State of New Jersey
DEPARTMENT OF BANKING AND INSURANCE
DIVISION OF INSURANCE
OFFICE OF SOLVENCY REGULATION
PO BOX 325
TRENTON, NJ 08625-0325

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PHIL MURPHY
Governor

SHEILA OLIVER
Lt. Governor

MARLENE CARIDE
Commissioner

February 21, 2020

Re: 2019 ODS Annual Financial Reporting Requirements

The purpose of this correspondence is to standardize financial reporting for Organized Delivery Systems (ODS) licensed in New Jersey, and to ensure that data is properly captured in order to be in compliance with statute and regulations. All filings are due no later than the indicated due date. The annual filing fee of $100.00 made payable to the State of New Jersey – General Treasury shall accompany the annual statement per N.J.A.C 11:29-4.9(a). **Please note that items outlined in "bold" are new and/or changes in requirements from last year's guidelines**. Late filings will be subject to the penalties imposed by NJSA 17:48H-22.

The major reporting requirements are as follows:

ITEM	REPORT	DUE DATE
A.	Annual Statement (including all supporting schedules)	March 1
	Actuarial Certification	March 1
	Management Discussion & Analysis	March 1
	Restricted Deposits (Attachment A)	March 1
	Analysis of MNW Requirements (Attachment B)	March 1
	2020 Projections (Attachment C)	March 1
	Liquidity Ratio (Attachment D)	March 1
B	Audited Annual Financial Statements	June 1
	Internal Control Letter	
	CPA Qualification Letter	
C.	Quarterly Report (1st-3rd Qtr only)	May 15, August 15, November 15

A. ANNUAL STATEMENT: ODSs shall submit the annual statement for calendar year 2019 using the current format established by the National Association of Insurance Commissioners for ODSs, more commonly referred to as the "NAIC Health Blank". The forms are available for purchase through several independent insurance service companies throughout the United States.

Original signatures are required on all filings. The President and Secretary, or in their absence two principal officers must sign the annual statement. All requests for exceptions from normal filings must be submitted at least 30 days prior to the due date. The NAIC Health Annual Statement Instructions manual and the Accounting Policies and Procedures Manual should be kept current and may be obtained from:

National Association of Insurance Commissioners
Insurance Products & Service Division
2301 McGee Street
Suite 800
Kansas City, MO 64108-2604
Telephone (816) 783-8300
Facsimile (816) 460-7593
Web address: **http://www.naic.org/prod_serv_publications.htm**

All ODSs are required to complete the blanks and supplemental schedules in their entirety. If a specific schedule is not applicable to the ODS, that should be so indicated using "N/A" or "None". Please note this includes both the General Interrogatories and the Notes to the Annual Statement. Any deviations from the instructions in this announcement, without the permission of the Commissioner of Banking and Insurance will be considered a violation of filing requirements and cause the entire statement filing to be rejected. Accordingly, the Departments may also impose the maximum penalties and enforcement measures available under statute for failure to file proper or timely financial statements.

The ODS shall segregate assets into categories of "Admitted Assets" and "Non-Admitted Assets". The Non-Admitted Assets will be excluded by the Department in considering the ODS's minimum statutory net worth, solvency, deposit and reserve requirements.

- See SSAP #4 "Assets and Non-admitted Assets" for further guidance. Assets not specifically identified as an admitted asset within the Accounting Practices and Procedures Manual shall be considered Non-admitted.

- Guidance on allowable Goodwill can be found in SSAP #68. Goodwill carried by any merged entity related to a previous business combination shall be charged or credited to surplus immediately in the event that the investee that the goodwill relates to ceases to exist (e.g. by merger or dissolution).

ODSs are required to comply with the requirements of N.J.S.A. 17B:20, regarding Investments.

ODS contract revenues should be included on line #5 “Risk Revenues” of the Statement of Revenues and Expenses. They should not be included on line #2 “Net Premium Income”

All expenses paid to medical providers (including dentists) should be included on line #10 “Other professional services” of the Statement of Revenue and Expenses. They should not be included on line #9 “Hospital/medical benefits” or line #29 “Aggregate write-ins for other income or expenses.”

The annual statement shall include an actuarial certification. It should include a statement by an actuary who is a member in good standing of the American Academy of Actuaries and who is familiar with the actuarial aspects of health plans setting forth his or her opinion relating to reserves, and any other actuarial items. The Actuarial certificate should be prepared in accordance to the NAIC Annual Instruction filings.

A supplement to the annual statement titled “Management’s Discussion and Analysis” must be submitted by March 1 (not April 1 as recommended by the NAIC) each year. This supplement is primarily a narrative document setting forth information which enables the Departments to enhance its understanding of the ODS’s financial position, results of operations, changes in capital and surplus accounts and cash flow. (See Attached NAIC MD &A instructions for specific format and detailed guidance). The comparison on the Balance Sheet accounts should be made between the current period and the prior year end (not PYTD) and discuss in detail any change that is greater than 20%.

General Interrogatories: Most of the questions are self-explanatory; however, for Item #3, state the date initiated or completed and the period covered for the latest financial examination of the ODS by New Jersey or any other state Department of Insurance. This is not the CPA annual audit report.

Notes to the Financial Statements: The notes are an essential part of the Financial Statement. When addressing the notes, show a “none” or “not applicable” if appropriate. Do not alter the numbering of the notes. These disclosures are to be consistent with those required by the standards set by the AICPA. The ODS Annual Statement Instructions contain complete instructions and examples for each note.

All items listed as “other” with a value of 10% or greater of total assets, total liabilities, total revenue, total expenses, etc. must be broken out as a “Detailed Write In” with an appropriate identification including:

> Aggregate write-ins for gains or (losses) in surplus, in Statement of Revenue and Expenses, Page 5, Line 47 and,
>
> Other cash provided (applied), in Cash Flow, Line 16.6.

Disclose these items in the MD&A, also in the Notes to Financial Statement when applicable.

ODSs are subject to complete and submit the RBC Report, please refer to N.J.A.C.11:2-39 and 11:2-39A.

ODSs are subject to submit the Holding Company filings, please refer to N.J.S.A 17:27A and N.J.S.A 17:48.

In addition, no dividends (ordinary or extraordinary) should be declared or distributed unless a request was submitted to the DOBI via a Form D filing and the ODS has received a non-disapproval letter from the Department.

B. AUDITED ANNUAL FINANCIAL STATEMENTS: ODSs shall submit, no later than June 1, 2020 audited annual financial statements for the calendar year 2019 for the ODS. The ODS's statement must be done on a Statutory basis segregated account.

The annual audited financial statements shall be certified by an independent public accountant. Any internal control letters concerning the audit should be submitted with the statement or as soon thereafter as possible.

C. QUARTERLY REPORT: ODSs shall submit quarterly reports no later than 45 days following the close of each calendar quarter (that is May 15, August 15, and November 15, respectively) completed in accordance with SAP using the most current format for the quarter NAIC blank. Specific Quarterly instructions for the 2020 Filings will be posted on the Department's website on approximately April 1st, July 1st, and October 1st.

MAILING ADDRESS:

ODSs shall submit copies of the following reports to:

Kwame Asare
NJ Department of Banking and Insurance
Office of Solvency Regulation
20 West State Street, 10th Floor
PO Box 325
Trenton, NJ 08625-0325

Item	Copies
Annual Statement & Supplements	**3**
Risk Based Capital Formula	2
Audited Annual Financial Statements	2
Quarterly Reports	**3**

Questions concerning this instruction filing, should be directed to Mariam Awad at (609) 940-7455 or e-mail her at mariam.awad@dobi.nj.gov

Questions concerning quality of care, network access, complaints or utilization appeals should be directed to Barbara Hanlon at the Department of Banking and Insurance, Office of Managed Care at (609) 940-7510 or e-mail her at Barbara.hanlon@dobi.nj.gov

ODS
Attachment A
Restricted Deposits

RESTRICTED ASSETS ON DEPOSIT WITH THE DEPARTMENT OF BANKING AND INSURANCE
12/31/2019

Name of ODS:
Date of Licensure:
Deposit at:
Amount Required:
DEPOSIT **(Market Value)**

Worksheet Calculation to Determine Minimum Deposit Requirement in accordance with N.J.A.C. 11:22-4.8(e)

SAMPLE #1 (The highest quarterly Risk Revenue is **below** the minimim deposit requirement)

For the Quarter Ending

	3/31/19	6/30/19	9/30/19	12/31/19
1. Total Risk Revenues from Line #5 of the Statement of Revenue and Expenses (based on New Jersey Revenue Only)				
2. Highest Quarterly Revenue				
3. Multiply by .5				
4. Subtotal				
5.The minimum deposit requirement at 6/30/19 based on the CPI annual adjustment as of 12/31/18.				40,357
6. Deposit requirement (greater of 4 or 5)				

SAMPLE #2 (The highest quarterly revenue is **above** the minimum deposit requirement **during** the **1st two years of licensure**)

	3/31/19	6/30/19	9/30/19	12/31/19
1. Total Risk Revenue from Line #5 of the Statement of Revenue and Expenses (based on New Jersey Revenue Only)				
2. Highest Quarterly Revenue				
3. Multiply by .5				
4. Subtotal				
5.The minimum deposit requirement at 6/30/19 based on the CPI annual adjustment as of 12/31/18.				40,357
6. Amount greater than the minimum deposit requirement (Subtract 4 from 5)				
7. Multipy 6 by 50%				
8. Deposit requirement (Add 5 plus 7)				

SAMPLE #3 (The highest quarterly revenue is **above** the minimum deposit requirement **after** the **1st two years of licensure**)

	3/31/19	6/30/19	9/30/19	12/31/19
1. Total Risk Revenues from Line #5 of the Statement of Revenue and Expenses (based on New Jersey Revenues Only)				
2. Highest Quarterly Revenue				
3. Multiply by .5				
4. Subtotal				
5.The minimum deposit requirement at 6/30/19 based on the CPI annual adjustment as of 12/31/18.				40,357
6. Deposit requirement (greater of 4 or 5)				

ODS
Attachment B
Minimum Net Worth Requirement

Name of ODS: For the Period Ending 12/31/2019

Date of Licensure:

ANALYSIS OF MINIMUM NET WORTH REQUIREMENTS

	Prior Quarter 4 3/31/2019	Prior Quarter 3 6/30/2019	Prior Quarter 2 9/30/2019	Latest Quarter 12/31/2019	Total
(a) 2% annual compensation received but no less than $100,000 *	$	$	$	$	$
(b) **i** 8% of annual expenditures (not including those paid on capitated basis or managed hospital payment basis)					
(c) **ii** 4% hospital expenditures paid on a managed hospital payment basis					
Total of (i) and (ii)					

Minimum Net Worth Requirement -Maximum of Total Column (a) or (b)** ____________
Actual Net Worth as of the period ending date ____________
Net Surplus / (Deficit***) ____________

* Annual Compensation is that as reported on Page #4 Line #5 Col. #2

** Minimum Net Worth Requirement is to be Phased-in over 48 month. 25% of minimum net worth required above at the of the 12th month after it was issued a license, 50% after the 24th month; 75% after the 36th month and 100% at the end of the 48th month following the month it was issued a license.

*** A deficit requires a detailed plan of action, subject to the review and approval of the Commissioner of Banking and Insurance, demonstrating how and when the minimum net worth will be re-established and maintained.

ATTACHMENT C
Projections

		ODS		
		Attachment C		
	2020 Projections			
	1st Qtr	2nd Qtr.	3rd Qtr	4th Qtr
(All Cost in 000's)	2020	2020	2020	2020
	Budget	Budget	Budget	Budget
Total Risk Revenues				
TOTAL Medical Expenses				
Medical Loss Ratio				
TOTAL Administrative Expenses				
Administrative Expense Ratio				
Net Income/(Loss)				
Net Worth				
Net Worth Requirement				

ODS
LIQUIDITY WORKSHEET

ATTACHMENT D

COMPANY:
NAIC #
DATE ENDED:

1	TOTAL LIABILITIES	XXX	
2	MINIMUM NET WORTH REQUIREMENT	XXX	
3	TOTAL LINES #1 & #2		#VALUE!
4	CASH & SHORT-TERM INVESTMENTS	XXX	
5	Bonds	XXX	
6	Total Line #4 & #5		#VALUE!

IS LINE #6 GREATER THAN LINE #3?

DOES THE COMPANY MEET LIQUIDITY REQUIREMENTS?

Per N.J.A.C. 11:22-4.8(b), an ODS is to, at all times contain cash & cash equivalents in the amount at least equal to the sum of liabilities, including reserve liabilities, plus minimum net worth requirement.

INSURANCE
DEPARTMENT OF BANKING AND INSURANCE
DIVISION OF INSURANCE
OFFICE OF THE COMMISSIONER

Minimum Deposit Requirements for Organized Delivery Systems

Notice of Increase in Medical Component of Consumer Price Index

Take Notice that the Commissioner of Banking and Insurance, in compliance with N.J.A.C. 11:22-4.8(e), hereby provides notice that an average 3.3 percent increase from December 2017 to December 2018 in medical component of the Consumer Price Index for all urban consumers in the New York-Northern New Jersey-Long Island region and the Philadelphia-Wilmington-Atlantic City region as reported by the United States Department of Labor, Bureau of Labor Statistics.

The required deposits shall be made read as including an increase of 3.3 percent effective July 1, 2019 as follows:

$39,068.03 specified at N.J.A.C. 11:22-4.8(e) shall be $40,357.27

Date

Marlene Caride,
Commissioner

MANAGEMENT’S DISCUSSION AND ANALYSIS[1]

Reporting entities are required to file a supplement to the annual statement titled “Management’s Discussion and Analysis” (MD&A) by April 1 each year.

MD&A Requirements:

Discuss the reporting entity’s financial condition, changes in financial condition and results of operations. The discussion shall provide information as specified in paragraphs that follow and also shall provide such other information that the reporting entity believes to be necessary for an understanding of its financial condition, changes in financial condition and results of operations. Discussions of liquidity and capital resources may be combined whenever the two topics are interrelated.

Introduction

1. The MD&A requirements are intended to provide, in one section, material historical and prospective textual disclosure enabling regulators to assess the financial condition and results of operations of the reporting entity. There is a need for a narrative explanation of the financial statements, because a numerical presentation and brief accompanying footnotes alone may be insufficient for regulators to judge the quality of earnings and the likelihood that past performance is indicative of future performance. The MD&A is intended to give the regulator an opportunity to look at the reporting entity through the eyes of management by providing both a short-term and long-term analysis of the business of the reporting entity.

2. The MD&A shall be of the financial statements and of other statistical data that the reporting entity believes will enhance a regulator’s understanding of its financial condition, changes in financial condition and results of operations. Generally, the discussion shall cover the two year period covered by the financial statements and shall use year-to-year comparisons or any other formats that in the reporting entity's judgment enhance a regulator’s understanding. However, where trend information is relevant, reference to the five year selected financial data schedule may be necessary.

3. The purpose of the MD&A shall be to provide regulators with information relevant to an assessment of the financial condition and results of operations of the reporting entity as determined by evaluating the amounts and certainty of cash flows from operations and from outside sources. The information provided pursuant to this MD&A need only include that which is available to the reporting entity without undue effort or expense and which does not clearly appear in the reporting entity's financial statements.

4. Management should ensure that disclosure in MD&A is balanced and fully responsive. To enhance regulator understanding of the financial statements, entities are encouraged to explain in the MD&A the effects of the critical accounting policies applied, the judgments made in their application, and any subsequent changes in assumptions or conditions which would have resulted in materially different reported results. Analytical discussion of significant accounting policies in the MD&A should not include information already reported in the significant accounting policies section of the notes to the financial statement.

5. The discussion and analysis shall focus specifically on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition. This would include descriptions and amounts of (a) matters that would have an impact on future operations and have not had an impact in the past, and (b) matters that have had an impact on reported operations and are not expected to have an impact upon future operations.

[1] These requirements have been developed, in part, based upon the requirements set forth in Title 17–Commodity and Securities Exchanges, Chapter II–Securities and Exchange Commission (SEC), Part 229--Standard Instructions for Filing Forms Under Securities Act of 1933, Securities Exchange Act of 1934 and Energy Policy and Conservation Act of 1975, Regulation S-K, Section 229.303 (Item 303) Management's Discussion and Analysis of Financial Condition and Results of Operations. These requirements have also incorporated certain interpretative guidance as set forth in Release No. 33-6835, *SEC Interpretation: Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures* (issued May 18, 1989), Release No. 33-8040, *Cautionary Advice Regarding Disclosure About Critical Accounting Policies* (issued December 12, 2001) and Release No. 33-8056, *Commission Statement about Management's Discussion and Analysis of Financial Condition and Results of Operations* (issued January 22, 2002).

6. Reporting entities are required to prepare the MD&A on a non-consolidated basis, unless the following conditions are met:

   a. The entity is part of a consolidated group of insurers that utilizes a pooling arrangement or one hundred percent reinsurance agreement that affects the solvency and integrity of the entity's reserves and such entity ceded substantially all of its direct and assumed business to the pool. An entity is deemed to have ceded substantially all of its direct and assumed business to a pool if the entity has less than $1,000,000 total direct plus assumed written premiums during a calendar year that are not subject to a pooling arrangement and the net income of the business not subject to the pooling arrangement represents less than 5% of the company's capital and surplus.

      Or

   b. The entity's state of domicile permits audited consolidated financial statements.

      If a group of insurance companies prepares the MD&A on a consolidated basis, the discussion should identify and discuss significant differences between reporting entities (e.g., investment mix, leverage, liquidity, etc.).

Results of Operations

7. Reporting entities should describe any unusual or infrequent events or transactions or any significant economic changes that materially affected the amount of reported net income or other gains/losses in surplus and, in each case, indicate the extent to which net income or surplus was so affected. In addition, describe any other significant components of income that, in the reporting entity's judgment, should be described in order to understand the reporting entity's results of operations.

8. Reporting entities should describe any known trends or uncertainties that have had or are reasonably probable to have a material favorable or unfavorable impact on premiums, net income or other gains/losses in surplus. If the reporting entity knows of events that will cause a material change in the relationship between expenses and premium, the change in the relationship shall be disclosed.

9. To the extent that the financial statements disclose material increases in premium, reporting entities should provide a narrative discussion of the extent to which such increases are attributable to increases in prices or to increases in the volume or amount of existing products being sold or to the introduction of new products.

Prospective Information

10. Reporting entities are encouraged to supply forward-looking information. The MD&A may include discussions of "known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the reporting entity's liquidity increasing or decreasing in any material way." Further, descriptions of known material trends in the reporting entity's capital resources and expected changes in the mix and cost of such resources should be included. Disclosure of known trends or uncertainties that the reporting entity reasonably expects will have a material impact on premium, net income or other gains/losses in surplus is also encouraged.

11. In the event that a reporting entity does supply forward-looking information, the reporting entity may disclaim any responsibility for the accuracy of such information and condition the delivery of such information upon a waiver of any claim under any theory of law based on the inaccuracy of such information; provided that the reporting entity supplied such information in good faith.

Material Changes

12. Reporting entities are required to provide adequate disclosure of the reasons for material year-to-year changes in line items, or discussion and quantification of the contribution of two or more factors to such material changes. An analysis of changes in line items is required where material and where the changes diverge from changes in related line items of the financial statements, where identification and quantification of the extent of contribution of each of two or more factors is necessary to an understanding of a material change, or where there are material increases or decreases in net premium.

13. Repetition and line-by-line analysis is not required or generally appropriate when the causes for a change in one line item also relate to other line items. The discussion need not recite amounts of changes readily computable from the financial statements and shall not merely repeat numerical data contained in such statements. However, quantification should otherwise be as precise, including use of dollar amounts or percentages, as reasonably practicable.

Liquidity, Asset/Liability Matching and Capital Resources

14. The term "liquidity" as used in this MD&A refers to the ability of the reporting entity to generate adequate amounts of cash to meet the reporting entity's needs for cash. Except where it is otherwise clear from the discussion, the reporting entity shall indicate those balance sheet conditions or income or cash flow items, which the reporting entity believes, may be indicators of its liquidity condition. Liquidity generally shall be discussed on both a long-term and short-term basis. The issue of liquidity shall be discussed in the context of the reporting entity's own business or businesses.

15. The discussion of liquidity shall include a discussion of the nature and extent of restrictions on the ability of subsidiaries to transfer funds to the reporting entity in the form of cash dividends, loans or advances and the impact such restrictions may, if any, have on the ability of the reporting entity to meet its cash obligations.

16. Generally, short-term liquidity and short-term capital resources cover cash needs up to 12 months into the future. These cash needs and the sources of funds to meet such needs relate to the day-to-day operating expenses of the reporting entity and material commitments coming due during that 12-month period.

17. The discussion of long-term liquidity and long-term capital resources must address material expenditures, significant balloon payments or other payments due on long-term obligations, and other demands or commitments, including any off-balance sheet items, to be incurred beyond the next 12 months, as well as the proposed sources of funding required to satisfy such obligations.

18. Reporting entities should identify any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the reporting entity's liquidity increasing or decreasing in any material way. If a material decline in liquidity is identified, indicate the course of action that the reporting entity has taken or proposes to take to remedy the decline. Also identify and separately describe internal and external sources of liquidity, and briefly discuss any material unused sources of liquid assets.

19. Reporting entities should describe any known material trends, favorable or unfavorable, in the reporting entity's capital resources. Indicate any expected material changes in the mix and relative cost of such resources. The discussion shall consider changes between equity, debt and any off-balance sheet financing arrangements.

20. Reporting entities are expected to use the statement of cash flows, and other appropriate indicators, in analyzing their liquidity, and to present a balanced discussion dealing with cash flows from investing and financing activities as well as from operations. This discussion should address those matters that have materially affected the most recent period presented but are not expected to have short-term or long-term implications, and those matters that have not materially affected the most recent period presented but are expected materially to affect future periods. Examples of such matters include:

    a. Discretionary operating expenses such as expenses relating to advertising;

    b. Debt refinancings or redemptions;

    c. Dividend requirements to the reporting entity’s parent to fund the parent’s operations or debt service; or

    d. Future potential sources of capital, such as a parent entity’s planned investment in the reporting entity, and the form of that investment.

21. MD&A disclosures should not be overly general. For example, disclosure that the reporting entity has sufficient short-term funding to meet its liquidity needs for the next year provides little useful information. Instead, reporting entities should consider describing the sources of short-term funding and the circumstances that are reasonably likely to affect those sources of liquidity. The discussion should be limited to material risks, and, as with the MD&A generally, should be sufficiently detailed and tailored to the entity's individual circumstances, rather than "boilerplate."

22. If the reporting entity's liquidity is dependent on the use of off-balance sheet financing arrangements, such as securitization of receivables or obtaining access to assets through special purpose entities, the reporting entity should consider disclosure of the factors that are reasonably likely to affect its ability to continue using those off-balance sheet financing arrangements. Reporting entities also should make informative disclosures about matters that could affect the extent of funds required within management's short- and long-term planning horizons.

23. Reporting entities are reminded that identification of circumstances that could materially affect liquidity is necessary if they are "reasonably likely" to occur. This disclosure threshold is lower than "more likely than not." (See guidance provided in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*.) Market price changes, economic downturns, defaults on guarantees, or contractions of operations that have material consequences for the reporting entity's financial position or operating results can be reasonably likely to occur under some conditions. Material effects on liquidity as a result of any reasonably likely changes should be disclosed.

24. To identify trends, demands, commitments, events and uncertainties that require disclosure, management should consider the following:

    a. Provisions in financial guarantees or commitments, debt agreements or other arrangements that could trigger a requirement for an early payment, additional collateral support, changes in terms, acceleration of maturity, or the creation of an additional financial obligation, such as adverse changes in the reporting entity's credit rating, financial ratios, earnings, cash flows, stock price or changes in the value of underlying, linked or indexed assets;

    b. Circumstances that could impair the reporting entity's ability to continue to engage in transactions that have been integral to historical operations or are financially or operationally essential, or that could render that activity commercially impracticable, such as the inability to maintain a specified claims paying ability or investment grade credit rating, level of earnings, earnings per share, financial ratios, or collateral; and

    c. Factors specific to the reporting entity and its markets that the reporting entity expects to be given significant weight in the determination of the reporting entity's credit rating or will otherwise affect the reporting entity's ability to raise short-term and long-term financing.

Loss Reserves (Property & Casualty Companies only)

25. The MD&A should include a discussion of those items that affect the reporting entity’s volatility of loss reserves, including a description of those risks that contribute to the volatility.

Off-Balance Sheet Arrangements

26. Reporting entities should consider the need to provide disclosures concerning transactions, arrangements and other relationships with entities or other persons that are reasonably likely to affect materially liquidity or the availability of or requirements for capital resources. Specific disclosure may be necessary regarding relationships with entities that are contractually limited to narrow activities that facilitate the reporting entity's transfer of or access to assets. These entities are often referred to as structured finance or special purpose entities. These entities may be in the form of corporations, partnerships or limited liability companies, or trusts.

27. Material sources of liquidity and financing, including off-balance sheet arrangements and transactions with limited purpose entities should be discussed. The extent of the reporting entity's reliance on off-balance sheet arrangements should be described fully and clearly where those entities provide financing, liquidity, or market or credit risk support for the reporting entity; engage in leasing or hedging services with the reporting entity; or expose the reporting entity to liability that is not reflected on the face of the financial statements. Where contingencies inherent in the arrangements are reasonably likely to affect the continued availability of a material historical source of liquidity and finance, reporting entities must disclose those uncertainties and their effects.

28. Reporting entities should consider the need to include information about the off-balance sheet arrangements such as: their business purposes and activities; their economic substance; the key terms and conditions of any commitments; the initial and ongoing relationships with the reporting entity and its affiliates; and the reporting entity's potential risk exposures resulting from its contractual or other commitments involving the off-balance sheet arrangements.

29. For example, a reporting entity may be economically or legally required or reasonably likely to fund losses of a limited purpose entity, provide it with additional funding, issue securities pursuant to a call option held by that entity, purchase the entity's capital stock or assets, or the reporting entity otherwise may be financially affected by the performance or non-performance of an entity or counterparty to a transaction or arrangement. In those circumstances, the reporting entity may need to include information about the arrangements and exposures resulting from contractual or other commitments to provide investors with a clear understanding of the reporting entity's business activities, financial arrangements, and financial statements. Other disclosures that reporting entities should consider to explain the effects and risks of off-balance sheet arrangements include:

    a. Total amount of assets and obligations of the off-balance sheet entity, with a description of the nature of its assets and obligations, and identification of the class and amount of any debt or equity securities issued by the reporting entity;

    b. The effects of the entity's termination if it has a finite life or it is reasonably likely that the reporting entity's arrangements with the entity may be discontinued in the foreseeable future;

    c. Amounts receivable or payable, and revenues, expenses and cash flows resulting from the arrangements;

    d. Extended payment terms of receivables, loans, and debt securities resulting from the arrangements, and any uncertainties as to realization, including repayment that is contingent upon the future operations or performance of any party;

    e. The amounts and key terms and conditions of purchase and sale agreements between the reporting entity and the counterparties in any such arrangements; and

    f. The amounts of any guarantees, lines of credit, standby letters of credit or commitments or take or pay contracts or other similar types of arrangements, including tolling, capacity, or leasing arrangements, that could require the reporting entity to provide funding of any obligations under the arrangements, including guarantees of repayment of obligors of parties to the arrangements, make whole agreements, or value guarantees.

30. Although disclosure regarding similar arrangements can be aggregated, important distinctions in terms and effects should not be lost in that process. The relative significance to the reporting entity's financial position and results of the arrangements with unconsolidated, non-independent, limited purpose entities should be clear from the disclosures to the extent material. While legal opinions regarding "true sale" issues or other issues relating to whether a reporting entity has contingent, residual or other liability can play an important role in transactions involving such entities, they do not obviate the need for the reporting entity to consider whether disclosure is required. In addition, disclosure of these matters should be clear and individually tailored to describe the risks to the reporting entity, and should not consist merely of recitation of the transactions' legal terms or the relationships between the parties or similar boilerplate.

Participation in High Yield Financings, Highly Leveraged Transactions or Non-Investment Grade Loans and Investments

31. A reporting entity, consistent with its domiciliary state's law, may participate in several ways, directly or indirectly, in high yield financings, or highly leveraged transactions or make non-investment grade loans or investments relating to corporate restructurings such as leveraged buyouts, recapitalizations including significant stock buybacks and cash dividends, and acquisitions or mergers. A reporting entity may participate in the financing of such a transaction either as originator, syndicator, lender, purchaser of secured senior debt, or as an investor in other debt instruments (often unsecured or subordinated), redeemable preferred stock or other equity securities. Participation in high yield or highly leveraged transactions, as well as investment in non-investment grade securities, generally involves greater returns, in the form of higher fees and higher average yields or potential market gains. Participation in such transactions may involve greater risks, often related to credit worthiness, solvency, relative liquidity of the secondary trading market, potential market losses, and vulnerability to rising interest rates and economic downturns.

32. In view of these potentially greater returns and potentially greater risks, disclosure of the nature and extent of a reporting entity's involvement with high yield or highly leveraged transactions and non-investment grade loans and investments may be required, if such participation or involvement has had or is reasonably likely to have a material effect on financial condition or results of operations. For each such participation or involvement or grouping thereof, there shall be identification, consistent with the Annual Statement schedules or detail; description of the risks added to the reporting entity; associated fees recognized or deferred; amount, if any, of loss recognized; the reporting entity's judgment whether there has been material negative effect on the entity's financial condition; and the reporting entity's judgment whether there will be material negative effect on the entity's financial condition in subsequent reporting periods.

Preliminary Merger/Acquisition Negotiations

33. While the MD&A requirements could be read to impose a duty to disclose otherwise nondisclosed preliminary merger or acquisition negotiations, as known events or uncertainties reasonably likely to have material effects on future financial condition or results of operations, the NAIC does not intend to apply the MD&A in this manner. Where disclosure is not otherwise required, and has not otherwise been made, the MD&A need not contain a discussion of the impact of preliminary merger negotiations where, in the reporting entity's view, inclusion of such information would jeopardize completion of the transaction. Where disclosure is otherwise required or has otherwise been made by or on behalf of the reporting entity, the interests in avoiding premature disclosure no longer exist. In such case, the negotiations would be subject to the same disclosure standards under the MD&A as any other known trend, demand, commitment, event or uncertainty. These policy determinations also would extend to preliminary negotiations for the acquisition or disposition of assets not in the ordinary course of business.

Conclusion

34. In preparing the MD&A disclosure, reporting entities should be guided by the general purpose of the MD&A requirements: to give regulators an opportunity to look at the reporting entity through the eyes of management by providing a historical and prospective analysis of the reporting entity's financial condition and results of operations, with particular emphasis on the reporting entity's prospects for the future. The MD&A requirements are intentionally flexible and general. Because no two reporting entities are identical, good MD&A disclosure for one reporting entity is not necessarily good MD&A disclosure for another. The same is true for MD&A disclosure of the same reporting entity in different years. The flexibility of MD&A creates a framework for providing regulators with appropriate information concerning the reporting entity's financial condition, changes in financial condition and results of operations.