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NY Regulators Could Throw Wrench In PE Insurance Deals

By **Kaitlyn Kiernan**

Law360, New York (August 26, 2014, 3:44 PM ET) -- The already tepid market for insurance company deals could come to a screeching halt by the end of the year if New York's insurance commissioner pushes forward with new regulations that could drive away private equity investors, some experts say.

Proposed changes to the New York Department of Financial Services Regulation 52 — which lays out information the department requires as it considers Form A applications for approval of insurance company buyouts — would increase the burden of the pre-deal approval process while also extending regulatory authority with regard to post-takeover plans.

"There have been a number of comments from the insurance law committee of the New York City Bar expressing concern that these amendments would change the scope of the pre-acquisition approval process and leave it vulnerable to post-acquisition micromanaging of insurers by the department," said Lawrence R. Hamilton, a partner with the corporate and securities practice and insurance industry group at Mayer Brown LLP.

Benjamin Lawsky, the superintendent of New York's Department of Financial Services, has been pushing for these changes that some say could drive away private equity buyers at a time when the insurance sector is increasingly looking to step up M&A activity.

The current iteration of Regulation 52 "has worked well for traditional takeovers," said Elisabeth Curzan, counsel with the insurance regulation practice at Nelson Brown Hamilton & Krekstein LLC. "But there has been a trend over the last few years with private equity firms taking over insurance companies — particularly life insurers — and the old structure doesn't work as well for these alternative investors."

The proposed changes to New York's Regulation 52 would also require potential buyers to file five-year financial projections for the target insurer, as well as detailed plans of operations, including any plans to declare dividends or to change the insurer's investment portfolio. And the catch: Those plans can't be changed — even post-closing — without regulatory approval.

That level of oversight of the post-closing private equity management could drive away private equity investors who are used to having a high degree of control, experts say. It would remove some of the firm's flexibility in responding to underperformance or other obstacles.

With the average U.S. private equity firm investment holding period hovering right around five years, the new rules would mean most private equity firms would be restricted for the duration of their ownership.

“If you want to stay out of the public eye as you overhaul a company, this probably isn’t the right investment for you,” said Curzan, who expects the changes to deter many private equity investors.

Still, she said, she sees why regulators want to make these changes.

“There have been some pretty spectacular instances of an insurance company being taken over and then looted,” Curzan said, citing the example of Martin R. Frankel, who was sentenced to more than 16 years in prison for causing more than $200 million in proven losses to insurance companies he bought through his Thurnor Trust.

“The fund might have a five-year horizon, but a 65-year-old retiree might be counting on an annuity to support her until she’s 90,” Curzan said. “Those are the interests they are trying to balance.”

But even private equity firms that could stomach the loss of some future freedom in the management of an insurance portfolio company might be turned off by another onerous aspect of the proposed changes: that they are required to set up a trust account should regulators deem a takeover potentially risky for a company’s insureds.

Under the proposed changes, a buyer could be required to set up a trust “in an amount and for a duration to be determined by the superintendent if the superintendent determines that, absent such action, the acquisition is likely to be hazardous or prejudicial to the insurer’s policyholders or shareholders.”

For private equity firms, where every uninvested dollar can weigh on future returns, that requirement could be a burden.

“Capital efficiency and use of capital is pretty important to private equity,” Hamilton said. “A requirement to put aside money in a trust could change the economic calculus of a proposed investment.”

But it isn’t just private equity firms targeting a total buyout that would be subject to the added oversight. Anyone looking to acquire control of an insurance company domiciled in New York must file for New York DFS approval. And control is defined quite loosely at anything more than a 10 percent voting stake.

Moreover, a widespread workaround to the 113-year-old New York DFS Appleton Rule — which requires insurance companies merely licensed in New York to adhere to New York regulations in all states in which they do business — leaves many insurance companies, including those not headquartered in New York, subject to the changes.

For years, insurers looking to skirt Appleton oversight have set up a separate entity that only does business in New York to register in the state. But a side effect of that structure is that anyone looking to buy out the parent company must apply for approval from regulators in both the state in which the parent is headquartered and in New York.

The proposed changes aren’t yet finalized, but Hamilton said he expects to see something final by the end of this year or early in 2015.

“Superintendent Lawsky sees himself very much as the person who is policing the industry for the benefit of policyholders, so I anticipate we’ll see something similar to the proposal promulgated as a regulation,” he said.

--Editing by Jeremy Barker and Philip Shea.
