

Report for Special Master's Status Conference
July 23, 2018
Grand Court Order of Calanthe (Calanthe) in Receivership # 560

Special Deputy Receiver (SDR): Resolution Oversight Corporation

Primary Responsible Person: Ernesto A. Garza

Estate Counsel: Rachel Stroud

Receiver's Counsel: David Wheelus

RLO Analyst: Moses Chao

Background on Calanthe:

- Date of Permanent Injunction: May 31, 2018
- Date of Appointment of SDR: June 4, 2018
- State Licensed: Texas
- Lines of Business: Whole Life and Term Insurance
Pre-need Policies

Calanthe is a Texas domiciled fraternal benefit society that has been in existence for 120 years. The company is only licensed in Texas and its operations are conducted under Chapter 885 of the Texas Insurance Code. As a fraternal benefit society, Calanthe is owned by its members, and provides social activities and educational scholarships that are funded through fund raiser events and membership fees. It has no affiliates or investments in subsidiaries, partnerships or other companies.

Statement of Assets and Liabilities: Not available. There are significant gaps in the financial records of the company. The SDR is piecing together information to prepare statements.

Status and Activity since the Filing of Rehabilitation Proceeding:

The *Agreed Order Appointing Rehabilitator, Permanent Injunction and Notice of Automatic Stay* (the PI) was filed on May 31, 2018. The SDR was appointed on June 4, 2018. The SDR and subcontractors arrived at the Calanthe offices in Houston, Texas on June 4th. Calanthe has not had employees since July, 2016 and has operated with the assistance of two volunteers from Calanthe's board of directors since August, 2016. They learned to bill the premiums and pay the death claims under the procedures previously established by the company.

Banks: The PI specifies that Calanthe's property does not include social membership fees, scholarship funds or other funds that are not related to its insurance business. ("Membership Property"). The Rehabilitator is required to determine if there is any identifiable Membership Property that is not inextricably commingled with Calanthe's property, and transfer any Membership Property as directed by the Receivership Court. The SDR served copies of the PI, Oath and Appointment of SDR on all banks within 48 hours of appointment. The Chase and Bank of America bank accounts were transferred to control of the SDR by June 12, 2018 and the Unity Bank accounts were closed on June 19, 2018. There is one account at Bank of America, which was established by Calanthe to hold funds for scholarships. The SDR determined that the funds in that account were excluded by the PI and had not been commingled with funds from Calanthe's

insurance business, so that account was left in the control of the Calanthe Grand Worthy Counsellor. Another account at Chase has been used by the volunteers to deposit membership dues. However, this account names Calanthe and the SDR must determine if any funds may have been commingled, so the SDR took control of that account. The SDR has been working with the volunteers to fund the needs of the fraternal organization unrelated to the insurance business from this account. The SDR is in the process of reconciling this account so the balance of the funds can be released as directed by Grand Worthy Counsellor.

Information Technology: There was little in the way of IT. The computer with the Peachtree accounting software had been hit with a ransomware virus in 2014. The computer had not been backed up so the data remained encrypted when the ransom was not paid. The company relies primarily on manual record techniques.

Beginning in 2010, Policyholder data was kept in a QuickLife (QL) policy administration system. The SDR completed the backup of the QL system within 24 hours of arriving on site. The SDR staff discovered that the overnight backup function to the QL server had been disabled for several months and the current firewall and virus protection of that system were lacking. The SDR team reinstated the automatic evening back up and installed new firewall and virus protection software to protect the QL system. The other computer that was in use by the staff also had expired virus protection so new firewall and virus protection software were installed on that computer.

The SDR team also located five internal hard drives from computers that were not being used or out of service. These hard drives were analyzed and were determined to be filled with viruses and not assessable. The SDR was able to ascertain the age of the files on hard drives to determine they were not likely relevant to the rehabilitation efforts. These drives will be stored.

Calanthe Employees: As stated Calanthe had no employees but the SDR did retain the two volunteers on a contract basis.

Policies: All policies of Calanthe are still in force. Calanthe bills its premiums on a quarterly basis. Working with the volunteers, the SDR was able to timely prepare and mail premium billings for the third quarter on July 12th. The records concerning the policies are incomplete and the SDR is working to determine if the information can be found in the records or if the information is missing. The SDR prepared a notice letter and a missing address report for each Court and mailed those with the premium billing to those Worthy Counsellors with good addresses. The SDR also prepared missing address reports for those Courts without Worthy Counsellors and for courts with fully paid up policies. The SDR is in the process of locating address information on those Courts to mail the notice letters and the missing address reports.

As of May 31, 2018, the QL system shows 2,788 policies in force with a face value of \$3,145,901 and a reserve value of \$1,031,308. The SDR is in the process of determining the validity of these values.

Records: Calanthe kept all records manually. The SDR team arrived on site to find hundreds of boxes of records stacked wall to wall in all the offices with very little organization. The insurance records were not segregated from the social records. The SDR began inventorying the records on

June 4th and has been working with the Grand Worthy Counsellor to locate and separate the records that are not related to Calanthe's insurance business. It is expected that Calanthe's members will create an organization to continue its social and educational activities, and these records may be transferred to this entity in accordance with the PI and the Receivership Court's orders.

a) Policy Records:

The SDR has determined that policy files were not organized or cataloged according to the name of each policyholder, but were grouped according to the Court to which the policyholder belonged.

The Worthy Counsellors collect the premiums (called endowment payments) and pay them to Calanthe. In cases where a Court doesn't have a Worthy Counsellor, those members still owing on their policies are billed directly. The SDR has found many instances where a Court no longer has a Worthy Counsellor and the members have policies that are fully paid up. In those instances the SDR is having difficulty locating the policyholders, as the policy application does not contain the policyholder's address or social security number. The Worthy Counsellors' routine practice when preparing applications was to list Calanthe's office address as the policyholder's address, and omit the policyholder's social security number. In some cases the Worthy Counsellors are deceased and the policies have been paid up for decades. The SDR is not sure it will be able to locate those policyholders but it is in the process of inventorying the records to try and locate as many as possible. The SDR has determined that each Court had several types of files. The names of these files varied over the years, but generally there is an application file, a billing file, a payment file, and, in some instances, a correspondence file. There also index cards for each member that are kept in Court Order, which show the beneficiaries and some payment history. There are significant discrepancies between some index card information and information found in the QL system. Currently, the SDR estimates it doesn't have good addresses on two-thirds of policyholders.

b) Accounting Records:

The accounting records were, likewise, all kept manually. The SDR learned that current accounting records other than cash receipts and cash disbursements journals are virtually non-existent. After the Peachtree system was infected with ransomware in 2014, attempts were made to input the manual records into Quickbooks, but that was discontinued when the last employees left in mid-2016. The SDR has reviewed those old Quickbooks entries and have determined that they are not helpful in preparing financial records for the company. Apparently the prior Secretary-Treasurer took the 2016 cash receipt and disbursement journal with her. It was returned with some of the cash receipt and disbursement journal pages missing. The two volunteers have kept cash disbursements records since August of 2016 but monthly reconciliations of the bank statements are not done. The SDR will have to create financial statements from bank statements and partial cash receipt and disbursement journals for the beginning of 2016. The last tax return filed was for 2015. The SDR also located requests from IRS for information to reconcile the 2015 W2s to the Form 941s paid for the year. The SDR is trying to locate the requested information.

Reinsurance:

Calanthe entered into a Reinsurance Indemnity Agreement ("Agreement") with Clear Spring, effective January 1, 2017. In consideration for the Agreement, Calanthe liquidated the majority of its assets and deposited the proceeds in a Trust Account. Clear Spring administers the Trust to fund

claim and administration expense payments on Calanthe policies. Prior to receivership, Calanthe and Clear Spring explored an assumption of Calanthe's policies by Clear Spring, but this was not consummated. The Trust has a balance as of May 31, 2018 of \$1,048,482. The SDR is working with Clear Spring to evaluate the Agreement.

Calanthe Office Building:

Calanthe sold its office building in November, 2015. The majority of the proceeds of the sale were deposited in the Trust Account with Clear Spring. Calanthe entered into a lease with the purchaser in 2016 but then filed suit to set aside the sale. The lawsuit is stayed under Tex. Ins. Code §443.008. The SDR's counsel has been in touch with the defendant's attorney and has obtained the pleadings in the suit. The SDR is evaluating its options in the lawsuit.

Summary of Takeover Activities:

- The SDR secured the building and changed the locks.
- The SDR inventoried the furniture, fixture, and equipment.
- All bank accounts have been secured and are under the control of the SDR.
- The SDR has established a website for the receivership: www.Calanthereceivership.com.
- All of the computer hard drives were backed up within 24 hours of takeover. The overnight backup function on the QL server was reinstated and new firewall and antivirus software were installed.
- The SDR has begun inventorying the boxes not only determine contents but to prepare them for any company that might assume the policies. The SDR has also been locating and separating the records that belong solely for the benefit of the fraternal society.
- The SDR has verified that there are no Texas statutory deposits.
- Arrangements have been made with the two Calanthe volunteers to continue their services.
- The SDR has learned that there are two small lots that are owned by Calanthe. However, based upon the property tax invoices, the SDR doesn't believe that these lots have much value. The SDR will determine the best course of action for these lots.
- The SDR processed and paid death claims and policy surrenders which have been made on a couple of policies.
- The SDR prepared the monthly reports and submitted them to Clear Spring for payment owed to Calanthe from the trust.
- The SDR prepared notice letters, missing address reports, and 3rd Quarter billing statements and mailed them to the Worthy Counsellors.
- Estate Counsel prepared an Application for Approval of Fees and Expenses and an Application to Require Electronic Service and submitted them for approval to the Texas Department of Insurance.

Estate Team Goals for the next quarter:

- Finish the inventory of records and begin sending those boxes not needed for the rehabilitation to Safesite in Austin.
- Make a recommendation for the building lawsuit.
- Make a recommendation for the reinsurance agreement.
- Collect 3rd Quarter premiums and update any corrected addresses supplied by the members and Worthy Counsellors.

- Prepare the 4th Quarter premium billings and coordinate with the fraternal organization to separate the process for collecting membership dues from premium collections.
- Complete the reconciliation on any commingled accounts.
- Create a beginning balance sheet and first financial statements to begin monthly reporting to the Texas Department of Insurance.
- Make recommendations to the Rehabilitator for rehabilitation strategies.

Estimated Closing Date of Receivership: **TBD**

Identification of Factors Affecting Closing Date and Final Distribution: **TBD**