

CLIENT UPDATE

CITING PRIVATE EQUITY CONCERNS, NEW YORK DEPARTMENT OF FINANCIAL SERVICES PROPOSES INCREASED SCRUTINY AND DISCLOSURE FOR ACQUISITIONS OF NEW YORK DOMESTIC AND COMMERCIALY DOMICILED INSURERS

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On May 14, 2014, the New York State Department of Financial Services (NYDFS) proposed an amendment to the regulation that sets forth the filing and other regulatory requirements for the acquisition and retention of control of New York domestic and commercially domiciled insurers that includes specific requirements directed at acquisitions by private equity firms and other similar investors. In the regulatory impact statement that accompanies the proposed changes, the NYDFS stated that the changes reflect the NYDFS' concern that private equity firms and other similar investors have a "focus on maximizing their short-term financial returns rather than ensuring that long-term policyholders receive the insurance benefits for which they have paid." The NYDFS went further to state their concern that the short-term focus may lead to "an incentive to increase investment risk and leverage in order to boost short-term returns."

The proposed amendment would, among other things, in connection with applications to acquire control of New York domestic and commercially domiciled insurers:

- Require disclosure of information about general partners and managing members of limited partnerships, limited liability companies or similar entities, including the agreement whereby such an entity controls the limited partnership or limited liability company, e.g., management agreement, limited partnership agreement, etc.;

- Require disclosure of materials used to solicit investors in the acquisition vehicle, including any offering memoranda or disclosure statements;
- Require a description of any plans within the next five years to sell the insurer’s assets, merge the insurer, declare a dividend, change the investment portfolio of the insurer or make any other changes in the insurer’s business operations or corporate structure, with any changes to such plans requiring the NYDFS’ prior approval;
- Require a submission of new five-year financial projections if, following the change of control, the insurer enters into any reinsurance or investment transaction with an affiliate or any transaction with or for the benefit of an affiliate that encumbers the insurer’s assets, and if the NYDFS finds that the projections do not show that the insurer will have adequate capital, the procurement of additional capital by the insurer; and
- In connection with an acquisition of a life insurer, give the Superintendent discretion to require the acquirer to establish a trust account for the benefit of the target insurer in an amount and for a duration that would cause, in the opinion of the Superintendent, the acquisition not to be “hazardous or prejudicial to the insurer’s policyholders or shareholders.”

The requirements of the proposed amended regulation would apply to all applications for control, but many of them are similar to those that the NYDFS imposed in the last year on private equity firms (or similar entities) that acquired a controlling interest in a New York insurer, including the establishment of a trust. In exercising discretion whether to require a trust account, the Superintendent would be authorized to consider whether the applicant is “a company primarily engaging in investing or investment management activities” or similar entity.

The proposed changes to the regulation were published in the New York State Register, and are currently in a 45-day comment period (see “Proposed Fifth Amendment to Regulation 52” <http://www.dfs.ny.gov/insurance/rproindx.htm>).

The NAIC has also been deliberating whether the acquisition of insurers by private equity firms warrants heightened scrutiny, having established a working group to examine the issue late last year. The working group most recently directed NAIC staff to develop guidance for state insurance regulators regarding such acquisitions, but the working group has not yet proposed any changes to existing law, regulation or regulatory guidance.

We will continue to monitor these developments and provide updates as appropriate.

If you would like more information on these or other topics of interest, please contact the undersigned or any insurance industry lawyer at Debevoise & Plimpton LLP.

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Please do not hesitate to contact us with any questions.

May 20, 2014