M Financial Group™

DUE CARE BULLETIN

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The Liquidation of Executive Life of New York: Regulatory Response and Policyholder Protections

Life insurance due care requires an understanding of the factors that impact policy performance and drive product selection.

M Financial Group continues to lead the industry in life insurance due care and client advocacy, providing valuable insight and analysis that delivers significant value to clients.

On August 8, 2013, the Superintendent of Financial Services of the State of New York initiated the liquidation of Executive Life of New York (ELNY) by order of the Receivership Court. The Superintendent was directed to liquidate ELNY's business and affairs in accordance with New York Insurance Law and in the manner provided for in the Restructuring Agreement.

Substantially all of ELNY's remaining assets have been transferred to Guaranty Association Benefits Company (GABC), a newly created not-for-profit insurance company. In accordance with the Restructuring Agreement:

- Beginning on the Liquidation Date, GABC is responsible for making payments to payees and beneficiaries.
- Benefit payments for all ELNY contracts have been restructured to the amount that can be satisfied by assets from the ELNY estate.

GABC has enhanced the benefits of the restructured contracts with funds and guarantees provided by the life and health Guaranty Associations and certain life insurance companies. As a result of the GABC enhancement, most payees and other beneficiaries will receive from GABC the same benefits due to them from ELNY; however, benefit payments for some payees and other beneficiaries, all from annuity-based contracts, have been reduced.

Executive Life Background

Executive Life Insurance Company (ELIC) was a multibillion-dollar life insurance company domiciled in California that operated in the state from 1962 to 1991. ELIC was a large issuer of life insurance, structured settlement annuities, group annuities, and guaranteed investment contracts (GICs) issued to pension plans and municipalities.

According to a 1994 report, ELIC invested 55–60% of its portfolio in high-yield, noninvestment-grade corporate bonds, also known as junk bonds, during the 1980s. At the time, the insurance industry average portfolio allocation for this type of investment typically ranged from 7–11%.

In late 1989, the junk bond market experienced a significant decline in value. In early 1991, the California insurance commissioner determined that ELIC's financial statements were grossly overstated and declared the company insolvent. On April 11, 1991, acting on a court conservation order, the California commissioner took over the operation of ELIC.

A liquidation order was entered on December 6, 1991, and in 1993 most of the company's policies were assumed by Aurora National Life Insurance Company, which is owned by a Crédit Lyonnais organized investor group. Aurora is a California-based insurance company licensed in 46 states and the District of Columbia. Today Aurora services more than 88,000 life and annuity contracts, with approximately $2.0 billion of insurance in force as of December 31, 2012. In August 2005, the California insurance department estimated ELIC policyholder losses at $936 million, which equates to policyholders recovering 90% of their original policy rights.

Executive Life of New York was a subsidiary of an Executive Life holding company. ELNY, a New York domestic life insurer, was placed in rehabilitation in April 1991 by New York's Superintendent of Insurance. In 1992, a plan of rehabilitation (the Rehab Plan) was approved by the New York court supervising the rehabilitation proceedings. Since then, the rehabilitation has been administered by the New York Liquidation Bureau (NYLB), on behalf of the Superintendent, as statutory rehabilitator. Note that ELNY policies were not transferred to Aurora.

In 1992, pursuant to the Rehab Plan, ELNY sold its surrenderable policies that had significant market value to MetLife. MetLife was financially strong, had experience taking over blocks of business from failed insurance companies, and agreed to pay ELNY policyholders 100 cents on the dollar for all benefits due. The vast majority of the contracts (by liability amounts) remaining with ELNY were non-surrenderable annuities sold to fund structured settlement agreements (SSAs). ELNY also retained a block of pension closeout annuities.

What does the liquidation of ELNY mean for owners, payees, and beneficiaries of ELNY contracts?

According to the Projected Liquidation Date Schedule, most ELNY contract owners (approximately 84%, or 7,700) will continue to receive from GABC the same benefit payments they have always received from ELNY. Approximately 16%, or 1,500, of ELNY payees are expected to have their benefits reduced under the Restructuring Agreement. The contracts listed in the Projected Liquidation Date Schedule with reduced benefits include the following:

- Structured Settlement Annuities
- Single Premium Immediate Annuities
- Pension Annuities

Of the 1,500 or so contracts with reduced benefits, the reduction is approximately 49% in total and up to 70% for some individual contracts.

No ELNY life insurance contracts had benefits reduced per the liquidation settlement, as those policies had been transferred to MetLife in 1992.

Subsequent Regulatory Response Protecting Policyholders

In response to several insolvencies during the mid-1980s to early-1990s, the National Association of Insurance Commissioners (NAIC) enacted several new regulations designed to better protect policyholders:

- **Risk Based Capital (RBC)**—the NAIC's RBC regime began in the early 1990s as an early warning system for U.S. insurance regulators. The RBC regime was created to provide a capital adequacy standard related to risk; it raises a safety net for insurers, is uniform among the states, and provides regulatory authority for timely action. It has two main components:
  1) The RBC formula, which established a hypothetical minimum capital level that is compared to a company's actual capital level, and
  2) An RBC model law that grants automatic authority to the state insurance regulator to take specific actions based on the level of impairment.
- **Financial Regulation Standards and Accreditation Program**—in 1989, the NAIC took a significant step toward establishing a sound program designed to aid state insurance departments and solvency regulation by adopting the Financial Regulation Standards (Standards). In an effort to provide guidance to the states regarding the baseline Standards, and as an incentive to put them in place, the NAIC adopted a formal certification program in 1990, under which each state's insurance department is reviewed by an independent review team to assess that department's compliance with the Standards. Departments meeting the Standards are publicly acknowledged, while departments not in compliance are given guidance by the NAIC to bring the department into compliance.

  The mission of the NAIC accreditation program is to establish and maintain standards to promote sound insurance company financial solvency regulation. The accreditation program provides a process whereby solvency regulation of multi-state insurance companies can be enhanced and adequately monitored with emphasis on the following:
  1) Adequate solvency laws and regulations in each accredited state to protect consumers and guarantee funds.
  2) Effective and efficient financial analysis and examination processes in each accredited state.
  3) Appropriate organizational and personnel practices in each accredited state.
  4) Effective and efficient processes regarding the review of organization, licensing, and change of control of domestic insurers in each accredited state.

- **Codification of Statutory Accounting Principles**—the Codification of Statutory Accounting Principles is the direct result of one of the initiatives of the 1991 NAIC Solvency Agenda: to evaluate existing statutory accounting principles presently outlined in the Accounting Practices and Procedures Manual for purposes of further developments, expansion, and codification. The purpose of the NAIC Codification is to "establish a comprehensive basis of accounting for insurance departments, insurers, and auditors that is recognized, and adhered to in the absence of conflict with, or silence of, state statutes and/or regulations." In this regard, statutory accounting principles, as they existed prior to codification, did not always provide a consistent and comprehensive basis of accounting and reporting.

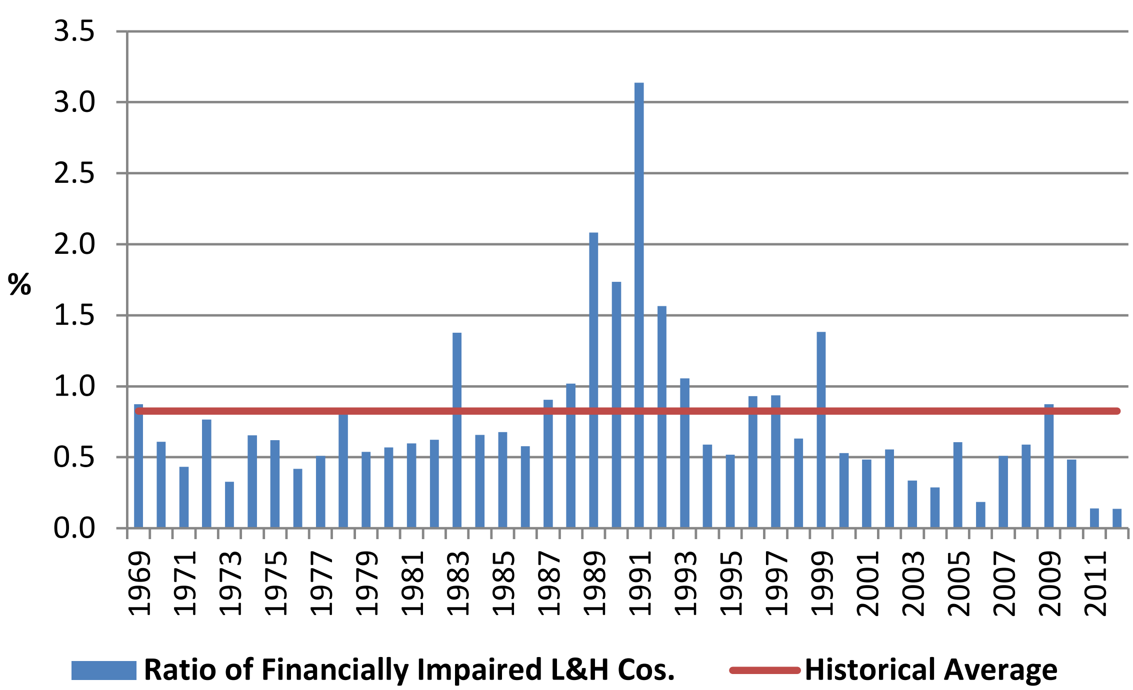
Enhanced Policyholder Protections and Positive Impact on Insurer Impairments

A.M. Best has historically tracked U.S. life and health insurer impairment rates (Figure 1). From 1969 through 2012, the annual rate of financial impairments for life and health companies averaged 0.83%. In 2012, the impairment rate was 0.14%, below the average for the period.

The emergence of the insurance guaranty systems (life and health and property/casualty) in the 1970s and 1980s was timely. Until the 1980s, insolvencies of major national insurers had been rare. Beginning in the 1980s and continuing into the early 1990s, several notable insurer failures took place. These included property/casualty carriers Reserve Insurance Company, Mission Insurance Company, and Transit Casualty Company. The first major life company failure in more than a generation involved Baldwin-United in 1983. Baldwin-United's failure was followed by a string of life and health company failures in the early 1990s, including Executive Life Insurance Company (1991), Mutual Benefit Life Insurance Company (1991), and Confederation Life Insurance Company (1994), along with a number of smaller companies. The number and severity of life and health insurer insolvencies declined after the mid-1990s. There have been no failures of nationally significant life carriers since 1994.

There is a strong connection between the lower insurance company financial impairment rates since the early 1990s and the enhanced regulatory policyholder protections put in place around that time. Regulators responded to the impairments with new standards and have implemented and maintained these standards in ways that continue to protect policyholders.

Figure 1. Annual Ratio of Financially Impaired Life & Health Insurance Companies (1969–2012)



Source: A.M. Best

Conclusion

The failure of the Executive Life Companies has resulted in reduced benefits being paid to ELIC policyholders and certain ELNY structured settlement, single premium, and pension annuity holders (even with funding from the state insurance and emergency funds).

Benefits have not been reduced for ELNY life insurance contracts, as those contracts were previously sold to MetLife.

Today the public is more aware of insurance company financial strength/solvency through more readily available information from rating agencies and stock analysts. This information remains critical to the process of selecting a carrier and evaluating available products.

The life insurance industry and its financial and actuarial consultants, life insurance ratings agencies, and state insurance regulators learned some important lessons from the company failures of the late 1980s and early 1990s and effectively enhanced regulatory policyholder protections. These standards—including Risk Based Capital, a Financial Regulation Standards and Accreditation Program, and Codification of Statutory Accounting Principles—provide consistency, transparency, and an early solvency warning system for regulators, all of which benefit policyholders. The Standards are working, as evidenced by the low ratio of life and health company impairments since the early 1990s.

M Financial group will continue to execute its client advocacy strategy by providing Due Care insight and analysis on individual life carriers, and the life insurance industry as a whole, to facilitate informed buying decisions.

For More Information

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