SUBJECT: Converting mutual insurance companies to stock insurance companies

COMMITTEE: Insurance — favorable, without amendment

VOTE: 8 ayes — Smithee, Van de Putte, Averitt, Bonnen, Burnam, Eiland, G. Lewis, Wise

0 nays

1 absent — Olivo

SENATE VOTE: On final passage, April 16 — 31-0

WITNESSES: *(On original version of House companion, HB 2842)*
For — Tom Bond, Millers Mutual Fire Insurance Company; Joy Keller

Against — Rob Schneider, Consumers Union

BACKGROUND: A mutual insurance company is owned entirely by its policyholders and does not issue stock. Profits in a mutual insurance company are distributed among all policyholders through dividends or reductions in premiums.

In recent years, some mutual companies have chosen to convert from mutual companies to publicly-traded stock companies. These conversions can be accomplished in various ways. In one type of conversion, a mutual company issues "subscription rights" to eligible members, which may include policyholders, employees, and company officers and directors. Recipients can use subscriptions to purchase stock before the stock is offered to the general public, usually at a significantly lower price. Another conversion method is to allow executives to create a mutually owned parent company that sells stock to the general public.

DIGEST: SB 1447 would establish regulations and guidelines for the conversion of a mutual insurance company to a stock insurance company. The bill establishes guidelines for conversion plans that would allow policyholders, company employees and officers and directors of the company to buy subscription rights. The board of directors could adopt an alternative conversion plan that did not rely wholly or partially on transferring the right of members to purchase subscription rights if the commissioner found that the plan was fair and equitable and complied with the terms of the law.

Conversion plans would have to provide that each eligible member was to receive, without payment by the member, nontransferable subscription rights to purchase a portion of the capital stock of the converted company and that company policyholders would have the right, before any other party, to purchase 100 percent of the capital stock of the converted company, after capital stock had been offered to company employees and officers and directors.

The conversion plan could give directors and officers up to 35 percent of subscription rights for a company with assets of up to $50 million and up to 25 percent of subscription rights for a company with assets of between $50 and $500 million; and company employees up to 10 percent of subscription rights.

The conversion plan would have to specify that directors and officers would be prohibited from buying additional stock in the company within three years of the conversion, and could not sell stock before the first anniversary of the conversion date.

The conversion plan would have to provide for allocation of subscription rights in whole shares among the eligible members using a fair and equitable formula.   The plan would also have to provide a fair and equitable means for allocating capital stock if there was an oversubscription to shares among eligible members. Policyholders would have the right to purchase stock shares at the lowest available price.

The board of directors of a mutual company would have to adopt, by a two-thirds majority, a conversion plan that met the requirements outlined in the bill. The plan would have to be filed with the insurance commissioner no later than 90 days after adoption.

The company would have to file with the insurance commissioner documents relating to the conversion plan, notices to policyholders and other required information. The commissioner would have to approve or disapprove a conversion plan within 60 days, but could extend this time period by 30 days upon written notice to the company or for 60 days beyond the basic time period if a qualified expert had to be retained to review the information. The qualified expert would be retained at the company's expense. The commissioner would have to approve a conversion plan that was found to be fair and equitable and satisfied requirements applicable to a stock insurance company.

Within 10 business days after filing the documents with the commissioner, the company would have to send each of its members a notice about the conversion plan and their rights to file comments with the commissioner or company. Members would have 30 days from the time notice was sent to submit written comments. The company would have to notify policyholders of a meeting to vote on the plan within 60 days after the commissioner granted approval. The notice would have to explain briefly but fairly the proposed conversion plan and inform the member of the member's right to vote on the plan.

The plan would have to be approved by at least two-thirds of eligible members. The company would have to submit to the insurance commissioner the minutes of the meeting and any approved changes to the articles of incorporation and bylaws of the converted stock company.

The conversion plan would have to include provisions that each policy in effect before the conversion would remain in effect under the terms of that policy, except that a member’s voting rights and rights to share in a company's surplus or profits would be extinguished on the effective date of the conversion.

The board of directors of a mutual company that was insolvent or in hazardous financial condition could petition the commissioner to waive policyholder notice and approval requirements. The petition would have to specify the method and basis for issuing the company's shares of its capital stock that would restore the company to a sound financial position and that the conversion was to be accomplished without payment of consideration to past, present, or future policyholders if the commissioner found that the value of the company was not sufficient to warrant this consideration.

Members whose policies were issued after the conversion plan was adopted but before its effective date could cancel their policies and receive a pro rata refund of premium, provided they had not made or filed a claim. A person who received a refund could not then make or file a claim under the policy.

A converted mutual company would be subject to all rights, privileges and requirements imposed on stock companies and could not exercise rights or privileges that other stock companies did not have. Unless otherwise specified in the conversion plan, the directors and officers of the mutual insurance company would continue to serve until new directors and officers were elected under the bylaws of the converted stock company.

SB 1447 would take effect September 1, 1997.

SUPPORTERS SAY:

SB 1447 would enable the few mutual companies operating in Texas to convert to stock companies, thereby gaining greater access to capital and improve their competitive position in today's market. The bill would fill a void in the law, which is silent about such conversions.

Six mutual insurance companies registered in Texas would be affected by the bill, and only about half of these would have the potential to convert to stock companies. Only one mutual company, the Fort Worth-based Millers Mutual Fire Insurance Company, has indicated a clear desire to convert to a stock insurance company.

SB 1447 was carefully crafted to protect the interests of policyholders while enabling companies to attract increased capital. The bill would allow directors and officers of the company to purchase up to 35 percent of offered shares. Most companies would probably offer these shares at market price in order to generate income. If officers and directors were not allowed to purchase a significant share of stock, the stock offering would not be profitable because policyholders could buy shares at less-than-market rates. Further, these officers and directors should be able to benefit from their significant contributions to the company's success. Under the bill, the insurance commissioner would have to approve this arrangement and certify that it was fair and equitable.

Company employees would be able to buy 10 percent of shares, and policyholders could buy the remaining 55 percent, which would give them controlling interest in the company and oversight of the board of directors. The bill specifies that policyholders could buy shares at the lowest available purchase price. Policyholders would be almost assured of a financial windfall when the stock was issued to the general public.

Conversions allowed by SB 1447 would be conducted under the oversight of the insurance commissioner. The commissioner would have the power to reject a conversion plan outright or to have the terms adjusted so that policyholders would be protected.

OPPONENTS SAY:

SB 1447 would allow insurance executives to reap huge profits at the expense of policyholders. SB 1447 would authorize officers and directors of the company to buy up 35 percent of the shares and employees to buy up another 10 percent before policyholders could buy the remaining 55 percent. Policyholders own mutual insurance companies, and they should get 100 percent of profits if a majority of the policyholders approve a plan to go public. Company executives should not put themselves and their employees in line for profits ahead of policyholders.

SB 1447 does not contain adequate notice and hearing provisions to ensure that the interests of policyholders would be protected. The company would only have to provide a brief explanation if the conversion process were approved. Many policyholders may not be sophisticated enough to understand the financial opportunity that was being offered with the brief explanation allowed by the bill.

SB 1447 contains no requirement that the conversion be in the best interests of the policyholder. The bill includes only a vague requirement that the commissioner determine that the conversion should be fair and equitable. Even though policyholders could purchase 55 percent of stock in the company, there are no protections in the bill to ensure that policyholders maintain meaningful control over the board of directors.

Policyholders should not even have to purchase stock shares. They own the company and should be given a portion of stock that reflects their ownership share in the company.