the "great man" camp in this debate. While economic and social vectors clearly play a part in determining the course of events, the talents and contributions made by specific individuals often control which one of the various possible outcomes actually takes place. I do not believe that our world would be the same had there been no Charlemagne; no Shakespeare; no Beethoven; no Lincoln; no Einstein; no Churchill; no Dr. Martin Luther King, Jr.

The same principle, I believe, is at least as valid in specialized fields as it is in major historical movements. That is, individual contributions are critical in shaping important developments in most areas of endeavor. In the context of our guaranty system, I am acutely reminded of this by the untimely passing of our good friend Chuck LaShelle, the Executive Director of the Texas Life, Accident, Health & Hospital Service Insurance Guaranty Association. Elsewhere in this issue, Charlie Richardson discusses some of the signal successes to which Chuck helped lead our system. I cannot add to Charlie's magnificent commentary on Chuck's achievements.

But Charlie's closing comments do bring out one fact concerning contributions of individuals: we accomplish much more when we work together as an organized team than when we each try to go it alone. The life and health guaranty system is a great illustration of that generally valid principle. While there is much that can be done separately by the individual Guaranty Associations, their administrators, and their member companies, there is yet so much more that can be and has been accomplished as a consequence of the commitment of the Associations to work together as an organized system. Put another way, the contributions of individual players are critical, but the strength derived by acting through our organized system magnifies, even multiplies, the significance of each participant's contribution.



In the relatively brief period I have been at NOLHGA, I spent much time working with Chuck: on the Thunor insolvencies and other receiverships; because of Chuck's role as a member of the NOLHGA Board and a representative to the Members' Participation Council; and on special projects of various types. In all of that time, I don't recall one occasion when Chuck expressed the sentiment, "How do we keep doing what we've always done?" However, I recall many times when he asked, "How can we do our job of protecting policyholders better, faster, and more effectively?" He was not the type of general preoccupied with the proper way to fight the last war; Chuck looked rather to the future.

I saw Chuck work towards moving our system in those

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Chuck LaShelle

President, From Page 2

directions in a number of ways, primarily involving education, preparation, and communication.

Chuck was an active supporter of, and participant in, various educational efforts of our system, including particularly the annual NOLHGA Legal Seminar. At this year's Legal Seminar, Chuck would have contributed to the health insolvency issues discussion.

He was also a believer in preparing in every way possible for management of the crises that are the raison d'etre for our system. He was a member of the recently formed NOLHGA Health Insurance Issues Committee, on which he was working to find ways to better enable our Associations to respond to the special challenges of health carrier failures. His last project for the NOLHGA Board was an effort to secure a credit facility for Guaranty Associations, to facilitate prompt settlement of claims and transfers of blocks of business from insolvent carriers to healthy companies.

Chuck also worked in many ways to improve communications among the Guaranty Associations. He was instrumental in the production of a number of stories for the Weekly Wire and the Journal, and he was an early and leading advocate of the maintenance by NOLHGA of an online library of important documents and records.

Our system depends on the continued dedication and committed efforts of each of us who participate in it. As individuals, each of us is always able to improve our ability to contribute to the fulfillment of our shared mission. We could demonstrate no greater living legacy to our friend Chuck than by continuing to strive, as he did, towards the improvement of our system and the roles that we play in it.

Plan to Attend NOLHGA's Legal Seminar

NOLHGA's 10th Annual Legal Seminar promises an impressive line-up of speakers providing a look at legal and other issues currently facing Guaranty Associations and the insurance insolvency system. Featured speakers include two insurance commissioners, Lee Covington of Ohio and Nathaniel S. Shapo of Illinois.

In addition, the seminar will include panels about:

* financial services modernization
* "e-Legal" risks in the internet age
* health insolvencies
* closing estates
* tracking down estate assets in the wake of criminal activity
* ethics from a "vintage film" perspective
* hot legal topics in the insurance industry.

This year's seminar will be held on July 12-13th at New York's Marriott Marquis in the heart of Times Square. The hotel and meeting registration deadline is June 15th. For further information, please contact NOLHGA's Meg Melusen at 703.787.4130 or Aimee Frye at 703.787.4115.

NOLHGA 18th Annual Meeting

Mark Your Calendars
October 16-18
Hyatt Regency Tamaya
Santa Ana Pueblo, New Mexico

This year's Annual Meeting will focus on the two biggest challenges facing the Guaranty Associations. Day one will focus on the brave new world given the reality of financial services modernization. Day two will feature a look at the challenges faced and lessons learned by insolvency task forces as they have worked to resolve often complex health insurer insolvencies. In addition, a full MPC Meeting has been scheduled on October 16 so that attendees can hear the latest on active insolvencies confronting the system.

Preliminary information is available at:
www.nolhga.com/registration/annualmeeting1001.html

Registration materials will be available on August 1.

Superpriority:Everything is Different, But Has Anything Changed?

by William P. O'Sullivan
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While the federal government is viewed by some as the "white knight" that will modernize insurance regulation, it continues to wear the "black hat" in state receivership proceedings by disputing priority laws enacted to protect policyholders. These disputes have arisen out of the government's contention that the Federal Priority Statute[1] requires its claims to be paid on a priority basis, and that any state laws to the contrary are preempted. Receivers, guaranty associations and other interested parties have countered by arguing that the McCarran Ferguson Act[2], which reserves to the states the regulation of insurance, shields state priority statutes from federal preemption. While the last few years have been relatively quiet with respect to these priority disputes, the federal government recently challenged the validity of the Massachusetts priority statute in the American Mutual Liability Insurance Company (AMLICO) insolvency. After providing a brief overview of the history of federal priority challenges in receiverships, this article will discuss the AMLICO case and what the future may hold for these challenges.[3]

Overview of Priority Disputes with the Federal Government

Disputes between the federal government and insurance receivers over priority issues date back to the 1980s, but the seminal case on the matter is United States Department of Treasury v. Fabe.[4] In Fabe, the U.S. Supreme Court held that a state priority statute, to the extent that it protects or regulates policyholders, was part of the regulation of insurance and therefore eligible for McCarran Ferguson Act protection. As a consequence, the Court found that the Ohio priority statute could prefer policyholder claims to those of the federal government without being preempted by the Federal Priority Statute. The Supreme Court also found that the preference afforded administrative expenses under the Ohio statute was sufficiently connected to the goal of protecting policyholders to avoid federal preemption under McCarran-Ferguson. However, the Court refused to uphold those parts of the Ohio statute preferring claims of employees and other general creditors over those of the federal government, finding they were not sufficiently related to protecting policyholders to avoid preemption.

Following Fabe, many states sought to avoid additional litigation by amending their priority statutes to comply with the Supreme Court's ruling in that case.[5] Undeterred, the federal government opened a new front in the battle by challenging a state priority statute that had been amended to comply with Fabe. In Boozell vs. United States of America[6], the federal government argued that the Illinois priority statute — which was "Fabe cured" — was still subject to federal preemption because it allowed guaranty association claims to be paid at the policyholder level. According to the government, this feature of the Illinois statute violated the Fabe decision because it forced policyholders to compete with guaranty associations for payment on their claims. In a major win for the state receivership system, the U.S. District Court presiding over the case rejected the government's argument, finding that guaranty associations are designed to protect policyholders of insolvent insurers and as a consequence it was permissible under Fabe to place their claims prior to those of the federal government. Perhaps believing that discretion is the better part of valor, the federal government did not appeal the Boozell case but instead decided to wait for another opportunity to litigate its position. That opportunity apparently presented itself in the American Mutual Liability Insurance Company insolvency.

The American Mutual Case

American Mutual Liability Insurance Company (AMLICO) was a Massachusetts domiciled property and casualty insurer that was placed in liquidation in 1989. AMLICO wrote primarily worker's compensation, general liability and automobile policies. In addition, AMLICO had a small block of A&H policies that were covered by life and health guaranty associations. However, P&C guaranty funds were by far the largest claimants of the estate with nearly $674 million in claims.

During the course of the AMLICO proceedings, the Receiver made four early access distributions to the P&C funds in accordance with the Massachusetts priority statute.[7] Prior to each of these distributions, the Receiver requested and obtained from the federal government a conditional waiver acknowledging that the government would not object to or challenge the early access distribution. Notwithstanding this prior cooperation, the federal government refused to provide the Receiver with a similar waiver in connection with a fifth early access distribution and the closing of the estate. In an effort to resolve this impasse so as to expedite the closing of the estate, the Receiver offered to escrow funds to cover the federal government's potential claims in AMLICO. Inexplicably, the government rejected this solution. Given the risk of personal liability for violating the Federal Priority

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Federal Superpriority

Fabe, From Page 4

Statute, the Receiver was left with no choice but to seek a judicial solution to the impasse.[8]

On November 22, 2000, the Receiver filed an action seeking a declaratory judgment that, among other matters, the Receiver could pay administrative expenses and policyholder level claims — including those of guaranty funds — prior to the non-policyholder level claims of the United States. The federal government responded by filing a motion to dismiss in which it argued that the Federal Priority Statute preempted the relevant provisions of Massachusetts law because they did not comply with the Fabe decision. In particular, the government argued that the Massachusetts priority statute failed to protect policyholders because it permitted "the enormous claims of state insurance guaranty funds to compete as claims of equal rank with the claims of policyholders...." According to the government's brief, this feature of the Massachusetts priority statute not only failed to protect policyholders as required by Fabe, but was also directly contrary to their interests.

In response to the United States' motion to dismiss, the Receiver filed a motion for summary judgment, and the P&C guaranty funds affected by AMLICO and NOLHGA filed separate amicus briefs in support of the Receiver's position. The crux of the Receiver and guaranty association arguments was that the laws in question, including the specific priority assigned to guaranty associations, were part of a comprehensive state designed statutory plan for protecting policyholders of insolvent insurers and therefore were exempt from federal preemption under the McCarran Ferguson Act. In addition, they pointed out that guaranty association claims do not compete with policyholders but rather are the claims of policyholders assigned by statute.

On May 23, Massachusetts District Court Judge Douglas P. Woodlock held a hearing on the outstanding motions in the case. Judge Woodlock began with a series of pointed questions to counsel for the United States. At one point, he asked the United States why it had not appealed the Boozell case, and whether the government's strategy was to continue to litigate this issue on a district by district basis until it obtained a favorable result. While the government's attorney deftly responded by saying that the claims in Boozell weren't large enough to appeal, it seems clear that the judge had correctly pegged the government's strategy. There does not appear to be any logical explanation for the government's refusal to consider an escrow arrangement in AMLICO other than that it is determined to find the "right" forum to litigate the priority issue. Moreover, the government's arguments in AMLICO are essentially repeats of its failed positions in Boozell, which indicates that it may continue to advance the same positions until it can obtain a favorable ruling and force the issue back up to the U.S. Supreme Court.

Conclusion

So what does the AMLICO case portend for the future? While it would be presumptuous to predict how Judge Woodlock will rule on the merits, there are perhaps a couple of big picture insights worth noting. First, the AMLICO case shows that, notwithstanding the potential new world order of Gramm-Leach-Bliley and optional federal charters, the old world order of federal/state battles over the McCarran Ferguson Act is alive and well and likely to be with us in the insolvency arena for the foreseeable future.

The second insight that could be offered is that the federal government remains determined to litigate the priority issue. If recent experience is any guide, the government will not concede its position even if it loses in AMLICO but rather will bide its time waiting for the next opportunity to bring a challenge.

Those of us who work on behalf of the state receivership/guaranty association systems to protect policyholders must be prepared to respond to that challenge.

1 31 U.S.C. §3713.
2 15 U.S.C. §1011, et seq.
3 In addition to challenging the priority statute in AMLICO, the government also challenged the Massachusetts law establishing a deadline for filing claims in receiverships. While this is an important issue as well, this article will deal only with the priority statute challenge.
4 113 S. Ct. 2202 (1993).
5 At last count, 35 states have amended their priority statutes to conform to the Supreme Court's ruling in the Fabe case.
6 979 F. Supp. 670 (1997).
7 The Massachusetts priority statute has been amended to conform to the Fabe decision.
8 The Federal Priority Statute expressly provides that persons paying claims in violation of the statute will have personal liability to the government. At the outset of the AMLICO case, the federal government sent a letter to the receiver advising him of this potential liability under the Federal Priority Statute.

In Memoriam: Chuck LaShelle

The Following are excerpts of remarks given by Charles T. Richardson at an April 30 Memorial Service for Charles S. LaShelle.

Well, Chuck, you used to tell us that even a blind squirrel finds a nut in the forest sometimes. So let's hope this squirrel lawyer finds a few golden nuggets in the rich forest of heartwarming professional and personal relationships that you created for all of us in this church today.

For me, those relationships began with a lunch in August of 1994. Chuck had just been named by the National Organization of Life and Health Insurance Guaranty Associations, to chair the Task Force overseeing one of the largest insurance insolvencies in North American history - Confederation Life. Quite a job. Quite an honor to be asked to serve. Quite a risk if he failed - not only for himself and the NOLHGA organization, but also for the hundreds of thousands of policyholders whose retirements hung in the balance. At that lunch, Chuck was sizing me up to work on the project.

I thank my lucky stars that I apparently used the right salad fork and at least gave Chuck the minimum assurances he needed. From that day seven years ago until a week ago Sunday, when Chuck led a conference call to discuss an important brief being filed in the federal appellate court, and, as it turned out, on the very day he died, I have had the high honor of working with the supremely talented man we honor today.

He was my client. He was my confidant. He was our master story teller - without peer. He was my friend.

It is a tribute to Chuck that here with us are the leaders of the insurance industry who worked so closely with Chuck and who can testify, better than I, to his creativity, his common sense, his judgment, his passion for protecting everyday people caught in insurance insolvencies who can't help themselves, and his ability to take gigantic, disgusting, teeming, vomitatous legal and financial messes and negotiate expertly to turn them into solutions that all the warring factions could embrace. For those of you fortunate enough to be ignorant of the work Chuck and I do - protecting consumers when their life insurance company goes down the tube like the FDIC does for banks - I say only that in this church today are the President and the General Counsel of the NOLHGA, other representatives of the insurance guaranty system, including the Texas association which Chuck served so ably, the life insurance industry of which Chuck was a prominent part, and people from the most pedigreed professional firms in the country who have toiled in the vineyards with Chuck and know the measure of the man.

In short, while the confidence of your peers does not the man make, I would be remiss if I did not say that Chuck LaShelle was at the tip top of his profession. His family and those who knew Chuck in other ways should always know that his work achieved so much good - his work made a tangible difference in the lives of thousands of real people.

Chuck was my age. Frankly, his passing has brought me - as I bet it has many of you - face to face with my own mortality. When we look at Chuck's tombstone, the two dates on it - 1947 and 2001 - are going to jar us. He was too young to leave us. He had too many problems to solve, too many negotiations to conduct. He had too many golf games to play. He had too many trips to the Salt Lick and Bellos left. He had too many cuff links to buy. (I am wearing them today, Chuck, in your honor.) He had too many jokes yet to tell - and I will tell your jokes, Chuck, until the day I die in ways that will make you cringe. He had too many family memories to create: too many future grandchildren to adore.

But maybe we should not be looking at the two dates - birth and death. Maybe we should be looking at the dash between those two dates. Because that dash represents the living Chuck did between 1947 and 2001.

Let me give you some facts about the geese on the back of the memorial program you are holding. When you see the geese flying along in "V" formation, you might consider what science has discovered as to why they fly that way. As each bird flaps its wings, it creates uplift for the bird immediately following. By flying in the "V" formation, the whole flock adds at least 71 percent greater flying range than if each bird flew on its own.

When a goose falls out of formation, it suddenly feels the drag and resistance of trying to go it alone - and quickly gets back into formation to take advantage of the lifting power of the bird in front. People who share a common direction and sense of community can, like geese, get where they are going more quickly and easily because they are traveling on the thrust of one another.

When the head goose gets tired, it rotates back in the wing and another goose flies point for awhile.

When that head goose gets sick or is wounded by gunshot, and falls out of formation, two other geese fall out with that goose and follow it down to lend help and protection. They stay with the fallen goose until it is able to fly or until it dies, and only then do they launch out on their own, or with another formation to catch up with their group.

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NHL Trust A Success

Chuck, From Page 6

Our head goose - Chuck LaShelle - got tired and died, so he no longer is leading the flock. Like it or not, we'll have to replace him. But if we here have the sense that God gave a goose, we will stand by each other and keep the flock heading in the direction Chuck would have expected as a fitting tribute to him.

In what turned out to be the final chapter of his career and of his life, I saw Chuck LaShelle give of himself, sometimes against great odds and at personal sacrifice, and as a result he changed so many things and so many people in this church and around the country, starting with me. He personified the power of the flock. We pledge to you, old friend, that we'll do the same. We'll use our experiences - good and bad - to make our lives and the lives of those around us better, and to keep that flock moving forward. Too bad you will not be with us, but I have a feeling you will be watching us every step of the way, giving silent advice and whispering, "You never could tell a story, Richardson."

We love you, Chuck.

NHL, From Page 1

Trustees Begin Work

One of the first things the Trustees did was to establish and solidify relationships with key personnel. For the entire duration of the Trust, the Trustees worked closely with the NHL Receiver. The success of the Trust is due in large part to the Receiver's support and the positive working relationship between the Receiver and the Trustees. Initially, the Trustees accepted the Receiver's recommendation that the existing personnel be retained or utilized for a 90-day trial period. Most of those personnel were retained after the initial period. In addition, the Trustees entered into contracts with consultants and other staff, including the engagement of a paralegal to assist in the legal efforts.

With the right personnel in place, the Trustees focused on the organizational systems. A paper filing system was created along with a database network for ease of access to information, including a history of recommendations and activity. The Trustees created and regularly reviewed a result-oriented task list, using the list as an agenda at weekly meetings.

Having the personnel and information structure in place, the Trustees made several adjustments related to the assets and their distribution. First, the Trustees modified the banking arrangements to increase yield and decrease risk for the invested assets. In addition, the Trustees sought certain modifications in the Trust Agreement to provide for easier, more efficient administration and sale of assets, such as requiring court approval for only larger asset transactions, establishing a limit of two checks per distribution, and allowing sufficient time for preparation of reports.

The Trustees then reviewed, among other things, the status of each asset, including the title, value, tax sale status, and the insurance status. Ultimately, the Trustees developed and implemented an individual disposition plan for each asset valued at over $500,000 and for all commercial real estate and mortgages.

The Trust was funded with assets valued at approximately $160 million in addition to proceeds from litigation. Nine distributions were made to the Trust beneficiaries - guaranty associations and uncovered policyholders - totaling approximately $220 million.

The NHL Trust terminated effective March 31, 2001, subject to a Trust Closing Agreement. The Trust succeeded in achieving several important goals. Most importantly, the Trust permitted NHL's assets to be liquidated over a five-year time frame, avoiding the losses typically suffered as a result of a fire sale. Also of importance, the Trust enhanced cooperation and communication among the NHL Receiver and the NOLHGA Task Force. In developing the Trust, the parties were able to work together toward achieving the common goal of realizing as much recovery as possible from the sale of NHL's assets. Each party contributed unique strengths and skills to the establishment and implementation of the Trust. The working relationship that ensued among the Receiver, the Task Force and the Trustees was one of the critical factors in achieving the Trust's success.

"The Trust permitted NHL's assets to be liquidated over a five-year time frame, avoiding the losses typically suffered as a result of a fire sale"

Upcoming Events

July 12-13	**NOLHGA Legal Seminar**	**New York, NY**
August 7-8	**NOLHGA Board of Directors' and Board Committee Meetings**	**Seattle, WA**
August 20-22	**NOLHGA MPC Meeting**	**Denver, CO**
Sept. 22-26	**NAIC Fall Meeting**	**Boston, MA**
Oct. 15	**NOLHGA Board of Directors' Meeting**	**Santa Ana Pueblo, NM**
Oct. 16	**NOLHGA MPC Meeting**	**Santa Ana Pueblo, NM**
Oct. 17-18	**NOLHGA Annual Meeting**	**Santa Ana Pueblo, NM**

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