HOUSE OF REPRESENTATIVES
FINAL BILL ANALYSIS

BILL #:	CS/HB 509	**FINAL HOUSE FLOOR ACTION:**	
SPONSOR(S):	Regulatory Affairs Committee; Van Zant	112 **Y's**	0 **N's**
COMPANION BILLS:	(SB 356)	**GOVERNOR'S ACTION:**	Approved

SUMMARY ANALYSIS

CS/HB 509 passed the House on April 29, 2013 as SB 356.

Financial guaranty insurance is regulated by the Office of Insurance Regulation and involves surety bonds, insurance policies, indemnity contracts, or any similar guaranty, under which loss is payable upon proof of occurrence of financial loss to an insured claimant, obligee, or indemnitee as a result of certain events specified by statute. In order to qualify for a certificate of authority to transact financial guaranty insurance in Florida, the insurer must meet capital, surplus, and contingency reserve requirements, in addition to other provisions in the Insurance Code relating to property and casualty insurance. Currently, only stock property and casualty insurers are permitted to become financial guaranty insurance corporations, but not mutual insurers. Stock insurers divide their capital into shares and pay dividends to investors, and mutual insurers are cooperatives without permanent capital and pay dividends to policyholders (members).

The bill amends provisions of part XX, ch. 627, Florida Statutes, to permit mutual property and casualty insurers to become licensed financial guaranty insurance corporations.

The bill also amends provisions in parts I and III of ch. 628, F.S., so that a mutual insurance holding company may own a not for profit insurer or a health care plan as a subsidiary, and may own a not for profit corporation as an intermediate holding company. The bill also amends the definition of "distribution" in the not for profit corporation statute, s. 617.01401, F.S., and enables a not for profit insurer to pay dividends to the mutual insurance holding company.

The bill has no fiscal impact on state and local government. Allowing mutual insurers to become financial guaranty insurance corporations may have an indeterminate positive impact on the private sector.

The bill was approved by the Governor on June 7, 2013, ch. 2013-125, L.O.F., and became effective on that date, except as otherwise provided.

I. SUBSTANTIVE INFORMATION

A. EFFECT OF CHANGES:

Background: Stock vs. Mutual Insurers

In order to transact insurance in this state, the Florida Insurance Code ("Code") states that a certificate of authority is required.[1] To qualify for and hold authority to transact insurance in this state, an insurer must be in compliance with the Code and its charter powers, and must be an incorporated stock insurer, an incorporated mutual insurer, or a reciprocal insurer.[2] In addition to applying for a certificate of authority to transact a particular kind of insurance, domestic insurers must apply to the Office of Insurance Regulation ("OIR") for a permit to form as either a stock or mutual insurer, and have its articles of incorporation approved by the Department of State.[3]

The distinction between stock and mutual insurers is governed by part I, ch. 628, F.S.:

- *Stock insurers* are defined as "incorporated insurers with its capital divided into shares and owned by its stockholders," and pay dividends to their stockholders, subject to specified surplus minimums and the OIR's approval.[4]
- *Mutual insurers*, on the other hand, are "incorporated insurers without permanent capital stock, the governing body of which is elected in accordance with this part," and pay dividends to their policyholders, who are members of the insurer.[5]

In other words, stock insurers are investor-owned, while mutual insurers are owned by their policyholders.

Mutual insurers may apply to demutualize to become a stock insurer, and stock insurers may apply to convert to a mutual insurer, subject to the OIR's approval.[6] In order to obtain regulatory approval of a mutual insurer's plan to demutualize, the plan must be equitable to the members and be approved by at least three-fourths of the insurer's members. In addition, the members must be given the opportunity to receive stock or cash for their ownership rights in the mutual organization.[7] According to the National Association of Mutual Insurance Companies, demutualization is a complex, expensive, and lengthy process. While demutualization can provide additional capital, cash distributions to policyholders can deplete surplus.[8]

Current Situation: Financial Guaranty Insurance

Part XX of ch. 627, Florida Statutes, was enacted in 1988[9] to set forth requirements for transacting financial guaranty insurance. *Financial guaranty insurance* means a surety bond, insurance policy, an indemnity contract issued by an insurer, or any similar guaranty, under which loss is payable upon proof of occurrence of financial loss to an insured claimant, obligee, or indemnitee as a result of:

1. The failure of an obligor on a debt instrument or other monetary obligation, including common or preferred stock guaranteed under a surety bond, insurance policy, or indemnity contract, to make principal, interest, premium, dividend, or purchase price payments when due, if the failure is the

[1] Section 624.401, F.S. The Florida Insurance Code consists of chs. 624, 632, 634, 635, 636, 641, 642, 648, and 651, F.S.
[2] Section 624.404, F.S.
[3] Section 628.051, F.S. Domestic insurers are formed under Florida law. Insurers formed under other states' laws (foreign insurers) are entitled to become domestic insurers by complying with the same legal requirements for licensing and organization and by designating a principal place of business inside Florida upon the OIR's approval. See ss. 624.06 and 628.520, F.S.
[4] Sections 628.021and 628.371, F.S.
[5] Sections 628.031, 628.381 and 628.301, F.S.
[6] Sections 628.431 and 628.441, F.S.
[7] Section 628.441(2), F.S.
[8] NAMIC, Focus on the Future Options for the Mutual Insurance Company: https://www.namic.org/policy/futureMutualAlts.asp (last accessed February 25, 2013).
[9] Chapter 88-87, Laws of Florida.

result of a financial default or insolvency, whether such obligation is incurred directly or as guarantor by or on behalf of another obligor who also defaulted;
2. Changes in the levels of interest rates or the differential in interest rates between various markets or products;
3. Changes in the rate of exchange of currency;
4. Changes in the value of specific assets or commodities, financial or commodity indices, or price levels in general; or
5. Other events which the office determines are substantially similar to any of the foregoing.[10]

Part XX of ch. 627, F.S., requires an insurer to obtain a certificate of authority from the OIR to transact financial guaranty insurance in Florida. The insurer must meet an initial $50 million surplus requirement at the date of initial licensing, and must maintain minimum capital, surplus, contingency reserve requirements and be within loss exposure limitations. Financial guaranty insurance corporations are subject to all provisions of the Florida Insurance Code applicable to property and casualty insurance, to the extent they are not inconsistent with part XX, ch. 627, F.S.[11] According to OIR's company search website, there are currently 50 insurers with financial guaranty insurance as an authorized line of business.[12]

By definition and by express requirement under current law, only stock property and casualty insurers are eligible to become financial guaranty insurance corporations, but not mutual insurers.[13] It is noted that the Financial Guaranty Insurance Guidelines, adopted by the National Association of Insurance Commissioners in 2008, does not make a distinction between stock and mutual insurers for purposes of transacting financial guaranty insurance.[14]

Effect of CS/HB 509 on Financial Guaranty Insurance

The bill amends ss. 627.971 and 627.972, F.S., respectively, to allow mutual property and casualty insurers to become financial guaranty insurance corporations, subject to meeting the requirements of the Code.

The bill does not change any existing requirements to become a stock or mutual insurer.

Current Situation: Mutual Insurance Holding Companies

Part III of ch. 628, F.S., provides for the organization and membership of *mutual insurance holding companies* (MIHCs), which, like mutual insurers, are incorporated entities without permanent capital stock.[15] A MIHC is generally created through a restructuring or reorganization, resulting in a MIHC and one or more controlled *subsidiary insurance companies*. A third entity known as an *intermediate holding company* may be a subsidiary of a MIHC, and owns a majority of the voting shares of the capital stock of one or more subsidiary insurance companies. This preserves some benefits of mutual organization, while allowing access to capital markets either though the sale of its stock, or in a three-entity structure, the sale of the intermediate holding company.[16] Additionally, MIHCs have the power to cast at least a majority of the votes to elect the board of directors of each controlled subsidiary and any intermediate stock holding company.[17]

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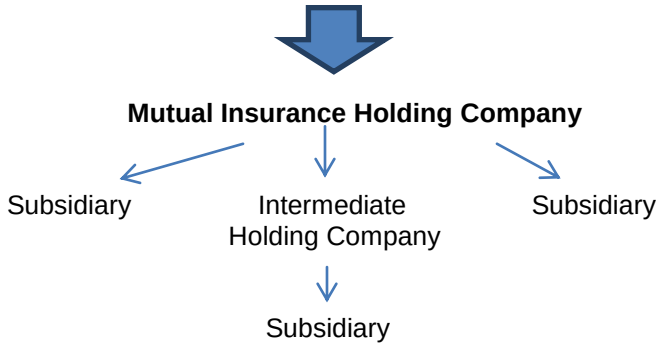
[10] Section 627.971(1)(a), F.S. See subsection (1)(b) for exclusions from the definition of "financial guaranty insurance."
[11] Section 627.972(1)(c), F.S.
[12] OIR Company Directory, http://www.floir.com/CompanySearch, last accessed February 20, 2013.
[13] Sections 627.971(6) and 627.972(1), F.S.
[14] GDL-1626, at NAIC Model Laws, Regulations, and Guidelines: http://www.naic.org/store_model_laws.htm (last accessed February 20, 2013).
[15] Section 628.703(1), F.S.
[16] Mutual Insurance Holding Company Treated as Insurance Company, 77 Fed. Reg. 25,349 (April 30, 2012) (to be codified at 12 C.F.R. pt. 380). This final rule of the FDIC treats MIHCs as an insurance company for purposes of liquidation and rehabilitation of a "covered financial company" as defined by the federal Dodd-Frank Wall Street Reform and Consumer Protection Act, to provide consistency with state insurance company insolvency laws.
[17] Section 628.709(1), F.S.

The Insurance Code provides for the general Florida corporation statutes applicable to domestic MIHCs, except that the Florida Not for Profit Corporations Act (ch. 617, F.S.) applies where the Insurance Code is silent with regards to the MIHC's articles of incorporation, bylaws, organization, and other matters.[18] Additionally, when a mutual insurance company (organized as a nonprofit corporation under ch. 617, F.S.) reorganizes, the resulting MIHC shall be deemed to be a nonprofit corporation.

The following diagram illustrates an example of reorganization by a mutual insurance company, only after the mutual insurance company's members (policyholders) and board of directors adopts the plan of reorganization and the OIR's approval of the plan of reorganization.[19] The OIR may hold a public hearing to allow public comment on the plan of reorganization, and may not approve a plan unless it is "fair and equitable to the members of the mutual insurance company."[20] In addition, the OIR and the Department of State must approve the MIHC's articles of incorporation prior to the MIHC's formation.[21] Following the reorganization, the mutual insurance company and its members are essentially absorbed into the MIHC.



Under the current Insurance Code, the MIHC's subsidiaries can only be stock insurance companies and the intermediate holding company can only be a stock company.[22]

Effect of CS/HB 509 on Mutual Insurance Holding Companies

The bill makes several changes to permit:

- A MIHC to own a not for profit insurer or a health care plan as a subsidiary,
- A MIHC to own a not for profit corporation as an intermediate holding company,
- A not for profit insurer to pay dividends to the MIHC to protect ownership interests of the insurer's policyholders and the MIHC members, and
- The MIHC's articles of incorporation to accommodate the voting and ownership interests of the members of the not for profit insurer.

The bill amends s. 628.703, F.S., to amend the definition of "subsidiary insurance company" to include a *not for profit insurance company* or *health care plan*, and like current law's treatment of stock insurers who are subsidiaries of MIHCs, provides that the MIHC owns the majority of the voting membership interests of either subsidiary. The bill also provides that the not for profit insurance subsidiary is subject to the provisions of ch. 628, F.S., applicable to stock insurers, but ch. 617, F.S. (the Florida Not for Profit Corporations Act) applies to the organization of the not for profit insurance company. The definition of "intermediate holding company" is also amended to include a not for profit corporation that is a subsidiary of a mutual insurance holding company. In addition, a definition of *nonprofit health care plan* is created to mean a not for profit hospital or medical and surgical service plan or corporation (domestic or foreign) that

[18] Section 628.707(3), F.S.
[19] Section 628.711, F.S.
[20] Section 628.711(4), F.S.
[21] Section 628.717, F.S.
[22] Sections 628.703(2-3) and 628.09(1), F.S.

is licensed in one or more states, that issues no capital stock and is engaged in the business of providing prepaid indemnity or health care benefits.

The bill provides that a mutual insurance holding company may acquire a not for profit insurance company or not for profit health care plan through a merger, as well as the membership interests in either not for profit entity. The bill also substitutes the term "nonprofit" with "not for profit" to conform to the Florida Not for Profit Corporations Act.

The bill states that a mutual insurance holding company's articles of incorporation and bylaws may provide for membership classes, and may restrict the rights (including voting rights) of membership classes constituted of policyholders of a not for profit health care plan, if those rights involve distributions under ch. 628, where the assets may not be treated as assets available for such distribution.[23] The bill also permits the not for profit subsidiary to make dividends and distributions up to its MIHC, and specifies that a not profit insurance company's distributions to its intermediate holding company is *not* a distribution for purposes of ch. 617, F.S.[24]

II. 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:

Sections 1 and 2 of the bill will allow mutual insurers to become licensed as financial guaranty insurance corporations. The OIR has indicated its support for these two sections of the bill in the interest of bringing new insuring entities into Florida.

D. FISCAL COMMENTS:

None.

[23] This provision prevents dilution of the voting or distribution rights held by members in the subsidiary and MIHC, particularly when not for profit corporations have membership classes that have no ownership or voting rights.

[24] Section 617.01401(7), F.S., of the current Florida Not for Profit Corporations Act defines "distribution" as the payment of a dividend or any part of the income or profit of a corporation to its members, directors, or officers. Donated assets or income from another tax-exempt not-for-profit corporation are excluded from the definition. Not for profit corporations can only make distributions as authorized by ch. 617, F.S.