



**STATE OF TENNESSEE  
DEPARTMENT OF COMMERCE AND INSURANCE**

**Insurance Division  
500 James Robertson Parkway  
Fourth Floor, Davy Crockett Tower  
Nashville, Tennessee 37243  
615-741-2176**

July 18, 2005

Robins H. Ledyard, Esq.  
Bass, Berry & Sims, PLC  
AmSouth Center  
315 Deaderick Street  
Suite 2700  
Nashville, Tennessee 37238-3001

**Re: Interpretive Opinion No. 02-05  
Valuation of Investment in a Wholly-Owned Subsidiary Insurance Company**

Dear Mr. Ledyard,

I have received your letter dated May 26, 2005, which makes a request for an interpretive opinion from the Insurance Division ("Division") of the Department of Commerce and Insurance ("Department"), pursuant to Tenn. Comp. R. & Regs. Tit. Dept of Commerce and Ins., ch. 0780-1-77-.01(1).

The facts, as understood by the Division, are as follows:

Protective Life Insurance Company ("Protective Life"), a Tennessee domestic life insurance company, owns all of the issued and outstanding shares of stock in Golden Gate Captive Insurance Company ("Golden Gate"), a special purpose financial captive company organized under the laws of the State of South Carolina. Also in the Protective Life group of companies are West Coast Life Insurance Company ("West Coast"), a Nebraska domiciled company, and Empire General Life Assurance Corporation ("Empire General"), a Tennessee domiciled company.

As represented, Golden Gate plans to accept 100% coinsurance on a significant portion of all the term life insurance produced by Protective Life, West Coast and Empire General. Golden Gate, in turn, would cede some assumed reinsurance to unaffiliated professional reinsurers in one or more monthly renewable term reinsurance transactions, resulting in Golden Gate holding all of the legal reserves on

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this entire block of ceded reinsurance business. Relevant to properly reserving for this block is the National Association of Insurance Commissioner's ("NAIC") Regulation XXX ("Reg. XXX"), effective in Tennessee through the codification process, which requires additional legal reserves on certain term insurance.

As part of its reinsurance program, Golden Gate will issue surplus notes [which had been referred to as "promissory notes" in certain correspondence between you and the Division, but which you confirmed would, in fact, be surplus notes] that are limited as to collectibility to the amount by which Reg. XXX legal reserves exceed marketplace estimates of economic reserves and would become collectible only as such legal reserves are released. Golden Gate's notes will be approved as to form by South Carolina's Director of Insurance prior to their issuance and such approval will be a condition to any payment of principal or interest on the notes or to any amendment of the notes. The notes would be payable initially to Lehman Brothers, and, in a subsequent securitization transaction, to one or more trusts. The notes or successor notes will serve collateral for obligations issued to unrelated investors, which will be guaranteed by an unrelated financial organization and will be rated Aaa (or AAA) by one or more nationally recognized statistical rating organizations by reason of such guarantee.

Protective Life expects to carry its investment in Golden Gate as an investment in subsidiary and to value it in the same amount as Golden Gate reports to South Carolina and other regulators and to the NAIC. It is expected that the issuance of such promissory notes will increase Golden Gate's surplus, and this will be recognized by Golden Gate in its financial statements. Protective Life will value its investment in Golden Gate as the smallest of: (A) Golden Gate's capital and surplus as reported to and accepted by its domiciliary regulator and other regulators and the NAIC; (B) the amount permitted by Tenn. Code Ann. § 56-1-405; or (C) the amount permitted by Tenn. Code Ann. § 56-3-303(b). If and to the extent that Tenn. Code Ann. §§ 56-1-405 or 56-3-303(b) may require, Protective Life will reduce the value of its investment in Golden Gate so as to limit its value to the amount Protective Life could make available for payment of losses, which would effectively involve reduction to reflect (A) any assets admissible under South Carolina law but not under Tennessee law as required by Tenn. Code Ann. § 56-1-405, and (B) Tennessee limitations on investments in subsidiaries set out in Tenn. Code Ann. § 56-3-303(b).

You opine that the above valuation method is the appropriate method under state insurance law, and ask the Division to confirm this opinion.

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**RESPONSE:**

Basic to the issue of the valuation of a subsidiary is Tenn. Code Ann. § 56-1-501(g) which requires insurance companies to prepare their financial statements in accordance with the NAIC's Accounting Practices and Procedures Manual. Of particular relevance is Paragraph 7b of Statement of Statutory Accounting Principle ("SSAP") No. 46 – *Investments in Subsidiary, Controlled and Affiliated Entities*, which provides for investments in insurance company subsidiaries to be recorded based on the underlying statutory equity of the respective entity's financial statements, adjusted for unamortized goodwill as provided for in SSAP No. 68 – *Business Combinations and Goodwill*. As such, the general method of valuing an insurance subsidiary is to value it based on the subsidiary's statutory equity of the subsidiary's financial statements. It is important to note that the Division, while giving deference to the South Carolina Insurance Director's determination of the application of the NAIC's Accounting Practices and Procedures Manual to Golden Gate, is not bound by any determination of the South Carolina Director and will make appropriate adjustments as it feels are necessary and proper under the Manual.

The analysis, however, does not stop with Tenn. Code Ann. § 56-1-501. Domestic life insurers are also required to comply with Tenn. Code Ann. § 56-3-303(b) in valuing their subsidiaries. This section states, in pertinent part, that:

(1) A domestic life insurance company at the time of original issue or at any other time may acquire one (1) or more subsidiaries, subject to the limitations in subdivision (b)(2). Such subsidiaries may conduct any kind of lawful business and their authority to do so shall not be limited by reason of the fact that they are subsidiaries of a domestic insurer. For purposes of this section, "subsidiary" means a corporation in which the insurer owns and holds more than fifty percent (50%) of the voting stock of the corporation.

(2) The acquisition of subsidiaries by a domestic life insurer shall be subject to the following:

(A) Except as provided in subdivisions (b)(2)(B) and (C), the aggregate amount that may be invested in subsidiaries in the form of common stock, preferred stock or debt obligations shall not exceed the amount by which the capital and surplus of the insurer exceed the minimum capital and surplus required to form a new company to do the kind or kinds of insurance business the insurer is authorized to transact in this state...;

(B) A domestic life insurer may invest in excess of the amount permitted in subdivision (b)(2)(A) in the common stock, preferred stock or debt obligations of one (1) or more investment subsidiaries, subject to the

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limitations in subdivision (a)(15) and, with the approval of the commissioner, a domestic life insurer may invest any amount in excess of the amount permitted in subdivision (b)(2)(A) in common stock, preferred stock or debt obligations of one (1) or more subsidiaries; provided, that after such investment, the insurer's surplus as regards policyholders shall be reasonable in relation to the insurer's outstanding liabilities and adequate to its financial needs;...

As the minimum amount of capital and surplus required of a newly formed insurance company is two million dollars (\$2,000,000) in this State pursuant to Tenn. Code Ann. §§ 56-2-215 and 216, Tenn. Code Ann. § 56-3-303(b) limits the amount that a domestic insurer like Protective Life may invest in its subsidiaries to its capital and surplus amount in excess of this two million dollars (\$2,000,000) requirement.

Lastly, Tenn. Code Ann. § 56-1-405 also provides guidance on how the law would allow a domestic insurer to value a subsidiary. This section states that:

The commissioner shall allow to the credit of an insurance company in the account of its financial condition only such assets as are or can be made available for the payment of losses in Tennessee, but may credit any deposits of funds of the company set apart as security for a particular liability, or any deposits of funds of the company that are deposited for the purpose of meeting the requirements for doing business in another state or commonwealth. The commissioner may, in the commissioner's discretion, disallow stockholders' obligations of any description as part of the assets or capital of any insurance company, unless secured by competent collateral.

This statute essentially allows the Commissioner to admit only those assets which are deemed to be available for the payment of losses to Tennessee policyholders. For instance, this section provides the Division the authority to non-admit the goodwill which would be otherwise allowed for under SSAP 46, and it is the Division's policy to utilize this authority to non-admit such goodwill. Thus, if it were to be determined that an investment in a subsidiary was not an asset that was or could be made available for the payment of losses in Tennessee, the Division would non-admit the asset.

It is the analysis described above that the Division will use to determine the appropriate valuation of Golden Gate by Protective Life. As such, and in conclusion, therefore, it is the opinion of the Division that Protective Life must value its investment in Golden Gate as the smallest of: (A) the underlying statutory equity of Golden Gate's financial statements, adjusted for unamortized goodwill pursuant to Tenn. Code Ann. § 56-1-501(g); (B) less any amounts over the limits prescribed by Tenn. Code Ann. § 56-3-303(b); and (C) less any amount not available for the payment of losses in this State as required by Tenn. Code Ann. § 56-1-405.

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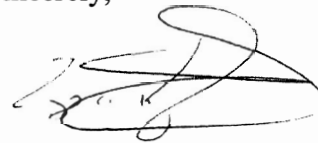
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This response by the Insurance Division to a specific fact situation relating to the interpretation of Tennessee Insurance Law should not be construed as a legal position or opinion of the Commissioner of Commerce and Insurance or any other official in the Department of Commerce and Insurance. As each inquiry is reviewed on the specific facts presented, this response is based only on such facts and may not be used as precedent. Any variation in the facts presented to the Insurance Division could result in a different conclusion as asserted herein.

Sincerely,

A handwritten signature in black ink, appearing to read "Larry C. Knight, Jr.", with a large, stylized flourish at the end.

Larry C. Knight, Jr.  
Assistant Commissioner for Insurance

LCK/jfm

cc: Paula A. Flowers, Commissioner  
Kathy Fussell, Insurance Analysis Director  
John F. Morris, Chief Counsel for Insurance  
Eric Stansell, Staff Attorney