



BERMUDA MONETARY AUTHORITY

GUIDANCE NOTES

LEGACY INSURANCE GROUPS ACCOUNTING AND CAPITAL TREATMENT FOR CORPORATE LIABILITIES

28 DECEMBER 2023

Table of Contents

1	Interpretation	3
2	Introduction	4
3	Objective	4
4	Application	4
5	Accounting and Capital Treatment.....	5
6	Implementation.....	6
7	Appendix	7

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 a 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) – A common structure to facilitate the managing of corporate liabilities.

LLC Transactions - Acquisitions and/or risk transfers, including joint or partial acquisitions of entity structures (inclusive of LLC) that enter and execute contractual agreements with 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 and were 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 exposures), the scope of this paper relates strictly to LLC transactions made by Bermuda-regulated Legacy Insurance Groups (Legacy Group) 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 an LLC 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 (COR) on their licence. 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 the 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 have 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 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 4(c) (unregulated financial operating entities) of Form 1EBS (see screenshot below) and will be considered as a Type 2 Equity Holdings – Other Equities. Net assets shall be computed based on Generally Accepted Accounting Principles (GAAP) as allowable under Section 17A (2) of the Act.

4.	INVESTMENTS IN AND ADVANCES TO AFFILIATES (EQUITY METHOD):		
(a)	Unregulated entities that conduct ancillary services	-	-
(b)	Unregulated non-financial operating entities	-	-
(c)	Unregulated financial operating entities	-	-
(d)	Regulated non-insurance financial operating entities	-	-
(e)	Regulated insurance financial operating entities	-	-
(f)	Total investments in affiliates (equity method)	-	-
(g)	Advances to affiliates	-	-
(h)	Total investments in and advances to affiliates (equity method)	-	-

Capital Factor Assessment: At the time of 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. Please be advised that the capital requirement for these types of investments will be subject to a floor.

More specifically, the (capital requirement) floor will be based on the assumption that the GAAP Net Asset Value of the LLC is never below 15% of the value of the Corporate Liabilities of that LLC (as usual, adjusted for the group participation, where applicable).

Reporting Requirements:

- For BSCR disclosure, a schedule similar to Schedule V(1) (Schedule of Segregated Accounts) will be required to be completed on a per-transaction basis. Please note this additional schedule will need to be added in subsequent years specifically to capture this information on LLC Transactions
- 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

6 Implementation

The above treatment will apply prospectively with effect from **1 January 2024**.

When in place, the reporting requirements will apply to all transactions retroactively, irrespective of the acquisition date.

7 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:

- An application detailing the rationale and structure of the transaction and its adherence to risk appetites and tolerances, capital impact, expertise and entity-specific key performance indicators (IRR, etc.)
- A 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 transaction
- An independent solvency or financial opinion inclusive of the financial statements
- A run-off report reviewed by the risk management function
- Investment guidelines detailing types of assets, thresholds and the overall quality of investments 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.