# New York DFS Issues Guidance Regarding Transactions with New York Insurers with Broad View of Potential Control Issues

**April 20, 2022**

Yesterday, the New York Department of Financial Services ("DFS") issued a Circular Letter to all New York domiciled insurers and other interested parties regarding how DFS is viewing certain transactions with insurers and what constitutes "control" of an insurer by another party under the New York Insurance Law ("NYIL"). Circular Letter No. 5 (2022) (Acquisitions of Control and Disclaimers of Control) (the "Circular Letter") may be viewed here.

Whether a party controls or will control (including exercising a controlling influence over) a New York domiciled insurer is significant because the NYIL requires, among other things, prior approval by the Superintendent of Financial Services (the "Superintendent") under § 1506 before a party acquires such control. Other states have substantially similar laws regarding acquisitions of control of insurers domiciled in their states.

DFS uses Circular Letters to provide guidance regarding how it interprets existing law and regulations, to address issues DFS sees in or related to the insurance industry and to clarify DFS's expectations. In this case, DFS states that it "wishes to remind industry participants of the requirements of the [NYIL] and [DFS]'s expectations given the apparent misconception in the marketplace and the recent increase in insurance company transactions."

In the Circular Letter, DFS explains what it means to "control" a New York domestic insurer under the NYIL, emphasizing the following:

- A determination of "control" depends on all the facts and circumstances.

- "Control" may exist even if the statutory presumption of control (which is based on 10% or more of the insurer's voting securities, as described below) is not met. DFS states that "this presumption does not create a safe harbor for acquisitions below the 10% threshold, which may still result in a control determination."

- Rather, "a control relationship can arise from a contract or other factors, in the absence of any ownership of voting securities of an insurer." (Emphasis added.)

- Although § 1501(a)(2) states that "no person shall be deemed to control another person solely by reason of [their] being an officer or director of such other person," (emphasis added), "these facts may, in combination with other factors, lead to a control determination."

- Transactions raising potential control issues "includ[e], but [are] not limited to, transactions involving the acquisition of an insurer's voting securities by, the grant of a board seat to, or a new contractual relationship with, a transaction counterparty, or any combination of these factors."

- DFS urges parties contemplating a transaction that raises potential control issues (described very broadly as quoted above) "to engage with [DFS] as early in the transaction structuring process as practicable, even if the parties believe that such transaction will not give rise to a control relationship, to give [DFS] a reasonable opportunity to review the transaction and the parties' position."

## "Control" and the Holding Company System Framework under the NYIL

Under NYIL § 1501(a)(2):

> "Control," including the terms "controlling," "controlled by" and "under common control with," means the possession direct or indirect of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract (except a commercial contract for goods or non-management services) or otherwise; but no person shall be deemed to control another person solely by reason of [their] being an officer or director of such other person.

Some of the terms used in the definition are defined further.

- "'Voting securities' means securities of any class or any ownership interest having voting power for the election of directors, trustees or management of an institution, other than securities having such power only by reason of the happening of a contingency." NYIL § 107(a)(45).

- "'Person' means an individual, partnership, firm, association, corporation, joint-stock company, trust, any similar entity or any combination of the foregoing acting in concert." NYIL § 1501(a)(1).

### The Rebuttable Presumption of Control

Subject to NYIL § 1501(c), a "person" (which, as noted, includes a combination of parties "acting in concert") is presumed to control an insurer if such person "directly or indirectly owns, controls or holds with the power to vote ten percent or more of the voting securities of any other person." NYIL § 1501(a)(1). Section 1501(c) permits a person to apply to the Superintendent for a determination that the person "does not or will not upon the taking of some proposed action control another person" (commonly referred to as a "disclaimer of control"). Even if the Superintendent approves such an application, she "may prospectively revoke or modify [her] determination, after notice and opportunity to be heard, whenever in [her] judgment revocation or modification is consistent with . . . [A]rticle [15 of the NYIL]."

### Controlling Influence

The Circular Letter points out that NYIL § 1501(b) provides that the Superintendent may find a "controlling relationship" "after notice [to the party] and [an] opportunity to be heard," without the presumption of control described above being triggered. The law states:

> Notwithstanding the provisions of [§ 1501(a)(2), which defines control and describes the presumption of control], the [S]uperintendent may determine, after notice and opportunity to be heard, that a person exercises directly or indirectly either alone or pursuant to an agreement with one or more other persons such a controlling influence over the management or policies of an authorized insurer as to make it necessary or appropriate in the public interest or for the protection of the insurer's policyholders or shareholders that the person be deemed to control the insurer.

This little-cited section of the statute could have enormous implications as companies seek to negotiate their contractual obligations based on their business goals and whether they intend to enter into a control relationship.

## Significance of Being a Control Person to an Insurer or under Common Control

Although the Circular Letter explicitly discusses NYIL § 1506 (acquisitions of control), § 1501(c) (disclaimers of control) and § 1510 (violations), there are other consequences to

being a control person of a New York domiciled insurer. For example, the definitions of "controlled insurer," "controlled person," "holding company" and "holding company system" depend upon control determinations, with certain implications.

Notably, the Circular Letter also lists NYIL § 1505 in its statutory references. Among other things, NYIL § 1505 provides requirements for transactions within a holding company system to which a controlled insurer is a party (§ 1505(a)) requires prior approval by the Superintendent for certain transactions (§ 1505(c)), and requires notice for certain for other transactions (§ 1505(d)).

Additionally, although not cited, being a control person to a New York domiciled insurer also would have other implications, including, but not limited to, the insurer's registration statement under NYIL § 1503 and 11 NYCRR 80-1.4, reporting by the insurer and DFS's examination powers over controlled persons in a holding company system under NYIL § 1504, prohibitions of indirect action by a holding company or controlled person that would violate certain sections of the NYIL if done by the controlled insurer and financial statement reporting.

## Conclusion

The Circular Letter does not change applicable law or regulations but instead sets forth DFS's interpretations and expectations. Although transparency to regulators is advisable generally, DFS clarifies that it expects to be consulted "even if the parties believe that such transaction will not give rise to a control relationship" and urges doing so "as early in the transaction structuring process as practicable . . . to give [DFS] a reasonable opportunity to review the transaction and the parties' position." Accordingly, it may be advisable for a New York domestic insurer and its potential counterparties to a transaction to consult with DFS before signing agreements. If parties choose not to do so, it may be advisable to build in mechanisms for potential later restructuring of a transaction upon later disclosure (beyond customary conditions that the transaction is subject to any necessary regulatory approvals). Although in some cases acquiring control and the consequences are sequential, it is also common in corporate transactions to enter into several related agreements simultaneously. Whether control will be attained based on the total facts and circumstances may affect the sequencing and approvals or notices required for various parts of the transaction.

We note that this guidance may cause uncertainty and significantly more submissions to DFS for the avoidance of doubt, so we advise parties to take that into account in their timing expectations.

We are prepared to help clients in interpreting the Circular Letter, including with respect to existing relationships that may fall within the scope of the guidance.

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Please do not hesitate to contact us with any questions.

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