Published on *The National Law Review* https://natlawreview.com

Divide and Conquer: New Connecticut Division Statute Permits Segregation of Insurance Business Into New Insurers

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Connecticut Governor Dannel Malloy has signed into law Public Act No. 17-2, An Act Authorizing Domestic Insurers to Divide (the "Act"), which will take effect on October 1, 2017. The Act is potentially transformative for insurance companies domiciled in Connecticut because it will, among other things, provide increased flexibility in restructuring legacy lines of business and operations.

Overview

The Act permits an insurance company ("dividing insurer") domiciled in Connecticut to divide into two or more insurance companies ("new" or "resulting" insurers) pursuant to a plan of division. A division is conceptually the reverse of a merger. In a merger of two insurers, one insurer merges into another and the assets and liabilities, including policy liabilities, of the non-surviving insurer become the assets and liabilities of the surviving insurer by operation of law. In a division, assets and liabilities of the dividing insurer, including insurance policies and reinsurance agreements, are allocated to two or more resulting insurers and become the assets and liabilities of the resulting insurers by operation of law.

Connecticut insurers will now be able to restructure legacy lines of business and operations into separate insurers, either for operational efficiencies or for sale to a third party. Prior to the Act, such restructurings could only be accomplished through reinsurance transactions that, in many cases, would have left residual credit and operational risks with the ceding insurer.

The Act is modeled after the Pennsylvania division statute, codified at 15 Pa.C.S. §§ 361 to 368, which authorizes divisions of various types of Pennsylvania domestic entities, including insurance corporations. Bill Clark was the draftsman of the Pennsylvania division statute, which was used in a landmark 1996 transaction in which CIGNA utilized a division to allocate certain runoff liabilities to Brandywine Holdings. Unlike the Pennsylvania division statute, the Connecticut Act permits divisions only of insurance companies and not divisions of other types of entities.

In addition, the Act is not a "solvent scheme" type statute like the Rhode Island and Vermont statutes, which generally permit certain types of commercial business (not including life, health or

personal lines) in run off to be commuted or novated. In contrast, the Act permits a division of any type of insurer writing any type of business, and is not limited only to closed blocks.

Division Process

Plan of Division. In order to effect a division, a dividing insurer must file a plan of division with the Connecticut Insurance Commissioner ("Commissioner"). The plan of division must include all relevant details about the proposed division, including the names of the resulting insurers created by the division, proposed organizational documents (such as articles and bylaws), how assets and liabilities will be allocated between or among the resulting insurers, and the manner of distributing interests in the new insurers to the dividing insurer and/or other its owners.

Approvals Under Organization Documents and Certain Contracts. Before a plan of division can be filed with the Commissioner, the plan must be approved in accordance with the organizational documents of the dividing insurer or, if the organizational documents do not require approval, in accordance with Connecticut laws governing approval of a merger. In most cases, this will mean the plan of division must be approved by the board of directors of the dividing insurer and its interest holders (i.e., stockholders or other owners).

Important Transition Provisions. The Act also contains important transition provisions for organization documents adopted prior to October 1, 2017, and utilizes existing approval requirements applicable to a plan of merger for a plan of division. Similarly, if the provision of a contract (other than insurance policy, annuity or reinsurance agreement) issued, incurred or executed prior to October 1, 2017, requires consent of the obligee to a merger or treats a merger as an event of default, that provision will apply to a division as if the division were a merger. After October 1, 2107, provisions of organic documents or such contracts only will apply to divisions in accordance with their express terms.

Commissioner Approval. A plan of division cannot become effective unless approved by the Commissioner after reasonable notice and a public hearing, if the Commission determines notice and hearing are in the public interest. The Commission shall approve a plan of division unless the Commissioner finds (1) the interest of any policyholder or interest holder will not be adequately protected, or (2) the proposed division would constitute a fraudulent transfer. Importantly, approval of a plan of division by policyholders and reinsurers of the dividing insurer is not required.

Certificate of Division; Effectiveness. Once a plan of division has been approved by the Commissioner, an officer or authorized representative of the dividing insurer must sign a certificate of division, which must contain certain information about the division. This information must include the name of the dividing insurer and each new insurer; how the division was approved; certain amendments to the organizational documents of the dividing insurer and the organizational documents for each new insurer; a statement that the dividing insurer provided reasonable notice to each reinsurer that is party to a reinsurance contract being allocated in a plan of division; a reasonable description of capital, surplus, property and liabilities of the dividing insurer to be allocated to each new insurer; and the effective date of the division. The division will become effective on the later of filing the certificate of division with the Secretary of State or on such other date specified in the plan of division.

The End Result

When a division becomes effective, each resulting insurer is responsible individually for policies and

other liabilities the insurer issues, undertakes or incurs in its own name after the division, as well as policies and liabilities allocated to it under the plan of division. Nevertheless, each resulting insurer remains jointly and severally liable for policies and liabilities of the dividing insurer not allocated in the plan of division. Similarly, if the division breaches obligations of the dividing insurer, all of the resulting insurers are liable for the breach (although the breach will not affect the validity and effectiveness of the division).

Liens, security interests and similar items are not impaired by a division, and each resulting insurer will continue to be bound by security agreements to which the dividing insurer was bound. Finally, except as provided in the plan of division, the allocation of a policy liability will not affect the rights of a policyholder or creditor, except that those rights only will be available against the resulting insurer responsible for the policy or liability, and will not release any reinsurer, surety or guarantor of the policy or liability.

Conclusion

The Act represents a new and powerful tool for insurers domiciled in Connecticut to restructure their operations or exit lines of business in a streamlined regulatory process that essentially retains all the protections available to policyholders, creditors and owners under a merger. Please contact us if you have questions or would like further information about the Act.

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National Law Review, Volume VII, Number 170

Source URL:https://natlawreview.com/article/divide-and-conquer-new-connecticut-division-statute-permits-segregation-insurance