

Mutual Holding Company Recent Developments

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During the last several months, there have been a number of significant developments relating to mutual insurance holding companies, a structure in which mutual insurers reorganize to form a mutual holding company which directly or indirectly owns at least 51% of the converted mutual insurer. This report discusses new provisions affecting mutual holding companies in the Gramm-Leach-Bliley Act, state legislative activity in Indiana and Michigan, a recent SEC no-action letter concerning member-based benefits, recent litigation, as well as recent actions taken by a number of mutual life insurance companies and mutual holding companies.

I - Gramm-Leach-Bliley Act

The provisions of Subtitle B of Title III of the Gramm-Leach-Bliley Act authorize a mutual insurer organized under the laws of one state to transfer its domicile or redomesticate to a state which has a law authorizing mutual holding companies. State laws authorizing the formation of mutual insurance holding companies have been adopted in twenty-three states and the District of Columbia.

If a mutual insurer is located in a state which does not have a mutual holding company statute, the mutual insurer can now relocate to another state which permits such a corporate structure so long as various procedural requirements are met. These procedural requirements include (a) approval by the Board of Directors of the mutual insurer; (b) approval of a majority of the policyholders who vote after receiving notice and disclosure of the effects of the transaction; (c) continued voting control of the converted insurer through the mutual holding company; (d) no award of stock or stock options for a specified period; (e) preservation of the contractual rights of the policyholders and (f) the reorganization is approved as fair and equitable by the insurance regulator of the transferee domicile.

Section 313 of Title III preempts any state law which would prevent or restrict a redomestication to form a mutual holding company. Differential treatment of a redomesticated insurer or an affiliate by a state law, regulation as interpretation is also preempted. A U.S. District Court has exclusive jurisdiction over litigation arising under these provisions relating to any redomesticating or redomesticated insurer.

Section 306 also states that no state may "prevent, significantly interfere with, or have the authority to review, approve, or disapprove a plan of reorganization by which an insurer proposes to reorganize from mutual form to become a stock insurer (whether as a direct or indirect subsidiary of a mutual holding company or otherwise) unless such state is the state of domicile of the insurer." This statutory provision should prevent non-domiciliary states, such as New

York, from regulating mutual holding company reorganizations or demutualizations solely because the converting mutual insurer is licensed in that state.

II. State Legislative Activity - Indiana and Michigan

In the aftermath of the passage of the mutual holding company redomestication provisions of the Gramm-Leach-Bliley Act, Indiana promptly passed mutual holding company legislation. American United Life Insurance Company, an Indiana-based mutual life insurer, was actively considering redomestication if the law were not passed.

The Indiana legislation has a number of provisions which are not in many of the other MHC statutes. Under the Indiana law, an application to form an MHC must include a study comparing the risks, costs and benefits of an MHC reorganization as opposed to "reasonable alternatives," including a demutualization in which policyholders receive consideration in the form of stock, cash or other consideration. The Nebraska MHC law contains a similar provision and Vermont has imposed a similar requirement by regulation.

A subsidiary of an MHC may (but is not required to) issue stock to the public. An initial public offering must be made pursuant to a plan approved by the Indiana Commissioner after a public hearing and must include a subscription offering to eligible members, subject to certain limited exceptions.

There is a provision in the Indiana law called the "members' surplus protection principle" under which shareholder dividends can only be paid out of the net earnings of a publicly-owned subsidiary after the reorganization. Acquisitions or investments that the MHC makes after the reorganization have to come from funds separately raised or from the publicly-owned subsidiary after the reorganization.

No individual officer or director can own more than 5% of the outstanding shares of the subsidiary stock company. While other state MHC laws impose some restrictions on share ownership - usually for limited periods of time following an initial public offering - the Indiana provisions, which impose limits on total stock ownership, are more restrictive. The Indiana law also imposes some statutory restrictions on executive compensation, but permits amounts that would be deemed reasonable compensation by the Internal Revenue Service.

Mutual holding company legislation has also been introduced in Michigan. The Michigan Senate Financial Services Committee approved the legislation in November, 1999. In introducing the legislation, State Senator Shirley Johnson commented that "the competitive nature of the financial-services industry today is so keen that only companies nimble enough to take advantage of fast-moving business opportunities will survive. Mutual insurers are limited in their ability to raise capital, and a full demutualization is expensive and time-consuming."

III. MHC Member - Based Benefits Plan

Minnesota Mutual Companies, Inc., a mutual holding company, and Minnesota Life Insurance Company, its indirect wholly-owned subsidiary, received a no-action letter from the Securities and Exchange Commission that the proposed establishment of a "Member-Based Benefits Plan" would not cause the membership interests in the mutual holding company to be deemed securities under the Securities Act of 1933.

Minnesota Mutual Companies stated that it intended to develop a Member-Based Benefits Plan for the payment of patronage-based benefits in the form of premium rebates or enhanced policy benefits, such as policy credits or increased insurance coverage, to policyholders, annuity contractholders, or, in certain instances, to holders of certificates of insurance under group insurance policies and group annuity contracts.

Under the proposal, it is contemplated that Minnesota Mutual Companies will make payments from time to time directly to Minnesota Life. Such payments, if any, will be determined at the discretion of the Board of Directors of Minnesota Mutual Companies. The proposed benefits would be distributed or allocated no more frequently than once a year and, more likely, every two or three years. Practical considerations relating to the cost of providing the member-based benefits may dictate the establishment of a de minimus level to receive a benefit or a particular method of paying the member-based benefit. The adoption and implementation of a plan is subject to certain conditions including the approval of the Minnesota Insurance Commissioner and other regulatory approvals.

Other mutual holding companies with appropriately worded plans of conversion, incorporation documents and SEC no-action letters should be able to take advantage of the concepts approved in this SEC no-action letter.

IV. Recent Litigation Involving MHC Plans of Conversion

In the case of Butler v. Provident Mutual Life Insurance Company (Court of Common Pleas, Philadelphia County, Pa., September 16, 1999), Judge Steven E. Levin ruled that the directors of Provident Mutual Life Insurance Company breached their duty of disclosure by disseminating a policyholder information statement that unfairly described a plan to convert to a mutual holding company and therefore prevented policyholders from making an informed vote on the plan.

In granting a permanent injunction, the county court held that the policyholders' information statement distributed by Provident Mutual did not inform the policyholders that the closed block mechanism which Provident Mutual wished to use to protect participating policyholders' interests relied on a 1997 dividend scale, which did not include a component for performance dividends. The Court also found that the policyholders' information statement omitted reference to the statements of the company's financial advisor, Morgan Stanley Co., that full demutualization coupled with an IPO or merger with a stock company was "strongly positive" for current policyholders while the mutual holding company structure was merely "positive." The court also ruled that the policyholders' information statement inadequately described potential conflicts of interest. Following the ruling, Provident Mutual stated that it could not complete the reorganization by the December 31st deadline imposed by the Pennsylvania Insurance Department and terminated its plan to form a mutual holding company.

In the case of Cranley v. National Life Insurance Company of Vermont, a class action suit was filed in the U.S. District Court in Vermont challenging the conversion of National Life of Vermont to a mutual holding company. The complaint alleges that Vermont's mutual holding company statute constitutes an unconstitutional taking of plaintiffs' interests as participating policyholders in National Life in violation of Article I, Section 10 of the United States Constitution prohibiting impairments of contracts and the due process clause of the Fourteenth Amendment to the United States Constitution. The complaint also asserts policyholder or shareholder derivative claims against directors of National Life for alleged breaches of fiduciary duty and alleges concealment of pertinent information in communications with policyholders.

The National Life of Vermont case is unusual in that it was filed well after the reorganization was completed following approvals by the Vermont Insurance Commissioner and the affirmative vote of the policyholders of

National Life. It also alleged that the officers and directors of National Life will "profit from this scheme via valuable stock options" although no options have been proposed or granted and further approval of the Vermont Insurance Commissioner is required for any public offering.

V. Recent Developments Involving Mutual Holding Companies

American Mutual Holding company announced in December, 1999 that it plans to go public and merge with its indirect majority-owned subsidiary, AmerUs Life Holdings, Inc. American Mutual indirectly owns approximately 58% of AmerUs Life Holdings with the balance owned by public shareholders.

The three hundred thousand members of the mutual holding company will be eligible for compensation in the form of stock, cash or policy credits in the planned demutualization. Approval is needed from the members of American Mutual, the shareholders of AmerUs Life Holdings and the Iowa Department of Insurance. It is expected that the demutualization will be completed during the second quarter of this year.

American Mutual was formed in 1996 when AmerUs Life Insurance Company became the first company in the United States to reorganize as a mutual insurance holding company under Iowa's mutual holding company law.

AmerUs estimates that its members will receive about \$280 million in enhanced value from the demutualization as a result of its capital raising, growth and acquisitions which occurred during the more than three years it was organized as a mutual holding company.

During the same period that American Mutual began its plans to demutualize, General American Mutual Holding Company, a Missouri mutual holding company formed in 1997, also completed the first phase of its restructuring. In August, 1999, General American Mutual Holding Company's subsidiary, General American Life Insurance Company, was placed in administrative supervision by the Missouri Department of Insurance as a result of a multi-billion dollar liquidity crisis involving funding agreements issued by General American Life. In order to solve the liquidity crisis, General American Mutual Holding Company sold all of the stock owned in GenAmerica Corporation (the parent company of General American Life) to Metropolitan Life Insurance Company for \$1.2 billion, less adjustments. Met Life also assumed responsibility for the General American Life funding agreements. The sale was completed on January 6th.

General American Mutual Holding Company was placed in rehabilitation by the Missouri Department of Insurance in September, 1999. A Plan of Rehabilitation for General American Mutual Holding Company was approved without objection by the Circuit Court of Cole County, Missouri on November 10, 1999. The Plan of Rehabilitation provides for the distribution of the \$1.2 billion to the eligible members of the mutual holding company after claims, taxes, and expenses have been paid.

VI. Six Mutual Insurers Adopt Mutual Holding Company Conversion Plans.

During the last several months in 1999, six mutual life or health insurers adopted plans of conversion to mutual holding companies. In September, 1999, the board of directors of American Republic Insurance Company, a \$450 million insurance company based in Des Moines, approved changing the corporate structure to a mutual holding company under Iowa law. Also, National Travelers Life Company, based in West Des Moines, Iowa with about \$470 million in assets, adopted a plan of MHC reorganization under Iowa law in October, 1999.

In Illinois, Mutual Trust Life Insurance Company, a \$1 billion mutual life insurer based in Oak Brook, Illinois, and Trustmark Insurance Company (Mutual), a health and life insurer without over \$1.5 billion in combined

assets, based in Lake Forest, Illinois, each adopted plans of conversion to a mutual holding company. In each case, the plans were approved by the Illinois Department of Insurance and overwhelmingly approved at policyholder meetings in December. Both conversions were completed at the end of December.

In Nebraska, Security Mutual Life Insurance company, with \$600 million in assets, adopted its plan of reorganization in July, 1999. It was approved by the Nebraska Department of Insurance in September and by a 95% vote of its policyholders in November.

Woodman Accident and Life Company, a Nebraska mutual insurer, adopted its plan of reorganization in August, 1999. Following regulatory approval, greater than 95% of the policyholders voted in favor of the plan in December. The reorganization was effective December 31, 1999.

The largest of these six companies forming mutual holding companies has about \$1.5 billion in assets. It may be that a trend is developing for smaller mutual insurers to form mutual holding companies while very large mutual insurers, such as John Hancock and Metropolitan Life, demutualize and become 100% stock companies. None of these six companies announced an intention to issue stock to the public in the near future. Among the reasons given for choosing the mutual holding company structure, the companies mentioned that the new structure makes it easier for a company to acquire other companies, mutual holding companies receive a tax break not available to mutual life insurers (the elimination of the §809 tax), additional corporate flexibility and the potential to raise additional capital, if needed. Comments were made that demutualization was considered too costly and cumbersome and, if they went public, the market capitalization would be very small and the stock price would likely suffer as a consequence.

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ABOUT SIDLEY & AUSTIN

In today's environment, insurance companies need greater innovation and creativity to grow and prosper. Mutual insurance holding company legislation, which permits a mutual insurer to organize as a stock company under a parent mutual holding company, has been adopted in 23 states and the District of Columbia. Demutualizations have also been increasing. Other innovative steps, such as trust preferred securities, joint ventures and mutual company affiliations, also have been developed and utilized.

Sidley & Austin is an international firm with approximately 850 lawyers practicing on three continents. Our firm, one of the largest in the United States, represents a broad range of North American and overseas businesses, associations, government agencies and individuals. We have developed experience in handling complex insurance company reorganizations, mergers, acquisitions and financings. It is one of the few law firms that has significant experience with mutual insurance company reorganizations and mergers of mutual insurers.

ABOUT RICHARD G. CLEMENS

Richard G. Clemens is a partner in the Chicago office of Sidley & Austin. He joined the firm in 1965 and became a partner in 1973. His principal areas of practice include securities offerings, mergers, acquisitions, divestitures, sales of business, recapitalizations, corporate structuring, and a broad range of counseling on corporate and securities law matters.

Mr. Clemens represented AmerUs Life Holdings, Inc., a newly established life insurance holding company, which completed an initial public offering in February, 1997. The transaction involved the formation of a mutual insurance holding company under Iowa law (the first transaction of its kind in the country) followed by a reorganization which split the company's non-life businesses (a federal savings bank, a mortgage company, a homebuilder, a title company, a real estate development company and a real estate brokerage firm) from its life insurance business. Only the life insurance business was taken public.

Mr. Clemens represented Allied Life Financial Corporation in connection with its acquisition by Nationwide Mutual Insurance Company. He represented Protection Mutual Insurance Company in its merger with Allendale Mutual Insurance Company and Arkwright Mutual Insurance Company. He represented Acacia Mutual Life Insurance Company which formed a mutual insurance holding company in the District of Columbia and Ameritas Life Insurance Company which formed a mutual insurance holding company in Nebraska. He has represented Minnesota Mutual Life Insurance Company, Mutual Trust Life Insurance Company, National Life of Vermont and Trustmark Insurance Company (Mutual) in similar reorganizations. Mr. Clemens represented the Ohio Department of Insurance in the Ohio National mutual holding company reorganization, and represented the Oregon Department of Justice in the Standard Insurance Company demutualization. He represented General American Mutual Holding Company (in rehabilitation) in connection with the sale of

GenAmerica Corporation, the parent company of General American Life Insurance Company, to Metropolitan Life Insurance Company for \$1.2 billion.