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# When CHINA Comes Knocking

U.S. insurers must be mindful of myriad federal, state and foreign regulations when considering being acquired by Chinese firms.

by Sean M. Keyvan and Greg Oguss

During the past two years or so, China-based enterprises have dramatically increased the volume of investments in the United States, particularly in less volatile sectors such as real estate and financial services, including the insurance industry.

For its part, Chinese conglomerate Fosun International Ltd. has invested a reported $5.7 billion in foreign insurance and banking assets over the past two years, a total that includes its acquisitions of Michigan-based Meadowbrook Insurance Group Inc., and Bermuda-based Ironshore Inc. Over the same period, Anbang Insurance Group Co. Ltd., acquired more than $5 billion in U.S., European and South Korean insurance assets and more than $8.5 billion in U.S. real estate assets. In addition to its consummated deals, Anbang announced in November 2015 an agreement to acquire Iowa-based Fidelity & Guaranty Life for $1.58 billion, a transaction which remains subject to regulatory approval. As recently as April 2016, China Minsheng Investment Corp. Ltd., consummated its $2.6 billion purchase of global insurer Sirius International Investment Group. In October 2016, China Oceanwide Holdings Group Co. Ltd. announced an agreement to acquire Genworth Financial Inc. for approximately $2.7 billion. These transactions, and the perception that Chinese buyers are willing to pay higher purchase prices than their U.S. counterparts, have generated a substantial amount of industry attention.

The wave of Chinese outbound acquisitions in large part reflects the natural maturation of the country's developing economy, as Chinese companies begin to pursue more global aspirations. However, the recent trend also can be attributed to a number of other factors, including a desire by Chinese investors to diversify and to place their money in the relatively safe haven of dollar-denominated assets in light of recent Chinese economic volatility and concerns about the renminbi's potential devaluation.

In addition, certain Chinese companies, such as Anbang and Fosun, have pursued targets in relatively low cost-of-capital jurisdictions such as the United States as a means of emulating Warren Buffett's float-driven investment approach—in which insurance company invested assets are the centerpiece of an enterprisewide asset management strategy. Other deal drivers include an interest in gaining exposure to U.S. industry expertise and the ability to distribute U.S.-style insurance products in the growing Chinese market.

Notwithstanding this trend, certain countervailing developments have made news recently. In early 2016, Fosun terminated its pursuit of a $462 million acquisition of Israeli insurer Phoenix Holdings Ltd. Since then Fosun-controlled Ironshore filed for an initial public offering and recently there has been speculation that Fosun is pursuing a sale of the company. Additionally, in March 2016 Anbang withdrew from its highly publicized bidding war with Marriott over Starwood Hotels and Resorts and, more recently, announced the withdrawal, at least temporarily, of its application to the New York State Department of Financial Services in connection with the pending Fidelity & Guaranty Life acquisition.

## Key Points

**The Big Picture:** Chinese businesses are increasing their investments and acquisitions abroad.

**Behind the Trend:** The wave of Chinese outbound acquisitions reflects the maturation of the country's developing economy and a desire to diversify and invest in the relatively safe haven of dollar-denominated assets in light of recent Chinese economic volatility and concerns about the renminbi's potential devaluation.

**What Needs to Happen:** U.S. insurers that receive takeover offers from Chinese businesses should take into consideration a number of factors, including U.S. and Chinese regulatory requirements and execution risk.

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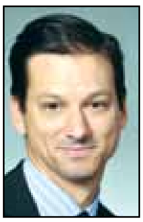
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There has also been speculation regarding possible behind-the-scenes pressure from the Chinese government to control outbound investments due to concerns about the renminbi's value. While these developments may herald a short-term slowdown, the interest in North American and European insurance assets, demonstrated by companies such as Fosun, Anbang, China Minsheng and others, is likely to persist in the longer term. In light of this, market participants in U.S. insurance deals involving Chinese bidders should consider the following:

### Regulatory Hurdles

As a threshold matter, a Chinese acquisition of a U.S. insurer must comply with both U.S. and Chinese regulatory requirements. In the United States, the filing and approval of a "Form A" application, under the Insurance Holding Company System Regulatory Act, in the target insurer's state of domicile is the primary regulatory hurdle for the acquisition of a controlling interest in an insurer. In reviewing Form A applications, state insurance regulators generally will consider the qualification and fitness of the acquirer and its management, the acquirer's proposed plans for the insurer, the effect of the transaction on competition, and whether the proposed acquisition will be hazardous or prejudicial to the target's policyholders or the insurance-buying public.

> Notwithstanding the potential for a higher price when selling to a Chinese buyer, sellers must carefully assess execution risk when evaluating Chinese acquisition proposals.

While Chinese acquirers such as Fosun and China Minsheng have successfully navigated the Form A process, state insurance regulators generally are more likely to subject Chinese acquirers to an enhanced level of scrutiny. The heightened scrutiny may occur because state insurance regulators typically are less familiar with Chinese buyers compared to their U.S. competitors and may be concerned that such buyers are equally unfamiliar with the U.S. regulatory and market landscapes. Chinese acquirers also face a perception that Chinese companies may be less transparent than their U.S. counterparts—particularly with respect to funding sources and ownership structure.

### Government Involvement

Another regulatory consideration is the possibility of some level of Chinese government ownership interest in would-be Chinese acquirers. More than half of U.S. state insurance codes prohibit an insurer that is owned or controlled by a domestic or foreign government to hold a certificate of authority to conduct insurance or reinsurance business in such states. There is also the potential for U.S. federal review by the Committee on Foreign Investment in the United States, which reviews all transactions with foreign entities that could affect U.S. national security.

### Local Regulatory Requirements

Prior to consummating any outbound direct investment, including the acquisition of a U.S. or European insurer, a Chinese acquirer would need various Chinese regulatory approvals from, or make filings with, China's National Development and Reform Commission, the Ministry of Commerce, the State Administration of Foreign Exchange and the China Securities Regulatory Commission, as well as certain applicable industry-specific agencies (e.g., China's Banking Regulatory Commission and/or Insurance Regulatory Commission).

A state-owned acquirer would also have to follow certain regulatory procedures of the State-Owned Assets Supervision and Administration Commission.

In addition, a Chinese insurance company acquiring a U.S. target would have to ensure the transaction complied with the so-called 15% rule reiterated in 2012 by the Chinese Insurance Regulatory Commission, which prohibits Chinese insurers from investing more than 15% of their assets outside of China. While Chinese restrictions on outbound mergers and acquisitions have loosened over the past few years—indeed, the relaxing of such restrictions has been a key driver of the recent acquisition wave—transaction participants should be aware of the applicable Chinese restrictions.

### Execution Risk

Notwithstanding the potential for a higher price when selling to a Chinese buyer, sellers must carefully assess execution risk when evaluating Chinese acquisition proposals. Sellers should assume that, all else being equal, the prudent level of sell-side due diligence will increase if a Chinese company is chosen as a final bidder. This is necessary to accurately assess the likelihood of a smooth U.S. regulatory approval process—in other words, sellers will want to carefully evaluate a Chinese bidder's business plan and ownership structure to evaluate how they will be received by regulators. Sellers also should not hesitate to ask direct questions of Chinese bidders regarding the status of required outbound approvals, to accurately assess Chinese regulatory risk.

### Incentives

Sellers entering into final negotiations with a Chinese bidder should consider proposing that additional deal protections be included in the purchase agreement to efficiently allocate execution risk and appropriately incentivize all parties to consummate the transaction. Finally, although a general concern with any foreign buyer, sellers may want to consider the challenges of enforcing a judgment against a Chinese counterparty in the event of a broken deal, as well as various techniques to mitigate such risk. BR