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INSURERS: "DEMUTUALIZATION"

House Bill 4521 as enrolled
Public Act 215 of 1995
Second Analysis (1-18-96)

Sponsor: Rep. John Llewellyn
House Committee: Insurance
Senate Committee: Financial Services

THE APPARENT PROBLEM:

Insurance industry representatives say that Michigan's Insurance Code does not contain a detailed set of provisions spelling out how a domestic (Michigan-based) mutual insurance company can convert to a stock corporation. The current provisions are very general and require case-by-case decisions by the insurance commissioner; there is no statutory road map for companies to follow. The term "mutual" insurer refers to an insurance company that is owned by its policyholders and does not have stock available for purchase on a stock exchange. A stock insurance company is owned by its stockholders. The conversion of a company from a mutual company to a stock company is commonly referred to as "demutualization", and the purpose is to raise new sources of capital by issuing stock. Legislation has been proposed to spell out in statute how demutualizations are to occur in the state.

THE CONTENT OF THE BILL:

The bill would amend Chapter 59 of the Insurance Code, which provides for the conversion of a domestic (Michigan-based) mutual insurance company to a domestic stock insurance company. The chapter's current provisions would be deleted and a new chapter provided. The conversion from a mutual (policyholder-owned) company to a stock (stockholder-owned) company would require a conversion plan that would only become effective after approval by the insurance commissioner, approval by the company's eligible members (policyholders), and adoption of revised articles of incorporation.

The bill, among other things, would specify the process for the adoption of a conversion plan and would specify the provisions that a conversion plan would have to contain, including how shares of capital stock would be distributed.

Continuation of Corporate Existence. The bill provides that upon the conversion of a mutual company to a stock company, the corporate existence of the mutual company would be continued in the converted stock company. All the rights, franchises, and interests of the mutual company in and to every species of property and any accompanying things in action would be transferred to and vested in the converted company without any deed or transfer. In addition, the converted company would assume all the obligations and liabilities of the mutual company. The directors and officers of the mutual company, unless otherwise specified in the plan of conversion, would serve as directors and officers of the converted company until new directors and officers were elected under the revised articles of incorporation and bylaws.

Plan Approval Process. A mutual insurance company seeking to convert to a stock company would be required to adopt, by the affirmative vote of two-thirds of its board of directors, a plan of conversion consistent with the provisions in the bill. (At any time before approval by the insurance commissioner, a company could amend or withdraw the plan on a similar two-thirds vote.)

Before a company's members could vote on approval of a plan, the company would have to submit all of the following documents to the insurance commissioner: the plan of conversion, including an independent evaluation of pro forma market value; the form of the notice required to be provided to eligible members; any proxies to be solicited from members; the form of notice required to be given to policyholders whose policies were issued after adoption of the plan but before its effective date; the proposed articles of incorporation and bylaws of the converted stock company; and a business plan for the converted company describing anticipated changes in the post-conversion business of the company, if any, and the company's plan to deploy capital acquired in the conversion.

The insurance commissioner would have to approve or disapprove the plan within 90 days after the filing of documents. The commissioner would have to approve the plan if he or she found that the plan complied with the chapter; that it would not prejudice the interests of the members; that its method of allocating subscription rights was fair and equitable; and that a substantial reason for and effect of the plan was to benefit the members of the company or additional capital was needed to implement the business plan submitted.

The commissioner could retain, at the company's expense, any qualified expert to assist in reviewing the plan and the independent evaluation of the pro forma market value.

All eligible members (policyholders) would have to be given notice of the meeting to vote on the plan. The notice would be required to briefly but fairly describe the proposed conversion plan, inform each member of the right to vote, and be mailed to the member's last known address at least 21 days before the time fixed for the meeting. If the meeting to vote on the plan was held during the company's annual meeting of policyholders, only one combined notice of meeting would be required.

The plan would be adopted upon receiving the affirmative vote of at least two-thirds of the votes cast by eligible members. Members could vote in person or by proxy. Any proxies to be solicited from members would have to be filed with and approved by the commissioner. The number of votes each member could cast would be determined by the bylaws. If the bylaws were silent, each member would cast one vote. The revised articles of incorporation would have to be considered at the same meeting and would require a two-thirds vote for adoption.

After the eligible members had approved the plan, the converted stock company would have to file with the insurance commissioner the minutes of the meeting at which the plan was voted on (unless this requirement was waived by the commissioner) and the revised articles of incorporation and bylaws. Upon a company's request, a business plan could be granted confidential treatment by the commissioner. If granted confidential treatment, the plan would not be subject to disclosure by the commissioner under the Freedom of Information Act.

The Conversion Plan. The conversion plan would have to contain the reasons for the proposed conversion, the effect of the conversion on existing policies; and the subscription rights to eligible members. The plan would have to provide a fair and equitable means of allocating shares of capital stock in the event of an over-subscription to shares by eligible members. (A person insured under a group policy would not be an eligible member under the bill.) Also, the plan would have to provide that any shares not subscribed to by people exercising subscription rights be sold in a public offering through an underwriter, unless the number of shares was so small as not to justify the use of an underwriter. In that case, an alternative method approved by the insurance commissioner could be used. Further, the plan would have to set forth the total price of the capital stock equal to the estimated pro forma market value of the converted stock company or the stock of another company participating in the conversion plan and set forth the purchase price per share of capital stock. Additionally, a plan would have to provide for notice and a clear explanation to eligible members of their right to subscribe to the stock of the converted stock company or the stock of another company participating in the conversion plan.

Conversion Plan: Existing Policies & Members' Subscription Rights. Under a plan, all policies in force on its effective date would continue to remain in force, except that the voting rights of policyholders would be extinguished upon conversion. Participating policies would continue to have the right to receive dividends as provided in the policies. Upon the renewal date of a participating policy, the stock company could issue the insured a non-participating policy as a substitute for a participating policy. (This would not apply to life policies, guaranteed renewable accident and health policies, and guaranteed renewable, non-cancelable accident and health policies.)

Each eligible member would receive, without payment, nontransferable subscription rights to purchase a portion of the capital stock of the converted stock company. As an alternative, the company could provide each eligible member rights to purchase a portion of the capital stock of a corporation organized for the purpose of purchasing and holding all the stock of the converted stock company; an unaffiliated corporation that purchased all of the stock of the converted stock company; or a stock insurance company into which the mutual company was to be merged. Subscription rights would be allocated in whole shares among the eligible members using a fair and equitable formula. The formula could, but need not, take into account how the different classes of policies contributed to the surplus of the mutual company, or any other factors that were fair or equitable.

The board of directors could adopt a plan of conversion that did not rely in whole or in part upon issuing non-transferable subscription rights to members if the commissioner found that the plan did not prejudice the interests of the members, was fair and equitable, and was not inconsistent with the purpose and intent of the chapter. An alternative plan could include a merger of a domestic mutual insurer into a domestic or foreign stock insurer, issuing stock or cash to policyholders instead of subscription rights, or another plan approved by the commissioner. The commissioner could retain, at the company's expense, a qualified expert not otherwise on staff to assist in reviewing the plan.

Limits On Stock Acquisition. The conversion plan would provide that any person or group acting in concert could not acquire more than five percent of the capital stock of the converted stock company or the stock of another company participating in the conversion plan for five years from the effective date of the plan, except with the approval of the insurance commissioner. This limitation would not apply to any entity that was to purchase 100 percent of the capital stock as part of a plan approved by the commissioner.

No director or officer or person acting in concert with director or officer could acquire any capital stock of the converted company for three years after the effective date of the plan, except through a broker/dealer, without the permission of the commissioner. This would not prevent them from purchases through subscription rights (see below). Stock options could not be made available to directors or officers during the two-year period following the effective date of the plan if the aggregate stock holdings of directors and officers would exceed 25 percent of the total number of shares issued if total assets were less than $50 million, or 15 percent if assets were more than $500 million. For companies with assets between $50 million and $500 million, the company size threshold for limiting stock options would be interpolated.

The plan could allow directors and officers to receive, without payment, nontransferable subscription rights to purchase capital stock. The subscription rights would have to be allocated among directors and officers by a fair and equitable formula. The total number of shares that could be purchased could not exceed the 15 to 25 percent limits cited above. Stock purchased by a director or officer could not be sold within one year after the effective date of the conversion.

The plan could allocate to a tax-qualified employee benefit plan nontransferable subscription rights to purchase up to 10 percent of the capital stock of the converted company. This employee benefit plan would be entitled to exercise its subscription rights regardless of the total number of shares purchased by other persons.

Participating Life Policies. The plan would have to provide that a mutual life insurance company's participating life policies in force on the effective date of the conversion be operated by the converted company for dividend purposes as a closed block of participating business, except that any and all classes of group policies could be excluded from the block. (Participating policies are those that pay a dividend to policyholders.)

The plan would have to establish one or more segregated accounts for the benefit of the closed block of business and allocate to those segregated accounts enough assets so that the assets, together with revenue from the closed block of business, were sufficient to support the closed block, including the payment of claims, expenses, taxes, and any dividends. The amount of assets would at least have to equal the amount of reserves then held in connection with the closed block or the minimum reserve permitted by statute or regulation for the closed block, whichever was greater. The amount of assets allocated would be based upon the company's last annual statement, updated to the date of the conversion. The insurance commissioner could waive the closed block requirement if it was in the best interests of the policyholders. The commissioner could permit the discontinuing of a segregated account if its size did not warrant the expense of maintaining it.

Insolvent Insurers. If a mutual insurer became insolvent, its board of directors by a majority vote could request in its petition that the insurance commissioner waive the requirements imposing notice to and policyholder approval of the planned conversion. The petitioner would have to specify both: (1) the method and basis for the issuance of the converted insurer's shares of its capital stock to an independent party in connection with an investment by the independent party in an amount sufficient to restore the insurer to a sound financial condition; and (2) that the conversion would be accomplished without consideration to the past, present, or future policyholders, if the commissioner found that the value of the insurer, due to insolvency, was insufficient to warrant consideration. If the commissioner, upon the review of the plan of conversion and after a financial examination, found that the mutual insurer no longer met statutory requirements with respect to capital, surplus, deposits, and assets, the commissioner could waive, by a written order, the requirement of a vote by eligible members.

Notice To New Policyholders. All members whose polices became effective after the proposed plan had been adopted by the board of directors and before the effective date of the plan of conversion would have to be given written notice of the plan of conversion on or before the 45th day after the plan's effective date. The notice would have to specify the member's right to rescind or cancel the policy. A member of a life or health insurance company would be entitled to rescind the policy and receive a full refund within ten days after he or she had received the notice. Each member of a property or casualty company would be advised of the right of cancellation and to a pro rata refund of unearned premiums.

Challenges. If the mutual insurance company complied substantially and in good faith with the notice requirements of the chapter, the company's failure to give a member the required notice would not impair the validity of any action under the chapter. Any action challenging the validity of, or arising out of, acts taken or proposed to be taken would have to be commenced within 30 days after the effective date of the conversion plan. However, an action based upon non-compliance with a business plan would have to be commenced in Ingham County Circuit Court within three years after the cause of action had accrued or within two years after the time when the cause of action was discovered or reasonably should reasonably have been discovered by the complainant, whichever occurred first.

MCL 500.5901

FISCAL IMPLICATIONS:

The bill would have no fiscal impact on state or local government, according to the Senate Fiscal Agency. (Analysis dated 10-17-95)

ARGUMENTS:

For:

The bill would put into the Insurance Code detailed provisions on how a mutual insurer can convert to a stock insurer. Current provisions are considered inadequate. Industry officials say this legislation will provide a better method for Michigan-based companies to access capital markets. The ability to raise capital through the sale of stock can be important for a number of reasons, including allowing a company to recover from large unanticipated losses (e.g., due to a disaster) and allowing a company to expand its sales (since the amount of insurance a company can extend is related to its available capital). The bill spells out in detail what must be contained in a plan of conversion, including who has "subscription" rights (that is, the ability to purchase stock); the reasons for conversion; and the effect of the conversion of existing policies. The bill also contains special provisions for conversions for insolvent insurers. A plan of conversion would require approval by the insurance commissioner, by two-thirds of the company's board of directors, and by two-thirds of the company's policyholders.

This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.