

## Recent Amendments to the Pennsylvania Insurance Holding Company Act Changes Affecting Controlling Persons

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Pennsylvania's Insurance Holding Company Act (IHCA) was recently amended by Act 136, which was signed into law on July 5, 2012. Act 136 makes a number of changes to the IHCA, including requiring new filings, mandating prior notice and/or approval for certain transactions, and expanding the Insurance Department's regulatory authority. In this Alert, we discuss certain changes made by Act 136 that affect "controlling persons." Future Alerts will discuss others changes made by Act 136.

### Definition of Control

Under existing Pennsylvania insurance laws, a person is in "control" of a domestic insurance company if the person possesses, directly or indirectly, the power to direct or cause the direction of the management and policies of the insurer. Control can exist due to stock ownership, contractual arrangements or otherwise. Act 136 made two clarifying changes to the existing definition of control.

First, Act 136 provides a presumption of control arises if a person owns, controls, or holds proxies representing 10 percent or more of the **votes that all shareholders would be entitled to cast in the election of directors**. This change was intended to add clarity for companies that have more than one class of securities. Persons at or approaching the 10 percent ownership threshold may need to verify whether they have "control" under the revised definition.

Second, Act 136 now expressly recognizes there can be more than one controlling person of an insurer. While this addition is a newly stated concept in the statute, the amendment is consistent with the Insurance Department's historic interpretation of the IHCA.

### Divestiture of Control

Pursuant to the Act 136 amendments, the IHCA now newly regulates a divestiture of control by a controlling person, in addition to regulating the acquisition of control of an insurer.

Under the changes to the IHCA, if a controlling person of a domestic insurer plans to divest its controlling interest, the controlling person must first file a notice regarding the proposed divestiture with the Insurance Department, unless the acquiring person has filed a Form A statement. The divestiture notice must be filed at least 30 days prior to the cessation of control and must contain information sufficient for the Insurance Department to determine whether the person(s) acquiring the divested interest(s) must first obtain the Insurance Department's approval pursuant to 40 P.S. § 991.1402(a) (relating to prior approval of certain acquisitions, mergers, consolidations and changes in control affecting Pennsylvania domestic insurance companies). However, regardless of whether the acquiring person is required to obtain regulatory approval, the divestiture transaction may not be completed unless the Insurance Department's approval has been granted to the controlling person who is seeking to divest control.

This change under Act 136 arose from the Insurance Department's unsuccessful attempt to regulate a complete divestiture of control of Lincoln General Insurance Company, an insurer that had been placed in run-off, by its ultimate parent, Kingsway Financial Services, Inc.<sup>1</sup> However, the IHCA now apparently regulates more than a complete

<sup>1</sup> See *Pennsylvania Insurance Department v. Kingsway Financial Services, Inc.*, 992 A.2d 255 (Pa. Commw. Ct. 2010).

divestiture of control by a controlling person. For example, if a person owns 12 percent of the voting shares of a domestic insurer, it appears such controlling person must now obtain approval from the Insurance Department to sell (or gift or otherwise transfer) its shares if, after the transaction, the controlling person will have less than 10 percent of the outstanding voting shares of the insurer, assuming the 12 percent shareholder has not previously obtained regulatory approval for a rebuttal or disclaimer of control. Additionally, if a controlling person becomes deceased, it appears the executor will need to obtain the Insurance Department's approval to transfer the shares owned by the decedent to the decedent's heirs.<sup>2</sup> Further, if control exists through a manner other than ownership of voting securities (e.g., because of a contract), then Insurance Department approval will be required to terminate the arrangement that caused the control to exist.

### **Rebuttals and Disclaimers of Control**

Under the existing IHCA, a person may seek to rebut a presumption of control or disclaim control by making a submission to the Insurance Department. Act 136 now expressly provides the person will remain a controlling person unless the Insurance Department approves the filing. The change in the law is consistent with the Department's historic practices regarding such filings.

It should be noted Act 136 did not impose a specific time period for the Insurance Department's review of these types of filings.

### **Public and Regulator Access to Filings**

Act 136 provides that divestiture and disclaimer of control filings are protected from public disclosure under Pennsylvania's Right-to-Know Law. Under the current IHCA, filings relating to an acquisition generally are not protected from disclosure under the Right-to-Know Law and Act 136 did not change the existing law regarding such filings.

Act 136 authorizes the Insurance Department to share information obtained under the IHCA with insurance regulators in other states, law enforcement officials in

Pennsylvania or other jurisdictions, the International Association of Insurance Supervisors, the National Association of Insurance Commissioners (NAIC), and members of any supervisory college.

### **Hearings on Acquisitions, Mergers, Consolidations and Changes in Control**

Currently, under the IHCA, a hearing on a proposed acquisition, merger, consolidation or change in control (collectively, herein, acquisitions) must be held if the acquiring party or the insurer being acquired requests a hearing. A hearing may also be held on a proposed acquisition in the Insurance Department's discretion.

Under Act 136, if insurance regulators in more than one state have the authority to approve a proposed acquisition, the acquiring party may request a consolidated hearing in which all of the involved insurance regulators participate. While Act 136 does not expressly grant the insurer the right to request a consolidated hearing, the Insurance Department would likely accept such a request, because multistate hearings on proposed acquisitions have been held by the Insurance Department in the past.

Act 136 does not mandate a public hearing be held on a disclaimer of control filing and, historically, the Insurance Department has not held public hearings on such filings.

### **Imposition of Costs**

The IHCA currently requires that an acquiring party pay the expenses incurred by the Insurance Department for attorneys, accountants, actuaries or other experts during the review of an acquisition filing. Notwithstanding the other changes, Act 136 did not expressly allocate to the filing party the expenses incurred by the Insurance Department in the review of a divestiture or a disclaimer of control filing. However, the fiscal note to the legislation states the Insurance Department intends to assess any additional expense incurred under Act 136 upon the regulated entities. Thus, entities that make IHCA filings under the new requirements should anticipate the possibility of an assessment for expenses incurred by the Insurance Department in reviewing those filings.

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<sup>2</sup> Each heir receiving shares constituting a controlling interest would also need to obtain regulatory approval.

### **Effective Date**

The changes discussed in this Alert become effective September 3, 2012.

### **Conclusion**

If a controlling person plans to change its relationship with a Pennsylvania domestic insurance company, the controlling person should carefully review the new requirements to assure the proposed transaction complies with the IHCA, as amended by Act 136.

This Alert discusses only some of the changes made by Act 136 and only certain of the applicable filing requirements. Because these changes are new, and no regulatory guidance

or regulations have been issued as yet, the interpretations of the new statutory requirements as discussed herein are subject to change. Further, it should be noted that while the Act 136 changes mirror the amendments to the model IHCA adopted by the NAIC in 2010, the Pennsylvania law is not identical in all respects to the NAIC model law.

The attorneys in our Insurance Corporate and Regulatory practice group are available to provide assistance with respect to specific transactions regulated under the IHCA or otherwise providing advice on the changes to the IHCA enacted by Act 136. Please feel free to contact Linda Kaiser Conley or James Potts for advice and assistance.