

## **BILL ANALYSIS**

Senate Research Center

C.S.S.B. 1447  
By: Harris  
Economic Development  
4-11-97  
Committee Report (Substituted)

### **DIGEST**

Currently, the Insurance Code does not provide a process for domestic mutual insurance companies to convert to stock insurance companies. Conversion provides an insurer with greater access to capital markets and the ability to better compete in the marketplace. Other states authorize these conversions and some Texas domestic insurance companies may redomesticate to one of these states to take advantage of those laws. This bill would allow for the conversion of mutual insurance companies to stock insurance companies and include safeguards for policyholders of the mutual insurance company.

### **PURPOSE**

As proposed, C.S.S.B. 1447 sets forth the regulations and guidelines for the conversion of a mutual insurance company to a stock insurance company and provides safeguards for policyholders of the mutual insurance company.

### **RULEMAKING AUTHORITY**

The bill does not grant any additional rulemaking authority to a state officer, institution, or agency.

### **SECTION BY SECTION ANALYSIS**

SECTION 1. Amends Chapter 15, Insurance Code, by adding Article 15.22, as follows:

#### Art. 15.22. CONVERSION TO STOCK INSURANCE COMPANY

Sec. 1. DEFINITIONS. Defines "conversion plan," "converted stock company," "eligible member," "mutual insurance company," "participating policy," and "stock company."

Sec. 2. ADOPTION OF CONVERSION PLAN. Requires a mutual insurance company that seeks to convert to a stock company to adopt by an affirmative vote a conversion plan consistent with the requirements of this article. Prohibits a mutual insurance company from engaging in the business of insurance as a stock company until it complies with the requirements of this article. Requires the mutual insurance company to comply with Section 3 before a conversion plan vote.

Sec. 3. PLAN INFORMATION FILED WITH COMMISSIONER; COMMISSIONER POWERS AND DUTIES. (a) Requires a company, no later than the 90th day after the date on which a mutual insurance company's board of directors adopts a conversion plan, to file with the commissioner of insurance (commissioner) a copy of the documents relating to the conversion plan, including the independent evaluation of pro forma market value required by Section 10(b) of this article; the form of notice required by Section 5 of this article; the form of proxy to be solicited from eligible members under Subsection 6(b) of this article; the form of notice required by Section 16 of this article to persons whose policies are issued after adoption of the conversion plan but before the effective date of the conversion plan; the proposed amended or restated articles of incorporation of the converted stock company; a statement regarding acquisition of control, if applicable, as required by Article 21.49-1 of this code; and any other information requested by the commissioner.

(b) Requires the commissioner, except as otherwise provided by this subsection, to approve or disapprove a conversion plan no later than the 60th day after the first day on which all the documents required under Subsection (a) of this section are filed with the commissioner. Authorizes the commissioner to extend the time for approval or disapproval by an additional 30 days on written notice to the mutual insurance company. Prohibits the commissioner from extending the time for approval or disapproval beyond this time period unless he finds it necessary to retain a qualified expert pursuant to Subsection (d), in which case he may extend the time to review for an additional 60 days beyond the initial 60-day period. Requires the commissioner to immediately give written notice to the mutual insurance company of the commissioner's decision and, in the event of disapproval, a detailed statement of the reasons for the adverse decision.

(c) Requires the commissioner to approve a conversion plan if the commissioner finds that the conversion plan complies with this article; the conversion plan's method of allocating subscription rights or other value is fair and equitable; and the converted stock company would satisfy the current requirements applicable to a domestic stock company for a certificate of authority.

(d) Authorizes the commissioner to retain, at the mutual insurance company's expense, a qualified expert to assist the commissioner in reviewing the conversion plan and the independent evaluation of the pro forma market value required under Section 10(b).

(e) Authorizes the commissioner to hold a hearing on the terms of the conversion plan after notice is given to certain entities and persons. Provides that notice to interested persons who have not filed an appearance in the matter may be made through publication in the Texas Register.

Sec. 4. AMENDMENTS; WITHDRAWAL OF PLAN. Authorizes the mutual insurance company, at any time before the conversion plan becomes effective, by an affirmative vote of two-thirds of the members of its board of directors, to amend or withdraw the conversion plan.

Sec. 5. NOTICE TO ELIGIBLE MEMBERS; COMMENTS. (a) Requires the mutual insurance company, within 10 business days after filing the documents required under Section 3(a) with the commissioner, to send to each eligible member a notice advising the eligible member of the adoption and filing of the conversion plan and of the member's right to provide to the commissioner and the mutual insurance company comments on the plan. Requires the notice to include certain information.

(b) Requires an eligible member who elects to make comments to make the comments in writing by the 30th day after the date on which the notice is sent.

(c) Requires the mutual insurance company, within 60 days after the commissioner's approval of the plan, to send to eligible members notice of the members meeting to vote on the conversion plan. Requires the notice to be sent to the member's last known address before the 30th day preceding the date set for the meeting. Requires the notice to contain certain information.

(d) Provides that only a combined meeting notice is required if the meeting to vote on the conversion plan is held during the mutual insurance company's annual meeting of policyholders.

Sec. 6. ELECTION; ADOPTION OF PLAN. Provides that a conversion plan is adopted on receiving the affirmative vote of at least two-thirds of the votes cast by eligible members at a duly convened meeting to consider the plan of conversion. Sets forth the voting guidelines. Requires the members, at the meeting held to vote on the conversion plan, to consider the adoption of amended or restated articles of incorporation. Provides that adoption of the amended articles requires the affirmative vote of at least two-thirds of the votes cast by eligible members.

Sec. 7. **FILING BY CONVERTED STOCK COMPANY.** Requires the converted stock company to file with the commissioner certain items by the 30th date after the date on which the eligible members adopt the conversion plan.

Sec. 8. **REQUIRED PROVISIONS IN GENERAL.** Requires each conversion plan to include the provisions required by this article. Provides that the following rights are extinguished on the effective date of the conversion: any voting rights of policyholders provided under the policy; except as provided in Subsection (c), a right to share in the surplus or profits of the mutual insurance company; and any assessment provisions provided under the policy. Provides that the holder of a participating policy in effect on the date of the conversion continues to have a right to receive dividends as provided by the participating policy. Authorizes a certain converted stock company to issue the insured a nonparticipating policy as a substitute for the participating policy.

Sec. 9. **SUBSCRIPTION RIGHTS.** (a) Requires each conversion plan, except for an alternative plan under Section 14 of this article, to specify the subscription rights of eligible members.

(b) Requires the plan to include provisions that each eligible member is to receive nontransferable subscription rights to purchase a portion of the capital stock of the converted stock company; and in the aggregate, all eligible members have the right, before the right of any other party, to purchase 100 percent of the capital stock of the converted company after provisions for capital stock required to be sold or distributed to the holders of surplus notes, if any; capital stock purchased by the company's tax-qualified employee stock benefit plan as permitted by Section 13(c) of this article; and capital stock acquired by the mutual insurance company's directors and officers, as permitted by Section 13(a) of this article.

(c) Authorizes the conversion plan to provide that each eligible member is to receive nontransferable subscription rights to purchase a portion of certain capital stock as an alternative to subscription rights in the converted stock company.

(d) Requires the conversion plan to provide that the subscription rights are allocated in whole shares among the eligible members using a fair and equitable formula. Authorizes the formula to consider certain factors or any factors that may be fair or equitable as determined by the board of directors.

(e) Requires the conversion plan to provide a fair and equitable means for allocating shares of capital stock in the event of an oversubscription to shares by eligible members exercising subscription rights under this section.

Sec. 10. **SALE OF CAPITAL STOCK.** (a) Requires the conversion plan to provide that any shares of capital stock not sold or distributed to holders of surplus notes, subscribed to by a tax-qualified employee benefit plan, as permitted under Section 13(c), subscribed to by directors and officers, as permitted under Section 13(a), or subscribed to by eligible members exercising subscription rights under Section 9 to be sold in a private placement, public offering, or other alternative method approved by the commissioner.

(b) Requires the conversion plan to set the total price of the capital stock in an amount equal to the estimated pro forma market value of the converted stock company based on an independent evaluation by a qualified expert, giving consideration to the amount of capital deemed necessary by the board of directors to be raised by the company. Authorizes the pro forma market value to be the value estimated to be necessary to attract full subscription for the shares, as indicated by the independent valuation, and to be stated as a range of values.

(c) Requires the conversion plan to set the purchase price per share of capital stock at any reasonable amount. Provides that the purchase price per share need not be the same for

each class of purchaser; provided, however, that eligible members purchasing stock pursuant to subscription rights received under Section 9 of this article shall have the right to purchase shares at the lowest available purchase price under the plan.

(d) Requires the conversion plan to provide that a person or group of persons acting in concert may not acquire, in the public or private offering or through the exercise of subscription rights, more than 10 percent of the capital stock of the converted stock company except with the approval of the commissioner. Provides that this limitation does not apply to an entity that purchases 100 percent of the capital stock of the converted company as part of the conversion plan approved by the commissioner.

(e) Requires the conversion plan, except as otherwise provided in this article, to provide that a director or officer of the mutual insurance company, or a person acting in concert with a director or officer, may not acquire without the permission of the commissioner any capital stock of the converted stock company or the stock of another corporation that is participating in the conversion plan before the third anniversary of the effective date of the conversion, except through a broker-dealer. Provides that this subsection does not prohibit a director or officer from making purchases through the exercise of subscription rights received under the conversion plan; or participating in a stock benefit plan permitted by Section 13(c) of this article or approved by the eligible members pursuant to Section 6 of this article.

Sec. 11. **LIMITATION ON RESALE.** Requires the conversion plan to provide that a director or officer may not sell stock purchased pursuant to the conversion plan before the first anniversary of the effective date of the conversion; provided, however, the conversion plan may provide for the purchase or redemption of stock in the event that a director or officer is no longer associated with the converted stock company during such period.

Sec. 12. **HOLDER OF SURPLUS NOTE.** Requires the conversion plan to provide that the rights of a holder of a surplus note to participate in the conversion are governed by the terms of the surplus note.

Sec. 13. **OPTIONAL PROVISIONS.** Authorizes the conversion plan to provide that the directors and officers of the mutual insurance company receive certain nontransferable subscription rights to purchase capital stock of the converted stock company or the stock of another corporation that is participating in the conversion plan. Sets forth purchasing guidelines relating to the aggregate number of shares that may be purchased by directors and officers of the mutual insurance company under Subsection (a). Authorizes the conversion plan to allocate to a tax-qualified employee benefit plan nontransferable subscription rights to purchase no more than 10 percent of the capital stock of the converted stock company. Authorizes the conversion plan to provide for the creation of a certain liquidation account for the benefit of members in the event of voluntary liquidation after conversion.

Sec. 14. **ALTERNATIVE CONVERSION PLAN.** (a) Authorizes the board of directors to adopt a conversion plan that does not rely wholly or partially on issuing nontransferable subscription rights to members to purchase stock of the converted stock company if the commissioner finds that the alternative conversion plan complies with this article; is fair and equitable; and permits the converted stock company to satisfy the current requirements applicable to a domestic stock company for a certificate of authority.

(b) Authorizes an alternative conversion plan to include the merger of a domestic mutual insurance company into a domestic or foreign stock company; provide for issuing stock, cash, or other consideration to members instead of subscription rights; provide for the formation of a mutual holding company pursuant to Section 24 of this article; or set forth another plan containing any other provisions approved by the commissioner.

(c) Authorizes the commissioner to retain, at the mutual insurance company's expense, a qualified expert to assist in reviewing whether the alternative conversation plan may be approved by the commissioner.

Sec. 15. EFFECTIVE DATE OF CONVERSION. Sets forth the required conditions for a conversion plan to take effect. Provides that a conversion plan takes effect when the amended or restated articles of incorporation are filed with the commissioner.

Sec. 16. RIGHTS OF MEMBERS WHOSE POLICIES ARE ISSUED AFTER ADOPTION OF CONVERSION PLAN AND BEFORE EFFECTIVE DATE. (a) Requires the mutual insurance company to send to the member to whom a policy is issued a written notice regarding the conversion plan on issuance of a policy after a conversion plan has been adopted by the board of directors but before the effective date of the conversion plan.

(b) Entitles a certain notified member of an accident and health insurance company to rescind the member's policy and receive a full refund of any amount paid for the policy no later than the 10th day after the date on which the member receives the notice.

(c) Provides that each member who is insured under a property or casualty insurance policy is entitled to receive the notice prescribed by Subsection (a) and shall be advised of certain rights.

(d) Provides that a member who has made or filed a claim under the insurance policy is not entitled to a right to receive a refund under Subsection (b) or (c). Provides that a person who has exercised the rights provided by Subsection (b) or (c) is not entitled to make or file a claim under the insurance policy.

Sec. 17. CORPORATE EXISTENCE. Provides that on the effective date of the conversion, the corporate existence of the mutual insurance company continues in the converted stock company; and all assets, rights, franchises, and interests of the mutual insurance company in and to property, real, personal, or mixed, and any accompanying things in action, are vested in the converted stock company and the converted stock company assumes all the obligations and liabilities of the mutual insurance company. Provides that the directors and officers of the mutual insurance company serving on the effective date of the conversion serve as directors and officers of the converted stock company until new directors and officers of the converted stock company are elected under the articles of incorporation and bylaws of the converted stock company.

Sec. 18. CONFLICT OF INTEREST. (a) Prohibits certain persons of the mutual insurance company from receiving certain consideration. Provides that this subsection does not prohibit the payment of reasonable fees and compensation to an attorney, accountant, or actuary for professional services performed by that person, even if the attorney, accountant, or actuary is also a director or officer of the mutual insurance company.

(b) Requires all the costs and expenses connected with a conversion plan to be paid for or reimbursed by the mutual insurance company or the converted stock company.

Sec. 19. EFFECT OF FAILURE TO GIVE NOTICE. Provides that the mutual insurance company's failure to send a member the required notice does not impair the validity of any action taken under this article if the mutual insurance company complies substantially and in good faith with the notice requirements of this article.

Sec. 20. LIMITATION ON ACTIONS. Requires an action challenging the validity of or arising out of facts taken or proposed to be taken regarding a conversion plan under this article to be commenced by the 30th day after the effective date of that conversion plan.

Sec. 21. INSOLVENT MUTUAL INSURANCE COMPANY. Authorizes the board of directors of a mutual insurance company that is insolvent or in hazardous financial condition to request, by a majority vote, the commissioner to waive the requirements imposing notice to and policyholder approval of the planned conversion. Requires the petition to specify certain items.

Sec. 22. LAWS APPLICABLE TO CONVERTED STOCK COMPANY. Prohibits a mutual insurance company from being permitted to convert under this article if any person or any affiliate acquires control of the converted stock company, unless that person or the affiliate complies with the requirements of Section 5, Article 21.49-1 of this code. Provides that a stock company converted under this article has all of the rights and privileges and is subject to all of the requirements and regulations imposed on stock companies formed under this code and any other laws of this state relating to the regulation and supervision of insurance companies.

Sec. 23. AMENDMENT OF POLICIES. Authorizes a mutual insurance company to simultaneously with or at any time after the adoption of a conversion plan amend any outstanding insurance policies to extinguish the right, if any, of the holder of the policy to share in the surplus or profits of the mutual insurance company. Provides that such an amendment is void if the conversion plan does not take effect.

Sec. 24. MUTUAL HOLDING COMPANY. (a) Authorizes a mutual insurance company, on approval by the commissioner, to reorganize by forming an insurance holding company based on a mutual plan and continuing the corporate existence of the reorganization insurance company as a stock insurance company. Requires the commissioner, if satisfied that the requirements of Section 14 are met, to approve the proposed plan of reorganization and may require as a condition of approval such modification of the proposed plan of reorganization as the commissioner finds necessary for the protection of the members' interests. Authorizes the commissioner to retain a qualified expert as provided in Section 3(d). Requires the commissioner to retain jurisdiction over a mutual holding company organized pursuant to this section to assure that member interests are protected. Requires all of the initial shares of the capital stock of the reorganized insurance company to be issued to the mutual holding company. Requires the membership interests of the policyholders of the reorganized insurance company to become membership interests in the mutual holding company. Requires the eligible members of the reorganized insurance company to be members of the mutual holding company in accordance with the articles of incorporation and bylaws of the mutual holding company. Requires the mutual holding company, at all times, to own a majority of the voting shares of the capital stock of the reorganized insurance company or of an intermediate holding company established to hold the voting shares of the reorganized insurance company.

(b) Authorizes a foreign mutual insurance company to reorganize on approval by the commissioner and in compliance with the requirements of any law or regulation which is applicable to the foreign mutual insurance company by transferring its members' membership interest into a mutual holding company formed under a procedure similar to that described in Subsection (a) and continuing the corporate existence of the reorganizing foreign mutual insurance company as a foreign stock insurance company subsidiary of the mutual holding company. Authorizes the reorganizing foreign mutual insurance company to remain a foreign company and to be admitted to do business in this state. Authorizes a foreign mutual insurance company at the same time to redomesticate in this state by complying with the applicable requirements of Article 1.38.

(c) Requires a mutual holding company resulting from the reorganization of a domestic mutual insurance company organized under this chapter to be incorporated pursuant to Article 15.02 and the Texas Non-Profit Corporation Act (Article 1396-1.01 et seq., V.T.C.S.). Requires the articles of incorporation, and any amendments to such articles, of the mutual holding company to be subject to approval of the commissioner in the same manner as those of a mutual insurance company.

(d) Provides that a mutual holding company is deemed to be an insurer subject to this chapter and shall automatically be a party to any administrative proceeding under this code involving an insurance company which, as a result of reorganization pursuant to this section, is a subsidiary of the mutual holding company. Provides that in any proceeding involving the reorganized insurance company, the assets of the mutual holding company are deemed to be assets of the estate of the reorganized insurance company for purpose

of satisfying the claims of the reorganized insurance company's policyholders. Prohibits a mutual holding company from dissolving or liquidating without the approval of the commissioner.

(e) Prohibits a membership interest in a mutual holding company from constituting a security as defined in Section 4, the Securities Act (Article 581-4, V.T.C.S.).

(f) Prohibits the majority of the voting shares of the capital stock of the reorganized insurance company from being conveyed, transferred, assigned, pledged, subjected to a security interest or lien, encumbered, or otherwise hypothecated or alienated by the mutual holding company or intermediate holding company. Provides that any conveyance, transfer, assignment, pledge, security interest, lien, encumbrance, or hypothecation or alienation of, in, or on the majority of the voting shares of the reorganized insurance company is in violation of this section and shall be void in inverse chronological order from the date of such conveyance, transfer, assignment, pledge, security interest, lien, encumbrance, or hypothecation or alienation as to the shares necessary to constitute a majority of such voting shares.

(g) Defines "majority of the voting shares of the capital stock of the reorganized insurance company." Provides that the ownership of a majority of the voting share of the capital stock of the reorganized insurance company which are required by this section to be at all times owned by a parent mutual holding company includes indirect ownership through one or more intermediate holding companies in a corporate structure approved by the commissioner. Prohibits indirect ownership through one or more holding intermediate holding companies from resulting in the mutual holding company owning less than the equivalent of a majority of the voting shares of the capital stock of the reorganized insurance company. Defines "intermediate holding company."

(h) Authorizes a mutual holding company to convert to a stock holding company pursuant to the provisions of this article as if such mutual holding company were a mutual insurance company.

SECTION 2. Effective date: September 1, 1997.

SECTION 3. Emergency clause.

## **SUMMARY OF COMMITTEE CHANGES**

SECTION 1.

Amends Section 1, Article 15.22, Insurance Code, to revise the proposed definitions of "conversion plan" and "converted stock company." Amends Section 3, Article 15.22, Insurance Code, to revise proposed Subsections (a)-(c) and (e). Amends Section 4, Article 15.22, Insurance Code, to revise proposed provisions. Amends Section 5, Article 15.22, Insurance Code, to revise proposed Subsections (a) and (c). Amends Section 6, Article 15.22, Insurance Code, to revise proposed Subsections (a) and (c). Amends Section 7, Article 15.22, Insurance Code, to make conforming changes. Amends Section 8, Article 15.22, Insurance Code, to revise proposed Subsection (b). Amends Section 9, Article 15.22, Insurance Code, to revise proposed Subsections (a), (b) and (d). Amends Section 10, Article 15.22, Insurance Code, to revise proposed Subsections (a)-(e). Amends Section 11, Article 15.22, Insurance Code, to revise proposed provisions. Omits Section 13, Article 15.22, Insurance Code, Repurchase of Capital Stock, and replaces it with proposed Section 14, Article 15.22, Insurance Code, Optional Provisions. Redesignates proposed Sections 14-24 as Sections 13-23, Article 15.22, Insurance Code. Amends Section 13, Article 15.22, Insurance Code, to revise proposed Subsections (a)-(c). Amends Section 14, Article 15.22, Insurance Code, to revise proposed Subsections (a)-(c). Omits rulemaking authority granted to the commissioner in Subsection (c). Amends Section 15, Article 15.22, Insurance Code, to revise proposed Subsections (a) and (b). Amends Section 16, Article 15.22, Insurance Code, to revise proposed Subsections (c) and (d). Amends Section 17, Article 15.22,

Insurance Code, to revise proposed Subsection (a). Amends Section 18, Article 15.22, Insurance Code, to revise proposed Subsection (b) and omit proposed Subsection (c). Amends Section 22, Article 15.22, Insurance Code, to revise proposed Subsection (a). Amends Section 23, Article 15.22, Insurance Code, to revise proposed provisions. Adds Section 24, Article 15.22, Insurance Code, Mutual Holding Company.

## SECTION 2.

Makes a nonsubstantive change.