**STORAGE NAME**: h2247a.in
**DATE**: April 19, 1999

**HOUSE OF REPRESENTATIVES**
**COMMITTEE ON**
**INSURANCE**
**ANALYSIS**

**BILL #**: HB 2247

**RELATING TO**: Mutual Insurance Holding Companies

**SPONSOR(S)**: Representative Tullis

**COMPANION BILL(S)**: SB 2048 (s)

**ORIGINATING COMMITTEE(S)/COMMITTEE(S) OF REFERENCE**:
(1) INSURANCE YEAS 10 NAYS 0
(2)
(3)
(4)
(5)

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I. SUMMARY:

A *domestic* insurance company is one formed under the laws of Florida. A *foreign* insurance company is one formed under the laws of another state. Both domestic and foreign insurers may be *authorized* insurers and, as such, allowed to sell insurance in Florida by obtaining a certificate of authority from the Department of Insurance.

Under Florida law, a mutual insurance holding company is authorized to merge with or acquire certain other insurers, subject to the approval of the Department of Insurance and a majority of the members of each domestic mutual holding company involved in the transaction. However, the type of mergers and acquisitions are limited to certain circumstances.

The bill would prescribe the factors that directors of a domestic insurance company may consider in carrying out their duties. It would similarly prescribe the factors that directors of a domestic mutual insurance holding company may consider in carrying out their duties.

The bill would also authorize a mutual insurance holding company to merge or consolidate with a foreign mutual insurance company.

This bill would have no fiscal impact on state or local government.

Amendments:

On April 19, 1999, the Committee on Insurance adopted three amendments, which are traveling with the bill. See the amendments section of the analysis for an explanation of these amendments.

II. SUBSTANTIVE ANALYSIS:

A. PRESENT SITUATION:

**Florida Domestic Insurance Companies; Florida Corporations Generally**

A *domestic* insurance company is one formed under the laws of Florida. A *foreign* insurance company is one formed under the laws of another state. Both domestic and foreign insurers may be *authorized* insurers and, as such, allowed to sell insurance in Florida by obtaining a certificate of authority from the Department of Insurance.

A Florida domestic insurance company is subject to the requirements of chapter 628, F.S. There are two forms of corporate organizations available to a domestic insurance company: a mutual insurance company and a stock insurance company. A mutual insurance company is owned solely by its policyholders, while a stock insurance company is owned by stockholders. A stock insurance company can be owned by an insurance holding company, which itself may be another stock insurance company or a mutual insurance company.

The primary financial requirements for authorized insurers apply equally to foreign and domestic insurers, but part I of chapter 628 adds requirements and generally provides for a greater degree of state regulation for domestic insurers relating to the board of directors, maintenance of records in this state, limitations on dividends to stockholders, procedures for converting a mutual insurer into a stock insurer and vice-versa, and department approval of acquisition of 5 percent or more of the controlling stock, among other requirements.

Part II of chapter 628, F.S., provides for the formation and operation of *assessable mutual insurers*. These laws were created in 1991 to authorize department approval of a form of group self-insurance, in addition to other types of self-insurance funds that the law currently allows.

Part III of chapter 628, F.S., enacted In 1997, authorizes a new form of domestic insurance corporate organization known as a *mutual insurance holding company*. The creation of this corporate form provided an alternative method for a domestic mutual (policyholder-owned) insurance company to convert into a stock (stockholder-owned) insurance company. This type of organization is explained in greater detail, below.

Part IV, Insurance Holding Companies, provides for the registration and filing of certain information regarding insurance companies that are owned by a holding company or parent company. The law is generally intended to provide for department oversight of the financial transactions between an insurer and affiliated companies.

As provided in s. 628.041, F.S., all of the applicable statutes of Florida that relate to the powers and procedures of domestic private corporations formed for profit apply to domestic stock insurers and to domestic mutual insurers, except: (1) as to any domestic mutual insurer incorporated as a nonprofit corporation pursuant to chapter 617, that chapter governs when in conflict with chapter 607, F.S. (Corporations); and (2) the provisions of the Insurance Code control in the case of any express conflict.

**Factors that Florida Corporate Directors May Consider in Discharging Duties**

Section 628.231, F.S., sets out certain requirements for the board of directors of a domestic insurer, relating to the election, terms, and qualifications of the directors. However, nothing in this section or the rest of the chapter appears to directly relate to the factors that the directors may consider in discharging their duties. Therefore, due to the provisions of s. 628.041, F.S., which apply to domestic insurers, the statutes that relate to the powers and procedures of domestic private corporations formed for profit, the provisions of s. 607.0830, F.S., which specify standards for directors of Florida domestic corporations, would apply to a domestic insurer. This law states:

"(1) A director shall discharge his or her duties as a director, including his or her duties as a member of a committee:
(a) In good faith;

(b) With the care an ordinarily prudent person in a like position would exercise under similar circumstances; and
(c) In a manner he or she reasonably believes to be in the best interests of the corporation.

(3) In discharging his or her duties, a director may consider such factors as the director deems relevant, including the long-term prospects and interests of the corporation and its shareholders, and the social, economic, legal, or other effects of any action on the employees, suppliers, customers of the corporation or its subsidiaries, the communities and society in which the corporation or its subsidiaries operate, and the economy of the state and the nation." [s. 607.0830(1) and (3), F.S.]

Boards of all Florida *nonprofit* corporations are subject to the standards specified in s. 617.0830, F.S., which provides the same standards in subsection (1), of s. 607.0830, F.S., quoted above, but does *not* contain any provisions comparable to subsection (3), quoted above, applicable to for-profit corporations. As provided in s. 628.041, F.S., as to any domestic mutual insurer incorporated as a nonprofit corporation pursuant to chapter 617, that chapter governs when in *conflict* with chapter 607, F.S. It is not clear if the absence of certain standards in chapter 617 would be considered to be in *conflict* with chapter 607 which does contain these standards. Therefore, it is unclear whether these additional standards apply to the directors of a domestic nonprofit mutual insurer.

The analysis is different in the case of a *mutual insurance holding company*, described in more detail below. This type of corporate entity is subject to the provisions of chapter 617, F.S., to the extent that part III of chapter 628 and the Insurance Code are silent with respect to the directors and other matters relating to a mutual insurance holding company (s. 628.707, F.S.). There is no reference to applying any requirements of chapter 607 (for-profit corporations). Therefore, the standards for directors of nonprofit Florida corporations in s. 617.0830, F.S. are applicable to a mutual insurance holding company, and the additional standards that apply to for-profit Florida corporations in s. 607.0830, F.S. do not appear to apply.

Many states have enacted standards similar to Florida's as to the factors that directors of corporations may consider in carrying out their duties. The broad nature of the factors appear to be directed at enabling directors to reject an offer by an outside party to acquire the corporation. Under common law (case law), the directors of a corporation have a fiduciary obligation to represent the interests of their shareholders. This may dictate the acceptance of an acquisition offer that would be in the best interests of the stockholders. However, to protect employees and the local or state economy, laws have been enacted to help shield directors from shareholder lawsuits if the directors reject an acquisition offer, which rejection may not be in the best interests of the corporation's shareholders, but may be based on other factors that the law allows the directors to consider.

For example, Pennsylvania's corporation laws have standards very similar to the Florida law quoted above, with additional standards including "the short-term and long-term interests of the corporation, including benefits that may accrue to the corporation from its long-term plans and the possibility that these interests may be best served by the continued independence of the corporation; [and] the resources, intent and conduct (past, stated and potential) of any person seeking to acquire control of the corporation." [Title 15, Chapter 17, s. 1715, Penn. Stat. (1998)]

**Mutual Insurance Holding Companies**

In 1997, laws were enacted in Florida to create a new form of domestic insurance corporate organization known as a "mutual insurance holding company." The creation of this corporate form provided an alternative method for a domestic mutual (policyholder-owned) insurance company to convert into a stock (stockholder-owned) insurance company. [Ch. 97-216, L.O.F.]

At this time one former mutual insurance company has converted into a mutual insurance holding company, the FCCI Mutual Insurance Holding Company, which now has a stock insurance company subsidiary, the FCCI Insurance Company (and an intermediate holding company between these two companies). This domestic insurer is the state's leading writer of workers' compensation insurance. There are currently 11 domestic mutual insurance companies in Florida, the largest of which is Blue Cross Blue Shield of Florida.

Converting into a stock insurer significantly enhances an insurer's ability to raise capital, issue debt, and engage in mergers and acquisitions. Prior to 1997, the law allowed a domestic mutual insurance

company to convert into a stock insurance company pursuant to s. 628.441, F.S., which remains an option under current law. This requires approval by the Department of Insurance and, among other conditions, requires that the policyholders receive a distribution of cash or stock upon the conversion of the mutual insurer into a stock insurer.

Under the 1997 and current law in part III of chapter 628 (ss. 628.701-628.733, F.S.), a mutual insurance company may convert into a corporate form of a mutual insurance holding company, with a stock insurance company subsidiary. The policyholders of the former domestic mutual insurance company are not entitled to any distribution of cash or stock upon the conversion of the mutual insurance company into a mutual holding company, but they become owner-members of the mutual holding company and are insured by the subsidiary stock insurer (and are entitled to a distribution of cash or stock upon liquidation of the holding company).

Conversion of a domestic mutual insurer into a mutual insurance holding company requires approval of the department. The mutual holding company must have one or more subsidiary stock insurance companies (insuring the policyholders of the former mutual insurance company) and one or more intermediate stock holding companies and other subsidiaries. The subsidiary stock insurance company, or an intermediate stock holding company owned by the mutual holding company, is then able to issue stock, incur debt, and engage in mergers and acquisitions without certain restrictions that limit the flexibility of mutual insurance companies. There are also procedures for the mutual insurance holding company to convert itself into a stock insurance holding company.

The mutual insurance holding company must have the power, either directly or indirectly, to cast at least a majority of votes for election of the board of directors of each subsidiary or intermediate holding company. All of the initial stock in the new subsidiary stock insurance company (i.e., the former mutual insurance company) must be issued either to the mutual holding company or to a wholly-owned intermediate holding company. The insurance company may subsequently issue additional stock, as long as the mutual holding company directly or indirectly owns a majority of the voting shares.

All policyholders of the new subsidiary stock insurance company which was formerly the mutual insurance company, become members of the mutual insurance holding company. Policyholders of other insurance company subsidiaries are not members of the mutual insurance holding company unless the subsidiary is a mutual insurance company that merged with the holding company.

The Department of Insurance may approve the reorganization plan only if the department finds that the plan is fair and equitable to the mutual policyholders. The plan is then submitted to the members of the mutual insurance company and the affirmative votes of a majority of the members is required for approval. The law contains limits on the ability of the officers, directors, and employees of the mutual holding company to receive shares of a subsidiary (stock) company as part of a compensation plan.

**Mergers and Acquisitions involving a Mutual Insurance Holding Company**

Section 628.715, F.S. allows a mutual insurance holding company to merge with or acquire certain other insurers, subject to the approval of the department and a majority of the members of each domestic mutual holding company involved in the transaction. However, the type of mergers and acquisitions are limited to those specified in subsection (1), as follows:

(a) Merge or consolidate with, or acquire the assets of, a mutual insurance holding company licensed pursuant to this act or any similar entity organization pursuant to laws of any other state;
(b) Either alone or together with one or more intermediate stock holding companies, or other subsidiaries, directly or indirectly acquire the stock of a stock insurance company or a mutual insurance company that reorganizes under this act or the law of its state of organization;
(c) Together with one or more of its stock insurance company subsidiaries, acquire the assets of a stock insurance company or a mutual insurance company;
(d) Acquire a stock insurance company through the merger of such stock insurance subsidiary with a stock insurance company or interim stock insurance company subsidiary of the mutual insurance holding company; or
(e) Acquire the stock or assets of any other person to the same extent as would be permitted for any not-for-profit corporation under chapter 617.

The above list does not specifically authorize the merger or consolidation with a foreign mutual insurer. Paragraph (c) allows the mutual insurance holding company, together with one or more of its stock insurance company subsidiaries, to "acquire the assets" of a mutual insurance company, which would include either a foreign or domestic mutual insurance company. But, acquiring the assets of a mutual insurer is fundamentally different that a merger or consolidation. Acquiring the assets involves a purchase or buy-out of another insurer, while a merger or consolidation involves shared ownership and restructuring of the ownership interest of the two entities which, in the case of two mutual insurers, are the ownership interests of the policyholders.

Under the current law, all mergers require the approval of the department, but the department may disapprove a merger only if it finds that the merger would be inequitable to the policyholders of any domestic insurance company involved in the merger or to the members of any domestic mutual holding company involved in the merger, or if the merger would substantially reduce the security of and service to be rendered to policyholders of a domestic insurance company. All mergers also require the approval of a majority of the members of the mutual insurance holding company who actually vote. [s. 628.715(2)(b), F.S.]

A mutual holding company may also convert into a stock holding company, which also requires approval of the department and the affirmative vote of a majority of the mutual holding company's members voting on the question. The department may approve the conversion only if each member's corporate equity is determined under a fair formula based upon not more than the company's net assets, all current members and persons who were members within the preceding 3 years participate, each member has a right to use the equity to acquire stock in the new company at a price not greater than that subsequently offered to others, and that each member has the right to a cash payment of at least 50 percent of the member's equity in lieu of receiving stock. [s. 628.733, F.S.]

**Change of Domicile of a Foreign Insurer to a Domestic Insurer**

Under Florida law, a foreign insurer may become a domestic insurer by complying with all of the requirements of Florida law relative to the organization and licensing of a domestic insurer of the same type and by designating its principal place of business in Florida, upon approval by the department. (s. 628.520, F.S.). However, the insurer's original state of domicile is likely to require approval by that state, and if the insurer is a mutual insurer, the law is likely to require adequate protection of the interests of the policyholders/owners

B. EFFECT OF PROPOSED CHANGES:

The bill would prescribe the factors that directors of a domestic insurance company may consider in carrying out their duties. Some of the standards that would be prescribed are substantially the same as the standards that currently apply to the directors of a for-profit Florida corporation, as specified in s. 607.0830(3), F.S. These standards would allow the directors of a domestic insurance company to consider such factors as they consider to be relevant, including the long-term prospects and interests of the corporation and its shareholders; the social, economic, legal, or other effects of any action on the employees, suppliers, or customers of the corporation or its subsidiaries, the communities and society in which the corporation or its subsidiaries operate; and the economy of the state and nation.

In addition, the bill would add standards for directors of a domestic insurer that are *not* standards that currently apply to Florida corporations in s. 627.080, F.S., such as short-term and long-term interests of the insurer, including but not limited to benefits that may accrue to the insurer from its long-term plans, and the possibility that these interests may be best served by the continued independence of the insurer; the resources, intent, and conduct of any person seeking to acquire control of the insurer; and any other relevant factors. Since these standards do not apply to Florida corporations generally, they would be uniquely applied to the directors of Florida domestic insurance companies, both stock and mutual.

The bill would also prescribe factors that directors of a domestic mutual insurance holding company may consider in carrying out their duties, which would be the same factors as prescribed in the bill for directors of a domestic insurance company. As a result, this bill would apply to directors of a mutual insurance holding company the standards that currently apply to Florida for-profit corporations, as well as the bill's additional standards that are not currently in the Florida corporation law.

Lastly, the bill would authorize a mutual insurance holding company to merge or consolidate with, or acquire the assets of, a foreign mutual insurance company which redomesticates to Florida pursuant to s. 628.520. The members of the foreign mutual insurance company would be authorized to approve in a contemporaneous vote both the redomestication plan and the agreement for merger and reorganization. This bill would have no direct effect on the laws of the state where a foreign mutual insurer is domiciled. Any redomestication of a foreign mutual insurer to Florida and a merger with a Florida mutual insurer will be additionally subject to such other state's laws and, most likely, approval by such state's insurance department.

C. APPLICATION OF PRINCIPLES:

1. Less Government:

a. Does the bill create, increase or reduce, either directly or indirectly:

(1) any authority to make rules or adjudicate disputes?

No.

(2) any new responsibilities, obligations or work for other governmental or private organizations or individuals?

No.

(3) any entitlement to a government service or benefit?

N/A

b. If an agency or program is eliminated or reduced:

(1) what responsibilities, costs and powers are passed on to another program, agency, level of government, or private entity?

N/A

(2) what is the cost of such responsibility at the new level/agency?

N/A

(3) how is the new agency accountable to the people governed?

N/A

2. Lower Taxes:

a. Does the bill increase anyone's taxes?

N/A

b. Does the bill require or authorize an increase in any fees?

N/A

c. Does the bill reduce total taxes, both rates and revenues?

N/A

d. Does the bill reduce total fees, both rates and revenues?

N/A

e. Does the bill authorize any fee or tax increase by any local government?

N/A

3. Personal Responsibility:

a. Does the bill reduce or eliminate an entitlement to government services or subsidy?

N/A

b. Do the beneficiaries of the legislation directly pay any portion of the cost of implementation and operation?

N/A

4. Individual Freedom:

a. Does the bill increase the allowable options of individuals or private organizations/associations to conduct their own affairs?

Yes. The bill would authorize mutual insurance holding companies to merge or consolidate with a foreign mutual insurance company which redomesticates to this state. The bill would also authorize directors of domestic insurers and mutual insurance holding companies to consider a wider range of factors when discharging their duties than is currently authorized by law.

b. Does the bill prohibit, or create new government interference with, any presently lawful activity?

N/A

5. Family Empowerment:

a. If the bill purports to provide services to families or children:

(1) Who evaluates the family's needs?

N/A

(2) Who makes the decisions?

N/A

(3) Are private alternatives permitted?

N/A

(4) Are families required to participate in a program?

N/A

(5) Are families penalized for not participating in a program?

N/A

b. Does the bill directly affect the legal rights and obligations between family members?

N/A

c. If the bill creates or changes a program providing services to families or children, in which of the following does the bill vest control of the program, either through direct participation or appointment authority:

(1) parents and guardians?

N/A

(2) service providers?

N/A

(3) government employees/agencies?

N/A

D. STATUTE(S) AFFECTED:

This bill amends ss. 628.231, 628.715, and 628.723, F.S.

E. SECTION-BY-SECTION ANALYSIS:

N/A

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE AGENCIES/STATE FUNDS:

1. Non-recurring Effects:

N/A

2. Recurring Effects:

N/A

3. Long Run Effects Other Than Normal Growth:

N/A

4. Total Revenues and Expenditures:

N/A

B. FISCAL IMPACT ON LOCAL GOVERNMENTS AS A WHOLE:

1. Non-recurring Effects:

N/A

2. Recurring Effects:

N/A

3. Long Run Effects Other Than Normal Growth:

N/A

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

1. Direct Private Sector Costs:

N/A

2. Direct Private Sector Benefits:

N/A

3. Effects on Competition, Private Enterprise and Employment Markets:

N/A

D. FISCAL COMMENTS:

The broad nature of the factors that could be considered by directors of domestic insurance companies may enable the directors to reject an offer by an outside party to acquire the insurer. The directors would be less likely to be liable to stockholders (or policyholders, in the case of a mutual insurer), by rejecting an offer that may be in the best interests of the stockholders (or policyholders), but based on other factors that the law would allow the directors to consider.

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

N/A

B. REDUCTION OF REVENUE RAISING AUTHORITY:

N/A

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

N/A

V. COMMENTS:

N/A

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

On April 19, 1999, the Committee on Insurance adopted the following three amendments:

**Amendment 1 by Tullis (p. 3, between lines 4 and 5):** would change a time period reference in current law relating to voluntary dissolution of mutual insurance holding companies so that it conforms to another provision of current law.

*(Section 628.729, F.S., currently provides that upon the voluntary dissolution of a mutual insurance holding company, the assets shall be distributed to existing persons who were its members at any time within "the 3-year period" preceding the date of liquidation. Section 628.729 goes on to also*

*provide that the Department of Insurance may "enlarge the 5 year qualification period" if the Department finds that the management of the mutual insurance holding company caused or encouraged the reduction of the number of members. This amendment would revise the 5-year period to a 3-year period to be consistent with the first reference to a 3-year period.)*

**Amendment 2 by Tullis (p. 2, lines 6 and 25):** would revise proposed language in the bill by changing the word "customers" to "policyholders."

**Amendment 3 by Tullis (p. 1, between lines 28 and 29):** would authorize the Department of Insurance to retain outside consultants to evaluate mergers and would require the mutual holding company to pay the costs associated with retaining such consultants.

VII. SIGNATURES:

COMMITTEE ON INSURANCE:

| Prepared by: | Staff Director: |
| --- | --- |
| Robert E. Wolfe, Jr. | Stephen Hogge |