DEPARTMENT OF FINANCE
CALIFORNIA

EDMUND G. BROWN JR. ▪ GOVERNOR
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Transmitted via e-mail

April 14, 2011

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

Dear Mr. Wilson:

Final Report—ELIC Opt Out Trust Financial Statement Review, December 2010

The Department of Finance, Office of State Audits and Evaluations, has completed its review of the ELIC Opt Out Trust assigned to the Conservation & Liquidation Office (CLO) for the period January 1, 2010 through December 31, 2010.

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 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

ELIC Opt Out Trust
Conservation & Liquidation Office
For the Period January 1, 2010 through December 31, 2010

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

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April 2011

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EXECUTIVE SUMMARY

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, 2010, 22 open estates and 3 trusts of liquidated insurers are subject to the oversight of the CLO. In 2010, the CLO made distributions totaling $476 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' and trusts' Statement of Assets and Liabilities, Statement of Operations, and Statement of Cash Flows (Statements) as of December 31, 2010, in accordance with attestation standards established by the American Institute of Certified Public Accountants. An individual report for each estate and trust reviewed, including any applicable restrictions on its use, will be issued.

Our review included those estates and trusts assigned to the CLO's Special Deputy Insurance Commissioner and considered open by the Superior Court; and did not include estates and trusts assigned to other Special Deputy Insurance Commissioners. Financial reports for estates and trusts 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, 2010 are not presented, in all material respects, in conformity with Generally Accepted Accounting Principles.

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.

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INDEPENDENT ACCOUNTANT'S 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 ELIC Opt Out Trust for the year ended December 31, 2010. 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 ELIC Opt Out Trust for the year ended December 31, 2010 are not presented, in all material respects, in conformity with Generally Accepted Accounting Principles.

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

April 8, 2011

ELIC Opt Out Trust
Statement of Assets and Liabilities
As of December 31, 2010

	Balance
Assets	
Participation in Pooled Investments, at Market	$ 9,639,892
Non-Pooled Short-Term Investments, at Market: Restricted	545,749
Accrued Investment Income	48,403
Total Assets	$ 10,234,044
Liabilities	
Secured Claims	$ 7,568,784
Unclaimed Funds Payable	2,474,624
Reserve for Administrative Expenses	190,636
Total Liabilities	$ 10,234,044

The notes are an integral part of the financial statements.

ELIC Opt Out Trust
Statement of Operations
For the Year Ended December 31, 2010

	Balance
Investments	
Investment Income	$ 156,721
Investment Expenses	1,845
Gain (Loss) on Securities	(44,588)
Net Investment Income	113,978
Expenses	
Legal Expenses	747
Consultants and Temps	309,169
Office Expenses	10,267
Allocated Overhead Expenses	311,272
Total Expenses	631,455
Net Income (Loss)	**$ (517,477)**

The notes are an integral part of the financial statements.

ELIC Opt Out Trust
Statement of Cash Flows
For the Year Ended December 31, 2010

Cash Flows from Operating Activities	
Net Income (Loss)	$ (517,477)
Increase (Decrease) in Secured Claim Liabilities	(10,578,148)
Adjustments to Reserve for Administrative Expenses	145,467
Net Cash Flows from Operating Activities	(10,950,158)
Cash Flows from Investing Activities	
Decrease (Increase) in Accrued Investment Income	(47,158)
Cash Flows from Financing Activities	0
Net Increase (Decrease) in Cash	**(10,997,316)**
Cash at Beginning of Period	21,182,957
Cash at End of Period	**$ 10,185,641**

The notes are an integral part of the financial statements.

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 bidders was approved by the Superior Court.

In March 1992, ELIC's junk bond portfolio was transferred to Altus Finance S.A. for a total purchase price of approximately $3 billion. In August 1993 the Superior 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 ELIC 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.

The ELIC Opt Out Trust (Trust) was created in 1994 to hold assets to be disbursed to policyholders who opted out. It is also a cost center for charging expenses that apply only to opt out policyholders. The Trust received funds from the Enhancement Trusts, and with those trusts being closed, it now receives funds from the ELIC estate. Specific processes for how ELIC funds are distributed to opt in and opt out policyholders are determined by the provisions of the ELIC Rehabilitation Plan and the ELIC Enhancement Agreement.

2. Basis of Presentation

The accompanying financial statements of the Trust have been prepared in conformity with generally accepted accounting principles. These financial statements reflect the financial position and activities of the Trust.

3. Summary of Significant Accounting Policies

ASSETS:

Pooled Investments

The invested assets of the Trust are combined for investment purposes into an investment pool, divided equally between two investment management firms. Each of the participating trusts 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 ownership is computed monthly based on contributions and withdrawals by participating trusts. Realized and unrealized gains and losses are allocated monthly based on the trust's ownership percentage in the pool at month end.

Pooled investments may be considered restricted. However, the Trust held no restricted pooled investments as of December 31, 2010.

Non-Pooled Short-Term Investments

Non-Pooled Short-Term Investments consist 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 Trust held $545,749 in restricted non-pooled short term investments as of December 31, 2010.

Accrued Investment Income

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

LIABILITIES:

Secured Claims

Secured Claims represents amounts due to opt out policyholders which have not yet been disbursed.

Unclaimed Funds Payable

Unclaimed Funds Payable 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 or the state treasurer of the claimants' last known address.

Reserve for Administrative Expenses
Reserve for Administrative Expenses is the projected administrative expenses to be incurred in closing the Trust.

INVESTMENTS:

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

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.

EXPENSES:

Administrative Expenses
Administrative Expenses consists of both direct and indirect expenses.

Direct expenses are directly charged to the trust whenever individually attributable. These expenses consist of legal costs, consultants and contractors, and office expenses.

Administrative expenses not directly charged to an individual trust are allocated on a proportional basis. Allocated expenses 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 trust based on factors derived from the direct CLO labor hours charged to each trust, and in some instances direct contractor hours charged.

4. Litigation

The Commissioner, on behalf of the ELIC estate, is party to certain legal proceedings. If the Commissioner is successful in collecting additional recoveries, the Trust will receive 33.9 percent of any net recoveries, which will increase funds available for distribution to its beneficiaries.

5. Subsequent Events

There are no reportable subsequent events for this Trust.