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Insurance Company Acquisitions: Legal Considerations in New York State

In general, when one company wants to take over another company's business, it is assumed that the company will purchase the stock or assets of the other party. In a typical transaction, after considering matters such as the liabilities of the target company and the tax impacts of a structure, the parties negotiate whether an asset or stock deal is appropriate and then enter into an agreement.

For New York insurance companies, however, the analysis is often not so straightforward. Under the New York Insurance Law and related regulations, there are numerous obstacles which may impede one insurance company's ability to acquire another insurance company's stock or assets. In many cases, it is not possible for one insurance company to buy the stock or assets of another insurance company unless additional steps are taken or an alternative acquisition structure is used.

As an initial matter, under the New York Insurance Law, companies are typically prohibited from entering into fundamental transactions with dissimilar entities. For example, the law provides that, in general, a stock company may only merge or consolidate with another stock company or a reciprocal insurer and expressly

provides that a stock insurer may not merge with a mutual company. In addition, an assessment co-operative may only merge with another assessment co-operative (provided it is licensed to do business either wholly or substantially in a common territory of New York) and an advance premium co-operative may only merge with another advance premium cooperative. In addition to these restrictions, New York law provides that a domestic insurance company can only merge or consolidate with a foreign company if such company is authorized to do business in New York and the laws of the state in which the foreign company is domiciled permit such a merger or consolidation.

To overcome these restrictions, an insurance company may elect to

convert into a different type of entity, to the extent conversion is permitted under the New York Insurance Law. For example, the law provides:

- An assessment co-operative can convert to an advance premium co-operative (but not the reverse);
- An assessment or advance premium co-operative can convert to a mutual property/casualty insurance company, provided the converting company has in force insurance policies a mutual insurer is authorized to write covering not less than 300 separate risks and on which the premiums in force or the most recent annual assessment aggregates not less than \$100,000;
- A mutual property/casualty insurance company previously organized as an advance premium or assessment co-operative can re-convert to an advance premium or assessment co-operative, provided the converting company has in force insurance policies a co-operative is authorized to write covering not less than 300 separate risks and on which premiums in force aggregate not less than \$100,000;

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- A mutual property/casualty insurance company or advance premium cooperative can convert to a stock property/casualty insurance company; and
- A reciprocal insurer can convert to a stock property/casualty insurance company or a mutual property/casualty insurance company, provided (in the case of a conversion to a mutual company) that the converting company has in force insurance policies a mutual insurer is authorized to write covering not less than 300 separate risks and on which premiums in force aggregate not less than \$150,000.

Based on the above, if a New York mutual property/casualty insurance company wants to merge with a New York stock property/casualty insurer, it could not do so directly. Rather, it could only accomplish such a merger by first converting to a stock property/casualty insurance company.

Prior to merging, consolidating or converting, an insurance company should evaluate the following:

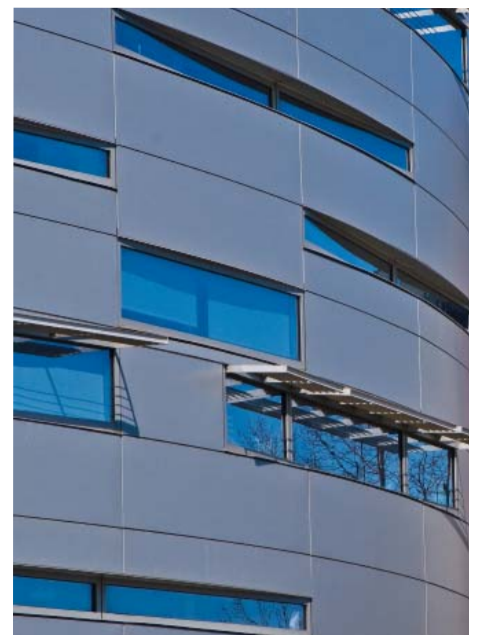
- Consider the impact of the proposed transaction on the financial well-being of the surviving entity, keeping in mind that the New York Insurance Department must provide its prior approval with respect to such transaction and will not provide approval unless it deems that the transaction is in the best interest of New York policyholders and the public. Moreover, the insurance department governing any foreign entity involved with the transaction will also need to provide its prior approval, taking into account similar considerations.
- What is the regulatory climate of the state in which the survivor is located?

How often are examinations conducted and how much do they cost? Are regulators accessible and responsive? Are insurance companies heavily taxed, assessed or fined? What is the origin of such assessments or fines? Does the state require the making/establishment of any trusts or deposits or require membership in any organizations?

- Consider the pros/cons of the regulations applicable to the surviving entity. For example, is the surviving entity subject to premium taxes, management expense limitations or investment limitations? What is the nature of such limitations and will the surviving entity be able to comply? Will all desired directors be able to serve on the survivor's board? Is the surviving entity permitted to write business outside of specified territories? Does the primary office of the surviving entity need to be located in the domiciliary state?
- The surviving or consolidated company must have the requisite capital and surplus required to write its proposed lines of business. In order to determine the amount of capital and surplus that will be required, the surviving company will need to determine what lines of business will be written. Once a company determines what lines of business the surviving or consolidated company intends to write, it is always a best practice to call the applicable insurance department to confirm any calculation relating to minimum capital or surplus. In addition, it is important to note that certain kinds of insurance companies can only write certain lines of business under applicable law.
- Under New York law, in the case of a stock company, the transfer must be ap-

proved by the Board of Directors and by votes representing at least 2/3rds of all of the shares. Correspondingly, under New York law, mergers or consolidations involving mutuals and co-operatives only need to be approved by the Board of Directors and 2/3rds of all the votes cast by members represented at the meeting in person or by proxy.

- Consider potential tax implications. For example, what happens to any net operating losses when one company merges with another? Will the merger, consolidation or conversion be a taxable event?
- Consider reinsurance implications in light of existing and future agreements. In general, an entity can only reinsure the types of risks similar to those that it can insure directly. Also, if the surviving entity is domiciled in New York and will be part of a reinsurance pool, it will in most cases not be able to take credit for insurance ceded to other entities in the pool unless such entities are licensed or accredited in New York.
- Consider the implication of a merger, consolidation or conversion on premiums/rates and policy forms.



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- Consider the desired timeframe for effectuating a merger, consolidation or conversion, keeping in mind that it may take a long time to complete such a transaction. Keep in mind that a mutual or advance premium co-operative insurance company converting to a stock insurer pursuant to Section 7307 of the New York Insurance Law will be restricted for 10 years from re-domesticating directly or indirectly or from moving its principal office out of the state.
- In the case of a mutual insurer or advance premium co-operative seeking to convert into a stock company, is the company affiliated with other mutual or co-operative companies? If so, such affiliates may also need to be converted to stock companies as required by Section 7307 of the New York Insurance Law.

Given the above, insurance companies often decide not to pursue a merger, consolidation or conversion. In such an event, a company should consider whether it can acquire the book of business of another insurance company through another transactional structure. For example, under New York law, an insurance company may acquire de facto control of another company by providing the target with a surplus loan, in exchange for which the other party will enter into an affiliation agreement whereby the acquiring company will have the ability to control the target's board and to otherwise control its policies and procedures. The use of a surplus loan is particularly attractive to mutual and co-operative insurance companies in that a surplus loan allows the company receiving the loan to increase its capital by treating the loan

as equity on its statutory balance sheet rather than debt, thereby increasing its statutory surplus. Before entering into such an arrangement, the parties will need to consider:

- The impact of making a loan on the financial well-being of the party making the loan.
- Reinsurance implications such as those specified above.
- Whether the state of formation of the controlled company will permit directors from the controlling company to serve as directors of the controlled company.
- Whether the surplus loan would be treated as debt or equity for federal tax purposes, and the tax consequences of such treatment.
- Under what circumstances the surplus loan will be allowed to be repaid under applicable law. In New York, principal and interest cannot be repaid without departmental approval.
- The creation or alteration of a holding company system and resultant Form B filings.

In addition, it may be possible to acquire another insurance company's book of business through other mechanisms, such as the use of a renewal rights agreement, subject to regulatory approval.

Developing an appropriate acquisition structure requires careful consideration of immediate and prospective concerns, keeping in mind that the surviving company will want to continue to grow its business in the future and will not want to be subject to burdensome regulatory restrictions. ■