

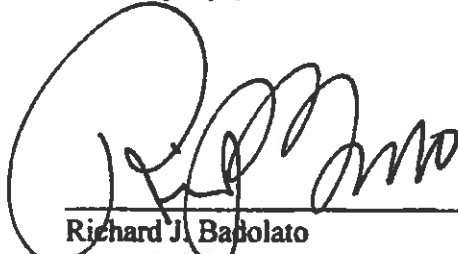
STATE OF NEW JERSEY  
DEPARTMENT OF BANKING AND INSURANCE

IN THE MATTER OF THE ACQUISITION OF )  
CONTROL OF PROFESSIONALS DIRECT )  
INSURANCE COMPANY BY WATFORD )  
SPECIALTY INSURANCE COMPANY )

ORDER APPROVING  
ACQUISITION

I have read the Hearing Officer's report dated *July 26, 2016* regarding the above-captioned matter and I concur with the recommendation contained therein. Accordingly, pursuant to N.J.S.A. 17:27A-2, I hereby approve the proposal of Watford Specialty Insurance Company to acquire control of Professionals Direct Insurance Company (to be renamed Watford Insurance Company).

7/26/16  
Date

  
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Richard J. Badolato  
Commissioner

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STATE OF NEW JERSEY  
DEPARTMENT OF BANKING AND INSURANCE

IN THE MATTER OF THE ACQUISITION OF )	
CONTROL OF PROFESSIONALS DIRECT )	HEARING OFFICER'S
INSURANCE COMPANY BY WATFORD )	REPORT
SPECIALTY INSURANCE COMPANY )	

Procedural History

In accordance with N.J.S.A. 17:27A-2, by a filing dated June 13, 2016, as supplemented through July 7, 2016, Watford Specialty Insurance Company (“WSIC” or “the applicant”) filed with the Department of Banking and Insurance (“the Department”) an application to acquire control (“the Form A filing”) of Professionals Direct Insurance Company (“Professionals Direct” or “the insurer”), a New Jersey-domiciled stock property/casualty insurer.<sup>1</sup> WSIC is ultimately wholly-owned by Watford Holdings Limited, Ltd., a Bermuda-domiciled holding company. Professionals Direct is ultimately wholly-owned by the Hanover Group.

Pursuant to N.J.S.A. 17:27A-2d, a public hearing was held on the Form A filing on July 25, 2016. Pursuant to N.J.A.C. 11:1-35.6(g), the public hearing was conducted based on the documents filed. The hearing panel and Department staff determined that the documents filed in connection with the proposed acquisition satisfied the requirements of N.J.S.A. 17:27A-2b. Public comments were allowed to be submitted through the close of business on July 25, 2016. No comments were received. No other documents were required and the record was closed on July 25, 2016.

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<sup>1</sup> Professionals Direct was domiciled in the State of Michigan and redomesticated to New Jersey pursuant to Order No. A16-112 dated July 26, 2016. The transfer of domicile from Michigan to New Jersey was approved by the Michigan Department of Insurance on July 7, 2016, contingent upon New Jersey’s approval of redomestication. It is intended that Professionals Direct will change its name to Watford Insurance Company, to be wholly owned by WSIC.

### Findings of Fact

WSIC is a New Jersey domestic surplus lines insurer transacting surplus lines insurance in New Jersey. WSIC was formed on September 8, 2015, and commenced business on September 30, 2015. WSIC is ultimately wholly-owned by Watford Holdings Limited, Ltd. ("Watford Holdings"), a Bermuda-domiciled holding company. The applicant stated that it will acquire all of the issued and outstanding equity securities of the insurer from the insurer's direct parent, the Hanover Insurance Company ("Hanover"). The applicant stated that the purchase price for the transaction will be approximately \$18.65 million. The funds will be derived from cash and cash equivalents from within the holding company system of WSIC. No debt will be incurred by the holding company or WSIC to complete the transaction.

Professionals Direct is licensed in all 50 states and the District of Columbia. It is presently in run-off and has no current policyholders or direct business. Professionals Direct recently redomesticated from the State of Michigan to the State of New Jersey. This redomestication was approved by both the Michigan Department of Insurance and the New Jersey Department of Banking and Insurance on July 26, 2016. See Order No. A16-112.

WSIC intends for the insurer to change its name to Watford Insurance Company ("WIC") and to add lines of authority to its Certificate of Authority to enable the insurer to become authorized to transact multiple lines of property/ casualty insurance. WSIC intends to have WIC write business on an admitted basis in all states and the District of Columbia. Immediately upon the acquisition, the applicant stated that the capital structure of WIC is intended to consist of \$4.5 million in common capital stock and \$6.5 million in surplus. The applicant expects to contribute additional surplus to WIC in 2016. The applicant has no plans or proposals to cause the insurer

to declare any extraordinary dividend for at least two years. In addition, the applicant has no plans to liquidate, sell any assets, merge or consolidate the insurer with any person or persons.

Based on the consolidated financial statements filed by the applicant, Watford Holdings had shareholders' equity of approximately \$830.3 million in 2015; and \$864.3 million in 2014.<sup>2</sup> In addition, Watford Holdings had net losses of approximately \$33.7 million in 2015 and \$31.3 million in 2014.

### Analysis

N.J.S.A. 17:27A-2d(1) provides that the Commissioner shall approve an acquisition of control of a domestic insurer unless he or she finds that one or more of the seven disqualifying factors set forth therein exist. The statute provides in pertinent part:

(1) The Commissioner shall approve any merger or other acquisition of control ... unless, after a public departmental hearing thereon, he [or she] finds that:

(i) After the change of control the domestic insurer ... would not be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is presently licensed;

(ii) The effect of the merger or other acquisition of control would be substantially to lessen competition in insurance in this State or tend to create a monopoly therein ... [applying the competitive standard as set forth in the statute];

(iii) The financial condition of any acquiring party is such as might jeopardize the financial stability of the insurer, or prejudice the interest of its policyholders;

(iv) The financial condition of any acquiring party is such that (a) the acquiring party has not been financially solvent on a generally accepted accounting principles basis, or if an insurer, on a statutory accounting basis, for the most recent three fiscal years immediately prior to the date of the proposed acquisition (or for the whole of such lesser period as such acquiring party and any

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<sup>2</sup> Watford holdings was formed in mid-2013. The earliest annual statement available is for 2014.

predecessors thereof shall have been in existence); (b) the acquiring party has not generated net before-tax profits from its normal business operations for the latest two fiscal years immediately prior to the date of acquisition (or for the whole of such lesser period as such acquiring party and any predecessors thereof shall have been in existence); or (c) the acquisition debt of the acquiring party exceeds 50 percent of the purchase price of the insurer;

(v) The plans or proposals which the acquiring party has to liquidate the insurer, sell its assets or consolidate or merge it with any person, or to make any other material change in its business or corporate structure or management, are unfair and unreasonable to policyholders of the insurer and not in the public interest;

(vi) The competence, experience and integrity of those persons who would control the operation of the insurer are such that it would not be in the interest of policyholders of the insurer and of the public to permit the merger or other acquisition of control; or

(vii) The acquisition is likely to be hazardous or prejudicial to the insurance buying public.

Upon a thorough review of the documents submitted into evidence, the hearing panel and Department staff have determined that none of the seven disqualifying factors set forth above should result if the proposed acquisition is effectuated. Each of these conditions is discussed below.

First, after the acquisition, the insurer will continue to meet the requirements to transact the business for which it is presently licensed pursuant to Title 17 of the New Jersey Statutes. Professionals Direct was formed on September 9, 2015, commenced business on September 30, 2015, and is currently in runoff with no active insurance policies.<sup>3</sup> The applicant intends to seek to have the insurer properly capitalized to transact multiple lines of property/casualty insurance.

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<sup>3</sup> As noted previously, the insurer was domiciled in Michigan and was approved to transfer its domicile to New Jersey on July 26, 2016.

Second, it does not appear that the acquisition of the insurer will substantially lessen competition in the New Jersey insurance market or tend to create a monopoly therein. N.J.S.A. 17:27A-2d(1)(ii) provides that in applying this competitive standard, the standard set forth in N.J.S.A. 17:27A-4.1d shall apply. That statute utilizes a complex formula based on the market shares of the insurers involved in the transaction. In the present matter, based on the countrywide data available (for 2015) at the time of the filing, the applicant and its subsidiaries, and the insurer and its affiliates, do not compete in the insurance business in New Jersey. The insurer is currently in runoff and has no current policyholders. The statute by its terms does not apply if, as an immediate result of the acquisition, there would be no increase in the market. See N.J.S.A. 17:27A-4.1b(2)(d). Accordingly, the acquisition will not violate the competitive standard set forth in N.J.S.A. 17:27A-4.1. Thus, it does not appear that the acquisition of the insurer will substantially lessen competition in New Jersey or tend to create a monopoly therein.

Third, it does not appear that the financial condition of the applicant will jeopardize the financial condition of the insurer. As reported in the applicable financial statements filed by the applicant, Watford Holdings had shareholders' equity of approximately \$830.3 million in 2015; and \$864.3 million in 2014.<sup>4</sup>

Fourth, it appears that the financial condition of the applicant is such that it has been solvent on a generally accepted accounting principles basis for the three-year period immediately prior to the date of the proposed acquisition. As set forth above, based upon the filing the applicant had substantial shareholders' equity for the most recent three years, indicating it has been in a sound and viable financial condition for the relevant period. Also, while Watford Holdings had net losses of approximately \$33.7 million in 2015 and \$31.3 million in 2014, it should be noted that losses are common in start-up companies. The applicant also stated the

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<sup>4</sup> See fn2 supra.

losses are largely related to non-recurring expenses incurred during the formation of Watford holdings and its subsidiaries, as well as unrealized “mark-to-market” reductions in the carrying value of its investment portfolio. The applicant stated that despite the mark-to-market impact on its balance sheet, its investment results to date have outperformed relevant indices and the results of many peer companies. The applicant stressed that the losses were driven by unrealized valuation reductions, and not, to any significant degree, by realized losses. In addition, the applicant stated that Watford Holdings balance sheet shows over \$1 billion of capital, and almost \$300 million of loss reserves, with its reinsurance subsidiaries receiving a “A-minus (Excellent)” financial rating by AM Best. For the foregoing reasons, the hearing panel and Department staff do not believe that the acquisition should be disapproved solely on the basis of the existence of these losses. Finally, no debt will be incurred by the applicant in connection with the proposed acquisition. Accordingly, the requirement that the acquisition debt may not exceed 50 percent of the purchase price is satisfied.

Fifth, the applicant does not propose to liquidate the insurer or sell its assets, nor declare an extraordinary dividend for at least two years.<sup>5</sup> As set forth above, the applicant intends to rename the newly domiciled insurer and expand its lines of authority and cause it to become active in all 50 states and the District of Columbia.

Sixth, there is nothing in the record from which it may be concluded that the competence, experience and integrity of the persons who will control the operations of the insurer are such that it would not be in the interest of the policyholders and of the public to permit the acquisition of control. The persons who will serve as officers and directors of the insurer are those presently

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<sup>5</sup> All dividends from domestic insurers are subject to review and possible disapproval by the Department pursuant to N.J.S.A. 17:27A-4c and N.J.A.C. 11:1-35.10.

in those positions with the applicant. In addition, the persons who will control the insurer have had experience in the insurance business.

Seventh, there is nothing in the record from which it may be concluded that the acquisition is likely to be hazardous or prejudicial to the insurance buying public for the reasons set forth above.

Recommendation

Based on the foregoing analysis, the hearing panel and Department staff recommend that the proposed acquisition be approved.

Upon a thorough review of the foregoing, I concur with the findings, analysis and recommendations of the hearing panel and Department staff. I therefore recommend that the proposed acquisition be approved.

7/26/16

Date

  
Jonathan Cuttler  
Hearing Officer

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