

## **BILL ANALYSIS**

S.B. 1056  
By: Wentworth  
Insurance  
Committee Report (Unamended)

### **BACKGROUND AND PURPOSE**

In 1997, the 75th Legislature amended the Insurance Code to allow a non-life mutual insurance company to convert to a stock insurance company or to a mutual holding company. Legislation was enacted last session to allow mutual life insurance companies to convert to a stock insurance company or to a mutual holding company. Such conversions occur through the original mutual insurance company becoming a stock insurance company that is wholly owned by the mutual holding company, allowing it to issue stock and attract additional capital. Texas statutes also permit conversion to capital stock companies by Lloyds companies, statewide mutual association companies, local mutual aid, and burial associations.

S.B. 1056 would provide similar organizational options for a reciprocal or interinsurance exchange governed by Chapter 942, Insurance Code. This bill would also provide the commissioner of insurance (commissioner) with the authority to approve or disapprove a conversion based upon the commissioner's determination of whether the conversion plan is fair and equitable and complies with this Act. Under the bill, the commissioner and two-thirds of the eligible members of the reciprocal or interinsurance exchange company must approve any conversion plan before it could take effect.

### **RULEMAKING AUTHORITY**

It is the committee's opinion that this bill does not expressly grant any additional rulemaking authority to a state officer, department, agency, or institution.

### **ANALYSIS**

SECTION 1. Amends Subtitle B, Title 6, Insurance Code, by adding Chapter 829, as follows:

#### **CHAPTER 829. CONVERSION OF RECIPROCAL OR INTERINSURANCE EXCHANGE TO STOCK COMPANY THROUGH CREATION OF A MUTUAL HOLDING COMPANY**

##### **SUBCHAPTER A. GENERAL PROVISIONS**

Sec. 829.001. DEFINITIONS. Defines "attorney in fact," "board of directors," "conversion plan," "converting exchange," "eligible member," "effective date," "exchange," "intermediate holding company," "member," "mutual holding company," "participating policy," "resulting company," and "subscriber."

Sec. 829.002. AUTHORITY TO CONVERT THROUGH CREATION OF A MUTUAL HOLDING COMPANY. (a) Authorizes a reciprocal or interinsurance exchange (exchange) to reorganize by converting to a stock insurance company and forming a mutual holding company to hold, directly or indirectly, shares of the resulting company or intermediate holding company in accordance with this chapter.

(b) Prohibits a converting exchange from engaging in the business of insurance as a stock insurance company until it complies with the requirements of this chapter.

Sec. 829.003. RIGHTS AND PRIVILEGES OF RESULTING COMPANY; LAWS APPLICABLE. Provides that a stock insurance company resulting from the conversion of an exchange (resulting company) has certain rights and privileges and is subject to certain provisions except as provided by this chapter.

Sec. 829.004. MUTUAL HOLDING COMPANY; LAWS APPLICABLE. (a) Provides that, except as provided by this chapter, a mutual holding company is considered an insurer subject to this chapter and Chapter 883 (Mutual Insurance Companies Other than Mutual Life Insurance Companies), Insurance Code.

(b) Provides that the commissioner of insurance (commissioner) has jurisdiction over a mutual holding company organized under this chapter to ensure that member interests are protected.

(c) Provides that the mutual company is automatically a party to a delinquency proceeding under Subtitle C, Title 4, involving an insurance company that, as a result of a reorganization under this chapter, is a direct or indirect subsidiary of the mutual holding company. Provides that in any proceeding described by this subsection involving the resulting company, the assets of the mutual holding company are considered assets of the resulting company for purposes of satisfying the claims of the resulting company's policyholders.

(d) Requires a mutual holding company that results from a reorganization of an exchange to be organized under Sections 883.051, 883.052, 883.054, and 883.056. Provides that the articles of incorporation of the mutual holding company, and any amendments to those articles, are subject to approval of the commissioner in the same manner as those of a mutual insurance company.

(e) Prohibits the mutual holding company from dissolving or liquidating without the approval of the commissioner.

(f) Provides that a mutual holding company formed under a conversion plan is not subject to certain statutes.

Sec. 829.005. CONFLICT OF INTEREST. (a) Prohibits certain individuals, except as provided by a conversion plan approved by the commissioner or by this section, from receiving a fee, commission, stock distribution, stock subscription rights, or other consideration, other than that individual's usual salary or compensation for aiding, promoting, assisting, or participating in a conversion under this chapter.

(b) Provides that Subsection (a) does not apply to consideration received in the individual's capacity as a member.

(c) Provides that this section does not prohibit the payment of reasonable fees and compensation to an attorney, accountant, or actuary for professional services performed by that person, without regard to whether the person is also a director or officer of the converting exchange or its attorney in fact.

Sec. 829.006. LIMITATION ON ACTIONS. (a) Requires an action challenging the validity of or arising out of acts taken or proposed to be taken regarding a conversion plan under this chapter, except as provided by Subsection (b), to be commenced not later than the 30th day after the date the conversion plan is approved by the commissioner.

(b) Requires an action challenging the validity of or arising out of acts taken or proposed to be taken regarding a conversion plan that contemplates a public offering of debt or equity registered under the federal Securities Act of 1933 (15 U.S.C. Section 77a et seq.), or a similar law of a foreign jurisdiction, to be commenced not later than the 60th day after the date the conversion plan is approved by the commissioner.

Sec. 829.007. SALE OF SECURITIES. (a) Exempts a sale, issuance, or offering of securities under this chapter from the registration and licensing provisions of The Securities Act (Article 581-1 et seq., V.T.C.S.).

(b) Exempts an officer, director, or employee of an exchange, an intermediate holding company, a mutual holding company, or a resulting company who

participates in a conversion under this chapter from the registration and licensing provisions of The Securities Act (Article 581-1 et seq., V.T.C.S.). Prohibits a person from receiving compensation, other than that person's usual salary or compensation, for services performed under the exemption provided by this subsection.

[Reserves Sections 829.008-829.050 for expansion.]

## SUBCHAPTER B. MUTUAL HOLDING COMPANY STRUCTURE

Sec. 829.051. CAPITAL STOCK HELD BY MUTUAL HOLDING COMPANY. (a) Defines "majority of the voting shares of the capital stock."

(b) Requires all of the initial shares of the capital stock of the resulting company to be issued to the mutual holding company or to an intermediate holding company.

(c) Requires the mutual holding company at all times to own a majority of the voting shares of the capital stock of the resulting company or of an intermediate holding company. Authorizes the requirements of this subsection to be satisfied by indirect ownership through one or more intermediate holding companies in a corporate structure approved by the commissioner.

(d) Prohibits the mutual holding company or intermediate holding company, except with the consent of the commissioner, from conveying, transferring, assigning, pledging, subjecting to a security interest or lien, encumbering, or otherwise hypothecating or alienating the majority of the voting shares of the capital stock that is required to be owned under Subsection (c).

(e) Provides that an act of the mutual holding company or intermediate holding company that violates Subsection (d) is void in inverse chronological order from the date of the conveyance or activity as to the shares necessary to constitute a majority of the voting shares of the capital stock.

(f) Prohibits the remaining minority portion of the voting shares of capital stock of the resulting company, or of an intermediate holding company, from being assigned, transferred, or pledged to any officer, director or employee of the converting exchange, or persons acting in concert with such persons, without also offering a similar opportunity to participate to all eligible members as required by Section 829.053(g).

Sec. 829.052. LIMITATION ON ACQUISITION OF CAPITAL STOCK. (a) Requires the conversion plan to provide that a person or group of persons acting in concert, other than the mutual holding company or an intermediate holding company, may not acquire, in a public or private offering or through an exercise of stock subscription rights, more than 10 percent of the capital stock of the resulting company unless the acquisition of the stock or stock subscription rights is approved in advance by the commissioner.

(b) Provides that Subsection (a) does not apply to an entity that purchases and retains at all times a majority of the voting shares of the capital stock of the resulting company as part of the conversion plan approved by the commissioner.

Sec. 829.053. DIRECTORS AND OFFICERS. (a) Requires the conversion plan, except as otherwise provided by this section, to provide that a director or officer of the converting exchange, or a person acting in concert with the director or officer, may not acquire, without the permission of the commissioner, any shares of the capital stock of the resulting company, or the shares of the capital stock of another corporation that is participating in the conversion plan, before the third anniversary of the effective date of the conversion. Provides that this subsection does not prohibit the director or officer from taking certain actions.

(b) Authorizes a conversion plan to provide that the directors and officers of the converting exchange to receive, without payment, nontransferable subscription rights to purchase shares of the capital stock of the resulting company or the shares of the capital stock of another corporation that is participating in the conversion plan.

(c) Prohibits the aggregate number of shares that may be purchased by directors and officers under Subsection (b) from exceeding a certain amount.

(d) Requires, for a converting exchange with total assets between \$50 million and \$500 million, inclusive, the maximum percentage of the total number of shares that may be purchased to be interpolated from amounts provided under Subsection (c).

(e) Requires a conversion plan to provide that a director or officer of the converting exchange is prohibited from selling stock purchased under the conversion plan before the first anniversary of the effective date of the conversion.

(f) Authorizes a conversion plan, notwithstanding Subsection (e), to provide for the purchase or redemption of stock in the event that a director or officer no longer serves as a director or officer of, or no longer is associated with, the resulting company during the period described by Subsection (e).

(g) Provides that, if, as part of the conversion, any director or officer of the converting exchange, the mutual holding company, or an intermediate holding company receives more than one percent of the shares of the capital stock of the resulting company, or other valuable consideration, which is paid from the surplus of the converting exchange, each eligible member also is entitled to receive an amount of the converting exchange's surplus on hand on the effective date of the conversion computed in the same manner as the amount received by the director or officer, or as otherwise provided in the conversion plan approved by the commissioner.

Sec. 829.054. SUBSCRIPTION RIGHTS; TAX-QUALIFIED EMPLOYEE BENEFIT PLAN. Authorizes the conversion plan to allocate to a tax-qualified employee benefit plan nontransferable subscription rights to purchase not more than 10 percent of the capital stock of the resulting company.

[Reserves Sections 829.055-829.100 for expansion.]

#### SUBCHAPTER C. PLAN ADOPTION AND APPROVAL

Sec. 829.101. PLAN ADOPTION. (a) Requires an exchange, to convert under this chapter to adopt a conversion plan consistent with this chapter by the affirmative vote of at least two-thirds of the members of its board of directors or, if the exchange does not have a board of directors, by approval of the attorney in fact. Requires the proposed articles of incorporation of the resulting company and the mutual holding company to be exhibits to the conversion plan.

(b) Sets forth certain requirements for a conversion plan to take effect.

Sec. 829.102. AMENDMENTS; WITHDRAWAL OF PLAN. Authorizes a converting exchange, before a conversion plan takes effect, to amend or withdraw the plan by the affirmative vote of at least two-thirds of the members of its board of directors or, if the exchange does not have a board of directors, by approval of the attorney in fact. Provides that the written consent of the commissioner is required for any amendment to a conversion plan adopted after the commissioner has approved the plan under Section 829.106.

Sec. 829.103. FILING OF PLAN AND RELATED DOCUMENTS WITH COMMISSIONER; COMMISSIONER'S POWERS AND DUTIES. (a) Requires the converting exchange, not later than the 90th day after the date on which a converting exchange's board of directors adopts a conversion plan, to file certain paperwork with the commissioner.

(b) Requires the converting exchange to promptly provide any other information requested by the commissioner that the commissioner considers necessary to consider the conversion plan.

Sec. 829.104. NOTICE TO ELIGIBLE MEMBERS; COMMENTS. (a) Requires the converting exchange to give eligible members at least 30 days' written notice of the members' meeting to vote on the conversion plan and advising of the members' right to comment on the plan to the commissioner and the converting exchange, including a description of the procedure to be used in making comments. Requires notice to the members of the proposed vote on the conversion plan to provide clear and conspicuous language apart from other meeting materials and provide a disclosure statement of the distribution of surplus or stock to directors and officers of the converting exchange, if any.

(b) Requires the commissioner, if the commissioner determines to hold a hearing on the plan, to approve the notice of hearing and notify the converting exchange not later than the 45th day following the first day on which all the documents required under Section 829.103 are filed with the commissioner. Requires the converting exchange to send to eligible members the commissioner's notice of the hearing at least 30 days before the date set for the hearing. Requires the commissioner to approve the content and print layout of the hearing notice before the converting exchange sends notice of the hearing to eligible members. Authorizes notice of the hearing to be made through publication in the Texas Register.

(c) Authorizes the notices required by Subsections (a) and (b) to be combined in a single mailing. Requires the notice or notices to be sent to the member's last known address, as shown on the converting exchange's records. Requires the notice of the members' meeting to describe the proposed conversion plan and inform the member of the member's right to vote on the conversion plan.

(d) Requires, if the notice of the meeting to vote on the conversion plan is combined with a notice of the converting exchange' [sic] annual meeting of members, the notice of the proposed vote on the conversion plan to be clear and conspicuous and set apart from other meeting materials. Provides that a notice that is approved in advance by the commissioner is deemed to be in full compliance with the requirements of this subsection.

Sec. 829.105. SUBSTANTIAL COMPLIANCE WITH NOTICE REQUIREMENTS. Provides that, if the converting exchange in good faith substantially complies with the notice requirements of this chapter, the converting exchange's failure to send a member the required notice does not impair the validity of an action taken under this chapter.

Sec. 829.106. APPROVAL OF PLAN BY COMMISSIONER. (a) Requires the commissioner to approve a conversion plan if the commissioner makes certain determinations.

(b) Requires the commissioner, except as otherwise provided by this section, to approve or disapprove a conversion plan not later than the 90th day after the first day on which all the documents required under Section 829.103 are filed with the commissioner.

(c) Authorizes the commissioner to extend the time for decision by an additional 30 days on written notice to the converting exchange. Prohibits the commissioner,

except as provided under Subsection (e) or (f), from extending the time for decision beyond that 30-day period.

(d) Requires the commissioner to immediately give written notice to the converting exchange of the commissioner's decision and, if the commissioner disapproves the plan, a detailed statement of the reasons for the disapproval.

(e) Authorizes the commissioner to retain, at the converting exchange's expense, a qualified expert who is not a member of the commissioner's staff to assist the commissioner in reviewing whether the conversion plan meets the requirements for approval by the commissioner or the value of the distribution of surplus of the resulting company to the officers and directors of the converting exchange, if any. Authorizes the commissioner, if the commissioner retains a qualified expert under this subsection, to extend the period for decision by an additional 90 days beyond the initial 90-day period specified in Subsection (b).

(f) Authorizes the commissioner, if the conversion plan contemplates a public offering of debt or equity registered under the federal Securities Act of 1933 (15 U.S.C. Section 77a et seq.), or a similar law of a foreign jurisdiction, to extend the period of time to approve the conversion plan by an additional 180 days beyond the initial 90-day period specified in Subsection (b).

(g) Authorizes the commissioner, after giving written notice to the converting exchange, to hold a hearing on whether the conversion plan complies with this chapter. Provides that the converting exchange has the right to appear at the hearing. Provides that other interested persons have the right to attend the hearing and comment on the conversion plan. Authorizes notice of the hearing to be made through publication in the Texas Register in accordance with Section 829.104(b).

Sec. 829.107. APPROVAL OF PLAN BY ELIGIBLE MEMBERS. (a) Authorizes the converting exchange, after notice that complies with this chapter, to convene a meeting to consider the conversion plan, and authorizes any eligible member entitled to vote on the proposed conversion plan to vote in person or by proxy at the meeting. Authorizes each eligible member, except as otherwise provided in the bylaws of the converting exchange, to cast one vote.

(b) Provides that adoption of the conversion plan requires the affirmative vote of at least two-thirds of the votes cast by eligible members.

Sec. 829.108. FILING OF MINUTES, ARTICLES OF INCORPORATION, AND BYLAWS; EFFECTIVE DATE OF CONVERSION. (a) Requires the converting exchange to file certain documents with the commissioner.

(b) Requires the converting exchange to make the filing required by Subsection (a) not later than the 30th day after certain dates.

(c) Provides that the conversion plan approved by the commissioner takes effect on the date specified in the articles of incorporation of the resulting company and the mutual holding company.

[Reserves Sections 829.109-829.150 for expansion.]

#### SUBCHAPTER D. EFFECT OF PLAN; RIGHTS OF MEMBERS

Sec. 829.151. CORPORATE EXISTENCE. (a) Sets forth certain events that will occur on the effective date of this Act.

(b) Sets forth certain events that will take place except as otherwise specified by the conversion plan.

Sec. 829.152. MEMBERSHIP INTERESTS. (a) Provides that the membership interests of the policyholders of the resulting company become membership interests in the mutual holding company. Provides that members of the converting exchange become members of the mutual holding company in accordance with the articles of incorporation and bylaws of the mutual holding company.

(b) Provides that a membership interest in a mutual holding company does not constitute a security as defined by Section 4, The Securities Act (Article 581-4, V.T.C.S.).

Sec. 829.153. RIGHTS OF MEMBERS WHOSE POLICIES ARE ISSUED AFTER ADOPTION OF CONVERSION PLAN BUT BEFORE EFFECTIVE DATE. (a) Requires the converting exchange, on issuance of a policy after a conversion plan has been adopted by the board of directors but before the effective date of the conversion plan, to send to each member to whom a policy is issued a written notice regarding the conversion plan.

(b) Provides that, except as provided by Subsection (c), each member insured under a property or casualty insurance policy is entitled to notice under Subsection (a) and is required to be advised in a clear and conspicuous manner of certain rights.

(c) Provides that a member who has made or filed a claim under the insurance policy is not entitled to a refund under Subsection (b). Prohibits a member who has exercised a right provided by Subsection (b) from making or filing a claim under the insurance policy.

Sec. 829.154. EFFECT OF CONVERSION ON POLICIES; SUBSCRIBER ACCOUNTS. (a) Provides that each policy in effect on the effective date remains in effect under the terms of that policy, except that certain rights, to the extent they existed in the converting exchange in favor of policyholders or members, are extinguished on the effective date.

(b) Provides that the holder of a participating policy in effect on the effective date of the conversion continues to have a right to receive dividends as provided by the participating policy.

(c) Authorizes, on the renewal date of a participating policy, the resulting company to issue to the insured a nonparticipating policy as a substitute for the participating policy.

(d) Requires all the costs and expenses connected with a conversion plan to be paid or reimbursed by the converting exchange or the resulting company.

(e) Requires, if a converting exchange maintains subscriber accounts as surplus, the subscriber accounts to continue as surplus in the resulting company, unless otherwise provided in a conversion plan approved by the commissioner. Provides that, subject to Subsection (f), the balances of the subscriber accounts are payable to the members to the extent and in the manner as is provided in the conversion plan.

(f) Authorizes the board of directors of the resulting company to reduce the balances of the subscriber accounts without payment to members of the mutual holding company who were members of the converting exchange if the board of directors of the resulting company determines in the board's discretion that the amounts are necessary to support the operations of the resulting company. Prohibits the board of directors of the resulting company, without the approval of the commissioner, from reducing the balance of a subscriber account under this subsection before the third anniversary of the effective date.

SECTION 2. Effective date: upon passage or September 1, 2007.

S.B. 1056 80(R)

**EFFECTIVE DATE**

September 1, 2007.