Client Update
Connecticut Adopts Act Authorizing Domestic Insurers to Divide

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On May 3, 2017, the Connecticut state Senate unanimously (except for those absent) passed the amended HB 7025, "An Act Authorizing Domestic Insurers to Divide." The amended HB 7025 was already unanimously (except for those absent) passed by the Connecticut state House of Representatives on April 5, 2017 and was automatically enacted into law on May 8, 2017 when Dannel Malloy, the Governor of Connecticut, did not sign or veto the bill within five days of its passage. This new law will take effect October 1, 2017.

HB 7025 sets forth a process by which a domestic insurance company (the "dividing insurer") may divide into two or more insurance companies (the "resulting insurers"). It is based in part on a Pennsylvania division statute, P.A. Bus. Corp. Law § 1951. The Pennsylvania statute was used most notably in 1996 by Cigna to divide the business of its Insurance Company of North America ("INA") unit, with a newly formed entity known as Brandywine assuming certain run-off blocks of business, while INA continued to write new business.

Connecticut's new division statute may prove to be a valuable tool for Connecticut domiciled insurance companies. It could be used to isolate a block of business for sale to a third party in a transaction that without the statute could only be accomplished through reinsurance. It could also be used by a company to separate its active book of business from a troubled run-off block, potentially improving the capital position and credit rating of the active company.

PLAN OF DIVISION

Before effecting a division, the dividing insurer must develop a plan of division to be filed with the Connecticut Insurance Department that sets forth, among other things:

- the manner of allocation of the dividing insurer's property if not owned by the resulting insurers as tenants in common;
- the manner of allocation of the dividing insurer's policies and other liabilities if not all the resulting insurers will be jointly and severally liable;
- the manner of distribution of the resulting insurers' interests or shares among the dividing insurer and its shareholders/interestholders;
- a reasonable description of the allocation of the dividing insurer's policies and other liabilities, capital, surplus or other property that will be allocated to each resulting insurer (including allocation of reinsurance contracts); and
- additional information based on whether the dividing insurer will survive the division (*e.g.*, the manner of the conversion or cancellation of the dividing insurer's interests, if applicable).

The plan of division can be dependent on facts "objectively ascertainable outside the plan" pursuant to Connecticut law.

INTERNAL AND THIRD-PARTY APPROVALS

Before the plan of division can be effected, it must be approved internally according to the organizational documents of such dividing insurer.

The dividing insurer's shareholders/interestholders do not necessarily need to approve the plan of division unless (i) required by the dividing insurer's organizational documents, (ii) required by the plan of division, (iii) the dividing insurer will be dissolved and the resulting insurer's shares will be owned solely by the dividing insurer or (iv) the dividing insurer has one class of interests outstanding and the resulting insurers' interest will not be distributed to the dividing insurer's shareholders/interestholders.

If the dividing insurer's organizational documents do not specify a process (*e.g.*, percentage of shareholder/interestholder vote required) for approval of a plan of division and were adopted before October 1, 2017, then the provisions setting forth approval of a merger apply to approval of a division. Additionally, if any debt or any provision of any other contract (other than an insurance policy, annuity or reinsurance agreement) entered into before October 1, 2017 requires consent to a merger, the division is treated as a merger for the purposes of the required consent. For reinsurance contracts, the dividing insurer must give notice within 10 business days after filing its plan of division to its reinsurers that are parties to reinsurance agreements allocated under the plan of division. It is not clear whether the provisions of the statute regarding contract

interpretation will be given effect where contracts are not governed by Connecticut law.

DEPARTMENT APPROVAL

After approved internally, the plan of division must be submitted for approval by the Connecticut Insurance Department. The commissioner of the Department may require reasonable notice and a public hearing if the commissioner deems that such notice and hearing are in the public interest. The commissioner has grounds for disapproval of a plan of division if:

- the interest of any policyholder or interestholder will not be adequately protected; or
- the proposed division constitutes a fraudulent transfer under the state Uniform Fraudulent Transfer Act.

The commissioner may not approve a plan of division unless the commissioner has issued licenses to the resulting insurers (although such licensure requirements may be waived for any resulting insurer that is immediately merged out of existence into a Connecticut domestic insurance company).

If approved, the commissioner will issue a certificate of approval and the dividing company must execute and file a certificate of division.

WHAT NEXT?

While the new division statute could become a popular alternative for Connecticut domestic insurance companies to segregate books of business, it remains to be seen whether insurers will take advantage of it. A newly created resulting insurer would in most cases need to be licensed in any state where it has policyholders. As a practical matter, this would most likely be achieved by merging the new insurer with a widely licensed insurance company, perhaps a shell company acquired for that purpose or perhaps an insurance company owned by the buyer if the division is part of a larger acquisition transaction. The statute expressly contemplates merger with another Connecticut domestic, but a merger with a foreign insurance company would be possible as well (although the company would not then be exempted from the requirement that it obtain a Connecticut license as part of the division process, even if its merger partner is already licensed in Connecticut).

There are other questions regarding how a division would work in practice, including the reaction of other states in which the resulting insurer has policyholders, corporate and contract law questions, the level of capitalization

and other conditions that Connecticut will require for a run-off company and the interplay with fraudulent conveyance and other insolvency laws. Once tested, however, it is possible that divisions will become a common practice and similar laws may be adopted by other states.

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Please do not hesitate to contact us with any questions.