

SB204

SENATE FINANCE COMMITTEE REPORT

DATE: 3/15/91

FURTHER:

Date of 5-Day Notice: 3-15-91
(in accordance with Uniform Rule 23)

DATE TURNED INTO OFFICE: 3/22/91

Finance Committee considered SB 204

Dept. of Revenue to purchase either guaranteed investment contracts held by the supplemental benefits system or the underlying securities; efd.

and recommended:

- replace with _____ CS SB 204 (Fin) same title
- or adopt _____ CS _____ new title
- attached amendment(s) technical title change (HB only)
- _____ letter of intent adopted

do pass

do not pass

no recommendation

individual recommendations

further referral to _____

ATTACHES NEW FISCAL NOTE(S):

APPROVES PREVIOUS:

fiscal note(s) 3/22/91 DOR (10,560.0) rev Dept/Date: _____
Indeterminate

zero fiscal note(s) 3/19/91 DOR Dept/Date: _____
Indeterminate

appropriation-no fiscal note

SIGNING DO PASS:

OTHER RECOMMENDATIONS:

[Signature]
[Signature]

Al Adams - NO Rec.
[Signature]
[Signature] (NO REC)

[Signature]

1. [Signature] 2. [Signature] No Rec.
Co-Chairs: Signatures and Recommendations

FISCAL NOTE

**STATE OF ALASKA
1991 LEGISLATIVE SESSION**

BILL NO. CSSB 204 (Finance)

Revision Date: March 22, 1991
 Title: DOR purchase of GIC contracts held by
 SBS or the underlying securities
 Sponsor: Senate Rules Committee by Request
 Requestor: Senate Finance

Department Affected: Department of Revenue
 BRU: Revenue Operations
 Component: Treasury Management

COMPONENT SERIAL NO. | 1 | 2 | 1 |

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LANDS & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING						
CAPITAL						
REVENUE	(10560.0)	(11404.8)	(12317.2)	(13302.6)	(14366.8)	(15516.1)

FUNDING: (Thousands of Dollars)

GENERAL FUND	(10560.0)	(11404.8)	(12317.2)	(13302.6)	(14366.8)	(15516.1)
FEDERAL FUNDS						
OTHER						
TOTAL	(10560.0)	(11404.8)	(12317.2)	(13302.6)	(14366.8)	(15516.1)

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

Estimate of current year impact: From \$0 to \$132 million reduction in unrestricted revenues.

ANALYSIS:

Reduction is based on 8% interest compounded annually. Assumes the entire \$132 million is non-performing and no cash will be realized at GIC maturity or sale of underlying securities. This is a worst case scenario.

Prepared By: Darrel Rexwinkel
 Division: Treasury

Phone: 465-2300
 Date: March 22, 1991

Approved by Commissioner: Lee E. Fisher *by Darrel Rexwinkel*
 Agency: Department of Revenue

Date: 3/22/91

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).

FISCAL NOTE

BILL NO. SB 204

STATE OF ALASKA
1991 LEGISLATIVE SESSION

Revision Date: _____
Title: An Act authorizing Department of Revenue to purchase GICs held by the Supplemental Benefits System
Sponsor: Senate Rules Committee for LB & A
Requestor: _____

Department Affected: Administration
BRU: Retirement and Benefits
Component: Retirement and Benefits
COMPONENT SERIAL NO. 64

Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LAND & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0

CAPITAL	0	0	0	0	0	0
---------	---	---	---	---	---	---

REVENUE	0	0	0	0	0	0
---------	---	---	---	---	---	---

FUNDING: (Thousands of dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS

FULL-TIME:	0	0	0	0	0	0
PART-TIME:	0	0	0	0	0	0
TEMPORARY:	0	0	0	0	0	0

Estimate of current year impact: _____

ANALYSIS: (attach a separate page if necessary.) The Supplemental Benefits System Annuity Plan holds "guaranteed investment contracts" (GIC's) with a present value of approximately \$450 million. Of the \$450 million, approximately \$132 million are from contracts issued by Executive Life Insurance Company. An exchange of general fund cash for GIC's (or underlying securities) could result in a complete loss if the GIC's (or underlying securities) become worthless.

Prepared By: Gary Bader *Gary M. Bader* Phone: 465-4460
Division: Retirement and Benefits Date: _____

Approved by Commissioner: Millett Keller *Millett Keller* Date: 3/19/91
Agency: Department of Administration

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB & Impacted Agency(ies).

Changes in CS SB 204 (F:11)
have no fiscal impact. This
fiscal note is appropriate.

3/22/91 *William*
date Comte Aide (initial)

CS FOR SENATE BILL NO. 204 (FINANCE)**IN THE LEGISLATURE OF THE STATE OF ALASKA****SEVENTEENTH LEGISLATURE - FIRST SESSION****BY THE SENATE FINANCE COMMITTEE**

Offered:

Referred:

Sponsor(s): **SENATE RULES/LEGISLATIVE BUDGET AND AUDIT COMMITTEE****A BILL****FOR AN ACT ENTITLED**

1 "An Act authorizing the Department of Revenue to purchase either the Executive Life
2 Insurance Company guaranteed investment contracts held by the supplemental benefits
3 system or the underlying securities; and providing for an effective date."

4 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

5 * Section 1. (a) The commissioner of revenue may use the residual money deposited in the state
6 treasury and described in AS 37.10.070(a) to purchase either the Executive Life Insurance Company
7 guaranteed investment contracts that are held by the Department of Administration for the supplemental
8 benefits system established under AS 39.30.150 - 39.30.180 or the underlying securities. The amounts
9 received by the supplemental benefits system under this subsection shall be invested as provided in
10 AS 37.10.071.

11 (b) A purchase authorized in (a) of this section is not subject to AS 37.10.071(c).

12 (c) The commissioner of revenue shall notify the chair of the Legislative Budget and Audit
13 Committee at least 2 days before the commissioner agrees to a purchase under (a) of this section.

14 * Sec. 2. Section 1 of this Act is repealed December 31, 1992.

1 * Sec. 3. This Act takes effect immediately under AS 01.10.070(c).

FISCAL NOTE

STATE OF ALASKA
1991 LEGISLATIVE SESSION

BILL NO. SB 204

Revision Date: March 21, 1991
 Title: An Act authorizing DOR to purchase either the GIC contracts held by SBS or the underlying securities...
 Sponsor: Senate Rules Committee by Request
 Requestor: _____

Department Affected: Revenue
 BRU: Revenue Operations
 Component: Treasury Management

Component Serial No.

	1	2	1
--	---	---	---

Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0

CAPITAL						
----------------	--	--	--	--	--	--

REVENUE						
----------------	--	--	--	--	--	--

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

Estimate of current year impact: _____

ANALYSIS: The General Fund would incur a loss of unrestricted revenue if the G.I.C.'s acquired at book value from SBS had suffered a permanent impairment in value.

Prepared by: Brian C. Andrews Phone: 465-2350
 Division: Treasury Date: March 21, 1991
 Approved by Commissioner: *David Reynolds*
 Agency: Revenue

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).

STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

3/22/91
SFC
WALTER J. HICKEL, GOVERNOR

P.O. BOX 5
JUNEAU, ALASKA 99811-0400
PHONE: (907) 465-2300
TELEFAX: (907) 465-2389

March 21, 1991

The Honorable Pat Pourchot
Alaska State Legislature
P.O. Box V
Juneau AK 99811

Dear Senator Pourchot:

The following is in response to your letter of March 19, 1991 asking certain questions about the possible purchase of Executive Life Insurance Company guaranteed investment contracts ("GICs") by the General Investment Fund ("GIF") as proposed by ~~SB 204~~ SB 204.

1. How will the GICs be accounted for on the general fund financial statements?

The recording of the GICs onto GIF books of record will be in compliance with Generally Accepted Accounting Principles ("GAAP"). GAAP mandates that marketable securities be recorded at the lower of aggregate cost or market. Non-current investments such as the Executive Life GICs should be written down to net realizable value if the asset has suffered permanent impairment in value.

There may be a question as to when any permanent impairment in value occurred and whether that loss should have been recorded by the SBS.

- a. Will the value of the assets be written down to reflect an estimated or known loss?

When it is determined that an asset of a long-term nature incurs a permanent impairment of value, an allowance for the anticipated loss should be recognized.

- b. How would the estimated loss be determined?

Any loss would be the difference between purchase price (in this case SBS's book value) and the market value of the GICs on the date of acquisition if it is determined that permanent impairment has occurred. The loss allowance would be adjusted thereafter to reflect any downward permanent impairment changes in market value. The market value of the GICs will be determined based on the best evidential matter available and practical to obtain. This determination may be of a direct or indirect nature in that there is not an established market for GICs

The Honorable Pat Pourchot
March 21, 1991
Page 2

- c. Would the income statement show as a loss the amount written off?

Investment earnings of the GIF would be reduced by any established loss of the GICs.

- d. When would these accounting entries be made?

The purchase would be recorded on the transaction date and any loss would be recorded when it was determined there was permanent impairment of value.

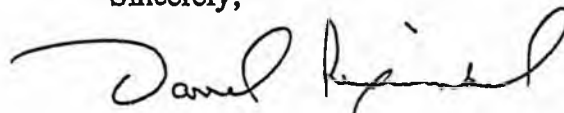
2. What would be the charge to estimated unrestricted revenues for FY 91, FY 92, or FY 93 from:
- losses written off; and
 - reduced general fund investment earnings?

The allowance would be whatever market conditions are at the time of the proposed transaction. Further impairment of the assets value over time would further reduce investment earnings.

3. Will the Governor's budget proposals for FY 92 be reduced to offset the loss and the reduced investment earnings?

The Office of Management and Budget needs to make recommendations with respect to budgetary considerations. Any loss would reduce unrestricted revenues which would reduce amounts available for appropriation. However, this does not necessarily mean that other budget items will have to be reduced. It may be that there are sufficient projected revenues, appropriation lapses, or fund balance to cover any loss.

Sincerely,



Darrel J. Rexwinkel
Deputy Commissioner

DJR/mem

cc: Lee E. Fisher, Commissioner of Revenue

91-38

Legislative Budget and Audit
Committee Meeting
March 12, 1991

Issues and Questions
regarding the
Supplemental Benefits System ("SBS")

1. Ability to sell GIC's
 - does contract allow sale
 - is issuer willing to allow sale
 - are there any tax or ERISA implications for issuer or SBS
 - if issuer files bankruptcy prior to sale, can sale be consummated
2. Use of Legislative Authorization
 - is a purchase expected in the near future
 - is speedy action required by the Legislature
 - what is the reason for the December 31, 1992 repeal
3. Cash Flow
 - would State's payment for purchase be paid in lump sum or over time, at or toward the front or back of any time period, or on same schedule as GIC's mature
 - what would be the projected monthly liquid general fund balances through FY 93, given the expected payment schedule and updated revenue forecasts
4. Management of Purchased GIC's
 - would the State expect to hold the GIC's to maturity, barring default
 - if not,
 - what would the State attempt to negotiate to shorten or cash out GIC's
 - what would be the expected cost to the State
 - how would this compare to expected value of GIC's in bankruptcy liquidation or workout

- who would negotiate for State, including legal or investment counsel
- would results of negotiation be placed before the Legislature or Budget and Audit

5. Budget

- would the Governor's budget for FY 92 be reduced by either
 - cash paid for GIC purchases
 - cost to the State if GIC shortening or surrender is negotiated

6. Alternatives

- what sureties or collateral could be negotiated from issuers to reinforce their guarantee under GIC's (see page labelled "Alternatives" attached to enclosed memorandum of March 8, 1990)
- what would happen if the State enacted a law requiring amendment or rescission of GIC contracts, allowing withdrawal of funds (see paragraph 5 of enclosed memorandum of March 8, 1990)
- could the potential purchase of a non-investment grade, illiquid asset for the State's operating account (general fund) set a precedent for allowing other uses of the State treasury requiring waiver of the statutory rule of prudence
- would it be preferable to make an appropriation, contingent upon a GIC loss to the State--either as a result of negotiated surrender or bankruptcy settlement--that would avoid waiver of prudence and the holding of a much larger non-investment grade, illiquid asset in the general fund

7. Issuer Creditworthiness

- what is the financial condition and outlook for GIC issuers, including Executive Life and Great Western (Deferred Compensation GIC issuer)
- what rating changes have occurred recently for GIC issuers
- what are the trends in policy and contract surrenders for issuers

HELLER, EHRMAN, WHITE & MCAULIFFE

ATTORNEYS

A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

848 UNIVERSITY AVENUE
PALM ALTO, CALIFORNIA 94301-1900
FACSIMILE (415) 320-6638
TELEPHONE (415) 320-7600

333 BUSH STREET, SAN FRANCISCO, CALIFORNIA 94104-2678
CABLE HELPOW, TELEX 184-886, FACSIMILE (415) 772-6288
TELEPHONE (415) 772-6000

701 FIFTH AVENUE
SEATTLE, WASHINGTON 98104-7088
FACSIMILE (206) 447-0848
TELEPHONE (206) 447-2800

888 SOUTH FLOWER STREET
LOS ANGELES, CALIFORNIA 90071-8388
FACSIMILE (213) 644-1888
TELEPHONE (213) 688-0800

March 8, 1990

1300 S.W. FIFTH AVENUE
PORTLAND, OREGON 97201-6600
FACSIMILE (503) 241-0550
TELEPHONE (503) 227-7400

PAUL W. BUGARMAN
DIRECT DIAL (415) 772-6817

VIA TELECOPY

The Hon. Frank Baxter, Commissioner
The Department of Administration
P.O. Box C
Juneau, Alaska 99811

Executive Life Insurance Company

Dear Commissioner Baxter:

In anticipation of tomorrow's meeting with Executive Life, I suggest the following overall negotiating position be presented. (Based on our telephone conversation earlier this week, I have assumed that your immediate objective is to terminate the most recent contract and not to address the earlier contracts at this time.)

- (1) The State of Alaska's purchase of Guaranteed Investment Contracts from Executive Life using retirement fund contributions of state employees has become a heated political issue in Alaska. Executive Life must understand and appreciate the political realities. The State of Alaska cannot, and will not, accept any result which is politically untenable.
- (2) Whatever the true state of Executive Life's finances -- a matter about which Alaska currently lacks sufficient information -- it has become politically impossible for the State to invest additional funds in any contract issued by Executive Life.

- (3) For the moment Alaska is willing to leave the three earlier, paid-in-full contracts in place, at least until such time as circumstances (whether political in Alaska, or financial at Executive Life) dictate otherwise. But the most recent contract, No. 26805, must be terminated effective immediately, with the full value of Alaska's account (principal and compound interest) transferred to a carrier to be selected by Alaska for reinvestment.
- (4) Alaska has no desire to cause Executive Life any further negative publicity and proposes that the contract be terminated in a consensual, low-key fashion, without public relations fanfare.
- (5) If Executive Life refuses to consent to contract termination, then Alaska will be forced -- politically -- to pursue other actions. At a minimum, in all likelihood these would entail exercising Alaska's right to audit Executive Life, a right available to Alaska both under contract and by virtue of Executive Life's insurance activities in Alaska. Alaska will also seek to achieve termination non-consensually. One likely scenario is that the Legislature, which is currently in session, will enact legislation forbidding the State or any of its agencies from investing public funds, or retirement plan funds, in instruments such as guaranteed investment contracts issued by an institution whose own assets are disproportionately invested -- for example, in excess of 20 percent -- in junk bonds. The existing contracts obligate Executive Life to remain in compliance with the laws of Alaska, and such a law would, in Alaska's view, entitle it to terminate the most recent contract, and the earlier contracts as well.
- (6) Another option, which Alaska is not anxious to utilize, would entail litigation. Several political leaders in Alaska have questioned how the State could have awarded a contract to Executive Life as late as December of last year. They suggest that Executive Life should have disclosed its imminent junk bond-related charge against earnings and that its failure to do so gives Alaska the right to rescind the contract. If necessary, Alaska will seek such a ruling from the Alaska Superior Court, which is the court specified to resolve disputes in connection with the contract.

The Hon. Frank Baxter
March 8, 1990

Page 3

An alternative approach would focus not on terminating the current contract, but on obtaining security for both existing funds held by and future contributions to Executive Life. Alaska could also try to negotiate an arrangement whereby future contributions are segregated into a trust account. It is difficult to assess the advisability of these approaches, however, in the absence of more information than we now have about Executive Life's financial condition and overall stability. The absence of that information also makes it difficult for us to formulate a credible negotiating position which is likely to persuade Executive Life to agree to change the status quo.

Obviously, Alaska's opening negotiating position can be softened or hardened as circumstances and judgment warrant. I understand that I will be joining you in your meeting on Friday, and I look forward to discussing these suggestions beforehand when we meet at the Radisson Hotel in Manhattan Beach. I am flying to LAX on Friday morning and, unless delayed by weather conditions, should arrive at your hotel by 9:00 A.M.

I look forward to meeting you tomorrow.

Very truly yours,



Paul W. Sugarman

cc: James Baldwin, Esq.

HELLER, EHRMAN, WHITE & MCAULIFFE
ATTORNEYS

A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

325 UNIVERSITY AVENUE
PALO ALTO, CALIFORNIA 94301-1808
FACSIMILE (415) 324-0838
TELEPHONE (415) 328-7800

333 BUSH STREET · SAN FRANCISCO, CALIFORNIA 94104-2678
CABLE HELPOW · TELEX 184-996 · FACSIMILE (415) 772-6288
TELEPHONE (415) 772-6000

701 FIFTH AVENUE
SEATTLE, WASHINGTON 98104-7098
FACSIMILE (206) 447-0848
TELEPHONE (206) 447-0800

855 SOUTH FLOWER STREET
LOS ANGELES, CALIFORNIA 90071-8308
FACSIMILE (213) 614-1888
TELEPHONE (213) 688-0200

March 22, 1990

1300 S.W. FIFTH AVENUE
PORTLAND, OREGON 97201-8888
FACSIMILE (503) 241-0880
TELEPHONE (503) 287-7400

PAUL W. SUGARMAN
DIRECT DIAL (415) 772-6217

The Hon. Frank Baxter, Commissioner
The Department of Administration
P.O. Box C
Juneau, Alaska 99811

Executive Life Insurance Company
Contract Award No. 26805

Dear Frank:

You have asked that I summarize my views concerning the modification of the above-referenced agreement (the "Agreement") which is memorialized in your letter of March 16, 1990 to Allan Chapman, Senior Vice President of Executive Life Insurance Company. Briefly, the proposed modification:

1. Relieves the State of Alaska ("Alaska") of any obligation to remit further payments to Executive Life Insurance Company ("Executive Life") under the Agreement, leaving only January's initial net contribution of \$1,377,375.90 to be retained by Executive Life until the end of the contract period (January 2, 1996);
2. Reduces the interest to be earned by Alaska on the \$1,377,375.90 by approximately \$160,770, which sum has a present value of \$100,000 discounted at the existing contract rate;
3. Enables Alaska to select an alternative investment medium for the approximately \$34,000,000 of SBS funds to be invested in 1990, which sum otherwise would have to be invested with Executive Life in accordance with the terms of the Agreement. I understand from you that you believe that, because of the recent

The Hon. Frank Baxter
March 22, 1990

Page 2

upward movement in interest rates, Alaska will be able to negotiate an interest rate of approximately 9.1% per annum for SBS funds to be invested in 1990; and

4. Precludes Alaska from seeking withdrawal of funds previously invested with Executive Life under Contract Awards Nos. 25980, 25992 and 26681 until maturity of those contracts, and from seeking to amend, rescind or otherwise modify those contracts, unless (a) Alaska is precluded by law from so refraining to act or (b) Alaska discovers facts of which it is currently unaware entitling it to relief (i.e., on the grounds of fraud, misrepresentation or material omission).

Whether one views the modification of the Agreement from a business or legal perspective, it appears to be a prudent and reasonable deal for Alaska. Although the proposed modification will entail a "cost" of \$100,000 (in present value terms) to be paid to Executive Life in the form of a reduced interest rate, that cost will be recouped several times over as a result of Alaska's ability to place 1990 SBS funds in another investment vehicle earning a significantly higher rate of interest. This situation is thus analogous to an investor who purchases a six year certificate of deposit at the rate of 8.46%, only to discover that interest rates move sharply higher after the CD is purchased. Although withdrawal of the funds prior to maturity of the CD would entail payment of a penalty, as long as the additional interest to be earned from an alternative investment more than offsets the penalty, it is prudent for the investor to withdraw the funds, pay the penalty and invest elsewhere.

An additional factor militating in favor of the modification, again from the business perspective, is that Alaska may well be able to negotiate more favorable terms for investment of its 1990 SBS funds if it has succeeded in resolving the uncertainty concerning its obligations to Executive Life. Otherwise, Alaska might need to negotiate an "out" in any substitute investment contract to protect Alaska in the event it must, for whatever reason, resume sending payments to Executive Life under the Agreement. Such an escape clause would no doubt come at a cost.

I also believe that the modification is prudent from a legal perspective. As you know, I have not researched Alaska's rights and obligations under the Agreement and therefore am unable to express any opinion concerning the likelihood of success on the merits should Alaska and Executive Life litigate their respective rights and obligations under the Agreement. I have been able to conceive of several legal arguments which Alaska might consider advancing -- whether asserted affirmatively in litigation initiated

The Hon. Frank Baxter
March 22, 1990

Page 3

by Alaska or in defense in response to claims brought by Executive Life -- in support of a claim that it is entitled to rescind the Agreement or at least terminate its future performance. (For example, Alaska might claim that Executive Life misrepresented and/or failed to disclose material facts at the time that the contract was awarded or that the laws of Alaska (in particular, the prudent investor rule) preclude Alaska from investing further funds with Executive Life.) Were these arguments successful, Alaska would be entitled to walk away from the contract and perhaps even to obtain return of the \$1,377,375.90 currently held by Executive Life. But I believe it unlikely that Alaska would be able to establish that it is entitled to affirmative damages beyond return of the January payment, with accumulated interest.

On the other hand, were Alaska's arguments to fail -- i.e., were Executive Life able to prove that Alaska breached its contractual obligations by discontinuing payments under the Agreement -- Alaska would have significant damage exposure. Executive Life would no doubt claim that it was damaged in an amount calculated as the difference between the Agreement's rate of interest (8.46%) and the amount Executive Life would have been able to earn on investment of those funds. (Executive Life claims that it has historically earned more than 11% on its investments.) A spread of 2.5% on approximately \$34,000,000 for 5-plus years would yield damages in excess of \$4,000,000. In addition, Executive Life would claim consequential damages, including damage to its reputation and, perhaps, damages resulting from further erosion of public confidence occasioned by Alaska's default. In short, litigation with Executive Life offers Alaska little upside potential and significant downside risk.

Furthermore, one cannot overlook the cost that such litigation would entail. Particularly if Alaska sought to establish misrepresentation on the part of Executive Life, a lawsuit would be fact-intensive and thus expensive to litigate. Executive Life might itself decide that such litigation involves a question of principle, because it could not afford to be perceived as a "soft touch" by any contract holder who wanted to terminate the relationship. It would thus be prudent for Executive Life to commit substantial resources to the litigation in the hope of obtaining a high profile victory.

The principal consideration Executive Life demanded for modifying the Agreement was Alaska's assurance that it would not seek rescission, amendment or modification of the three earlier, fully-funded contracts, or withdrawal of funds already invested, except under certain circumstances. Ideally, Alaska would not have had to give any undertakings with respect to those earlier contracts. From a practical perspective, however, Executive Life

The Hon. Frank Baxter
March 22, 1990

Page 4

apparently made it clear during your negotiations that it would not agree to forgive \$34,000,000 of future investments, only to be confronted down the road with a further demand from Alaska that funds already invested be returned.

I do not, however, think that Alaska gave up much by agreeing to this term, although again, I have not had the opportunity to research the law, nor have I investigated Executive Life's financial condition. However, some of the same factors which militated in favor of payment of \$100,000 to Executive Life in the form of a lower interest rate also support Alaska's decision to leave the earlier contracts in place.

First, whatever the merits of Alaska's arguments in support of a claim that it is entitled to rescind the most recent contract -- i.e., to decline to invest additional funds with Executive Life -- those arguments are weaker when directed to the earlier contracts, which were entered into 6 to 24 months ago and which Alaska has fully performed. I think it highly unlikely, for example, that Alaska could successfully rescind the contracts based on misrepresentation, given the passage of time and the fact that Executive Life's investments in junk bonds were public knowledge. And even if Alaska law (e.g., the prudent investor rule) precluded further investment of funds with Executive Life, it is more difficult to argue that that law entitles Alaska to withdraw funds already invested and avoid compensating the injured party for its damages.

Second, any effort by Alaska to seek return of the funds would in all likelihood require protracted, and expensive, litigation, which Executive Life would have every incentive to resist strenuously. While the litigation was pending Executive Life would continue to retain Alaska's funds. Moreover, even a final judgment in Alaska's favor might well prove either unnecessary (because in the meantime Executive Life would have successfully weathered the current storm) or Pyrrhic (because Executive Life would in the meantime have become insolvent, rendering enforcement of Alaska's judgment at full value impossible).

Third, and perhaps most importantly, the agreed-to modification contains two "outs" for Alaska: (1) it enables Alaska to seek to withdraw funds or to amend, rescind or otherwise modify the contracts, if required by law to do so; and (2) it permits such action on the basis of newly discovered facts of which Alaska is not now aware, or should not reasonably be aware. Thus, if the law of Alaska (including, presumably, laws enacted in the future by a cooperative legislature), should require Alaska to seek contract modification, Alaska is free so to act; similarly, Alaska is free

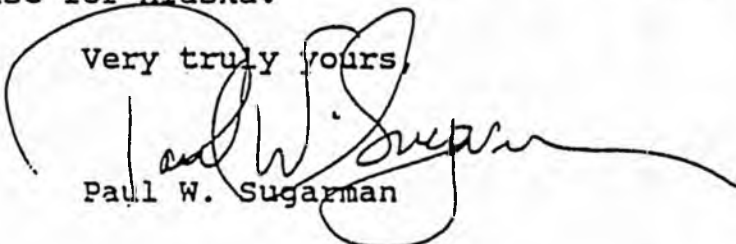
The Hon. Frank Baxter
March 22, 1990

Page 5

to bring an action based on fraud or misrepresentation if new facts are discovered. These provisions should give Alaska sufficient future flexibility with respect to the earlier contracts.

For all of these reasons, I believe that the modification to the Agreement makes sense for Alaska.

Very truly yours,



Paul W. Sugarman

cc: James Baldwin, Esq.

ALTERNATIVES

1. Obtain domestic or non-domestic LC.

BENEFIT: Guarantee financial viability of contract.

OBSTACLE: Given state of banking worldwide, extremely doubtful.

2. Assign proceeds of each Executive contract to a single or series of U. S. Trust(s).

- o Identify Pacific Rim investor(s) willing to purchase assignment value.
- o Equalize loss in future.

BENEFIT: No book value loss.

OBSTACLE: Find assignment buyer(s).
Length of time to amortize loss and yield.
What if Executive does not default?

3. Transfer proportionate share of underlying assets to stronger issuer in return for principal guarantee.

BENEFIT: Stronger Issuer surplus.
Principal guaranteed.
Investment experience pass-through
if Executive Life Survives.

OBSTACLE: No incentive to Executive Life.
If Executive Life does not default, what
is the cost?

4. Master Issuers(s).

BENEFIT: One or more issuers guarantees principal
without assignment.

OBSTACLE: Assembling appropriate group of issuers.
Cost to plan absent Executive Life failure.

5. Assignment of contracts to another plan and equalize smaller loss.

BENEFIT: No book value loss.

OBSTACLE: Determination of appropriate cost.
Identifying buyer that views such a
transaction as prudent.
If sale is intra-state, various potential
legal and fiduciary issues.

First Executive Insurance Units Still Face Woes

Year-End Filings Indicate Drop in Capital Reserves, Large Outflows of Cash

By FREDERICK ROSE

Staff Reporter of THE WALL STREET JOURNAL
LOS ANGELES — First Executive Corp.'s insurance operations remain heavily reliant on low-grade corporate bonds despite major sales of such securities last year, indicating that the units' major problems are not over.

The information is contained in year-end filings with the California Insurance Department. Insurance units of First Executive also reported sharply lower capital reserves and large cash outflows despite improved net income.

Analysts, apprised of the information, said the detailed regulatory filings suggest continued bad news for the insurance units. "The companies appear to be under considerable financial pressure," said Frederick Townsend, a partner in Townsend & Schupp, Hartford-based insurance analysts.

Insurance operations depend on accumulated capital as an underpinning for their obligations to policyholders. Investment losses, policy redemptions and underwriting pressures all can chip away at that financial foundation.

According to the First Executive filings, the combined capital reserves of its principal units tumbled 44% last year, to \$739.7 million. Combined assets dwindled by 22%, to \$13.34 billion.

Combined net income in these regulatory accounts was \$128.7 million last year compared with a net loss of \$6.6 million a year earlier. But, on a cash basis, the operations produced a combined \$2.87 billion outflow last year compared with a \$360 million inflow in 1989.

As with all such regulatory filings, the First Executive units' year-end reports are based on statutory accounting, which differs somewhat from the generally accepted accounting principles of shareholder reports. Statutory accounting, among other things, treats the costs of writing new business more onerously.

First Executive's consolidated results for shareholders are expected to be reported in a few weeks. In the meantime, details of the so-called statutory filings show some of the weaknesses of insurance portfolio valuations.

Junk-bond holdings in the two units rose to 79% of total bond holdings at year-end compared with 55% at Dec. 31, 1989. Although the increase may reflect in part stiffer regulatory definitions of investment-grade securities, it also suggests that better-quality bonds were sold last year to meet a torrent of policy surrenders and redemptions.

The two units, Executive Life Insurance Co. and Executive Life Insurance Co. of New York, overall reflect the strains of a combined \$3.97 billion in payouts for policy redemptions, more than double the 1989 payout, as well as \$908.3 million in realized and unrealized investment losses, a 71% widening from 1989 losses.

A spokesman for First Executive said that most such redemptions occurred early last year. William C. Adams, senior vice president, said the outflow has slowed since. He added that the company may benefit by a recent upsurge in junk-bond markets, which he said have climbed 12% since Dec. 31, the date of the statements. "If the economy stabilizes, we will have recouped the losses," Mr. Adams said.

First Executive, once one of the nation's largest life insurers, burgeoned in the 1960s on a combination of aggressive new products and junk bond investments. Executive Life Insurance, the larger of the parent company's main units, had \$10.17 billion in assets at Dec. 31. Executive Life Insurance Co. of New York, with \$3.17 billion in assets, has had operations sharply curtailed by New York state regulators for several years.

3/8/91

WSJ

First Executive Corp. Units Get Ratings Lowered by A.M. Best

By a WALL STREET JOURNAL Staff Reporter
OLDWICK, N.J.—A.M. Best Co. said it lowered ratings on First Executive Corp.'s main insurance units two notches to a "contingent single-B-plus" from "contingent single-A."

The insurance rating concern attributed the change to deterioration in high-yield bond holdings that it said have caused

losses for the fourth quarter and for 1990.

A.M. Best added that "uncertainties regarding the insurers' operating results are compounded by regulatory and accounting issues that may exacerbate current problems."

The ratings apply to First Executive's Executive Life Insurance Co. and Executive Life Insurance Co. of New York. Recent regulatory filings show the companies' combined capital surplus at the end of the year to \$739.7 million at Dec. 31, 1990, from a year earlier.

A spokesman for First Executive said "it's unfortunate that [A.M. Best] made this decision, because the high-yield bond market has improved in the last two months and is up 14% from year-end—more than recovering what it had lost."

A.M. Best's single-B-plus rating means "very good," a spokeswoman for the company said. The "contingent" status means that it remains under review, she said.

The First Executive units carried a single-A-plus, or "superior," rating from A.M. Best until Jan. 23 last year, when they were downgraded to an single-A, or "excellent," rating. The "contingent" status was added on July 2.

Feb 10 WSJ

First Executive's Main Insurance Unit Agrees to Withdraw From Massachusetts

By **FREDERICK ROSS**
Staff Reporter of THE WALL STREET JOURNAL

First Executive Corp.'s major insurance unit agreed to stop writing new policies in Massachusetts, the second major state from which it has withdrawn following pressure from regulators.

The Massachusetts Division of Insurance said the "voluntary" action by Executive Life Insurance Co. is effective today. The withdrawal follows a similar accord with New Jersey in December, where regulators also pressured the troubled insurer.

The Massachusetts step appears a further blow to state insurance regulators, who have tried to forge a common front in dealing with the woes of junk-bond-laden Executive Life and a smaller First Executive unit, Executive Life Insurance Co. of New York.

As part of that support effort, regulators across the country have urged each other not to demand special deposits, a common practice in the past. While the deposits are intended to protect residents of one state in case a company becomes insolvent, they impose cash strains on a company that can hasten its demise and, in effect, favor residents of one state over another.

Regulatory reformers have pointed to state coordination efforts as evidence that the nation's often disjointed patchwork of insurance regulations is being improved.

But, even as regulators succeed in their coordination efforts, it now emerges that Massachusetts secretly demanded a \$500 million deposit from Executive Life last July.

In early October, the state's Division of Insurance complained that the company hadn't responded to the demand and insisted on a deposit by Oct. 16.

Executive Life replied by letter that it thought Massachusetts had been persuaded at an Aug. 3 meeting that a deposit wasn't necessary and noted that it had written less than \$1 million in new business in Massachusetts during the first nine months of 1990.

Moreover, California regulators refused to allow Executive Life to make the \$500 million deposit.

In a curt, Feb. 8 letter to the Massachusetts insurance commissioner, Executive Life said it "has decided to review its entire marketing strategy" and would, effective Feb. 15, no longer write new policies in Massachusetts.

Executive Life didn't say that the marketing review would result in its withdrawal from other states. A company official didn't return calls yesterday seeking elaboration.

The Massachusetts case parallels New Jersey's insistence in December on a \$500 million deposit. That demand prompted angry reaction, notably from regulators in California, New York, and Illinois, who have spearheaded the coordinated action. The National Association of Insurance Commissioners, the guiding body for state insurance agencies, at the time blasted New Jersey's action as "irresponsible."

New Jersey persisted, however, and, as a last resort, Executive Life agreed to stop writing new business in the state.