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**MUTUAL HOLDING COMPANIES IN IOWA ROUND TWO**

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The adoption of a statute<sup>1</sup> authorizing the creation of a mutual holding company under Iowa law was discussed earlier in Volume VII, Edition 3 (September 10, 1995) of the *FORC Quarterly Journal*. Since the adoption of the statute, two Iowa insurers have taken advantage of it to create a mutual holding company and to reorganize the old mutual insurer into a stock insurer. The first company to secure regulatory approval and reorganize was American Mutual Life Insurance Company in 1995. The Plan of Reorganization created the American Mutual Life Holding Company, which, through a wholly-owned subsidiary, owned all the stock of the reorganized life insurer, AmerUs Life Insurance Company, a stock company which took over all the activities of the old American Mutual Life Insurance Company. In connection with the reorganization, American Mutual anticipated a potential problem with registration under the 1933 and 1934 Securities Acts and the Investment Company Act of 1940. They therefore sought and received a No-Action Letter from the SEC<sup>2</sup>. Subsequently, AmerUs had a public offering of stock with policyholders receiving prior subscription rights.

The second company to create a mutual holding company was National Chiropractic Mutual Insurance Company in 1997. Under its Plan of Reorganization, a mutual holding company, National Chiropractic Mutual Holding Company, was created which, through a stock holding company (NCMIC Group, Inc.), owns 100% of the stock of NCMIC Insurance Company, the reorganized mutual insurer. No stock from this reorganization has been sold to date.

The basic Iowa statute, Section 521A.14, Code of Iowa (1977), which authorizes the creation of the mutual holding company structure, is relatively brief. The Iowa Insurance Division has adopted Regulations under that statute to implement its mandate. These are contained in the Iowa Administrative Code, Chapter 191-45.1 *et seq.* The Regulations were the result of intense negotiations between the industry and the Insurance Division. As a result, they have some unique provisions.

The Regulations envision the creation of one of two types of structures. In one type of reorganization, a limited plan, none of the stock in the reorganized insurer or its parent stock holding company will be sold to outsiders. Thus, the mutual holding company, either directly or indirectly, will own 100% of the reorganized stock insurer.<sup>3</sup> The other, or standard plan, envisions the sale of stock in the stock insurer or its stock parent to outside interests.<sup>4</sup> Regardless of whether it is a limited or standard plan, there are many similarities in the Regulation's approach.

The new mutual holding company, as well as the stock insurer, are considered "persons" under the Iowa Holding Company Act<sup>5</sup>, and thus subject to its restrictions on transactions, dividends, non-insurance activities, etc. Also, in the event of the insolvency of the stock insurer, the assets of the mutual holding company will also be available to satisfy the claims of policyholders.<sup>6</sup> Of course, policyholders of the old mutual, as well as policyholders of the reorganized stock insurer, must become members of the mutual holding company with the same rights as members of a mutual insurer, such as the right to vote for directors, approve Articles of Incorporation, and receive the net assets upon termination of the mutual holding company.<sup>7</sup>

Another critical component of either the Standard or Limited Application is a provision that dividends or earnings which the mutual holding company has or receives must inure to the benefit of policyholders and that payment is subject to prior approval of the Insurance Commissioner.<sup>8</sup> For example, the mutual holding company is prohibited from waiving dividends from the stock insurer since this would increase the value of the stock insurer, and as a consequence, increase the value of the

from the stock insurer since this would increase the value of the stock insurer, and as a consequence, increase the value of the shares held by the public. Also, the mutual holding company must provide a plan for distribution of any sums it receives as dividends for the benefit of policyholders. For example, excess funds would be distributed as dividends to policyholders.

Another limitation is that at least 50% of the GAAP net worth of the mutual holding company is to be invested in insurance company subsidiaries.<sup>9</sup> There is also authority for a foreign mutual insurer to merge into a mutual holding company<sup>10</sup> or for the merger of two holding companies.<sup>11</sup>

If a Standard Application is intended which would include sale of stock to outsiders, by statute<sup>12</sup> and regulation,<sup>13</sup> provision must be made so that the holding company will always own 51% of the voting stock of the intermediate stock holding company or the insurer. Also, any stock sold to the public may not have greater dividend or other rights than the stock owned by the mutual holding company.<sup>14</sup> The Insurance Commissioner must approve the issuance of any stock.<sup>15</sup>

Normally, the filing of a Standard or Limited Application is preceded by a meeting of the policyholders of the old mutual to approve the new Articles of Incorporation and the Plan of Reorganization. There must be twenty (20) days notice of this meeting, and it should also include a notice of the public hearing before the Insurance Commissioner to approve the reorganization.<sup>16</sup> Mechanically, the process is initiated by the filing of a Standard or Limited Application. It must include a Plan of Reorganization describing the corporate structure, including the Articles of Incorporation of the mutual holding company and the stock insurer. Also, it must provide for policyholders' membership rights in the mutual holding company, setting forth the Board of Directors and include provisions on insolvency and limitations on dividends.

In addition, a Form "A" must be filed under the Holding Company Act, setting forth the information required by the Act.<sup>18</sup> The Insurance Commissioner then schedules a hearing on the Form "A" and the Plan of Reorganization.<sup>19</sup> The Insurance Commissioner has authority to approve or reject the Plan, as well as require modifications.<sup>20</sup>

Once the reorganization is approved, counsel and the company still have major tasks remaining, not the least being compliance with the requirements of other states in which the old mutual was licensed. Some states, in this author's experience, treat this primarily as a name change issue. They will require certified copies of the Articles of Incorporation of the new insurer (and perhaps the mutual holding company), the Order approving the reorganization, and copies of the new stock insurer's license. Others may additionally treat this as a quasi new admission, requiring attention to retaliatory tax and fee issues, etc.

Some states, however, have demonstrated a reluctance to understand that the reorganized stock insurer is just a continuation of the old mutual, with all the rights, liabilities, and licenses still intact. As more states adopt their own versions of this demutualization process, it is hoped that the level of understanding will increase, with an equal decrease in bureaucratic road blocks.

According to the May 19, 1997 issue of the National Underwriter, 22 states have adopted or have pending legislation with respect to mutual holding companies.

To give the reader some flavor of these other states' approaches, Minnesota's statutes generally appear to follow the Iowa plan, with the converted company issuing all its shares to the mutual holding company and the mutual holding company retaining 51% of the stock.<sup>21</sup>

Proposed California legislation, on the other hand, while allowing for the creation of a mutual holding company, requires that policyholders be given subscription rights to the stock based on their "equity" (surplus?) in the old mutual insurer. If they elect to cash in their subscription rights, they can receive up to 50% in cash and the balance in interest-bearing contribution certificates or surplus notes.<sup>22</sup>

One thing that is critical in the demutualization process is to begin talking to other insurance departments or regulators ahead of time to ease the process by answering their questions. Hopefully, this will avoid having a foreign state refuse to renew or reissue the license. In addition to dealing with other regulators, the company needs to address such issues as endorsements containing the new name, changing the name on all investments and statutory deposits, reprinting drafts, stationery, etc. Hopefully, all states will recognize the status of the reorganized company and won't require new form and rate filings.

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One final issue is the notice to policyholders of the annual meeting of the members of the mutual holding company. Many mutuals have historically included this notice in the policy and do not have a separate notice. Some means of notifying members will have to be developed by inclusion in the stock company's policy, or else the mutual holding company will be burdened with the expense of mailing a separate notice.

### *Endnotes*

1. 521A.14, Code of Iowa (1997).
2. 1996 WL 328302 (SEC).
3. 191-46.2(4).
4. 191-46.2(4).
5. Chapter 521A, Code of Iowa (1997).
6. 191-46.4(1)(f) and 191-46.4(2)(f).
7. 191-46.4(1)(c) and (d) and 191-46.4(2)(c) and (d).
8. 191-46.4(2)(q) and 191-46.6(6).
9. 191-46.6(5).
10. 191-46.7.
11. 191-46.8.
12. 521A.14, Code of Iowa (1997).
13. 191-46.10(4).
14. 191-46.10(4).
15. 191-46.10.
16. 191-46.3(2)(c).
17. 191-46.3 and 191-46.4.
18. 191-46.3(2)(h).
19. 191-46.3(3).
20. 191-46.5(2).

21. 60-A.077, Minn. Statutes.

22. Senate Bill 662.