



State of New Jersey

DEPARTMENT OF BANKING AND INSURANCE

PO Box 325

TRENTON, NJ 08625-0325

TEL (609) 292-7272

CHRIS CHRISTIE
Governor

KIM GUADAGNO
Lt. Governor

THOMAS B. CONSIDINE
Commissioner

XXXXXXXXXX
XXXXXXXXXX.
XXXXXXXXXX

September 30, 2011

Re: 2011 3rd Quarter Dental Plan Organizations (DPO) Report Filings

Dear XXXXXXXX,

The 3rd Quarter reports shall be received in this office no later than close of business (5:00 P.M.) Tuesday, November 15, 2011 in accordance with Statutory Accounting Practices using the most current format for the quarterly NAIC Health blank, and in accordance with the NAIC quarterly instructions for the Health blank. Contact the NAIC directly at (816) 842-3600 if you require copies of the quarterly instructions. These instructions implement the requirements of the Accounting Practices and Procedures effective **January 1, 2011**. The NAIC Health blank forms are available for purchase through several independent insurance service companies throughout the United States.

The Commissioner of Banking and Insurance has the regulatory authority (N.J.A.C. 11:10-1.14(b)) to impose enforcement remedies against any DPO that fails to reply to any inquiry of the Commissioner or fails to file quarterly or annual reports pursuant to this subchapter shall be subject to penalties pursuant to N.J.S.A. 17B:21-2.

This letter is reasonable notice and any DPO that files late will be fined \$100.00 per day.

Please note that any additional or revised quarterly filing requirements are outlined in bold.

- (1) The following manuals should be obtained and maintained current:
 - (a) ANNUAL STATEMENT INSTRUCTIONS HEALTH MANUAL
 - (b) ACCOUNTING PRACTICES AND PROCEDURES MANUAL EFFECTIVE **JANUARY 1, 2011 (AS OF MARCH 2011)** THIS VALUABLE RESOURCE CONTAINS THE STATEMENT OF STATUTOY ACCOUNTING PRINCIPLES (SSAP), EXTRACTS FROM NAIC MODEL LAWS, INTERPRETATIONS OF SSAP, ISSUE PAPERS AND POLICY STATEMENTS OF THE NAIC
 - (c) PURPOSES AND PROCEDURES MANUAL OF THE NAIC SECURITIES VALUATION OFFICE (SVO)

These may be obtained from:
National Association of Insurance Commissioners
Publications Department
2301 McGee Street
Suite 800
Kansas City, MO 64108-2604
Telephone (816) 783-8300

Facsimile (816) 460-7593
Email www.naic.org/1pubcat/

- (2) Original signatures are required on all filings. The President and Secretary, or in their absence two principal officers must sign the quarterly statement. All requests for exceptions from normal filings must be submitted at least 30 days prior to the due date.
- (3) All DPOs are required to complete the blanks and supplemental schedules in their entirety. If a specific schedule is not applicable to the DPO that should be so indicated using "N/A" or "None". 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, per N.J.A.C 11:10-1.14(b) the Department may also impose the maximum penalties and enforcement measures available under statute for failure to file proper or timely financial statements.
- (4) The DPO shall segregate assets into categories of "Admitted Assets" and "Non-Admitted Assets". The later will be excluded by the Department in considering the DPO's minimum statutory net worth, solvency, and deposit requirements.

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

Note that SSAP#84"Health Care Receivables" should be reviewed for further guidance.

Guidance on allowable Goodwill can be found in SSAP #68.

- (5) All DPOs are required to comply with the requirements of N.J.S.A. 17B:20, regarding Investments.
- (6) A Management Discussion and Analysis (MD&A) letter. This letter is primarily a narrative document setting forth information which enables the Department to enhance its understanding of the DPO'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)
- (7) DPO Quarterly Supplement Attachments A, B, C, D and E.
 - (a) DPO Quarterly Supplement Attachment A which includes information regarding Restricted Deposits, General Surplus, and Special Contingent Surplus (if applicable).
 - (b) DPO Quarterly Supplement Attachment B which included projections versus actuals for **2011**.
 - (b1) If your DPO is not a separate legal entity in New Jersey, please provide a second Attachment "B" which reflects your New Jersey business only.
 - (c) DPO Quarterly Supplement Attachment C (Quarterly General Interrogatories)
 - Group Contracts
 - Group Enrollees
 - Non-Group Enrollees
 - Benefit Plans

Full Time Equivalent Dentists

- (d) DPO Quarterly Supplement Attachment D (Quarterly General Interrogatories)
Specialty Pools
- (e) DPO Quarterly Supplement Attachment E (Quarterly General Interrogatories)
Payments Withholds
- (8) All items must be identified. If you use the “other” category, please identify what is included in “other”.
- (9) All expenses paid to medical providers (including dentists) should be included on line #9 “Hospital/medical benefits” of the Statement of Revenue and Expenses. They should not be included on line #10 “Other Professional Services” or line #29 “Aggregate write-ins for other income or expenses”.
- (10) **All DPOs domiciled in New Jersey should check the “Other” box on the Jurat Page in the section, “Licensed as business type.” DPOs not domiciled in New Jersey are to check the box as directed by their state of domicile.**
- (11) MAILING ADDRESS

Every DPO shall submit four (4) signed copies of the Quarterly Report and DPO Quarterly Supplement Attachments A, B, and C 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

Contact me at (609) 292-5350 Ext. 50358 or e-mail me at richard.kartes@dobi.state.nj.us if you have any questions concerning this correspondence.

Sincerely,

Richard K. Kartes
Financial Analyst/Insurance Examiner
Health Entities Financial Operations
Office of Solvency Regulation

CC: Raymond K. Conover, Acting Assistant Commissioner /Chief Insurance Examiner
Steve Kerner, Assistant Chief Insurance Examiner
Frank J. Cipriani, Assistant Chief Insurance Examiner, Health Entities Financial Operations
Mary Pesce, Supervisor, Health Entities Financial Operations
Fred Berger, Financial Analyst/Insurance Examiner, Health Entities Financial Operations
Miriam Awad, Financial Analyst/Insurance Examiner, Health Entities Financial Operations
Kwame Asare, Supervisor, Office of Solvency Regulation

State of New Jersey



Department of Banking and Insurance

Dental Plan Organization (DPO) Supplement to the Quarterly Report of

(Name of DPO)

Address

For the Calendar Quarter Ended
September 30, 2011

Submitted By:

(Printed Name & Title of Responsible Financial Officer Completing Report)

(Original Signature of Officer)

(Date)

(Telephone Number)

(Fax Number)

(Email Address)

Name of DPO _____

For the Calendar Quarter Ended September 30, 2011

ATTACHMENT A

Restricted Deposit

Deposit Required Per NJAC 11:10-1.8(a)	Market Value of Deposit at 09/30/2011
\$50,000	\$ _____

General Surplus

General Surplus <u>required</u> per NJAC 11:10-1.8(a) 3, (the greater of \$100,000 or 1% of the current annual premium at 12/31/10).	\$ _____
General Surplus at quarter ended 09/30/11	\$ _____

Special Contingent Surplus (if applicable)

Special Contingent Surplus per NJS 17:48D-7 Full Time Equivalent Dentists (FTE) = _____	
Contingent Surplus quarter ended 09/30/11	\$ _____

Name of DPO _____

For the Calendar Quarter Ended September 30, 2011

ATTACHMENT B

2011 Actuals/Projections

(All costs in 000's)

	4th QTR "10" Actual	1st QTR "11" Actual	2nd QTR "11" Actual	3rd QTR "11" Projection	3rd QTR "11" Actual
Premium					
Other Income					
Total Revenue					
Primary Capitation					
Specialist Pool Exp.					
Total Medical Exp.					
Medical Loss Ratio					
Total Admin. Exp.					
Admin. Exp. Ratio					
Income/Loss					
Taxes					
Net Income/Loss					
Membership#					
Member Months##					
General Surplus					
Gen. Surp. Req.					
Restricted Deposits					
FTE Dentists (Prim)					
FTE Dent. (Special)					
Contingent Surp.					

Do not revise projections during the calendar year unless instructed to by the Department

- # At end of Quarter (Include both Employees and Dependents)
- ## Summary of members for all three months in the quarter . Member months exposed equals the sum of the number of months that each enrollee was covered during the quarter (e.g., if 100 enrollees were covered for 3 months and 50 enrollees were covered for 2 months, the total member months exposed would be 400 (100X3+50X2)).

Name of DPO _____

For the Calendar Quarter Ended September 30, 2011

ATTACHMENT C

DPO QUARTERLY GENERAL INTERROGATORIES

1. List the number of group and non-group contracts in force and the group and non-group enrollees at **09/30/10** and **09/30/11**:

Date	Group Contracts	Group Employees	Group Dependents	TOTAL Enrollees
09/30/11				
09/30/10				

Date	Non-Group Contracts	Non-Group Subscribers	Non-Group Dependents	TOTAL Enrollees
09/30/11				
09/30/10				

2. List in reverse chronological order how many types of benefit plans are being offered.

Quarter end	Benefit Plans
09/30/11	_____
09/30/10	_____
09/30/09	_____

3. In reverse chronological order, specify the number of “full-time equivalent dentists” (FTE) as defined at N.J.A.C. 11:10-1.3 under contract with the DPO at the end of the quarter specified.

Date	FTE
09/30/11 _____	
09/30/10 _____	
09/30/09 _____	

- Column 12 The actual percentage of the Withhold for the Quarter just ended (100% -(Column 10 divided by Column 8))
- Column 13 The percentage of the Withhold that will being used for the next Quarter

MANAGEMENT'S DISCUSSION AND ANALYSIS¹

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 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, *SFC 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 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. 5, 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, or 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.