DEPARTMENT OF FINANCE
CALIFORNIA
DEPARTMENT OF FINANCE
ARNOLD SCHWARZENEGGER, GOVERNOR
915 L STREET ■ SACRAMENTO CA ■ 95814-3706 ■ WWW.DOF.CA.GOV

July 30, 2008

Mr. David E. Wilson, Chief Executive Officer
Conservation & Liquidation Office
425 Market Street, 23rd Floor
San Francisco, CA 94105

Dear Mr. Wilson:

Final Report—Executive Life Insurance Company Estate Financial Statement Review, December 2007

The Department of Finance, Office of State Audits and Evaluations, has completed its review of the Executive Life Insurance Company Estate assigned to the Conservation & Liquidation Office (CLO) for the period January 1, 2007 through December 31, 2007.

The enclosed report is for your information and use. We appreciate the assistance and cooperation of the CLO staff and management. If you have any questions regarding this report, please contact Susan M. Botkin, Manager, or Rick Cervantes, Supervisor, at (916) 322-2985.

Sincerely,

David Botelho, Chief
Office of State Audits and Evaluations

Enclosure

cc: Mr. Ray Minehan, Chief Financial Officer, Conservation & Liquidation Office
Mr. Ed Hahn, Vice President Estate Finance Group, Conservation & Liquidation Office
Mr. Keith Nelson, Chief, Ethics and Operational Compliance Office, California Department of Insurance
Mr. Dennis Ward, Chair, Audit Committee, California Department of Insurance

Financial Statement Review

Executive Life Insurance Company Estate
Conservation & Liquidation Office
For the Period January 1, 2007
through December 31, 2007

Prepared By:
Office of State Audits and Evaluations
Department of Finance

080845110

July 2008

TABLE OF CONTENTS

PREFACE

The California Department of Insurance (Department) takes a leading role to conserve, rehabilitate, or liquidate licensed California financially distressed and insolvent insurance enterprises under appointment by the Superior Courts. The Department's involvement helps secure consumer interests and provide for a stable, consistent insurance market.

The Conservation & Liquidation Office (CLO), created in 1994 to be the successor of the Conservation & Liquidation Division of the Department, is appointed by the California Insurance Commissioner (Commissioner) to oversee the affairs of financially impaired insurance enterprises domiciled in California. Financially impaired insurance enterprises are usually subject to a period of court supervised conservation under CLO administration. During this time, the CLO, along with the regulators, explore opportunities for rehabilitation. Financially distressed life insurance enterprises are frequently conserved, with policyholder liabilities and related invested assets transferred to a third party acquirer. However, for the vast majority of financially distressed property and casualty insurance enterprises, the enterprises will not be conserved, but liquidated.

For enterprises liquidated, the Commissioner, acting through the CLO, assumes title of the enterprise's assets. The insurance enterprise offices are closed, all outstanding policies are cancelled, and the process of obtaining and liquidating the enterprise's remaining assets begins. The books and records of the enterprise are acquired by the CLO for use during this process. The goal of liquidation is to apply the money acquired from liquidating the enterprise's assets toward the enterprise's debts and outstanding insurance claims. Upon issuance of a liquidation order, the CLO issues a notice to all interested parties, including the enterprise's policyholders, creditors, and shareholders. The notice requests proofs of claim be filed with the CLO in order to participate in a distribution of assets. An enterprise subject to a conservation or liquidation order is referred to as an estate. The costs of the CLO administration are borne by the estate of the insolvent entity. For estates with no assets, the California Insurance Fund supplements the costs. The process of conservation and subsequent liquidation can take several years.

The Commissioner, under California Insurance Code Section 1060, is required to transmit an annual report of information on the estates under his supervision to the Governor. These estates include those for which the Commissioner is fully responsible; those for which the Commissioner is partially responsible; those for which the Commissioner has custodial responsibilities; and those for which the Commissioner is fully responsible, but are operated separately. As of December 31, 2007, 25 open estates and 3 trusts of liquidated insurers are subject to the oversight of the CLO. In 2007, the CLO made interim and final distributions totaling $563 million and closed one estate.

The California Insurance Code Sections 1060 and 1061 authorize and require the Department of Finance to conduct biennial examinations of the Commissioner's books and accounts in support of the annual report transmitted to the Governor.

Specifically, the objectives of the engagement were to perform a review of the open estates' Statement of Assets and Liabilities, Statement of Operations, and Statement of Cash Flows as of December 31, 2007, in accordance with attestation standards established by the American Institute of Certified Public Accountants. An individual report for each estate reviewed, including any applicable restrictions on its use, will be issued.

Our review included those estates assigned to the CLO's Special Deputy Insurance Commissioner and considered open by the superior court; and did not include estates assigned to other Special Deputy Insurance Commissioners. Financial reports for estates assigned to other Special Deputy Insurance Commissioners are issued under separate cover by separate entities.

This report is intended for the information and use of the California Department of Insurance, the CLO, and the superior courts, and should not be used for any other purpose. However, the report is a matter of public record and its distribution is not limited.

STAFF:

Susan M. Botkin, CGFM
Manager

Rick Cervantes, CPA
Supervisor

Deborah Berry
Amanda Bihlman
Alexis Calleance
Emmie Hoang
Nichelle Thomas
Yeong Vardanega

DEPARTMENT OF FINANCE
ARNOLD SCHWARZENEGGER, GOVERNOR
915 L STREET ■ SACRAMENTO CA ■ 95814-3706 ■ WWW.DOF.CA.GOV

INDEPENDENT ACCOUNTANTS REPORT

Mr. David E. Wilson, Chief Executive Officer
Conservation & Liquidation Office
425 Market Street, 23rd Floor
San Francisco, CA 94105

We have reviewed the Statement of Assets and Liabilities, Statement of Operations, and Statement of Cash Flows (Statements) for the Executive Life Insurance Company Estate for the year ended December 31, 2007. The Conservation & Liquidation Office (CLO), as assigned conservator/liquidator, is responsible for the Statements.

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on the Statements. Accordingly we do not express such an opinion.

Based on our review, nothing came to our attention that caused us to believe that the Statements of the Executive Life Insurance Company Estate for the year ended December 31, 2007 are not presented, in all material respects, in conformity with Generally Accepted Accounting Principles Liquidation Basis of Accounting.

This report is intended solely for the information and use of the California Department of Insurance, the CLO, and the courts, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

David Botelho, CPA
Chief, Office of State Audits and Evaluations
(916) 322-2985

July 11, 2008

Executive Life Insurance Company Estate
Statement of Assets and Liabilities
As of December 31, 2007

Assets	**Balance**
Cash and Cash Equivalents: Unrestricted	$ 1,852,945
Participation in Pooled Investments, at market	40,721,972
Non-Pooled Short Term Investments, at market:	
Restricted	15,706,554
Accrued Investment Income	239,952
Other Receivable	1,653,411
Total Assets	$ 60,174,834
Liabilities	
Secured Claims	$ 6,664,605
Accrued Administrative Expenses	1,222,979
Policy Holder Claims	2,998,670,665
Distributions	(737,275,943)
All Other Claims	428,836
Total Liabilities	2,269,711,142
Net Assets (Deficiency)	**$(2,209,536,308)**

The notes to the statements are an integral part.

Executive Life Insurance Company Estate
Statement of Operations
For the 12 Months Ended December 31, 2007

	Balance
Expenses	
Legal Expenses	(3,469,651)
Consultants and Temps	1,140,491
Office Expenses	148,778
Allocated Overhead Expenses	973,347
Total Administrative Expenses	(1,207,035)
Total Expenses	(1,207,035)
Investments	
Investment Income	13,178,951
Investment Expenses	(70,975)
Gain (Loss) on Securities	(2,412,166)
Net Investment Income	10,695,810
Net Income	**$ 11,902,845**

The notes to the statements are an integral part.

Executive Life Insurance Company Estate
Statement of Cash Flows
For the 12 Months Ended December 31, 2007

Cash Flows from Operating Activities	
Net income	$ 11,902,845
Decrease (increase) in recoverable from reinsurers	903,817
Decrease (increase) in receivable from affiliates	513,106
Increase (decrease) in secured claim liabilities	5,721,607
Increase (decrease) in accrued administrative expenses	(1,058,755)
Increase (decrease) in policy holder claims	(60,866)
Decrease (increase) in distributions	(316,659,058)
Adjustments to Net Assets	787,348
Net cash flows from operating activities	(297,949,956)
Cash Flows from Investing Activities	
Decrease (increase) in accrued investment income	(1,272)
Cash Flows from Financing Activities	0
Net increase (decrease) in cash	**(297,951,228)**
Cash at beginning of period	356,232,699
Cash at end of period	**$ 58,281,471**

The notes to the statements are an integral part.

1. Organization

The California Insurance Commissioner (Commissioner), an elected official of the State of California, acts under the supervision of the Superior Court when conserving and liquidating insurance enterprises. In this capacity, the Commissioner is responsible for taking possession (conservation) of the assets of financially troubled insurance enterprises domiciled or incorporated in California. An enterprise subject to a conservation or liquidation order is referred to as an estate.

The Commissioner applies to the Superior Court for a conservation order to place a financially troubled enterprise in conservatorship. Under a conservation order, the Commissioner takes possession of the insolvent estate's financial records and real and personal property, and conducts the business of the estate until a final disposition regarding the estate is determined. The conservation order allows the Commissioner to begin an investigation that will determine, based on the estate's financial condition, if the estate can be rehabilitated, or if continuing business would be hazardous to its policyholders, creditors, or the public.

If, at the time the conservation order is issued or anytime thereafter, it appears to the Commissioner that it would be futile to proceed with the conservation of the financially troubled estate, the Commissioner will apply for an order to liquidate the estate's business. In response to this application, the Court may order the Commissioner to liquidate the estate's business in the most expeditious fashion.

In order to discharge his or her responsibility as conservator or liquidator, the Commissioner appoints special deputy insurance commissioners as agents to act on his behalf. The Commissioner has formed the Conservation & Liquidation Office (CLO) to support the activities of one of these special deputy insurance commissioners. The CLO was created in 1994 to be the successor to the Conservation & Liquidation Division of the Department of Insurance, which was managed by State employees. The CLO is based in San Francisco, California.

The Commissioner ordered the conservation of Executive Life Insurance Company (ELIC) on April 11, 1991, partly due to a decline in value of its multi-billion dollar investment portfolio of high yield corporate bonds, commonly known as "junk bonds." At the time, it was the largest life insurance insolvency in United States history. ELIC had more than 350,000 policyholders when the liquidation order was signed on December 6, 1991.

On March 3, 1992, pursuant to Superior Court approval, the Commissioner consummated the sale of ELIC's junk bond portfolio. A comprehensive rehabilitation plan was adopted and became effective on September 3, 1993. As a part of the plan, the policyholders either elected to accept new coverage (opt in) from Aurora National Life Assurance Company (Aurora) or elected to opt out and terminated their policies for cash. Over the years, enhancement trusts were established as a part of the liquidation process and which at various times have been used to distribute assets to the ELIC Opt Out Trust for subsequent disbursement to the policyholders that opted out, or to Aurora to distribute cash or dividends and/or to enhance the policy values of the policyholders that opted in.

2. Basis of Presentation

During 2007, the CLO managed three trusts in addition to the ELIC Estate: ELIC Holdback Trust, ELIC Opt-Out Trust, and ELIC FEC Litigation Trust. This report presents the results for the ELIC estate (Estate) only.

The accompanying financial statements of Estate have been prepared on the liquidation basis of accounting in conformity with generally accepted accounting principles. These financial statements reflect the financial position and activity of the Estate, which has been assigned to the CLO by the Commissioner in his role as liquidator.

Under the liquidation basis of accounting, assets are stated at their estimated net realizable values. Liabilities are stated at their ultimate amounts and are subsequently adjusted to settlement amounts upon final distribution. A new cost basis is established as of the date of liquidation.

3. Summary of Significant Accounting Policies

Priority of Claims

California Insurance Code section 1033 prescribes that claims on estate assets are paid according to a priority, except when otherwise provided in a rehabilitation plan. The probability of a valid claim being paid is dependent on the valuation of the claim, the order of preference of the claim, and the amount of funds remaining after other claims having higher preference have been discharged. Each priority class of claims must be fully paid before any distribution may be made to the next priority class. All members of a class receiving partial payment must receive the same pro-rata amount.

Estimate of Future Administrative Costs

Generally accepted accounting principles require that the financial statements of entities in liquidation provide for an estimate of future administrative costs. It is the CLO's policy not to accrue estimates of future administrative costs except when the Court has approved a final distribution order and the estate is scheduled to be closed within the following twelve months.

ASSETS:

Cash and Cash Equivalents

Cash and Cash Equivalents consists of cash in banks, investments in money market funds and all investments with original maturities of three months or less. Investments with maturities of greater than three months, but due in one year or less, are classified as short-term investments.

Restricted cash is segregated in accordance with restrictions imposed by court order, a loan or security agreement, California statute, or escrow agreements, and is generally unavailable for administrative expenses. The Estate held no restricted cash as of December 31, 2007.

Pooled Investments
All investments, including short-term investments and debt and equity securities, are stated at fair value, which approximates market value. Market values are those provided by the depository trust institution in possession of the securities at the balance sheet date or through brokerage institutions. Where market values are not readily determinable, book values are used.

The majority of the invested assets of the estates are combined for investment purposes into an investment pool, divided equally between two investment management firms. Each of the participating estates owns a percentage of the pool based on its proportionate share of the fair value of the pool's net assets. The net assets are valued at fair value on a monthly basis and estate ownership is computed monthly based on contributions and withdrawals by participating estates. Realized and unrealized gains and losses are allocated monthly based on the estate's ownership percentage in the pool at month end.

Pooled investments may be considered restricted. However, the Estate held no restricted pooled short term investments as of December 31, 2007.

Non-Pooled Short Term Investments
Non-pooled Short Term Investments consists of investments with maturities greater than three months but less than one year and are funds that cannot be commingled with other funds. Non-pooled investments are held by a custodian bank, and for larger non-pooled investment accounts, an investment manager oversees the investment.

Non-pooled investments are stated at fair value, which approximates market value. Market values are those provided by the depository trust institution in possession of the securities at the balance sheet date or through brokerage institutions. Where market values are not readily determinable, book values are used.

Restricted investments are either restricted by court order, held in trust, or represent a deposit whose use is restricted by statute. The Estate held $15,706,554 in restricted non-pooled short term investments as of December 31, 2007.

Accrued Investment Income
Accrued Investment Income represents monthly estimates of interest and dividends earned on cash and investments held by the Estate. For pooled investments, interest accruals are allocated based on the Estate's percentage of ownership in the pool. Non-pooled interest accruals are on an estate by estate basis. Each month interest and dividends are accrued and posted to the Estate's account. Upon receipt of the earnings, the accruals are reversed and actual amounts received are then posted.

Other Receivables
Other Receivables consists of an account held by Aurora reserved for covering the additional costs to policyholder adjustments for Opt In contracts as may be required. Any remaining amount will be returned to the ELIC estate for distribution to all Opt In policyholders.

LIABILITIES:

Secured Claims

Secured Claims represents funds allocated to Opt In policyholders involved in the PA Class Action suit, where the Pennsylvania Life and Health Insurance Guaranty Association (PLHIGA) has certain subrogation rights, and unclaimed funds payable, which are funds distributed to claimants that were returned as undeliverable and/or an accurate address could not be located. Unclaimed funds are eventually escheated to the California State Controller's Office.

Accrued Administrative Expenses

Accrued Administrative Expenses represents administrative accounts payable amounts which have been accrued but not yet paid.

Generally accepted accounting principles require that the financial statements of entities in liquidation provide for an estimate of future administrative costs. Because the final resolution of litigation, reinsurance and other matters which impact the closure of the estate may take more than 10 years to resolve, it is the CLO's policy not to accrue estimates of future administrative costs except when the Court has approved a final distribution order and the estate is scheduled to be closed within the following twelve months.

Policyholder Claims

Policyholder Claims is the difference between policyholder liabilities at the time the Estate was conserved and the restructured liability based on Conservation Date Statutory Reserve (CDSR) as defined in the ELIC Rehabilitation Plan.

Distributions

Distributions include the transfer of funds—since the CLO assumed management of the Estate on August 1, 1997—from the Estate to the ELIC Opt Out Trust for subsequent disbursement to the policyholders who opted out, or to Aurora National Life Assurance Company for subsequent disbursement of cash or dividends and/or to enhance the policy values of the policyholders that opted in.

In 2007, the Estate made $316,659,058 in distributions.

All Other Claims

All Other Claims represent pre-liquidation accounts payable amounts due to general creditors. To the extent that assets remain in the estate after higher priority class claimants have been satisfied, the general creditors will receive a distribution. This is deemed unlikely.

EXPENSES:

Administrative Expenses

Administrative Expenses consists of both direct and indirect expenses.

Direct Expenses are directly charged to estates whenever individually attributable to the estate. These expenses consist of legal costs, consultants and contractors, salaries and benefits of employees working exclusively for a single estate, office expenses, and depreciation and capitalization of property and equipment. Note that reversals or reimbursements of certain legal and litigation-related expenses incurred in prior years are booked to current year financial statements. In certain cases, such reversals or reimbursements may exceed current year expenses, and could result in net negative administrative expenses for the year for certain estates.

In October 2007, the Estate received a reimbursement of $4.5 million from the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) for attorney and expert witness fees related to the NOLHGA/Commissioner of Insurance Arbitration which was approved by the Conservation Court in mid-2007. Aside from this reimbursement, 2007 legal and consultant fees were $608,000 and $1.56 million, respectively.

Administrative expenses not directly charged to an estate are allocated to each estate on a proportional basis Allocated expenses applicable to all of the estates include CLO employee compensation and benefits, payroll taxes; indirect legal expenses, rent, utilities, and other general overhead costs. These shared expenses are allocated to each estate based on factors derived from the direct CLO labor hours charged to each estate, and in some instances direct contractor hours charged.

INVESTMENTS:

Investment income
Investment Income is comprised of interest and dividends earned on cash and investments held by the estate. For estates with investments in the pool, income is allocated based on the estate's proportional share in the pool.

Investment Expenses
Investment Expenses is comprised of investment and interest expenses related to cash and investments held by the estate. For estates with investments in the pool, the expenses are allocated based on the estate's proportional share in the pool.

Gain (Loss) on Securities
Gain (Loss) on Securities consists of long and short term gains and losses incurred as part of the investment pool, mark to market adjustments, gains and losses on non-pooled reappraisals of securities, and gains and losses incurred on the transfer of non-pooled securities into the pool. The long and short term gains and losses and mark to market adjustments are allocated based on the estate's proportional share in the pool. Gains and losses on the reappraisal of non-pooled securities and the transfer of non-pooled securities into the pool are reported on an estate by estate basis.

Unrealized and realized gains and losses are included as a component of net investment income. The cost of securities sold is based on specific identification and realized gains (losses) are computed based on the securities' original cost. Transfers of non-pooled investments to a pool are a sale resulting in non-pooled realized gains and losses and a noncash transfer. Transfers from one pool to the other are a sale resulting in pooled realized gains and losses and a non-cash transfer.

4. Litigation

The ELIC Estate is party to the legal proceeding *Garamendi v. Altus et al.* The Commissioner, acting on behalf of the Estate, commenced a civil action in 1999 against various defendants, alleging that they had fraudulently and unlawfully obtained control over a California insurance company, ELIC's former bond portfolio, and insurance assets in violation of Federal and State laws prohibiting a foreign government-owned bank from acquiring control of a California insurance company. Among the defendants in the civil action is Aurora, which is the new insurance company that received the transferred assets and issued the restructured policies under the Rehabilitation Plan, and Altus Finance S.A. (Altus), which is the entity that purchased and received the transferred bonds pursuant to the Rehabilitation Plan.

As of March 2008, the Commissioner has recovered approximately $730 million. In September 2007, the Court awarded restitution plus interest of $241,092,020, less $110,000,000 already received from the U.S. Department of Justice. The remaining $131,092,020 of the restitution award and the $700 million punitive damages award are on appeal. Outcome of the appeal is pending.

5. Subsequent Events

There are no reportable subsequent events for this Estate.