Reinsurance
802.1(b)
7(A-)(b)

[redacted]

September 7, 1995

BY FACSIMILE

Mr. Patrick Sharpe
Compliance Analyst
Premerger Notification Office
Bureau of Competition
Federal Trade Commission
Washington, D.C. 20580

Re: Applicability of HSR Reporting Requirements to Reinsurance Transaction

Dear Mr. Sharpe:

This letter confirms our discussions regarding whether a transaction (described below) which is essentially a reinsurance agreement would trigger the reporting requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended. This transaction is referred to below as Transaction 2. Transaction 2 follows on an earlier-occurring transaction, referred to below as Transaction 1, which we also discussed. In order to analyze Transaction 2, it is necessary to first understand Transaction 1. Thus, I have described Transaction 1 first.

Transaction 1:

In a transaction which will occur just prior to Transaction 2, Reinsurance Company B will agree to reinsure, on an indemnity basis, all of Reinsurance Company A's reinsurance policies (termed "treaties" in the industry). (Reinsurance of reinsurance is termed "retrocession" in the industry.) A's portfolio consists of reinsurance agreements with approximately 45 insurance companies, with aggregate liability of approximately $750 million. As consideration, B will give A $125 million. A will transfer to B its reserves related to these reinsurance treaties. After the transaction, B will receive the income stream associated with the reinsurance treaties, and A will no longer be responsible for administering the treaties. Pursuant to the overall agreement between A and B, B will write separate

purchase $125 m worth of assets

reinsurance treaties with A for each of the 45 insurance companies reinsured by A.

After this transaction, A will no longer write reinsurance treaties for any insurance companies, including the 45 insurance companies reinsured by A. However, A will remain the reinsurer of record of the 45 insurance companies; this is because A and B are entering into an indemnity reinsurance agreement, rather than an assumption reinsurance agreement. As a result, B will not have direct privity of contract with the 45 insurance companies (A will be the "link" in the contractual "chain"). Prior to this transaction, B has not entered into agreements of this type, although B commonly enters into other types of reinsurance treaties; however, B intends to enter into further agreements of this type in the ordinary course of its business in the future.

Transaction 2:

Because of the size of Transaction 1, B itself must seek to further reinsure ("retrocede") its reinsurance treaties with A. Our client, Reinsurance Company C, is in the business of reinsurance and is substantially larger than B. In Transaction 2, Reinsurance Company C, will agree to reinsure, on an indemnity basis, B's reinsurance of A. Although this transaction is larger than most reinsurance agreements entered into by C, it is the type of transaction which C enters into in the ordinary course of its business.

In contrast to Transaction 1, B will not transfer any reserves to C. C will retire $125 million of the $750 million in liabilities by paying $125 million to B. C will then acquire $625 million in letters of credit from affiliates and third parties to cover its remaining liability. After this agreement is in place, B will pay C an income stream consisting of most of the income stream associated with B's reinsurance treaties with A; however, B will retain a share of this income stream. Pursuant to the overall agreement between B and C, C will write separate reinsurance treaties with B for each of the 45 reinsurance treaties it has written with A. C may then seek to further reinsure (or "retrocede") some, and possibly all, of its reinsurance treaties with a number of affiliated and non-affiliated reinsurers.

[redacted]

Analysis:

For each of these transactions, an analysis needs to be undertaken. First, it must be determined whether an "acquisition" is taking place at all. If so, it must be determined whether the acquisition is reportable.

There is little prior analysis of the reportability of insurance transactions generally, and there appears to be nothing publicly available which discusses the reportability of reinsurance transactions specifically. Interpretation Number 139 in the Premerger Notification Practice Manual gives some guidance in analyzing the transactions under discussion. Interpretation No. 139 analyzed the value to be assigned to an acquisition of insurance policies where buyer received a lump sum cash payment (representing the cash reserves which ensured seller's ability to meet its further obligations under these insurance policies). The interpretation states that the value consists of the "premium" being "paid" by buyer, i.e., the difference between (i) the cash reserves and rights to future premiums being transferred and (ii) the actuarially determined present value of the obligations being transferred. In the transaction discussed in Interpretation No. 139, this premium was $7.5 million, which did not satisfy the "size of transaction" test. Thus, the transaction received no further analysis.

This analysis may not shed much light on the questions presented here: whether an acquisition is occurring and, if so, whether the acquisition is reportable. However, the "Commentary" section of Interpretation No. 139 suggests that such acquisitions may be exempt under § 7A(c)(1) as acquisitions in the ordinary course of business. This analysis appears useful in the present situation.

If the two transactions at hand are analyzed pursuant to § 7A(c)(1) (and 16 C.F.R. § 802.1(b)) -- assuming Transaction 2 is an "acquisition" at all -- it appears clear that Transaction 2 should be considered an ordinary course transaction. Transaction 1 provides an instructive contrast. In Transaction

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1, the "seller" (A) is exiting the business. In Transaction 2, the "seller" (B) is remaining in the business.[1/] In Transaction 1, the "buyer" (B) is receiving all of A's reserves relating to the reinsurance policies being indemnified by B. In Transaction 2, the "buyer" (C) is not receiving any reserves or other assets from B; C merely receives an income stream from B.

not an acquisition not reportable

correct

Based on these characteristics and the other facts set forth, Transaction 1 does not appear to be in the ordinary course of business -- A is exiting this line of business and B is "acquiring" substantially all of the assets associated with A's business, by acquiring the reserves and by indemnifying A's reinsurance policies. The acquisition of A's reserves also causes Transaction 1 to more closely resemble the acquisition analyzed in Interpretation No. 139, where reserves were also transferred to the buyer. The end result of the analysis of Transaction 1 is that this transaction should be reported under the HSR Act.

agreed

By contrast, Transaction 2 appears to be an ordinary course transaction -- the transaction is of the type that is in the ordinary course of both B and C's businesses, B is not exiting this line of business, and C is not acquiring any assets from B associated with the policies, other than the right to an income stream. Essentially, Transaction 2 is not an acquisition at all -- it is merely the writing of reinsurance policies. The end result of this analysis is that Transaction 2 need not be reported under the HSR -- either it is not an acquisition, or, if it is an acquisition, it is in the ordinary course of business, and thus exempt.

agreed

In your analysis, you agreed with this result. You first indicated that Transaction 1 appeared to be subject to the requirements of the HSR Act. You then indicated that Transaction 2 sounded like a transaction in the ordinary course of business, and was not an acquisition for purposes of the HSR Act. You also observed that reinsurer C was merely receiving an income stream

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1/ As a matter of fact, B is using its transaction with C to increase B's ability to write reinsurance. C's reinsurance frees up B's capital which otherwise would have to be held in reserve against the reinsurance treaties. It is apparently B's plan to use this free capital to allow B to write additional reinsurance policies.

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from entering into reinsurance treaties, and was not receiving any productive assets. This supported your conclusion that Transaction 2 did not require a filing under the HSR Act.

If this letter does accurately reflect your conclusions or your analysis please contact me immediately. Thank you for your interest in this matter.

Sincerely,

[redacted]

cc: [redacted]

called [redacted] 9/18/95

Transaction 1 - Appears to be reportable (if size-thresholds are met for the size-of-person test). It is the purchase of $45 mm worth of assets. It goes beyond letter #139.

Transaction 2 - The focus of the letter appears to be an ordinary course of business deal

RS

RS concurs

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[redacted]

[redacted]