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OPINION:

ELNY “Exorcism” Exposes System’s Sins

*“Bottom line. It is time
to shut down the New York
Liquidation Bureau.*

*Whoa! Shut it down?
Isn’t that a bit drastic?”*

You decide.

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Peter H. Bickford

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OPINION:

Ongoing ELNY Debacle Exposes Serious Problems

The New York Superintendent of Financial Services and the New York Liquidation Bureau have experienced two major victories in the past few weeks. First, they succeeded in having the lawyers for the shortfall victims of Executive Life Insurance Company of New York (lovingly referred to as ELNY) held in contempt for having the audacity to try and do what the Superintendent has failed to do – seek to hold accountable the parties responsible for the failure of ELNY; and secondly, they have succeeded in having the court’s approval of the liquidation and restructuring plan affirmed on appeal, including the broad grant of immunity to the superintendent and the Bureau. Before celebrating too much, however, the superintendent should recognize the hollowness of these victories.

Even though the courts have once again come to the rescue of the Bureau, the ELNY fiasco fully exposed the Bureau for its decades-long covert mismanagement of insolvent insurance companies. The Bureau has long held itself out as the champion of the victims of these insolvencies: the policyholders and claimants. For time immemorial it has been able to operate under the radar, without any significant oversight or accountability, while all along imposing its special brand of control over insolvent estates at the expense of the very policyholders and claimants it says it is protecting.

But now, because of ELNY, the dark underside of the beast has been exposed: the Bureau is now the king without his clothes – the faux wizard behind the curtain – the deep, dark rotting swamp whose pungent bouquet can no longer be ignored! *The great ELNY disaster has dispelled any lingering doubt about the failure of the Bureau to perform its most basic fiduciary responsibility to its constituents – policyholders and claimants.*¹

The great remaining mystery is the unwillingness of the administration, the courts, the legislature and the industry to admit the scope of the ELNY disaster and the failings of the insolvency process, and to take appropriate action to remedy these systemic problems. Even stranger are the lengths that the administration and the courts have gone to in order to preserve the myth of the Bureau’s fiduciary role without fiduciary accountability, or to protect it from any form of meaningful external investigation or scrutiny.

The superintendent's two recent court victories are just the most current examples of the strength of this continuing partnership between the administration and the courts. In essence, they fortify the superintendent's long-standing position that he and only he has the power to take action on behalf of victims of an insolvent insurer, even if the company became insolvent on his watch and even if he refuses to take any action to seek recovery for or to protect the victims.

What do you think would happen to the management of a licensed insurance company if it sold off its best business, transferred its best assets to the purchaser, left all the worst business supported by its weakest assets in the company, allowed the company to become insolvent by more than \$1.5 billion, and hid the company's insolvency from the public for over a decade? It is highly unlikely – no, totally unlikely – that management would be allowed to continue to control the company let alone be allowed to develop and implement a plan for restructuring the company's outstanding contracts and winding up its business. But this is what the Bureau, with the support of the administration and the courts, have been able to do with ELNY!

Lest anyone thinks that this is just a local NY problem only affecting a small number of claimants in one estate, you are wrong. *The ELNY debacle affects the entire industry, including the guaranty fund structure and the growing nationwide debate on State v. Federal regulation of insurance.* ELNY has exposed the deficiencies in the State insolvency process including the lack of meaningful and seamless financial standards for insolvent companies and guaranty fund coverage for its policyholders. The attacks against continued state regulation of the business of insurance is focused primarily on solvency and unless the states can show that they have appropriate standards and ability to enforce those standards the attacks could result in a sea change in regulation. The time to finally establish a responsible and responsive insolvency process is now. The recent court decisions should be the final straw dashing any lingering hope that those in charge of the process have any will to fix or interest in fixing the endemic problems. The decades long festering infection cannot be resolved with band-aids. It will require a complete overhaul of the system.

Bottom Line: It is time to shut down the New York Liquidation Bureau!

Whoa! Shut it down? Isn't that a bit drastic? Can't it simply be tweaked and made more accountable and responsive? What about all those hard-working people at the Bureau (yes, there have been many competent, conscientious people over the years at the Bureau)? The problem, however, is not the people; it is the institution – a Steinbergian contraption (As in artist Saul Steinberg: look it up!) whose lack of accountability over the decades has made it a breeding ground for corruption and abuse. Consider the following:

- The NY Insurance law has no definition of the Liquidation Bureau.
- The New York Court of Appeals (the State's highest court)

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ELNY Decision Unjust to Victims: Attorney for the Annuitants Charges “concealment, fraud, waste and mismanagement.”

Despite what appears to be over two decades of concealment, fraud, waste, and mismanagement at the highly secretive New York Liquidation Bureau (“NYLB”), the Superintendent of Financial Services of the State of New York, Benjamin Lawsky, is pulling out all of the stops to prevent the Executive Life victims from seeking justice. In an unprecedented move that ignores established case law and turns the US Constitution on its head, Lawsky asked for and obtained an order of contempt against attorneys representing shortfall victims for assisting innocent peo-

ple in seeking redress in federal court for the irresponsible waste that occurred during an insurance industry failure of epic proportions. To add insult to injury, in a curiously timed ruling, on February 6, 2013, the Appellate Division, Second Department rubber stamped Galasso’s decision and order approving the liquidation of ELNY without any review or analysis whatsoever. As a result, \$920 million in guaranteed benefit cuts are imminent and, for the time being, the New York Liquidation Bureau’s shady dealings will remain hidden from public scrutiny once again.

Background

In December, 2011 close to 1,500 structured settlement beneficiaries of the Executive Life Insurance Company of New York (“ELNY”) were told they were going to lose more than \$920 million dollars in benefits they were promised when they settled their personal injury or wrongful death claims in the mid 1980’s using structured settlements.¹ Ironically, those who were most catastrophically injured or suffered the biggest losses are slated to get hurt the most. The December 2011 notification was the first time victims had

ELNY Debacle Exposed

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had determined that the Bureau is NOT a state agency and therefore not subject to examination by the State Comptroller or subject to the Freedom of Information Law.

- Although each estate managed by the Bureau is purportedly “court supervised,” there is no requirement in the law for the Bureau to file any plan, financial or other report with the supervising court, or to issue any status report to policyholders or other creditors whatsoever. In fact, almost all of the Bureau’s contacts with the courts are done ex parte – without any notice to or involvement of interested parties.
- Once an insurer is placed under control of the Bureau, it ceases to be subject to any regulatory oversight, and ceases to file any standard, periodic, regular reports or financial statements with any regulatory body or the supervising court.

Because it has been able to operate under the radar and totally unaccountable for decades, the Bureau as it exists today

cannot and should not be saved. It is time for all affected parties – the regulators, legislators, guaranty funds and the industry and consumers who ultimately pay for the consequences of the failed system – to recognize this failure and to insist on a complete overhaul. The time has passed to simply kick the can down the road again.

In a future column (or two, or three), I will explore how the process should and can work efficiently and truly for the benefit of the victims of an insolvency, and what course the legislature with the support of the regulators and the industry could take to successfully and meaningfully restructure the insolvency process.

¹ I am not alone in this assessment. See, for instance, the special November 2012 issue of National Underwriter Health & Life entitled “*The Complete ELNY Saga: Twenty-one years of Mismanagement, Corruption, Broken Promises and Shattered Lives*,” which is still available on line at <http://www.lifehealthpro.com/pages/elny.php?ref=hp>

heard from the NYLB about ELNY since approximately 1993.

Most structured settlement agreements contain language stating that payments are “guaranteed” for a certain number of years and for “life thereafter” meaning that payments continue for as long as victims remain alive. These payment obligations were funded with ELNY annuities at the urging of specialty brokers, judges and attorneys. Little did the ELNY annuitants know – the “guarantees” they were promised were not worth the paper they were written on. In fact, more than 35% percent of ELNY’s structured settlement annuitants are now slated to have their benefits cut dramatically, with some losing up to 66% of their promised benefits.²

History of ELNY

In 1991, the Superintendent of Insurance of the State of New York took control of the Executive Life Insurance Company of New York. This was not because ELNY was insolvent, but rather because adverse publicity surrounding ELNY’s California parent company threatened to cause a hazardous number of surrenders of ELNY annuity contracts. By the end of 1992, the ELNY rehabilitation plan had been finalized and was formally approved. ELNY’s “good assets” were given to MetLife and what remained in the ELNY portfolio were close-out pension obligations, single premium immediate annuities, and structured settlement annuities. These all stayed with ELNY in rehabilitation and were serviced by MetLife, with investment responsibilities and trading authority turned over to First Boston Asset Management Corporation, now known as Credit Suisse Asset Management.

Over the next two decades, the New York Liquidation Bureau supervised the “rehabilitation” of a solvent, highly rated life insurance company. By outward appearances, ELNY was doing just fine. In fact, payments were made in a timely fashion for over twenty years. However, little did the ELNY victims know, but during those twenty years of “rehabilitation” ELNY’s assets were being depleted. After stripping away profitable businesses and charging the cost of surrenders back to ELNY, millions of dollars were paid to MetLife in servicing fees primarily for doing two things - sending out checks, and making sure payees were

With the ELNY liabilities hopelessly in excess of the remaining assets, in September, 2011 the Superintendent of Financial Services for the State of New York, Benjamin Lawsky, filed an ex-parte Order to Show Cause with the Nassau County Supreme Court seeking to have the court hold that ELNY was insolvent and approve a plan that would cut payments to what turned out to be 35% of the remaining structured settlement annuitants by more than \$920 million dollars.

still alive. Not only were the fees excessive, but for at least a decade MetLife did not maintain credible mortality data. Meanwhile, Credit Suisse took close to two million a year in investment management fees plus unknown “markups” for implementing a highly unsuitable investment strategy for a closed block of fixed and determined liabilities. At various times over the past two decades, more than 30% of ELNY’s assets were invested in common stocks and may have been held in “street name”. In some cases, senior tranches of high yield performing bonds were cashed in and exchanged for Z bonds – the lowest rated tranches available in the market. During unprecedented periods of market expansion ELNY’s invested assets lost hundreds of millions of dollars, dollars that the NYLB had a fiduciary duty to protect.

In December, 2007, Eliot Spitzer, Governor of New York, and the Superintendent of Insurance, Eric Dinallo, held a press conference to announce that an agreement had been reached that would protect the nearly 11,000 accident victims and other individuals receiving annual payments from ELNY structured settlements and pensions. What happened to that agreement and how it fell apart is unknown to those outside the NYLB and its chosen collaborators. What is clear is that none of the ELNY payees were ever told about this shortfall until December 2011 or the fact that the agreement had apparently fallen

apart and that ELNY’s liabilities were out of control. In fact, instead of warning victims so they could plan for reductions in benefits and looming lifestyle changes, the NYLB actively concealed the scope and extent of the known shortfall – requiring confidentiality agreements from anyone given data and threatening regulatory action to those who opposed the secret plans.

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The 2011 Holiday Gift

On December 7, 2011, in the middle of the holiday season, ELNY annuitants received letters from the NYLB telling them that the Superintendent of Financial Services was seeking court approval to liquidate ELNY. Almost fifteen hundred of them received a letter telling them their benefit payments would ultimately be reduced. For the first time, unsuspecting ELNY victims were told to brace themselves

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for reductions in their payments - some by as much as 66%. The letter required objections to be submitted by January 16, 2012, which was Martin Luther King Day, a national holiday. The people whose benefits were being cut frantically tried to make sense of the letter they had received. Some searched unsuccessfully for lawyers to represent them. Others may have simply decided they could not fight City Hall.

A hearing before Judge John Galasso of the Supreme Court of New York, Nassau County was held in March, 2012. While attorneys representing the Superintendent of Financial Services anticipated that the hearing would last for just a few hours, it went on for eleven days. In April, 2012 Judge Galasso granted the Superintendent's motion and approved the liquidation plan ("the Liquidation Plan"). After joining forces with Roger Christensen and Karra Porter of Christensen & Jensen of Salt Lake City, Utah, we filed an appeal of the liquidation order with the Second Department. Despite a thousand page record and detailed briefs citing controlling New York case law, the appeal was summarily dismissed on all grounds without so much as a discussion of what standards, if any, apply to the judicial immunity granted to the Superintendent and its agents.

The Class Action and the Contempt Motion

In November, 2012 a group of shortfall payees represented by Edward S. Stone, Esq. and Christensen & Jensen of Salt Lake City filed a class action lawsuit in the Southern District of New York alleging breach of fiduciary duty, fraudulent concealment and related causes of action against the Superintendent and his predecessors, along with MetLife and Credit Suisse.

Prior to filing this class action, the plaintiffs asked Superintendent Lawsky to take action on their behalf. Unfortunately, the Superintendent, whose job it was as the rehabilitator of ELNY to protect the interest of the annuitants, continued to turn a blind eye and refused to take any action. In fact, Mr. Lawsky did not even acknowledge or respond to our request. Apparently, yet another Superintendent is willing to allow decades of waste and mismanagement go unpunished.

Though it seems impossibly cruel to those slated for benefit cuts, on December 7th, 2012, the Superintendent took yet another jab at the ELNY victims and filed a motion in Nassau County Supreme Court seeking to enjoin the ELNY victims from proceeding with their class action lawsuit and to hold their counsel in contempt of court for filing that action, seeking to **"punish the accused for a contempt of court, and such punishment may consist of fine or imprisonment, or both, according to the law."**

On January 25, 2013, Judge Galasso found the three named plaintiffs and their attorneys in civil contempt of court for filing the federal class action lawsuit. Judge Galasso also issued a veiled threat to continue issuing contempt sanctions should the Superintendent "file a motion to dismiss the federal complaint upon a successful appellate result". This flies in the face of established United States Supreme Court precedent, as first expressed in *Donovan v. City of Dallas* 377 U.S. 408 (1964). *Donovan* establishes that State Courts cannot use contempt sanctions or the threat of contempt sanctions to interfere with federal actions. The *Donovan* line of cases have been consistently enforced by New York District Courts and there is simply no basis in fact or law for issuing contempt sanctions against attorneys for seeking redress in federal court for improper and unconscionable acts by the Superintendent's predecessors and agents. Judge Galasso's threats to repeatedly fine me, and my co-counsel, for asserting constitutionally protected legal claims in federal court are exactly the type of abuses that *Donovan* and its progeny were supposed to prevent.

The Superintendent and his outside counsel are quick to claim that the court itself supervises estates in rehabilitation. Nothing could be further from the truth. No supervision took place during the failed rehabilitation of ELNY. The NYLB violated specific orders of the court with callous disregard to the welfare of the policyholders it had a fiduciary duty to protect. From 1991 until sometime following December 7, 2011, shortfall victims had no reason to even suspect that something had gone horribly wrong with ELNY. The Court, the Superintendent, and the NYLB never said a word to them. In hindsight, their silence spoke volumes. Now they claim to repre-

sent the victims they are punishing by using every procedural slight of hand possible to avoid shedding light on what really happened over the past 21 years.

The blanket immunity and broad injunctive relief granted in the ELNY liquidation permits the Superintendent, the NYLB and their agents to hide the fraud, waste and mismanagement that doomed ELNY behind the pretext of court supervision. The contempt sanctions issued against the victims and their attorneys for doing the Superintendent's job are a blatant attempt to intimidate the plaintiffs into abandoning their claims. Sadly, instead of helping the victims of this tragedy, the Superintendent is choosing to blame and punish them – and he's using ELNY's assets and the court system to do it. [A]

1 A structured settlement is an agreement to take payments over time rather than in a lump sum. Many personal injury and wrongful death lawsuits are settled using a structured settlement. The plaintiff receives payments over time, from an annuity, tax free. Favorable tax treatment is awarded to property and casualty insurers who use structured settlements to settle claims due to a 1982 amendment to the tax code that caused explosive growth of the structured settlement industry in the 1980's.

2 The ELNY annuitants are people like the following: a woman seriously injured in a car accident as a child when hit by a drunk driver, who is just 40 but has already had a hip replacement and will one day likely be confined to a wheelchair whose benefits are being cut by 47%; a man accidentally shot in his early 20's who is a paraplegic, confined to a wheelchair for the last 27 years whose cuts will likely result in his need for public assistance; and a woman, whose husband, a merchant marine, was killed when his ship sank off the coast of Virginia; a man who was injured in a welding accident, seriously burned over 90% of his body whose benefits are being cut 42%.

Edward S. Stone represents over forty Executive Life of New York annuitants from Florida to Alaska, who are slated to receive cuts in their annuity benefits of up to 66%. He appeared on behalf of some of these annuitants at the March hearing in Nassau County before Judge John Galasso. Together with attorneys from the Salt Lake City firm of Christensen & Jensen he represented many ELNY annuitants in the appeal of the ELNY liquidation order and the federal class action filed in the U.S. District Court, S.D.N.Y. Mr. Stone has participated in complex insurance disputes and specialty finance matters.