



BERMUDA MONETARY AUTHORITY

GUIDANCE NOTES

CONSULTATION PAPER FOR LEGACY INSURANCE GROUPS ACCOUNTING AND CAPITAL TREATMENT FOR CORPORATE LIABILITIES

25 OCTOBER 2023

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1 Interpretation

Corporate Liabilities (Liabilities) - Liabilities of non-insurance corporations, predating self-insurance of companies or groups commonly known as captives, sharing risk characteristics that are similar to traditional insurance liabilities but legally not classified as insurance obligations. These risk characteristics typically require an obligation to pay, are long-tailed in nature and include uncertainty in the timing, frequency and severity. One such exposure is direct asbestos and environmental exposures in the form of employee or consumer liability that arose from business that was primarily conducted by manufacturing companies that supplied or produced asbestos-related products dating back to the late 1880s.

Legacy Business - Primarily focused on providing solvency solutions for discontinued operations and/or lines of business, through the acquisition of businesses or portfolios and/or by providing reinsurance to effectively manage the running-off of liabilities and/or provide finality for organisations.

Legacy Insurance Group (Legacy Group) - Bermuda licensed and regulated “Insurance Group”, as defined by the Insurance Act 1978 (Act), that conducts legacy business.

Legacy Insurer (Insurer) - Bermuda licensed and regulated “Insurer”, as defined by the Act, that conducts legacy business.

Legacy Industry - The sector of the Bermuda insurance market that focuses on conducting legacy business.

Limited Liability Corporations (LLC) – Companies structured to facilitate the managing of corporate liabilities.

LLC Transactions - Acquisitions and/or risk transfers entered and executed by Legacy Insurance Groups or Insurers, with the aim of providing finality to an organisation’s corporate liabilities.

Entities - Asbestos manufacturers and suppliers and other companies resulting in exposure that ultimately led to environmental and corporate/defendant asbestos health-related liabilities.

2 Introduction

Background:

A rising trend within the legacy industry is the acquisition of US Companies (LLC transactions) that have legal liability non-(re)insurance business, known as Corporate Liabilities (Liabilities). These Liabilities historically occurred in the 1970s or prior, associated with the use of asbestos by manufacturing and suppliers (Entities), resulting in exposure that ultimately led to environmental and corporate/defendant asbestos health-related liabilities. In order to facilitate the payment of these Liabilities, these Entities formed corporations, generally LLCs, to manage their exposure to these risks.

These Entities are currently seeking exit solutions from the legacy industry to achieve economic and legal finality. While the current focus of the legacy industry is on the types of exposures described above (i.e., mature and long-tailed asbestos and environmental), the scope of this paper relates strictly to LLC transactions made by Bermuda-regulated Legacy Insurance Groups and Insurers that meet the criteria defined in the preceding 'Interpretation' section of this paper.

3 Objective

This paper aims to guide Bermuda-regulated Legacy Groups on the supervisory requirements and treatment of LLC transactions to ensure compliance with regulatory obligations and capital requirements.

Please note that any Bermuda-regulated Insurer that is considering acquiring a LLCs should notify the Authority early in the process, as there may be different stipulations and/or methodologies applied.

4 Application

All Bermuda Legacy Groups and Insurers, require prior regulatory approval before entering into any contracts to conduct legacy business (Pre-approval), as required by a condition of registration on their licence (COR). Given the historical nature of LLCs, and the Liabilities therein, the Bermuda Monetary Authority (Authority or BMA) has taken the stance that **all** LLC transactions, including partial acquisitions or joint ventures, will require prior approval by the Authority under the aforementioned COR.

Legacy Group Transaction Approval

The Authority expects to receive a detailed Pre-approval application for assessment and approval of LLCs (see the Appendix of this paper).

The following conditions shall apply and be considered in the assessment of the pre-approval of the LLC Transaction and should be provided and/or adequately documented in the submission:

- a. An assessment showing that exposures from the Liabilities are to be limited to 15% of the existing total net insurance reserves of the acquiring Legacy Group as at the most recent year-end;
- b. An Independent/third-party solvency or financial opinion on the LLC; and
- c. A run-off plan, detailing how management intends to run down the ultimate Liabilities, inclusive of stress scenarios under a baseline and alternative stress scenarios. This plan should include a projection of expenses/cost allocation for the exposures verified by the risk management function.

Please note that depending on the nature of the LLC Transaction, it may also meet the definition of a material change pursuant to Section 30JA(1) (e) 'acquisition of controlling interest in an undertaking that is engaged in non-insurance business which offers services and products to persons who are not affiliates of the insurer' of the Insurance Act 1978 (Act). If the latter criteria has been met, the Legacy Group may combine the formal notification pursuant to Section 30JB (2), making specific reference to the section of the Act and the Pre-approval application as one.

5 Accounting and Capital Treatment

Classification: To establish capital charges associated with these transactions, the LLC will be accounted for using the equity method (net assets) versus on a consolidated basis due to their legal structure. In the Bermuda Solvency Capital Requirement model (BSCR), the Legacy Group would input the net asset value of the LLC on line 4C (unregulated financial operating entities) of Form 1EBS (see screenshot below). Net assets shall be computed based on Generally Accepted Accounting Principles (GAAP) as allowable under Section 17A (2) of the Act.

(c) SUBTOTAL - OTHER EQUITY INVESTMENTS		-	-
(d) Investments in Affiliates			
Unregulated Entities That Conduct Ancillary Services	Form 4EBS, Line (4a)	-	5.0%
Unregulated Non-Financial Operating Entities	Form 4EBS, Line (4b)	-	20.0%
Unregulated Financial Operating Entities	Form 4EBS, Line (4c)	-	55.0%
Regulated Insurance Financial Operating Entities	Form 4EBS, Line (4e)	-	20.0%
(d) SUBTOTAL - INVESTMENTS IN AFFILIATES		-	-

Capital Factor Assessment: At the initial application, Legacy Groups interested in acquiring these exposures will be required to submit a modelled BSCR proforma for review to ensure that the minimum capital factor is appropriate based on the exposures.

Following the initial assessment, the Authority will continue monitoring the appropriateness of the standard capital factor.

As part of the capital factor assessment, the Legacy Group may also provide their own actuarial volatility analysis of the Liabilities and exposures. In doing so, they should ensure that such analysis is consistent with the standards set out in the revised Section 6D regime as described in the consultation paper published on 28 July 2023 entitled *Proposed Enhancements to the Regulatory Regime and Fees for Commercial Insurers*.

Reporting Requirements:

- For BSCR disclosure, Schedule V(1) (Schedule of Segregated Accounts) is to be completed on a per transaction basis in the individual cells respectively (i.e., each cell, as shown in the screenshot below, will be populated with the details of each distinct transaction). Please note that an additional schedule may be added in subsequent years specifically to capture this information on LLC Transactions, which would replace this requirement
- Corporate Liabilities should be assessed within the Group Solvency Self-Assessment
- Corporate assets and liabilities per LLC are to be disclosed within the audited GAAP financial statements

	Cell 1	Cell 2	Cell 3
(A) Cell reference number	0	0	0
(B) Cell name	0	0	0
(C) Direct Insurer, Reinsurer or Both	0	0	0
ASSETS			
(D) Cash and Time Deposits	-	-	-
(E) Quoted: Bonds and Debentures	-	-	-
(F) Quoted: Equites and Other	-	-	-
(G) Unquoted: Bonds, and Debentures	-	-	-
(H) Investments in and Advances to Affiliates	-	-	-
(I) Funds Held by Ceding Reinsurers	-	-	-
(J) Other Assets	-	-	-
Total Assets	-	-	-
LIABILITIES AND SHAREHOLDERS' EQUITY			
(K) Unearned Premiums	-	-	-
(L) Net Loss & Loss Expense Provisions	-	-	-
(M) Other Liabilities	-	-	-
(N) Statutory Capital	-	-	-
(O) Statutory Surplus	-	-	-
Total Statutory Capital & Surplus	-	-	-
Total Liabilities and Shareholders Equity	-	-	-

6 Implementation

The above treatment will apply prospectively with the effective date to be determined.

7 Requested Market Feedback

Please provide feedback on the overall proposal to the Authority by **15 November 2023**.

8 Appendix

List of Requirements and Documents:

Below is a list of items to be submitted to the Authority for review, including a summary reporting template:

- Application detailing the rationale and structure of the transaction and its inherence to risk appetites and tolerances, expertise and entity-specific key performance indicators (IRR, etc.)
- Due diligence assessment, inclusive of third-party reports (such as actuarial reviews) and operational/governance considerations
- All draft agreements involved in the execution of the LLC
- Independent solvency or financial opinion
- Run-off report reviewed by Risk Management Function
- Modelled BSCR proforma that includes Schedule V(1) completed
- Independent memo prepared by the risk function on the transaction
- Investment guidelines detailing types of assets, thresholds and overall quality to be maintained, together with any other collateral or trust specifications
- Board resolutions/approvals on the transaction

Please note that the above list is not exhaustive and the Authority may require registrants to provide specific information to facilitate the approval of the LLC transactions.