

MEMORANDUM

TO: Jeff Hunt and Joel Sander, Co-Chairs, National Treatment and Coordination (E) Working Group

FROM: Kevin Fry, Chair, Financial Analysis (E) Working Group

DATE: April 24, 2019

RE: Enhanced Regulatory Guidance

As you may be aware, the Financial Analysis (E) Working Group (FAWG) meets annually in Kansas City to discuss among other things, potentially troubled insurers and insurance groups. During this meeting, FAWG also discusses issues and industry trends, including identifying any that are potentially adverse or might warrant communication and coordination with other NAIC groups. As a result of the issues and trends discussed, FAWG would like to refer the following items to the attention of your group.

1. **Parental Guarantees and Capital Maintenance Agreements** – While financial regulators have historically requested parental guarantees or capital maintenance agreements to support an underlying insurer’s financial condition, FAWG has become aware of situations where such agreements were not honored or fulfilled. FAWG generally supports requiring such agreements as conditions to license or change in control approval; however, FAWG would caution regulators from placing excessive reliance on such agreements and encourages follow-up review and analysis of the holding company financial condition and its ability to fulfill the commitment.
2. **Licensing Considerations Following a Merger** – It has come to the FAWG’s attention that, while not common, situations can occur where a traditional U.S. insurer writing business in multiple states could be merged into an international insurer defined by a state’s laws, thereby altering the legal entity structure and level of regulatory oversight performed by the domestic state. Therefore, in these situations it is important for the regulator reviewing a redomestication and/or acquisition/merger application to understand the acquiring party’s intent for future corporate structure changes. In addition, it is important that the regulator approving the merger and legal structure change engages in proactive communication with the states in which the insurer conducts business.

In considering this issue, FAWG recommends consideration of additional guidance for the NAIC’s *Company Licensing Best Practices Handbook* to ensure these concerns are adequately addressed. If there are any questions regarding this recommendation, please feel free to reach out to request additional information in this area from me or NAIC support staff (Bruce Jenson at bjenson@naic.org).

Thank you for your consideration of this referral.

Every Form A review should be tailored to the risks associated with the proposed acquisition, including the target company, acquiring entity, and the complexity of the transaction. The following best practices are presented as a guide for regulatory review and analysis of Form A acquisitions, recognizing that this list may not be comprehensive and not all items will apply to every acquisition. This list is intended to be a regulatory tool. **The NAIC Form A database should be updated as applicable throughout the Form A review process.**

1. Initial Review

- a) Determine if the filing is complete, note the missing items and promptly send a deficiency letter to the Applicant
- b) Identify attorneys, party contacts, and the other insurance regulator reviewing the Form A, including the lead regulator.
- c) The lead regulator should obtain key contact information from each state reviewing the Form A and consider organizing a regulator to regulator call to discuss concerns with the filing
- d) Assign appropriate analyst, legal and other professional staff to conduct regulatory review
- e) Carefully consider whether regulatory review can be completed by Applicant's target close date, including any interim deadlines and obtain deemer extension or waiver if appropriate, and
- f) Schedule and notice hearing/consolidated hearing, if applicable, within statutory timeframes

2. Background, Identity and Risk Profile of Acquiring Persons

- a) Identify and review all relevant parties to the proposed acquisition
- b) Assess the feasibility of the acquiring persons holding company structure including location and control (direct/indirect) of the target company post acquisition
- c) Review the lead state's assessment of the acquiring persons most recent ORSA Summary Report and Form F ERM, if applicable, to better understand the related risks
- d) Determine Ultimate Controlling Person and/or Parent (UCP), cross check with source of funds and consider debt funding sources
- e) Review NAIC and other external sources to gain a better understanding of the acquiring persons, its affiliates, and the UCP.
- f) Carefully scrutinize and understand complex organization and ownership structures
- g) Review Audited Financial Statements (or CPA reviewed financial statements for individuals) of the acquiring persons, its holding company, and the UCP, 10K and 10Qs, and other current financial information for enterprise condition, potential debt service by the UCP and its ability to service such debt. Understand the level of reliance on cash flow/dividends from the target company to service debt and other obligations of the holding company and UCP.
- h) Based upon nature of acquiring party, review detailed audited financial statement of all individuals who are source of funds.

- a. If not available, consider acceptability of unaudited financial statements, compiled personal financial or net worth statements and/or tax returns.
- i) Consider suitability of UCP through background review and regulatory review of the prospective new owners, using UCAA biographical affidavits and third-party background reviews by NAIC listed independent third party reviewing companies or fingerprinting criminal checks if applicable, and
- j) Consider acceptability of SEC disclosures by board members of publicly traded UCPs in suitability review.

3. Communication and Record Maintenance

- a) Communicate response to any confidentiality requests in writing as soon as possible
- b) Create a contact list of relevant persons and representatives
- c) Separate confidential and public documents, information, and communications and maintain as appropriate
- d) Contact and collaborate with other reviewing regulators involved in the review process, as appropriate, including the lead state regulator regarding ORSA and ERM reviews
- e) As applicable, contact other regulators of noninsurance entities of the acquiring party or target
- f) Respond as appropriate to questions from third parties and interested regulators
- g) Keep the acquiring party representatives informed as to status of review
- h) Receive and consider any information provided by external sources, including possible financial or other incentives or motivation of those commenting on a particular transaction
- i) Summarize review, findings, conclusions and action taken on Form A review in final action document, including stipulations, and conditions subsequent, and
- j) File and maintain documents under state procedures.

4. Transaction Review

- a) Determine how acquisition will be achieved by carefully reviewing transactional documents, e.g. merger, stock purchase, stock exchange
- b) Consider disposition of all classes of target shares, including addressment of any beneficial owners
- c) Ascertain propriety of disposition of minority interests and concerns, if applicable
- d) Consider any affiliate or employee benefit as appropriate
- e) Determine how any ancillary regulatory reviews or other interim procedural steps will be completed, including Form E-Pre-Acquisition Notification Form, for other licensed states
- f) Obtain copies of shareholder communications or sole shareholder consent
- g) Consider obtaining copies of fairness and other contractually required opinions if available
- h) Review relevant portions of board resolutions, power points and related board minutes pertinent to the Form A transaction, use care to keep documents confidential, and
- i) Determine whether additional professional transaction review is warranted.

5. Purchase Consideration

- a) Determine fairness (equivalency) of total amount to be paid to total value to be received, including derivation of price and value of target under standard valuation methodologies or to book value
- b) Consider quality of consideration, giving careful scrutiny to payments other than cash or cash equivalents which are disfavored particularly when any funds are being transferred to the target.
- c) Consider fairness opinions and actuarial appraisals, if provided
- d) Consider source, type and valuation basis of funds to be used for consideration
 - i. If funds are from a regulated entity, confirm the existence and valuation of such assets with that entity's regulator
- e) If applicable, consider implications of any debt financing including
 - i. The mechanics of any debt financing to be used to fund the transaction, whether funds are being borrowed in the ordinary course of business or on terms that are less favorable than generally commercial loans.
 - ii. The percentage of debt versus non-debt funds to be used
 - iii. The source of funds or stream of income to be used by parent for repayment and the ability of the acquiring party to repay the debt from sources other than the target
 - iv. Identity of the creditor(s) and creditors' financial condition.
 - v. How will debt be secured; consider prohibiting securing of debt on shares of target or target's assets if not already prohibited by state statute,
 - vi. Compare time period of loan commitment with parent's income stream over the same time period, including the ability of the acquiring party to repay the debt from sources other than the target until loan is repaid/retired, and
 - vii. Consider the long term impact of parent's debt service on operations of the target company and group.
 - viii. Follow-up on Parent's financial commitment to underlying insurer.

6. Target License Qualification /Insurer Operations

- a) Determine whether target insurer meets license qualifications upon change of control
- b) Consider operational changes post-acquisition, including business plans and projections
- c) Review required statutory deposits and authorized lines of business
- d) Consider changes to target management and key employees
- e) Consider suitability of changes to target management and key employees through background review and regulatory review of new owners, using UCAA biographical affidavits and third-party background reviews or fingerprinting criminal checks, if applicable
- f) Consider plans for technological interfacing with new affiliates and any potential adverse impact on operations including claims

- g) Consider suitability of any new affiliated and non-affiliated material agreements, including managing general agents, third party administrators, any professional organizations and reinsurance arrangements
- h) Review any ERM analysis of the transaction performed by the acquiring entity, including impacts on risk assessment, risk appetite and tolerances, and prospective solvency (capital and liquidity)
- i) Require Form D filings for any affiliated material transactions, post-acquisition; consider including language in the approval order
- j) Determine target's estimated financial condition and stability, post-acquisition, and
- k) Consider with disfavor any plans to liquidate the target or sell its assets, consolidate or merge, that may be unfair, unreasonable, or hazardous to policyholders
- l) Consider impact of U.S. insurer merging into an international insurer and/or alerting the legal entity structure and regulatory oversight performed by domestic state(s).

7. Market Impact

- a) Consider anticompetitive impact of acquisition on lines or products, including whether transaction will create a monopoly or lessen competition in insurance in the state; Disapprove transaction if completion will create a monopoly
- b) Consider Form E information and market concentration for combined lines and other appropriate information to assess market impact if warranted by nature of transaction, including coordination with other states where the target is admitted, and
- c) Consider imposing tailored conditions subsequent or undertakings as necessary to address competitive market concerns

8. Post-Approval Considerations, if applicable

- a) Receive notification of changes to effective closing date
- b) Confirm compliance with conditions precedent
- c) Receive waivers for market conduct or financial examination, and
- d) Receive notification if transaction does not close and consider withdrawal of approval.

9. Post-Acquisition Considerations

- a) Receive confirmation of the transaction following the closing, per your state's statutory requirement timeframe
- b) Request written details of the final purchase price after all adjustments are complete on the transaction
- c) Request confirmation of any capital contribution contemplated in the transaction.
- d) Request the names and titles of those individuals whom will be responsible for the filing of the amended Insurance Holding Company System Annual Registration Statement
- e) Request an amended Insurance Holding Company System Registration statement per your state's statutory timeframe within each applicable state's statutory required timeframe after the close of the proposed transaction.
- f) Consider requesting for a period of two years, commencing six months from closing, a semiannual report under oath of its business operations in your state, including but not

- limited to, integration process; any changes to the business of the Domestic Insurers; changes to employment levels; changes in offices of the Domestic Insurers; any changes in location of its operations in your state; and notice of any statutory compliance or regulatory actions taken by other state regulatory authorities against the acquiring parties or the Domestic Insurers
- g) Consider prior approval of all dividends for a two-year period from the close date
 - h) Consider undergoing a target financial and/or market conduct examination following the closing or
 - i) In lieu of an examination a meeting, conference call or receipt of certain information can be requested
 - j) Confirm compliance or satisfaction with any other conditions subsequent or undertakings, and
 - k) Monitor target's market performance to projections two years after transaction close date
 - l) Consider proactive communication with state(s) where the insurer conducts business if changes to the insurer's corporate structure occurs post-acquisition.