STORAGE NAME: h0215s1z.in ****AS PASSED BY THE LEGISLATURE****
DATE: June 20, 2000 **CHAPTER #**: 2000-273, Laws of Florida

HOUSE OF REPRESENTATIVES
COMMITTEE ON
INSURANCE
FINAL ANALYSIS

BILL #: CS/HB 215, 1st Eng.

RELATING TO: Stock and mutual insurance companies

SPONSOR(S): Committee on Insurance and Representative Tullis

TIED BILL(S):

ORIGINATING COMMITTEE(S)/COMMITTEE(S) OF REFERENCE:

(1) INSURANCE YEAS 11 NAYS 0
(2)
(3)
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(5)

I. SUMMARY:

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

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

Florida law regulates corporations, generally, and sets forth the factors their directors may consider in carrying out their duties. Florida law does not specify factors that directors of domestic insurance companies or mutual insurance holding companies may consider in carrying out their duties. Like directors of other Florida companies, directors of domestic insurance companies and mutual insurance holding companies are generally subject to Florida law relating to corporations.

The bill would:

- prescribe the factors that directors of a domestic insurance company may consider in carrying out their duties;
- similarly prescribe the factors that directors of a domestic mutual insurance holding company may consider in carrying out their duties;
- authorize a mutual insurance holding company to merge or consolidate with a foreign mutual insurance company, a domestic or foreign reciprocal insurer, a group self-insurance fund, or other similar entities;
- allow a mutual insurance holding company to merge "downstream" into its own intermediate stock holding company; and
- authorize the Department of Insurance to hold public hearings and retain outside consultants to evaluate mergers involving mutual insurance holding companies.

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

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

1.	Less Government	Yes [x]	No []	N/A []
2.	Lower Taxes	Yes []	No []	N/A [x]
3.	Individual Freedom	Yes []	No []	N/A [x]
4.	Personal Responsibility	Yes []	No []	N/A [x]
5.	Family Empowerment	Yes []	No []	N/A [x]

For any principle that received a "no" above, please explain:

B. 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 (Department).

Florida domestic insurance companies are 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.

According to s. 628.041, F.S., Chapter 607, F.S., relating to the powers and procedures of domestic for-profit corporations, applies 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, in which case, chapter 617 governs when in conflict with chapter 607, F.S.; 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 operation of s. 628.041, F.S., which applies to domestic insurers, the statutes that relate to the powers and procedures of for-profit corporations (s. 607.0830, F.S., which specify standards for

directors of Florida domestic corporations), would apply to a domestic insurer. Section 607.0830(1) and (3), F.S., state:

> (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.

The 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.

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

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

Mutual Insurance Holding Companies

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

A mutual insurance company has more management flexibility than a stock insurance company, because the management of the mutual insurance company need not focus on

short-term results. However, a mutual insurance company has less financial flexibility than a stock insurance company. A mutual insurance company cannot raise capital through the issuance of stock, its ability to issue debt instruments is severely limited, and it lacks flexibility with respect to mergers and acquisitions. However, conversion into a stock insurance company is complex and requires the valuation of each mutual policyholder's equity interest.

Mutual insurance holding companies, as a corporate form, were created as an alternative to the costs and complexities of conversion from a mutual insurance company to a stock insurance company. In general, the mutual insurance holding company concept allows a mutual insurance company to become a stock insurance company owned by a holding company, with the policyholders of the former mutual insurance company becoming owners of the holding company. The stock insurance company, or a stock holding company owned by the mutual holding company, is then able to issue stock, incur debt, and engage in mergers and acquisitions without the restrictions that limit the flexibility of mutual insurance companies.

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.

Mergers and Acquisitions involving a Mutual Insurance Holding Company

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

(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.]

Conversion from a Mutual Company to Stock Company

Mutual insurance companies are also allowed by law to convert (or demutualize) into stock insurance companies. See s. 628.441, F.S. Likewise, a mutual insurance holding company may demutualize into a stock insurance holding company. See s. 628.733, F.S. In both cases, Florida law preserves members' rights by giving the members the right to acquire their proportionate part of all of the proposed stock of the new stock company. See ss. 628.441(2)(e) and 628.733(2)(e), F.S.

Distribution of Assets after Voluntary Dissolution of a Mutual Insurance Holding Company

When a mutual insurance holding company voluntarily dissolves, the assets remaining after paying debts are required to be distributed to persons who were its members at any time within the 3-year period preceding the liquidation. Section 628.729, F.S. But, if the Department has reason to believe the mutual insurance holding company caused or encouraged a reduction in the number of members in anticipation of liquidation so as to reduce the amount of people who would share in its assets, it may enlarge the qualification period. However, in providing the authority to enlarge the qualification period, the statute refers to a "5-year qualification period." Since the statute appears to equate these two periods, either the 3-year reference or the 5-year reference is incorrect.

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.).

C. EFFECT OF PROPOSED CHANGES:

Factors Directors May Consider in Carrying Out Duties

Directors of a domestic insurance company, in carrying out their duties, would be permitted to consider a broader range of factors. Some of the factors that could be considered are substantially the same as the factors that currently may be considered by directors of for-profit Florida corporations. Directors of a domestic insurance company would be permitted to consider such factors as they consider to be relevant, including the long-term prospects and interests of the corporation and its shareholders; the social, economic, legal, or other

effects of any action on the employees, suppliers, or 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.

In addition, directors of a domestic insurer would be permitted to consider factors that are *not* specifically permitted to be considered by directors of for-profit Florida corporations, such as short-term and long-term interests of the insurer, including but not limited to benefits that may accrue to the insurer from its long-term plans, and the possibility that these interests may be best served by the continued independence of the insurer; the resources, intent, and conduct of any person seeking to acquire control of the insurer; and any other relevant factors. Since these additional factors may not be considered by directors of Florida corporations generally, they would be uniquely applied to the directors of Florida domestic insurance companies, both stock and mutual.

Also, directors of a domestic mutual insurance holding company, in carrying out their duties, would be permitted to consider the same factors as allowed for directors of a domestic insurance company.

Mergers Between Mutual Insurance Holding Companies and Outside Entities

Mutual insurance holding companies would be permitted to merge with either a domestic mutual insurance company or a foreign mutual insurance company which redomesticates to Florida. These companies would be permitted to do this through a joint application filed with the Department of Insurance. As a part of the merger with the mutual insurance holding company, the reorganizing mutual insurance company would have the option to merge with the stock subsidiary of the mutual insurance holding company or continue its corporate existence as a domestic stock insurance company subsidiary of the mutual insurance holding company. The members of a reorganizing foreign mutual insurance company would be authorized to approve in a contemporaneous vote both the redomestication plan and the agreement for merger and reorganization.

Mutual insurance holding companies would also be authorized to merge or consolidate with a foreign mutual insurance company, a domestic or foreign reciprocal insurer, a group self-insurance fund, or other similar entities.

Merger Between a Mutual Insurance Holding Company and its Own Intermediate Holding Company

Mutual insurance holding companies would be permitted, subject to a vote of the members and Department of Insurance approval, to merge "downstream" into its own intermediate holding company so that all that remains is a stock holding company and a stock insurance company. Just prior to the merger, the mutual insurance holding company would be permitted to sell up to 25 percent of the stock of its intermediate holding company. Then, the remaining stock of the intermediate holding company would be distributed to the members. The effect of such a merger would be similar to a demutualization of a mutual insurance holding company to a stock holding company, except that under a merger less than 100 percent of the stock (no less than 75 percent) of the resulting stock holding company would be distributed to the policyholder members. This stock distribution would not be taxable as it is in the typical demutualization.

Review of Mergers by Department of Insurance

Mergers between a mutual insurance holding company and outside entities and between a mutual insurance holding company and its own intermediate holding company would be subject to approval by the Department. The Department would be required to hold a public hearing on mergers within 90 days after receiving the merger plan. For mergers between a mutual insurance holding company and an outside entity, the Department would be authorized to retain outside consultants to review the merger at the company's expense.

Distribution of Assets Upon Voluntary Dissolution of Mutual Insurance Holding Company

The 5-year qualification period referred to in section 628.729, F.S., relating to the distribution of assets of a mutual insurance holding company, would be changed to conform with the 3-year period referred to in the same section. Thus, the relevant qualification period for purposes of determining members who would share in the assets of the liquidating mutual insurance holding company would be 3 years.

Distribution Rights of Merging Entities

For three years after a merger, the distribution rights of members of a merging entity would be the proportionate share of the total surplus of all the merging entities as determined by the percentage of the surplus contributed by that merging entity.

D. SECTION-BY-SECTION ANALYSIS:

N/A

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

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.

The committee substitute authorizes the Department to retain outside consultants to evaluate mergers involving a mutual insurance holding company, the costs of which are required to be borne by the mutual insurance holding company. The only limitation on the costs of retaining such consultants is that they be "reasonable." Staff contacted the Department to determine the average cost of retaining a consultant to evaluate a merger, but the Department was unable to provide an average cost. According to the Department, the cost of a merger evaluation could vary depending on the type of companies involved and the nature of the merger. In a recent merger involving a mutual insurance company, however, the Department stated that it paid a consultant $20,000 to conduct an evaluation, called a "fairness to policyholders" review.

D. FISCAL COMMENTS:

N/A

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

A. APPLICABILITY OF THE MANDATES PROVISION:

This bill does not require counties or municipalities to spend funds or to take an action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

This bill does not reduce the authority that municipalities or counties have to raise revenues in the aggregate.

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

This bill does not reduce the percentage of a state tax shared with counties or municipalities.

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

N/A

B. RULE-MAKING AUTHORITY:

N/A

C. OTHER COMMENTS:

N/A

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

On November 2, 1999, the Committee on Insurance adopted four amendments to the bill and approved the bill as a committee substitute. The committee substitute differs from the original bill in that it:

- authorizes the Department to retain outside consultants to evaluate mergers involving a mutual insurance holding company, the costs of which must be borne by the mutual insurance holding company;
- changes the word "customers" to "policyholders" and, as such, revises one of the proposed factors that directors of domestic insurance companies and mutual insurance holding companies can consider in carrying out their duties;
- changes a time period in section 628.729, F.S., relating to distribution of assets upon voluntary dissolution of a mutual insurance holding company, so that it conforms to another time period in the same section;
- expands the proposed language in the bill which authorizes a mutual insurance holding company to merge with a foreign mutual insurance company that redomesticates. The committee substitute authorizes a mutual insurance holding company to jointly apply to the Department for merger with either a domestic mutual insurance company or a foreign mutual insurance company that redomesticates.

On April 25 and April 28, 2000, the Legislature adopted amendments to CS/HB 215 on the floor (which were engrossed into the bill). CS/HB 215, 1st Engrossed, differs from CS/HB 215 in that CS/HB 215, 1st Engrossed:

- authorizes mutual insurance holding companies to merge with a domestic or foreign reciprocal insurer, a group self-insurance fund, and any other similar entity;
- authorizes a mutual insurance holding company to merge "downstream" into its own intermediate holding company;
- requires the Department of Insurance to hold a public hearing on mergers within 90 days after it receives the plan for merger; and
- determines the distributive share of members of merging entities within three years after a merger.

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VII. SIGNATURES:

COMMITTEE ON INSURANCE:

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

FINAL ANALYSIS PREPARED BY THE COMMITTEE ON INSURANCE:

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