

Heavy Regulation Skews Insurance M&A In Targets' Favor

By Karlee Weinmann

Law360, New York (May 02, 2014, 11:33 AM ET) -- A rival's hostile \$3.2 billion bid for Aspen Insurance Holdings Ltd. recently became the latest in what attorneys expect to be a robust deal-making run in the insurance sector. But despite swirling interest, buyout plays — especially unsolicited ones — face a rocky path to approval in one of the most heavily regulated corners of the marketplace.

Last month, Endurance Specialty Holdings Ltd. became one of relatively few strategic suitors in the insurance space to angle for a hostile takeover. Aspen immediately rejected the proposal and days later adopted a poison pill to insulate itself from unwelcome overtures, piling onto the implicit protections that complex regulatory regimes in the U.S. and Europe offer to insurance-industry targets.

In the U.S., strict oversight on the state and federal levels kicks in when a party tries to make a relatively nominal stock purchase — generally 10 percent. The threshold for regulatory scrutiny is far lower than for other types of businesses, a safeguard for policyholders against changes that could threaten their coverage.

"That's a very significant element that you wouldn't have in an unregulated industry," said Larry Hamilton, a Mayer Brown LLP partner who works in the firms' corporate and insurance groups.

Even in a friendly deal, it only gets more complicated from there.

Comprehensive, state-specific requirements for pitching a transaction to regulators is a costly process that demands time, energy and highly specific plans for the target company's future under new ownership.

"You could get a big M&A deal done in 30 to 40 days," said Eddie Best, another Mayer Brown partner with insurance deal-making experience. "In the insurance sector, if you can get a big deal done in three months, you're a hero. In six months, you've done a good job."

Across the board, state regulators require wannabe buyers to submit a form that extensively details a target company's prospective new structure plus a wealth of information about incoming directors and officers' backgrounds. The document, to be filed in each state where the target company has subsidiaries, steers watchdogs' evaluations and in some cases serves as a backdrop for public meetings.

The form's comprehensive nature and the dialogue it triggers between the deal parties and regulators provides a target breathing room that it would not ordinarily have in other industries — especially with

unsolicited offers. It also essentially demands that acquirers take on the tough task of preemptively addressing potential future issues that could arise, an especially cumbersome process for hostile bidders.

"Going in there as a hostile acquirer and not having done due diligence on the target makes it extremely difficult to put forth plans for the operations of the business that a regulator would expect to see when they're going to approve an acquisition," said Marilyn Lion, a Debevoise & Plimpton LLP partner who focuses on transactions in the insurance industry.

The sprawling regulatory overlay that covers the insurance sector in the U.S. and much of Europe means that a target's management team will almost always have a well-developed relationship with the agencies that oversee its operations — and its prospective M&A activity — that could give it an edge in the face of an unwanted offer. Familiarity between regulators and its top executives provides the target a platform to air its views on a deal proposition, for better or worse.

"It certainly adds arrows to their quiver. It certainly gives them added defensive maneuvering," Best said. "It throws in an extra layer of noise and in some cases substance."

Although an unsolicited offer is guaranteed to hit roadblocks throughout the approval process, such an approach is not necessarily doomed.

Lengthy conversations with regulators mean deeper insight into the details of a takeover proposal and also give companies time to familiarize themselves with the plans and each other. More breathing room could help a target cozy up to the idea of a sale, even after a knee-jerk refusal to pursue a transaction.

Several hungry buyers — notably including American International Group Inc. in its successful takeover of American General Corp. — have used a hostile approach as a springboard to boardroom meetings, eventually pinning down negotiated deals.

"I think that it's a tool, especially now when we have an M&A market that's becoming more active and a consolidating market, in some cases," Lion said. "Once there's been some unsolicited proposal or other types of shareholder activism, I think that has a fairly good chance of turning into a negotiated deal."

Still, regardless of whether a target backs its sale, built-in barriers to the massive regulatory framework that governs the insurance sector are guaranteed to pose substantial challenges.

Striking a balance between the best interests of policyholders and other stakeholders in a company can test attorneys' prowess in navigating a deal-making process made murky by pervasive regulation, where even basic considerations can be thrown in flux.

"Closing certainty for any M&A transaction is vitally important," said Sean Keyvan, who heads the insurance M&A group at Sidley Austin LLP. "With an insurance deal, the fact that the closing of the transaction is contingent on the approval of a powerful regulator with a great deal of discretion, creates uncertainty."

Politics can also figure into the review process, an important aspect to consider when mapping out the contours of a deal.

Beyond the financial framework for a transaction, regulators will also want to know how far the human

effects of a proposed deal reach, particularly when it comes to the target company's workforce in the watchdog's home state. Concerns about job cuts or unhappy workers could raise red flags above the agency's pay grade, casting interference from top state officials as a real — but unwelcome — prospect.

With the added complexity intrinsic to the insurance industry comes more openings for creative deal making.

Insurance M&A offers additional tools, for example the opportunity to explore alternative structures using reinsurance or other industry-friendly financing elements to drum up regulatory support and conquer the comparatively harsh deal approval process. But there's one theme woven throughout any successful transaction, Keyvan said.

"In negotiating an insurance deal, not only do you have to approach it from the perspective of what makes sense for the parties, but you also have to think about the perspective of another constituent that is not at the negotiating table," he said. "In the back of your mind, you always have to consider how the structure and deal terms are going to be perceived by the regulator."

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