SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based only on the provisions contained in the legislation as of the latest date listed below.)

BILL: CS/SB 2048

SPONSOR: Banking and Insurance Committee, Senator Diaz-Balart and others

SUBJECT: Insurance (Board of Directors of Domestic Insurer)

DATE: April 13, 1999 REVISED: _____ _____ _____ _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Deffenbaugh	Deffenbaugh	BI	Favorable/CS
2.				
3.				
4.				
5.				

I. Summary:

Committee Substitute for Senate Bill 2048 prescribes the factors that directors of a domestic insurance company and a domestic mutual insurance holding company may consider in carrying out their duties. Some of these factors currently apply to Florida for-profit corporations, generally, allowing directors to consider the social and economic effects of any action on the employees, suppliers, customers, the communities and society in which the corporation operates, and the economy of the state and the nation. Expressly applying such factors to a domestic stock insurance company appears to be a mere clarification of current law. Applying such factors to a domestic, *nonprofit mutual insurance company* may also be a clarification of current law, but this is less certain. It appears to be a substantive change, however, to apply such factors to a *domestic mutual insurance holding company*, a new form of domestic insurance corporate organization created by 1997 legislation as an alternative method for a domestic mutual (policyholder-owned) insurance company to convert into a stock (stockholder-owned) insurance company.

Certain factors that the bill allows directors of domestic insurers and domestic mutual insurance holding companies to consider, are *not* contained in the current Florida corporation laws and, as such, are substantive changes. These factors include "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, past, stated, and potential, of any person seeking to acquire control of the insurer." Since these factors are not in the current Florida corporation laws, they would be unique to directors of domestic insurer and domestic mutual insurance holding companies.

These changes and the broad nature of the factors may enable the directors of domestic insurers to reject (or accept) an offer by an outside party to acquire the insurer, which action may not be in the best interests of the stockholders or, in the case of a mutual insurer, the policyholder-owners. The directors may be less likely to be liable to stockholders (or policyholders) by taking actions that may be in the best interests of the stockholders (or policyholders), based on other factors that the law would allow the directors to consider.

The bill also authorizes a mutual insurance holding company to merge or consolidate with a foreign mutual insurance company. The current law allows a mutual insurance holding company to "acquire the assets" of a foreign or domestic mutual insurance company, but this is fundamentally different from 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 policyholders of the two entities.

This bill substantially amends the following sections of the Florida Statutes: 628.231, 628.715, and 628.723.

II. 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 (1997 Law creating part III of Ch. 628, F.S.)
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 (s. 628.715, F.S.)

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.

III. Effect of Proposed Changes:

Senate Bill 2048 prescribes 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 authorizes a mutual insurance holding company to merge or consolidate with a foreign mutual insurance company.

The effect of these proposed changes is more particularly described in the section-by-section analysis, below.

Section 1 amends s. 627.231, F.S., relating to directors of a domestic insurance company, to prescribe the factors that the directors may consider in carrying out their duties. Some of the standards that are listed 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 (on page 1, lines 19-26 of the bill) allow the directors to consider such factors as they consider to be 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, or policyholders 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."

Since these standards are substantially the same as in the current corporation law, they currently apply to a Florida domestic stock (for profit) insurer. However, it is not clear whether they currently apply to a nonprofit domestic mutual insurer, since it is not clear whether they are in "conflict" with standards contained in chapter 617 for nonprofit corporations. (See the explanation in Present Situation.) Therefore, the bill would have the effect of clearly and expressly making these standards applicable to the directors of domestic nonprofit mutual insurers, as well as domestic (for profit) stock insurers.

The bill *adds* the following standards (on page 1, line 27 through page 2, line 3) for directors of a domestic insurer that are *not* standards that currently apply to Florida corporations in s. 627.080, F.S.: "The directors may also consider the short-term and long-term interests of the insurer, including 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, past, stated, and potential, of any person seeking to acquire control of the insurer; and any other relevant factors." (These standards are substantially the same as contained in the current Pennsylvania corporation law, discussed in Present Situation, above.) 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 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.

Section 2 amends s. 628.715, F.S., relating to mergers and acquisitions involving mutual insurance holding companies. The bill would allow 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.

Currently, mutual insurance holding companies are authorized to merge or consolidate with, and acquire assets of, certain types of insurers, as detailed in Present Situation, above. But, the law does not specifically authorize merger or consolidation with a foreign mutual insurer. The current law allows a mutual insurance holding company, together with one or more of its stock insurance company subsidiaries, to "acquire the assets" of a foreign or domestic mutual insurance company. But, acquiring the assets of a mutual insurer is fundamentally different from 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.

A merger involving two mutual insurers, owned by their policyholders, subject to two different state laws, will involve many issues relating to the need to adequately protect the interests of the policyholders/owners of each insurer which are likely to be complex and controversial. The Florida law (unchanged by the bill) would require department approval prior to any such merger. The department must approve the merger unless 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.

The bill (or any Florida law) has 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.

Section 3 amends s. 628.723, F.S., relating to the directors of a mutual insurance holding company. The bill prescribes factors that the directors may consider in carrying out their duties, which are the same factors prescribed in Section 1, for directors of a domestic insurance company. The effect is different, however, in the case of a mutual insurance holding company which is currently 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 currently 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. The 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, all of which would appear to be substantive changes.

As in Section 1 for directors of a domestic insurer, the changes in Section 3 for directors of a domestic mutual insurance holding company, may enable the directors to reject (or accept) an offer by an outside party to acquire the insurer, which action may not be in the best interests of the policyholder owners. The directors would be less likely to be liable to policyholders (owners), by taking actions that may not be in the best interests of the policyholders, but are based on other factors that the law would allow the directors to consider.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

By prescribing broad factors that the directors of domestic insurance companies (Section 1) and domestic mutual insurance holding companies (Section 3) may consider, the bill may enable the directors to reject (or accept) an offer by an outside party to acquire the insurer or the holding company, which action may not be in the best interest of the stockholders or, in the case of a mutual insurer or holding company, the policyholder-owners. The directors would be less likely to be liable to stockholders or policyholder-owners, by actions that may not be in the best interests of the stockholders or policyholders, based on other factors that the law would allow the directors to consider. However, in the case of domestic insurance companies (Section 1), particularly domestic stock insurers, current law standards are also quite broad and may have the same effect, but for domestic mutual insurance holding companies (Section 3), the changes appear to have a much more substantive impact. All these changes would appear to benefit the directors and employees of domestic insurers and possibly protect the local and state economy, in general, to the possible detriment of stockholders of domestic stock insurers and policyholders of domestic mutual insurers.

Section 2 would allow a mutual insurance holding company (of which there is only one such company, currently) to merge or consolidate with a foreign mutual insurance company which redomesticates to Florida. A merger or consolidation involves shared ownership and

restructuring of the policyholder ownership interests of the two mutual insurers. This will involve many issues surrounding the need to adequately protect the interests of the policyholder/owners which are likely to be complex and controversial, subject to approval by the Department of Insurance and, most likely, the state of domicile of the foreign insurer. 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.

C. Government Sector Impact:

The Department of Insurance is authorized to hold public hearings, and would be expected to do so, if a mutual insurance holding company proposes to merge or consolidate with a foreign mutual insurance company which redomesticates in Florida. Any such proposal is likely to result in a significant use of department resources to analyze any such proposal.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Amendments:

None.