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HSR Premerger Notification In The Insurance Industry

Law360, New York (January 27, 2010) -- Mergers and acquisitions involving insurance and reinsurance companies are often complex. Depending on the structure and scope of the deal, such transactions can trigger filing requirements under the premerger notification program created by the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended ("HSR Act").

The applicable rules are complicated, and typically bear little or no relationship to whether the transaction at issue is likely to present substantive antitrust concerns.

This article first provides a brief overview of the HSR Act reportability rules, and then discusses in detail how these rules apply to insurance and reinsurance transactions.

Particularly in the insurance context, HSR rules are full of traps for the unwary, so counsel involved in planning M&A transactions need to proceed cautiously.

What Is Hart-Scott-Rodino?

The HSR Act, 15 U.S.C. § 18a, requires that parties to certain mergers or acquisitions notify the Federal Trade Commission and the U.S. Department of Justice prior to consummating the transaction.

Generally, both the acquiring and acquired party must submit a premerger notification form to the antitrust enforcement agencies and observe a waiting period before closing the transaction. The purpose of the HSR Act is to provide the FTC and DOJ with sufficient time and information before a transaction is consummated to decide whether to oppose the transaction on antitrust grounds.

In general, HSR Act filing requirements apply to acquisitions of voting securities, noncorporate interests (e.g., LLC or partnership interests) or assets, where U.S. commerce is affected by the transaction, and where the transaction meets certain size-of-transaction and size-of-person thresholds. The size thresholds are adjusted annually, usually in February or early March.

The size-of-transaction test is met if, as a result of the transaction, the acquiring person[1] will hold an aggregate amount of voting securities, noncorporate interests, or assets of the acquired person, valued at more than $63.4 million.

The size-of-person test is met if one of the parties has sales or assets of at least $126.9 million and the other party has sales or assets of at least $12.7 million. However, any transaction valued over $253.7 million is reportable without regard to the size-of-person test.

In some instances, even if the initial filing threshold criteria have been satisfied, a transaction still may not be reportable. The HSR Act and its implementing regulations set forth a number of exemptions for particular categories of transactions that need not be reported, despite meeting the thresholds.

Beyond the act and the regulations, another very important source of HSR law is the body of informal advisory interpretations issued by the FTC Premerger Notification Office ("PNO") staff.

While not technically binding on the commission, FTC informal interpretations are routinely sought and relied upon by practitioners to determine reporting obligations for complex transactions that may present issues falling within the "gray areas" of the act and the regulations.

Determining whether a transaction is HSR reportable is a highly analytical and fact-specific inquiry that often involves application of rules with "Alice-in-Wonderland" characteristics.

Failure to report a notifiable transaction can result in civil penalties of up to $16,000 per day for each day that assets unlawfully acquired continue to be held without satisfying reporting and waiting period requirements. Thus, in the world of Hart-Scott-Rodino, truly "an ounce of prevention is worth a pound of cure."

Exempt vs. Nonexempt Assets Under the HSR Act

One of the first questions that must be asked in a transaction is, "What is actually being acquired?"

Some categories of assets (e.g., cash) are exempt from HSR Act filing requirements. The acquisition of voting securities or noncorporate interests can also be exempt if the target entity holds exempt assets, plus not more than $63.4 million of nonexempt assets.

Thus, if the direct acquisition of the company's assets would be exempt, then acquiring interests in a corporation, LLC or partnership that holds those assets would also be exempt on the same basis.[2]

If a transaction involves the acquisition of both exempt and nonexempt categories of assets, premerger notification is required if the nonexempt portion of the transaction meets the filing thresholds.

Some of the more common categories of exempt assets and securities, as set forth in the regulations, include:

- bonds, mortgages, deeds of trust, or other obligations that are not voting securities;

- cash;

- convertible voting securities (i.e., presently nonvoting), although subsequent conversion may trigger a reporting obligation; and

- certain foreign assets or voting securities, if they lack a sufficient U.S. nexus.

Transactions Unique to the Realm of Insurance

Aside from acquisitions specifically exempted by regulation, there are several types of insurance-specific transactions addressed by the PNO in informal interpretations that may also be exempt. Each transaction, of course, must be assessed on its own facts by experienced HSR counsel to determine whether notification is required.

Renewal Rights

Many insurance transactions are structured not as an acquisition of any actual, existing insurance policies, but rather as an acquisition of so-called “renewal rights” or “expirations.”

These terms refer to the “right" of the acquiring company to offer its own “renewal” policies to the selling company’s customers when their existing policies with the selling company expire. The selling company often commits to help facilitate the renewal of its customers to a plan or product of the buyer.

The selling company may also provide to the acquiring company certain information about the selling company’s customers and their existing policies. This allows the acquiring company to tailor its approach to the specific needs of each customer, thus helping to smooth the customer’s hoped-for transition to the acquiring company.

Under this arrangement, the customers are free to renew with any insurance company, not just the acquiring company. The acquiring company does achieve a “preferred position,” but with no certainty regarding which, or how many, of the seller’s existing policyholders it will sign up.

The PNO has stated on numerous occasions that renewal rights do not count as “assets” for Hart-Scott purposes, because they are not actual contract rights and customers have no obligation to renew with the acquiring company. Thus, the PNO has advised that no HSR filing would be required when acquiring renewal rights.

In connection with a renewal rights acquisition, the acquiring company often hires the seller’s current sales force. These employees are often subject to ongoing noncompetition, confidentiality and other agreements with the seller, and these agreements are typically transferred to the acquiring company.

This permits the employees to continue to service existing customers on behalf of the buyer, because the employees would otherwise be prohibited from doing so under the agreements in place. The PNO view on these types of agreements is that they also do not constitute assets for HSR Act purposes.

Indemnification Reinsurance Agreements

Under typical indemnification reinsurance agreements, the risk is passed to the reinsurer, who then reimburses the ceding company for covered losses. The ceding company still retains its liability to, and its contractual relationship with, the insured.

According to the PNO, indemnity reinsurance transactions are not HSR-reportable, even if 100 percent of the premiums and reserves are ceded to the buyer, because such transactions do not constitute the purchase or sale of assets, voting securities or noncorporate interests. Any consideration allocated to entering into the reinsurance agreement would not be included in determining whether the size-of-transaction threshold is met.

Assumption Reinsurance Transactions

In contrast, assumption reinsurance transactions (where the reinsurer assumes another insurer's risk and becomes liable under the reinsured policies and contracts) are reportable if the HSR Act filing thresholds are met.

The FTC has established a formula for valuing an assumption reinsurance transaction that treats such a transaction as a "sale of contracts."

The value of an assumption reinsurance transaction equals the difference between the actuarially determined present value of the payment obligations under the transferred policies and the asset reserves transferred by the seller to the purchaser to cover those obligations, plus the value of the customer lists.

However, under the right set of facts, and subject to verification with the PNO, it is possible that some of these transactions may fall under the HSR exemption for "ordinary course of business" transactions, although this exemption is fairly narrow and certain criteria must be met by both the buyer and seller.[3]

For example, buyers that routinely purchase and reinsure in-force books of insurance, including acquiring the associated economic risks and benefits, may ordinarily qualify for the exemption. However, availability of the exemption is contingent on the seller not completely exiting the particular line of business in which the purchaser is making an acquisition.

Additional Considerations: Nonexempt Assets and Valuation Issues

It is important to note that in many insurance transactions — as in other transactions — the acquisition of exempt categories of assets such as cash, bonds or nonvoting securities is not reportable under the HSR Act.

Thus, for example, to the extent the buyer acquires reserves comprised of these categories of assets, the acquisition would be exempt. However, the acquisition of voting securities is potentially reportable, so a careful analysis of all the assets and securities being acquired is necessary.

Valuing a transaction under the Hart-Scott rules can be complex. For example, different rules apply to valuing assets, publicly traded voting securities and nonpublicly traded voting securities.

Typically the value of voting securities acquired previously must be aggregated with the value of a prospective acquisition, and sometimes the value of previously acquired assets must be aggregated as well. The acquirer often needs to determine the "fair market value" of the assets or voting securities being acquired.

Under the HSR regulations, such determinations must be made in good faith by the board of directors of the ultimate parent entity of the purchaser, or by an entity delegated that function by the board, and within 60 calendar days prior to the closing (if no HSR filing is required), or within 60 calendar days prior to the date of filing of an HSR filing if one is required.

The key point is that while determining the size of a transaction may appear relatively simple at first blush, in practice it can sometimes prove complicated.

Conclusion

Assessing HSR Act filing requirements can be difficult in many circumstances, but particularly so in the insurance industry. Insurance M&A transactions are often quite complex, and many key rules on what is exempt and what is not are “embodied” in informal PNO interpretations and not formal regulations.

Given this situation, insurance M&A transaction lawyers would be well-advised to consult with experienced HSR counsel early in the process in order to avoid last-minute required HSR filing surprises that could delay closing.

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[1] The term “person” under the HSR Act means an ultimate parent entity and all entities that it controls directly or indirectly. 16 CFR § 801.1. In the case of corporations, “person” encompasses the entire corporate family, including all parent corporations, subsidiaries and divisions (whether consolidated or unconsolidated, and whether incorporated or unincorporated), and all related corporations under common “control,” as defined in the rules. Id.

[2] 16 C.F.R. § 802.4.

[3] See 15 U.S.C. § 18a(c)(1) and 16 C.F.R. § 802.1.