

*Nebraska Life and Health Insurance Guaranty Association
Lincoln, Nebraska*

December 31, 2019 and 2018

*Financial Statements
and
Independent Auditor's Report*



CPAs & Consultants | Wealth Management

Nebraska Life and Health Insurance Guaranty Association

Years ended December 31, 2019 and 2018

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Nebraska Life and Health Insurance Guaranty Association
Lincoln, Nebraska

We have audited the accompanying financial statements of Nebraska Life and Health Insurance Guaranty Association, which comprise the statement of financial position as of December 31, 2019, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Nebraska Life and Health Insurance Guaranty Association as of December 31, 2019, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

We have previously audited Nebraska Life and Health Insurance Guaranty Association's December 31, 2018 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated March 18, 2019. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2018 is consistent, in all material respects, with the audited financial statements from which it has been derived.

HBE LLP

Lincoln, Nebraska
March 17, 2020

HBE
HBE

Nebraska Life and Health Insurance Guaranty Association

STATEMENTS OF FINANCIAL POSITION

December 31,

ASSETS

	<u>2019</u>	<u>2018</u>
CURRENT ASSETS		
Cash and cash equivalents (note A)	\$ 413,414	\$ 4,504,145
Certificates of deposit	100,047	247,951
Accrued interest receivable on investments	<u>101,941</u>	<u>69,574</u>
Total current assets	615,402	4,821,670
OTHER ASSET		
Investments (notes A, B and E)	<u>18,796,785</u>	<u>14,510,362</u>
Total assets	<u>\$ 19,412,187</u>	<u>\$ 19,332,032</u>

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES		
Accounts payable	\$ 51,438	\$ 78,653
Estimated claims payable (note C)	<u>2,708,000</u>	<u>2,761,000</u>
Total current liabilities	<u>2,759,438</u>	<u>2,839,653</u>
NET ASSETS (note A)		
Without donor restrictions		
Class A net assets for general administration	265,009	256,528
Classes B and C net assets for specific insolvencies (note D)	13,811,455	13,741,773
Contingency reserve for future obligations (note D)	<u>2,576,285</u>	<u>2,494,078</u>
Total net assets	<u>16,652,749</u>	<u>16,492,379</u>
Total liabilities and net assets	<u>\$ 19,412,187</u>	<u>\$ 19,332,032</u>

See accompanying notes to financial statements.

Nebraska Life and Health Insurance Guaranty Association

STATEMENTS OF ACTIVITIES

Year ended December 31, 2019
With comparative totals for the year ended December 31, 2018

	2019			2018
	Class A	Class B & C	Total	Total
CHANGES IN NET ASSETS (DEFICIT)				
Revenues				
Recoveries received	\$ 25	\$ -	\$ 25	\$ 17,032,749
Premiums received	-	23,119	23,119	33,804
Investment income, net	8,456	616,626	625,082	225,743
Total revenues	8,481	639,745	648,226	17,292,296
Expenses				
Benefit claims	-	112,304	112,304	69,223
Assumption reinsurance	-	4,308	4,308	5,318
Administration, legal fees, direct expenses	70,570	40,536	111,106	130,694
Assessments by NOLGHA for expenses	6,908	225,874	232,782	303,165
Dues to National (NOLHGA)	53,156	-	53,156	51,321
Meetings and travel expenses	4,830	-	4,830	9,429
Auditing and accounting fees	10,540	-	10,540	9,800
Assessment system software and services	10,440	-	10,440	5,880
Bank service charges	-	-	-	891
Bookkeeping fees	1,290	-	1,290	1,211
Postage, printing and general supplies	100	-	100	87
Class A general and administration expenses allocated to Classes B and C	(157,834)	157,834	-	-
Total expenses	-	540,856	540,856	587,019
Revenues over expenses	8,481	98,889	107,370	16,705,277
Decrease in claims payable	-	53,000	53,000	120,000
Increase in net assets	8,481	151,889	160,370	16,825,277
CHANGE IN NET ASSETS (DEFICIT)				
Net assets (deficit) at beginning of year	256,528	16,235,851	16,492,379	(332,898)
Net assets at end of year	\$ 265,009	\$ 16,387,740	\$ 16,652,749	\$ 16,492,379

See accompanying notes to financial statements.

Nebraska Life and Health Insurance Guaranty Association

STATEMENTS OF CASH FLOWS

Years ended December 31,

	<u>2019</u>	<u>2018</u>
Cash flows from operating activities		
Cash received from assessments, recoveries, and premiums	\$ 5,494	\$ 17,058,477
Cash paid to suppliers and paid for claims	(568,071)	(568,753)
Interest received	434,399	208,393
	<u>(128,178)</u>	<u>16,698,117</u>
Net cash provided (used) by operating activities		
Cash flows from investing activities		
Proceeds from sales of investments	14,200,000	14,204,979
Purchases of investments and deposits to assets limited as to use	(18,162,553)	(26,607,810)
	<u>(3,962,553)</u>	<u>(12,402,831)</u>
Net cash used by investing activities		
Net increase (decrease) in cash	(4,090,731)	4,295,286
Cash and cash equivalents at beginning of year	<u>4,504,145</u>	<u>208,859</u>
Cash and cash equivalents at end of year	<u>\$ 413,414</u>	<u>\$ 4,504,145</u>
Reconciliation of increase in net assets to net cash provided (used) by operating activities		
Increase in net assets	<u>\$ 160,370</u>	<u>\$ 16,825,277</u>
Adjustments to reconcile increase in net assets to net cash provided (used) by operating activities		
Realized and unrealized (gains) losses on investments Increase in assets	(175,966)	36,561
Accrued interest receivable	(32,367)	(61,987)
Increase (decrease) in liabilities		
Accounts payable	(27,215)	18,266
Estimated claims payable	<u>(53,000)</u>	<u>(120,000)</u>
	<u>(288,548)</u>	<u>(127,160)</u>
Total adjustments to increase in net assets		
Net cash provided (used) by operating activities	<u>\$ (128,178)</u>	<u>\$ 16,698,117</u>

See accompanying notes to financial statements.

Nebraska Life and Health Insurance Guaranty Association

NOTES TO FINANCIAL STATEMENTS

Nebraska Life and Health Insurance Guaranty Association (the Association), is a nonprofit, unincorporated association organized and established by the Nebraska Life and Health Insurance Guaranty Act, Sections 44-2701 through 2720, R.S. Supp. 1975, which provides for the creation of an association of member insurers to enable the guaranty of payment of benefits and the continuance of coverage of life insurance policies, health insurance policies, annuity contracts and supplemental contracts. Any insurer licensed to issue life and health insurance policies, and annuity and supplemental contracts in the State of Nebraska is required to be a member.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Method of Accounting. The accompanying financial statements of the Association have been prepared on the accrual basis of accounting.

Cash and Cash Equivalents. For purposes of the statements of cash flows, the Association considers all unrestricted highly liquid investments with a maturity of three months or less to be cash equivalents. Restricted amounts represent unspent grant proceeds that are required to be maintained separately according to the terms of a grant agreement.

Investments. Investments in marketable securities with readily determinable fair values and all investments in debt securities are reported at their fair values in the statement of financial position. Unrealized gains and losses are included in the statements of activities. Donated securities are recorded as contributions equal to the fair market value of the securities at the date of gift.

Fair Value Measurements. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at measurement date. The Association utilizes a framework to prioritize the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described as follows:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Association has the ability to access.

Level 2 Inputs to the valuation methodology include:

- quoted prices for similar assets or liabilities in active markets;
- quoted prices for identical or similar assets or liabilities in inactive markets;
- inputs other than quoted prices that are observable for the asset or liability;
- inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Transfers between levels shall occur at the actual date of the event or change in circumstances that caused the transfer. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

NOTES TO FINANCIAL STATEMENTS

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Net Asset Classification. Net assets, revenues, gains, and losses are classified based on the existence or absence of donor or grantor imposed restrictions. Accordingly, net assets and changes therein are classified and reported as follows:

Without donor restrictions. Net assets available for use in general operations and not subject to donor or grantor restrictions. Net assets whose use is contractually limited or assets set aside for specific insolvencies or to meet reserve requirements are considered without donor restrictions.

With donor restrictions. Net assets subject to donor- or grantor-imposed restrictions. Some restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. Restrictions are released when a restriction expires, that is, when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both, and are reported in the statements of activities as net assets released from restrictions. The Association does not have donors.

Assessments. Association member insurers may be assessed as follows:

Class A - Assessments for administration expenses of the Association.

Class B - Assessments to cover insurance benefit claims and expenses of domestic (Nebraska) and foreign (other than Nebraska) insurance companies with policyholders in Nebraska that are declared insolvent by the State Department of Insurance.

Revenue Recognition. The following is a description of principal activities from which the Association generates its revenue:

Recoveries. Revenue received from distributions of estate assets from the insolvent insurance company or from either litigation or reinsurance as stated in the liquidation order. The Association recognizes revenue when the liquidation order is received.

Assessments. Revenue received from assessments made on member insurance companies. The Association must make an assessment on similar insurance companies if there are insufficient assets from the estate and recoveries to cover claims stated in the liquidation order. The member's pro-rata share of the assessment is calculated based on premiums written by members for the most recent 3 full years. Assessments in any given year are capped at 2% of the average premiums calculated. The Association recognizes revenue when assessments are billed.

Premiums. Revenue received from policy holders to continue coverage for insurance plans with insolvent companies to entitle the policy holder to final settlement. The Association recognizes revenue when premiums are received.

Nebraska Life and Health Insurance Guaranty Association

NOTES TO FINANCIAL STATEMENTS

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Income Taxes. The Association is exempt from Federal income tax under Section 501(c)(6) of the Internal Revenue Code. As such, income earned in the performance of its exempt purpose is not subject to income tax. Any income earned through unrelated business activities is subject to income tax at normal corporate rates. For the years ended December 31, 2019 and 2018, the Association had no tax liability on unrelated business activity. The Association believes that it has appropriate support for any tax positions taken, and as such, does not have any uncertain tax positions that are material to the financial statements. The Association qualifies as an unincorporated entity of the State of Nebraska and is not required to file an annual federal return of Organization Exempt form Income Tax (Form 990).

Use of Estimates. The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

NOTE B - INVESTMENTS

Investments consist of:

	2019		2018	
	Cost	Market	Cost	Market
Bonds				
Corporate	\$ 622,440	\$ 627,772	\$ 473,297	\$ 470,109
U.S. government	17,908,367	18,169,013	13,964,293	14,040,253
	<u>\$ 18,530,807</u>	<u>\$ 18,796,785</u>	<u>\$ 14,437,590</u>	<u>\$ 14,510,362</u>
Gross unrealized gain		\$ 265,978		\$ 72,772

Investment income consists of:

	2019	2018
Interest and dividend income	\$ 466,766	\$ 270,380
Net realized and unrealized gains (losses) on investments	175,966	(36,561)
Investment management fees	(17,650)	(8,076)
	<u>\$ 625,082</u>	<u>\$ 225,743</u>

NOTE C - RESERVES FOR CLAIMS PAYABLE

The Association receives claims expense estimates from the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) and other entities. Management analyzes the information received from NOLHGA and other entities, industry trends and the effects of Nebraska statute limitations on the estimates prior to arriving at the recorded estimated reserves for claims payable. The methods for making such estimates and for establishing the resulting liability are continually reviewed, and any adjustments of estimates are reflected in the accompanying statements of activities.

Nebraska Life and Health Insurance Guaranty Association

NOTES TO FINANCIAL STATEMENTS

NOTE C - RESERVES FOR CLAIMS PAYABLE - CONTINUED

The total reserves for claims payable were:

	<u>2019</u>	<u>2018</u>
Insolvency		
Class B 70 - Lincoln Memorial Life Insurance Co., TX	\$ 102,000	\$ 70,000
Class B 72 - Penn Treaty Insurance Co. PA	2,200,000	2,200,000
Class B 74 - National States Insurance Co., MO	206,000	291,000
Class B 77 - CoOpportunity Health, IA	<u>200,000</u>	<u>200,000</u>
	<u>\$ 2,708,000</u>	<u>\$ 2,761,000</u>

These reserves are based on estimates and, while management presently believes the estimate of reserves for claims payable at December 31, 2019 is adequate, the actual liability could vary considerably from the amount presented in the accompanying statement of financial position.

NOTE D - DESIGNATED NET ASSETS

Net assets of \$13,811,455 and \$13,741,773 at December 31, 2019 and 2018, respectively, are reserved for specific insurance company insolvencies.

Class B 69 - Benicorp Insurance, Indiana	\$ (64,166)	\$ (61,947)
Class B 70 - Lincoln Memorial Life, Texas	609,770	808,391
Class B 71 - Medical Saving Insurance, Indiana	6,647	6,637
Class B 72 - Penn Treaty Insurance Co., Pennsylvania	(14,997,145)	(14,537,682)
Class B 74 - National States Insurance, Missouri	(464,162)	(499,303)
Class B 75 - Executive Life Insurance Co. of New York	(16,370)	(14,481)
Class B 76 - Standard Life Insurance Co. of Indiana	(2,225)	(2,145)
Class B 77 - CoOpportunity Health, Iowa	28,774,234	28,007,071
Class B 78 - SeeChange Health Insurance, California	(7,713)	(7,371)
Class B 79 - AF&L/SAIC	(45,561)	(13,821)
Class B 80 - Senior Health Insurance Co. of Pennsylvania	(32,519)	-
Class B 81 - Global/Colorado Banker's	(557)	-
Class C 20 - Executive Life, California	47,269	52,597
Class C 68 - Reliance	<u>3,953</u>	<u>3,827</u>
Total net assets for specific insolvencies	<u>\$ 13,811,455</u>	<u>\$ 13,741,773</u>

Net assets of \$2,576,285 and \$2,494,078 at December 31, 2019 and 2018, respectively, are reserved for future obligations.

The excess liabilities over assets, not covered by rehabilitation or liquidation of the insolvencies, will be covered by Class B assessments of member insurers.

Nebraska Life and Health Insurance Guaranty Association

NOTES TO FINANCIAL STATEMENTS

NOTE E - FAIR VALUE MEASUREMENTS

Following is a description of the valuation methodologies used for assets and liabilities measured at fair value. There have been no changes in methodologies used during the years ended December 31, 2019 and 2018.

Corporate bonds: Certain corporate bonds are valued at the closing price reported in the active market in which the bond is traded. Other corporate bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings.

U.S. government bonds: U.S. government and agency obligations are valued at the closing price reported in the active market in which the obligation is traded. Other U.S. government and agency obligations are valued using independent pricing models.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Association believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following table sets forth the balances of assets and liabilities measured at fair value on a recurring basis as of December 31, 2019 and 2018.

	2019			
	Fair Value	Quoted Prices in Active Markets for identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments				
Corporate bonds	\$ 627,772	\$ -	\$ 627,772	\$ -
US government bonds	18,169,013	-	18,169,013	-
	<u>\$ 18,796,785</u>	<u>\$ -</u>	<u>\$ 18,796,785</u>	<u>\$ -</u>
	2018			
	Fair Value	Quoted Prices in Active Markets for identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments				
Corporate bonds	\$ 470,109	\$ -	\$ 470,109	\$ -
US government bonds	14,040,253	-	14,040,253	-
	<u>\$ 14,510,362</u>	<u>\$ -</u>	<u>\$ 14,510,362</u>	<u>\$ -</u>

Nebraska Life and Health Insurance Guaranty Association

NOTES TO FINANCIAL STATEMENTS

NOTE F - PROGRAM EXPENSES

The Association is statutorily required to account for general and administrative expenses in one fund (Class A) and transactions directly related to the various insolvencies in another fund (Class B). By the very nature of the fund, all expenses recorded in Class B are program expenses. Management and general expenses initially recorded in Class A are allocated to Class B based on time spent by administrative personnel on the specific insolvencies. This procedure is in accordance with accounting guidelines recommended by the National Organization of Life and Health Insurance Guaranty Associations.

NOTE G - TRANSACTIONS WITH RELATED PARTY

The Association employs Cline Williams Wright Johnson & Oldfather, LLP, Attorneys at Law, to manage the Association's day-to-day operations. The Association is billed monthly for time spent performing Association operations. The Administrator, an employee of Cline Williams Wright Johnson & Oldfather, LLP, is also an officer of the Association. During 2019 and 2018, the Association made payments of \$111,002 and \$171,662, respectively, to Cline Williams Wright Johnson & Oldfather, LLP.

NOTE H - CONTINGENCIES

The Association is involved in litigation arising in the normal course of its business. In the opinion of management, the Association's recovery or liability, if any, under pending litigation or administrative proceeding would not materially affect its financial position.

NOTE I - AVAILABLE RESOURCES AND LIQUIDITY

The Association regularly monitors liquidity required to meet its operating needs and its insolvency-related obligations. The Association has various sources of liquidity at its disposal, including cash and cash equivalents, investment funds, and access, where available, to assets held in the estates of insolvent companies for which the Association has coverage obligations, which estates assets may include cash, saleable assets, potential litigation recoveries, and potential reinsurance recoveries. Where the assets just described are insufficient to meet the obligations of the Association, the Association is also authorized by Nebraska state statutes to assess its member insurers, subject to yearly limitations, in order to meet its financial obligations. The Association maintains its investment funds in an investment account managed by a qualified investment advisor, whose investment duties are described in an investment policy which is focused first on the preservation of principal. The work of the investment advisor is reviewed by the Association's Investment Committee, which is populated by member company representatives with investment expertise.

For purposes of analyzing resources available to meet operational expenditures over a 12-month period, the Association evaluates annual operating costs by considering all expenditures related to its ongoing administrative activities based on a rolling three-year average of actual expenditures in prior years and prepares and monitors an annual budget related to those operational expenditures. Further, the Association's coverage obligations on a going-forward basis are calculated based on estimates provided by actuaries and/or financial project managers who staff the task forces associated with each insolvency for which the Association has coverage obligations.

Nebraska Life and Health Insurance Guaranty Association

NOTES TO FINANCIAL STATEMENTS

NOTE I - AVAILABLE RESOURCES AND LIQUIDITY - CONTINUED

As of December 31, 2019 and 2018, the following tables show the total financial assets held by the Association:

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 413,414	\$ 4,504,145
Certificates of deposit (reserves)	<u>100,047</u>	<u>247,951</u>
Total financial assets	513,461	4,752,096
Reserves with liquidity horizons greater than one year	<u>(100,047)</u>	<u>(247,951)</u>
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 413,414</u>	<u>\$ 4,504,145</u>

Further, the Association retains the statutory ability to assess member insurers as needed to meet the obligations of the Association.

NOTE J - NEW ACCOUNTING PRONOUNCEMENT

Revenue Recognition

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers* ("ASU 2014-09"). ASU 2014-09 provides a single model for entities to use in accounting for revenue arising from contracts with customers. The new standard also requires expanded disclosures regarding the qualitative and quantitative information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The FASB has subsequently issued additional, clarifying standards to address issues arising from implementation of the new revenue recognition standard. ASU 2014-09 and all subsequently issued amendments, collectively "ASC 606," is effective for annual reporting periods beginning after December 15, 2018. The standard permits the use of either a full retrospective or a modified retrospective approach.

The Association adopted ASC 606 on January 1, 2019 using the modified retrospective method. The amount and timing of revenue recognition was not impacted by the new standard, and therefore, no cumulative adjustment was recognized in retained earnings upon adoption. Prior period amounts are not adjusted and continue to be reported in accordance with our historical accounting methods.

Fair Value Measurement

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. The ASU removed some disclosures; modified others, and added some new disclosure requirements. The ASU is effective for all entities for fiscal years beginning after December 15, 2019; however, the Association early adopted the standard, effective for the year ended December 31, 2019, as permitted by the standard. See note E for disclosure of the Association's assets and liabilities measured at fair value.

NOTE K - SUBSEQUENT EVENTS

Subsequent events have been evaluated through the audit report date, the date the financial statements were available to be issued.