



Transmitted via e-mail

April 26, 2012

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

Dear Mr. Wilson:

**Final Report—Executive Life Insurance Company Estate Financial Statement Review,  
December 2011**

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, 2011 through December 31, 2011.

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

Sincerely,

David Botelho, CPA  
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  
Ms. Nettie Hoge, Chief Deputy Insurance Commissioner, California Department of Insurance  
Mr. Keith Nelson, Chief, Organization Accountability Office, California Department of Insurance

# FINANCIAL STATEMENT REVIEW

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Executive Life Insurance Company Estate  
Conservation & Liquidation Office  
For the Period January 1, 2011  
through December 31, 2011

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

## **MEMBERS OF THE TEAM**

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Rick Cervantes, CPA  
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## EXECUTIVE SUMMARY

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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, 2011, 22 open estates and 1 trust of liquidated insurers are subject to the oversight of the CLO. In 2011, the CLO made distributions totaling \$385 million.

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 (Statements) as of December 31, 2011, 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.

### **Review Results**

Based on our review, nothing came to our attention that caused us to believe that the Statements for the year ended December 31, 2011 are not presented, in all material respects, in conformity with Generally Accepted Accounting Principles Liquidation Basis of Accounting.

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



## INDEPENDENT ACCOUNTANT'S REPORT

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Mr. David E. Wilson, Chief Executive Officer  
Conservation & Liquidation Office  
425 Market Street, 23<sup>rd</sup> 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, 2011. 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, 2011 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.

A handwritten signature in blue ink, appearing to read "David Botelho".

David Botelho, CPA  
Chief, Office of State Audits and Evaluations

April 17, 2012

STATEMENT OF ASSETS  
AND LIABILITIES

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**Executive Life Insurance Company Estate**  
**Statement of Assets and Liabilities**  
**As of December 31, 2011**

	<u>Balance</u>
<b>Assets</b>	
Cash and Investments	\$ 39,699,854
Accrued Investment Income	182,081
Other Receivables	<u>1,605,755</u>
Total Assets	<u>\$ 41,487,690</u>
<b>Liabilities</b>	
Secured Claims	\$ 6,224,195
Accrued Administrative Expenses	1,788,802
Policyholder Liability	5,924,618,082
Other Claims	<u>428,836</u>
Total Liabilities	<u>5,933,059,915</u>
<b>Net Assets (Deficiency)</b>	<b><u><u>\$(5,891,572,225)</u></u></b>

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The notes are an integral part of the financial statements.



# STATEMENT OF OPERATIONS

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## Executive Life Insurance Company Estate Statement of Operations For the Year Ended December 31, 2011

	<u>Balance</u>
<b>Revenue</b>	
Recoveries	\$ 28,116
Total Revenue	28,116
<b>Expenses</b>	
Legal Expenses	5,638,052
Consultants and Temps	126,947
Office Expenses	61,788
Allocated Overhead Expenses	<u>295,498</u>
Total Administrative Expenses	6,122,285
Interest on Policyholder Liability	<u>227,750,252</u>
Total Expenses	233,872,537
<b>Investments</b>	
Investment Income	1,145,610
Investment Expenses	(37,366)
Gain (Loss) on Securities	<u>(400,169)</u>
Net Investment Income	708,075
<b>Net Income (Loss)</b>	<b><u>\$(233,136,346)</u></b>

The notes are an integral part of the financial statements.

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# STATEMENT OF CASH FLOWS

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## Executive Life Insurance Company Estate Statement of Cash Flows For the Year Ended December 31, 2011

<b>Cash Flows from Operating Activities</b>	
Net Income (Loss)	\$(233,136,346)
Increase (Decrease) in Secured Claim Liabilities	(544,135)
Increase (Decrease) in Accrued Administrative Expenses	(278,120)
Increase (Decrease) in Policyholder Liability	<u>227,632,358</u>
Net Cash Flows from Operating Activities	(6,326,243)
<b>Cash Flows from Investing Activities</b>	
Decrease (Increase) in Accrued Investment Income	52,690
<b>Cash Flows from Financing Activities</b>	
	<u>0</u>
<b>Net Increase (Decrease) in Cash</b>	<b>(6,273,553)</b>
Cash at Beginning of Period	<u>45,973,407</u>
<b>Cash at End of Period</b>	<b><u>\$ 39,699,854</u></b>

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The notes are an integral part of the financial statements.

# NOTES TO THE STATEMENTS

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## **1. Organization**

The California Insurance Commissioner (Commissioner), an elected official of the State of California, acts under the supervision of the Superior Court (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.

Executive Life Insurance Company (ELIC) was placed in conservation by order of the Los Angeles County Superior Court on April 11, 1991. At the time, ELIC, which had more than 350,000 policyholders, was the largest life insurance insolvency in United States history. In the summer and fall of 1991, the Commissioner conducted an auction seeking bids to acquire the junk bond portfolio and insurance assets of ELIC. In December 1991, the Commissioner's selection of a group of French and European investors (the Altus/MAAF group) as the winning bidder was approved by the Court.

In March 1992, ELIC's junk bond portfolio was transferred to Altus Finance for a total purchase price of approximately \$3 billion. In August 1993, the Court approved a final Rehabilitation Plan under which the majority of ELIC's assets and its restructured insurance policies were transferred to a new California insurance company created by the European consortium that had won the 1991 bid. The Rehabilitation Plan became effective in September 1993. Under the terms of the Rehabilitation Plan, former ELIC policyholders were given a choice either to accept new coverage (Opt In) from Aurora National Life Assurance Company (Aurora) or to terminate their policies (Opt Out) in return for a pro rata share of ELIC's assets. The Rehabilitation Plan also provided for the establishment of various trusts, collectively known as the Enhancement Trusts, to marshal and distribute assets for the benefit of former ELIC policyholders.

## **2. Basis of Presentation**

The accompanying financial statements of the ELIC Estate (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 CLO by the Commissioner in his role as liquidator.

### **3. Summary of Significant Accounting Policies**

#### **ASSETS:**

##### **Cash and Investments**

All investments, including short-term investments and debt and equity securities, are stated at 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.

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.

##### **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 posted.

##### **Other Receivables**

Other Receivables consist 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 Estate for distribution to all Opt In policyholders.

#### **LIABILITIES:**

##### **Secured Claims**

Secured Claims represents funds allocated to Opt In policyholders involved in the Pennsylvania 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 state agency of the claimants' last known address.

##### **Accrued Administrative Expenses**

Accrued Administrative Expenses represent administrative expenses 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 and other matters which impact the closure of an estate will take an indefinite time to resolve, it is 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 Liability**

Policyholder Liability represents the amount the Estate owes to policyholders in accordance with provisions of the Modified Rehabilitation Plan and relevant judicial decisions, and includes accrued but unpaid interest of approximately \$2.6 billion.

**Other Claims**

Other Claims represent pre-liquidation accounts payable and claims due to general creditors. The stated amount does not include interest that has accrued on such claims. Accrued interest on these Other Claims will not be paid unless and until the Estate has sufficient funds to do so after paying all principal and interest owed to policyholders and other creditors with priority over these Other Claims.

**REVENUES:****Recoveries**

Recoveries include receipt of annuity payments, unclaimed funds and transfers from the Insurance Fund.

**EXPENSES:****Administrative Expenses**

Administrative Expenses consists of both direct and indirect expenses.

Direct expenses are those expenses which are directly charged to the Estate, such as legal costs, consultants and contractors, office expenses, and federal income taxes.

Indirect expenses are administrative expenses not directly charged to an estate but allocated to each estate on a proportional basis. Allocated expenses applicable to all of the estates include CLO employee compensation and benefits, payroll taxes, 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 and contractor hours charged to each estate.

**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 or 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 or losses and a non-cash transfer. Transfers from one pool to the other are a sale resulting in pooled realized gains or losses and a non-cash transfer.

#### **4. Litigation**

The Commissioner, in his capacity as conservator, rehabilitator, and liquidator of the Estate, commenced a civil action in 1999 against Altus Finance S.A. (Altus) and other defendants alleging that they had acquired the junk bond portfolio and insurance assets of the Estate through fraud. Settlements were reached with Altus and some of the other defendants in 2004 and 2005.

A trial against the remaining defendants in 2005 resulted in a jury verdict finding Artemis S.A., a two-thirds owner of Aurora, liable for knowing participation in a conspiracy with members of the Altus/MAAF group to defraud the Commissioner. In August 2008, the jury's verdict of liability was upheld on appeal and the case was remanded to the U.S. District Court for a new trial on the issue of damages. At present, no trial date has been set.

The Estate is a party to a proceeding brought by certain Indenture Trustee policyholders who challenged various CLO administrative expenses for the period January 1, 1997 to June 30, 2008. The Court issued an order on December 7, 2009 approving those expenses and subsequently denied the request by the Indenture Trustee policyholders for attorney fees. The policyholders have filed an appeal. At present, no date has been set for the appeal hearing.

#### **5. Subsequent Events**

There are no reportable subsequent events for this Estate.