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NAVIGATING THE BERMUDA REGULATORY LANDSCAPE FOR M&A

by Kendall Evans, Seth Darell, Matthew Ebbs-Brewer & Gary Harris

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In our Bermuda merger and acquisition series, we have discussed how acquisitions have been effected in Bermuda, the considerations a board of directors must have in the context of business combinations and acquisitions (particularly with reference to fiduciary duties) and the related deal protection mechanisms that are often put in place in Bermuda. These have identified some of the key issues that have manifested themselves during the past two years of unprecedented M&A activity in the Bermuda marketplace. Given that many of the largest deals we have advised upon have been in the (re)insurance space, the fourth and final part of this series focuses on the Bermuda regulatory landscape. It should be noted that, in general, Bermuda's regulators, such as the Bermuda Monetary Authority (**BMA**) are commercially minded, and well-disposed to new players in the market, provided that such persons are fit and proper.

STATUTORY CONSENTS AND APPROVALS

There are a number of statutory consents and approvals required under Bermuda law on a business combination or straight purchase of shares. Exchange Control consent, material change and change-of-control consents are required for entities licensed by the BMA, including, insurers under the *Insurance Act 1978*, as amended, banks under the *Banks and Deposit Companies Act 1999* and investment businesses under the *Investment Business Act 2003*, as amended (**IBA**). For the purposes of this article, we have focused predominately on the Insurance Act and the Investment Business Act.

EXCHANGE CONTROL

Permission from the BMA is required for all issues and transfers of securities of Bermuda companies, both local and exempted, involving persons who are nonresident in Bermuda. Certain general permission have already been granted by the BMA. The general permission, inter alia, provides for permission for the transfer of shares that do not carry the right to vote on or appoint one or more directors (such rights are often excluded from preferred shares), and, shares that do carry such rights but are also listed on an appointed stock exchange recognized by the BMA. A target may have already been issued one or more specific permissions by the BMA for the purposes of the *Exchange Control Act 1972* (**Exchange Control**) and related rules and regulations, as amended (**specific permissions**), which may permit certain transfers. Any potential purchaser should request that the seller and/or the target provide them with any specific permissions that have been issued by the BMA as part of the due diligence exercise.

If the acquisition is effected by way of a share sale, then Exchange Control consent will be required. Whether Exchange Control consent is required on a merger or amalgamation is a moot point, as arguably there is no transfer of shares. Conversely, some take the view that Exchange Control consent is required on the basis that the ultimate beneficial owner of one of the entities will change on an amalgamation or merger. Either position seems to have been accepted by the BMA, but for a belts-and-braces approach, obtaining Exchange Control consent is the sensible course.

INSURANCE ACT

Where the target, seller (if different, i.e. on a straight share sale) or purchaser (or indeed a subsidiary of the entities involved in a business combination) is a registered (re)insurer or the parent (whether directly or indirectly) of a registered (re)insurer, then a notification to or prior consent of the BMA will be required pursuant to the Insurance Act on a change of control effected by way of a business combination or acquisition.

If the proposed purchaser or the parent of the proposed purchaser is listed on any stock exchange recognized by the BMA, then notifications to the BMA rather than the consent of the BMA will be required within a specified time frame under the Insurance Act where a purchaser becomes a 10 percent, 20 percent, 33 percent or 50 percent shareholder controller (direct or indirect). A similar notification will be required where a shareholder controller intends to reduce or dispose of its shareholding, where the proportion of voting rights in such insurer or reinsurer held by it have reached or fallen below the thresholds set out above. This is because the BMA recognizes the provision of free transferability of shares where there is the existence of regulation or vetting by another acceptable regulatory body and, therefore, the prospective shareholder/shareholder will not have to seek its consent.

The Insurance Act provides a broad definition of “controller” (which includes directors, senior executives etc.). More specifically, it defines “shareholder controller” as a holder of 10 percent or more of the shares (carrying voting rights) in the registered insurer or reinsurer or a company of which that insurer is a subsidiary.

If the purchaser or the parent of the purchaser is not listed on an appointed stock exchange, then the prior consent of the BMA is required on a change of control of the registered (re)insurer. The Insurance Act provides that no person may become a 10 percent, 20 percent, 33 percent or 50 percent shareholder controller (as those terms are defined above) of the registered insurer or reinsurer or a company of which that insurer or reinsurer is a subsidiary unless he/it has served on the BMA a notice in writing stating that he/it intends to become such a controller of the insurer; and

- either the BMA has before the end of a prescribed period beginning with the date of service of that notice, notified him in writing that there is no objection to his becoming such a controller of the insurer, or

- that period has elapsed without the BMA having served him with a written notice of objection to his becoming such a controller of the insurer or insurer. Again similar requirements are imposed on a shareholder controller in this context if it intends to reduce or dispose of its holding in an insurer or reinsurer, where the proportion of the voting rights held by such shareholder controller in the insurer will reach or fall below the thresholds set out above.

In addition to the notifications or consents set out above, which pertain to the seller or purchaser, a registered (re)insurer is required under the Insurance Act to:

- notify the BMA within a specified period after becoming aware of any person who has become or has ceased to become a "controller" of that insurer or reinsurer;

- notify the BMA (and receive the BMA's consent or the prescribed period expires with no word from the BMA) prior to effecting a material change within the meaning of the Insurance Act unless the requirements of the Insurance Act have been satisfied. Under the Insurance Act, the following changes are material (as they relate to an acquisition, merger, amalgamation or business combination):

    - amalgamation with (for the avoidance of doubt this includes a merger) or acquisition of another firm;

    - acquisition of controlling interest in an undertaking that is engaged in noninsurance business that offers services and products to persons who are not affiliates of the insurer; and

    - the sale of an insurer.

It is customary, however, in the instance of an acquisition or other business combination to request that the BMA provide an indication of no objection to an acquisition following signing and in advance of closing (whether or not the registered (re)insurer, its parent company or the purchaser or its parent company is listed). The BMA will usually provide such indication of no objection within two weeks of being so requested. In approving any new controller or officer of any registered (re)insurer, the BMA will take into account whether such controllers are "fit and proper."

INVESTMENT BUSINESS ACT

Regardless of whether the bidder is a public or private company, under the *Investment Business Act*, notification of new or increased control will be required to be filed with the BMA in respect of a change in control of any target registered under the IBA.

The IBA provides that no person shall become a 10 percent or majority shareholder controller of an investment provider unless:

- he has served on the BMA a written notice stating that he intends to become such a controller of the investment provider; and

- either the BMA has, before the end of a specified period beginning with the date of service of that notice:

    - notified him in writing that there is no objection to his becoming such a controller of the investment provider, or

    - such period has elapsed without the BMA having provided a written notice of objection.

  The IBA has a similar definition of "controller" to that of the Insurance Act (which includes directors, senior executives etc.).

FUNDING AND DIVIDENDS

Often in connection with closing or as part of the consideration to be paid to shareholders on the business combination, a special dividend will be declared by the holding company. It is important to note that both the declaration and payment of the dividend must be subject to and contingent upon closing to ensure that no debt arises as between the company and its shareholders and, therefore, that the dividend would be payable even if the business combination were not to proceed.

Holding companies generally have limited funds and, therefore, prior to declaring any dividend or making a distribution, its operating subsidiaries will usually have to declare a dividend or make a distribution to put the holding company "in funds."

Under the Companies Act, there is a two-limbed statutory solvency test that a company must pass before it can declare and pay a dividend out of distributable reserves (or make a distribution out of contributed surplus). It is not possible for a company to declare or pay a dividend or make a distribution if there are reasonable grounds for believing that:

- the company is, and would after the payment be, unable to pay its liabilities as they become due; or

- the realizable value of the company's assets would thereby be less than its liabilities.

Note that both of the above limbs must be satisfied in order to declare and pay a dividend or make a distribution. If there is any doubt as to the ability to meet either test, then the payment of a dividend or making of a distribution out of contributed surplus should not be approved. The above tests must be satisfied both at the time of declaration and of payment of a dividend.

In addition to the above, the insurance operating subsidiaries will be required to comply with the Insurance Act when declaring and paying a dividend or making a distribution. Under the Insurance Act, an insurer is prohibited from declaring or paying a dividend if;

- it is in breach of its Minimum Solvency Margin (MSM),

- it is in breach of its Enhanced Capital Requirement (ECR) (in the case of commercial insurers) or minimum liquidity ratio or the
- declaration or payment of such dividend would cause such a breach.

Commercial insurers are prohibited from declaring or paying in any financial year dividends of more than 25 percent of its total statutory capital and surplus (as shown on its previous financial year's statutory balance sheet) unless they file (at least seven days before payment of such dividends) with the BMA an affidavit signed by at least two directors (one of whom must be a Bermuda resident director if any of the insurer's directors are resident in Bermuda) and the principal representative stating that they will continue to meet their solvency margin and minimum liquidity ratio.

CONCLUSION

Many of the recent business combinations have occurred in the insurance space, thus making consideration of regulatory consents and notifications of the utmost importance. While there are regulatory issues that need to be addressed, doing so should not be considered to be an unpalatable roadblock, rather an opportunity for sensible and pragmatic discourse to "get the deal done." Bermuda's regulators appreciate the need for swift decision-making and have created a regulatory approval climate that is clear, fair and commercially sensible.

This article has been written by:

Bermuda
Kendall Evans
Associate
+1 441 298 3590
kevans@applebyglobal.com

Bermuda
Seth Darrell
Associate
+1 441 298 3285
scdarrell@applebyglobal.com

Bermuda
Matthew Ebbs-Brewer
Associate
+1 441 298 3226
mebrewer@applebyglobal.com

Bermuda
Gary Harris
Associate
+1 441 298 3249
gcharris@applebyglobal.com

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