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 182

SPONSOR: Banking and Insurance Committee and Senator Diaz-Balart

SUBJECT: Insurance (Board of Directors of Domestic Insurers)

DATE: February 8, 2000 REVISED: _____ _____ _____ _____

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

I. Summary:

CS/SB 182 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, which allow directors to consider the social and economic effects of any action on the employees, suppliers, customers, and the communities in which the corporation operates. Other factors are not contained in the current Florida corporation laws and would be unique for directors of domestic insurers and mutual insurance holding companies. These would allow the directors to consider "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." Such factors may provide greater protection to the directors to reject (or accept) an offer by an outside party to acquire the insurer, and not be liable in a stockholder or policyholder suit alleging that such action is not in their best interests.

The bill also authorizes a mutual insurance holding company to merge or consolidate with a foreign mutual insurance company. A mutual insurance holding company is a form of domestic insurance corporate organization authorized by 1997 legislation as an alternative method for a domestic mutual (policyholder-owned) insurance company to convert into a stock (stockholder-owned) 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 legally different than 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, 628.723, and 628.729.

II. Present Situation:

Florida Domestic Insurance Companies
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 in Florida by obtaining a certificate of authority from the Department of Insurance to transact insurance in Florida.

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 financial requirements for authorized insurers apply equally to foreign and domestic insurers, but part I of chapter 628 provides additional requirements and stronger state oversight 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 acquisitions, among other requirements.

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

The provisions of chapter 607, F.S., which establish requirements for Florida corporations, apply to domestic insurers, except that: (1) the provisions of chapter 617, which establish requirements for Florida nonprofit corporations, apply to any domestic mutual insurer incorporated as a nonprofit corporation, if in conflict with chapter 607, F.S.; and (2) the provisions of the Insurance Code control in the case of any express conflict. [s. 628.041, F.S.]

Factors that Florida Corporate Directors may Consider in Discharging Duties
Section 628.231, F.S., sets out requirements for the board of directors of a domestic insurer, relating to election, terms, and qualifications. However, nothing in this section or chapter directly relates to the factors that the directors may consider in discharging their duties. But, section 628.041, F.S., applies to domestic insurers the statutes that relate to the powers and procedures of domestic private corporations formed for profit. Therefore, 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 directors of Florida *nonprofit* corporations are subject to the standards specified in s. 617.0830, F.S. This law provides the same standards as provided to for-profit corporations quoted in subsection (1), above, but does *not* contain provisions comparable to subsection (3), above. For any domestic mutual insurer incorporated as a nonprofit corporation pursuant to chapter 617, that chapter governs when in *conflict* with chapter 607, F.S. [s. 628.041, 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 with respect to a *mutual insurance holding company*. This type of corporate entity (described in more detail below) 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. Under common law (case law), the directors of a corporation have a fiduciary obligation to represent the interests of their shareholders. This fiduciary obligation may dictate the acceptance of an acquisition offer, for example, 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 that might be in the best interests of the shareholders, based on the broader 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, Florida law authorized 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.; creating part III of chapter 628, ss. 628.701-628.733, F.S.]

At this time, one former mutual insurance company has converted into a mutual insurance holding company, the FCCI Mutual Insurance Holding Company, which 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), which potentially could convert into a mutual insurance holding company.

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, which remains an option under current law. [s. 628.441, F.S.] 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 current law, a mutual insurance company may alternatively convert into a mutual insurance holding company with a stock insurance company subsidiary, subject to the approval of the department. The policyholders of the former domestic mutual insurance company are not entitled to any distribution of cash or stock upon the conversion, 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). 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 into a stock insurance holding company.

The mutual insurance holding company must have the power 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 (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.

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
A mutual insurance holding company may 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. [s. 628.715, F.S.] However, the types of mergers and acquisitions are limited to the following (quoting from s. 628.715(1), F.S.):

(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 a mutual insurance holding company to merge or consolidate with a foreign mutual insurer. Paragraph (c) allows the mutual insurance holding company to "acquire the assets" of a mutual insurance company (either foreign or domestic). But, acquiring the assets of a mutual insurer is legally 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. 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 may require approval by that state, and if the insurer is a mutual insurer, the law may require adequate protection of the interests of the policyholders/owners.

III. Effect of Proposed Changes:

CS/SB 182 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. 628.231, 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 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.) The bill would expressly make 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 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." 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 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), 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, F.S. 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.

The current law allows a mutual insurance holding company to "acquire the assets" of a foreign or domestic mutual insurance company. But, acquiring the assets of a mutual insurer is legally different than 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.

The bill authorizes the Department of Insurance to retain outside consultants to evaluate each merger, for which the domestic mutual insurance holding company would be required to pay reasonable costs.

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 requires 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 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 by require 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. As explained in Present Situation, above, 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 additional, broader

standards. See the discussion in Section 1 regarding the effects of the revised standards for directors of a domestic insurer.

Section 4 amends s. 627.729 to correct a reference in the current law related to dissolution of a domestic mutual insurance holding company. Upon dissolution, the assets are currently required to be distributed to persons who were members at any time within the 3-year period preceding the date of liquidation or the date of termination of the insurer's certificate of authority, whichever is earlier. An exception is provided if the department has reason to believe that management caused or encouraged the reduction of the number of members for the purpose of reducing the number who may be entitled to share in the distribution. In such a case the department may enlarge the qualification period by such time as it deems to be reasonable. However, this provision of the statute refers to "the 5-year qualification period," which the bill changes to "the 3-year qualification period" to be consistent with the prior reference.

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, based on broader factors that the law would allow the directors to consider. These changes would appear to benefit the directors and employees of domestic insurers and possibly protect the local and state economy, to the possible detriment of stockholders and policyholders.

Section 2 would allow a mutual insurance holding company (of which there is currently only one such company) 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 regarding adequate protection of the interests of the policyholder/owners, subject to approval by the Department of Insurance and, possibly, 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. The bill authorizes the department to retain outside consultants to evaluate each merger, for which the domestic mutual insurance holding company would be required to pay reasonable costs.

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 to determine whether the merger is equitable to policyholders. However, the bill authorizes the department to contract with outside consultants to evaluate each merger and to assess those costs against the mutual insurance holding company.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Amendments:

None.