April 3, 2012

TO: Board of Directors

FROM: James Wigand
Director
Office of Complex Financial Institutions

Michael H. Krimminger
General Counsel

SUBJECT: Treatment of a Mutual Insurance Holding Company as an Insurance Company for the Purpose of Section 203(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act--Final Rule

RECOMMENDATION

The attached Final Rule ("Final Rule") provides for the treatment of a mutual insurance holding company as an insurance company for the purpose of Section 203(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the ''Dodd-Frank Act''), 12 U.S.C. 5383(e). The Director of the Office of Complex Financial Institutions recommends that the Board of Directors approve and adopt the Final Rule and authorize its publication in the *Federal Register*. The General Counsel concurs in such recommendation.

EXECUTIVE SUMMARY

Discussions between the insurance industry and the FDIC concerning the FDIC's rules implementing the orderly liquidation authority provided in Title II of the Dodd-Frank Act led to a request to clarify whether a mutual insurance holding company would be treated as an insurance company or as a non-insurance financial company in the event it is a covered financial company subject to orderly resolution. A mutual insurance holding company, which can be organized under insurance regulatory regimes in many

states, is created through the restructuring of a mutual insurance company into two entities, a mutual insurance holding company and a stock insurance company that is converted from the original mutual insurance company. The purpose of the restructuring is to preserve the benefits of a mutual form of organization while allowing the converted mutual insurance company to obtain capital from public investors. In states where the mutual insurance holding company structure is authorized by law, the assets of the mutual insurance holding company generally are included in the estate of the converted mutual insurance company for the purpose of liquidation or resolution of a failed converted mutual insurance company.[1]

On December 13, 2011, the FDIC published a Notice of Proposed Rulemaking ("NPR") in the *Federal Register*[2] setting forth the conditions under which a mutual insurance holding company would be resolved as an insurance company under Section 203(e) of the Dodd-Frank Act. The comment period for the NPR closed on February 13, 2012, and the FDIC received four comment letters. Additionally, the FDIC held a conference call with representatives of the National Association of Insurance Commissioners on January 17, 2012, and received their comments on the NPR.

The Final Rule is promulgated pursuant to Section 209 of the Dodd-Frank Act, and harmonizes the treatment of mutual insurance holding companies under Section 203(e) of the Dodd-Frank Act with the treatment of such companies under state insolvency regimes. In accordance with the consultation requirement of Section 209, a term sheet outlining the Final Rule and a draft of the final regulatory text were circulated

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[1] *E.g.*, Iowa Code Ann. (West) 521A.14(4), 215 Ill. Comp. Stat. Ann. (West) 5/59.2(1)(f)(v), and Neb. Rev. Stat. § 44-6125(6)(g).

[2] 76 FR 77442 (December 13, 2011).

to the Financial Stability Oversight Council ("FSOC") Deputies on March 7, 2012. Given the nature of the proposed changes to the Final Rule, the positive industry comments received and the previous consultation with the FSOC, the FDIC concluded that a 30-day consultation period with the FSOC was appropriate. The FDIC invited interested FSOC Deputies to participate in a call to discuss the Final Rule, however, no call was requested. Staff responded, however, to written questions submitted by staff of one FSOC member.

DISCUSSION

I. Background

A mutual insurance holding company is created through the restructuring of a mutual insurance company into two entities, a mutual insurance holding company and a stock insurance company that is converted from the original mutual insurance company. In a variation of this restructuring, a third entity may be formed, an intermediate insurance stock holding company. In this three-entity structure, in most instances, the mutual insurance holding company initially owns 100 percent of the intermediate insurance stock holding company, and the intermediate insurance stock holding company initially owns 100 percent of the stock of the converted mutual insurance company. The purpose of the restructuring is to preserve the benefits of a mutual form of organization while allowing the converted mutual insurance company access to capital markets either through sale of its stock or, in a three-entity structure, the sale of the stock of the intermediate insurance stock holding company.

A mutual insurance holding company has no equity interests. Membership rights are held by the policyholders of the converted mutual insurance company who have rights similar to those they had as policyholders of the mutual insurance company before

conversion. Policyholders of the converted mutual insurance company are entitled to vote for members of the mutual insurance holding company's board of directors and may receive special dividends in the form of capital distributions or reductions of policy premiums.

A majority of the states have adopted statutes providing for the formation of mutual insurance holding companies. Those statutes generally: (a) provide for the regulation of a mutual insurance holding company at the holding company level by the insurance commissioner of the domiciliary state; (b) require that the mutual insurance holding company maintain voting control over the converted mutual insurance company; and (c) specifically subject a mutual insurance holding company to liquidation or rehabilitation under the state regime if the converted mutual insurance company is placed in liquidation or rehabilitation. In addition, either by statute, rule or regulation, in the liquidation of a converted mutual insurance company, the assets of the mutual insurance holding company generally are included in the estate of the converted mutual insurance company being liquidated.[3]

In providing for the orderly liquidation of a covered financial company under Title II of the Dodd-Frank Act, Congress recognized that insurance companies historically had been liquidated and rehabilitated pursuant to a state insolvency framework. As a result, Congress provided that "if an insurance company is a covered financial company or a subsidiary or affiliate of a covered financial company, the liquidation or rehabilitation of such insurance company, and any subsidiary or affiliate of

[3] *E.g.*, Iowa Code Ann. (West) 521A.14(4), 215 Ill. Comp. Stat. Ann. (West) 5/59.2(1)(f)(v), and Neb. Rev. Stat. § 44-6125(6)(g).

such company that is [an insurance company], shall be conducted as provided under applicable State law."[4]

The term "insurance company" is defined in Section 201(a)(13) of the Dodd-Frank Act to mean "any entity that is—(A) engaged in the business of insurance; (B) subject to regulation by a State insurance regulator; and (C) covered by a State law that is designed to specifically deal with the rehabilitation, liquidation, or insolvency of an insurance company."[5] The identical definition is found in Section 380.1 of Title 12 of the Code of Federal Regulations. Concerns have been raised with respect to the application of this definition to mutual insurance holding companies because, under applicable state laws, a mutual insurance holding company generally is prohibited from engaging in the business of insurance, that is, a mutual insurance holding company may not sell policies of insurance. Thus, a mutual insurance holding company arguably does not fit squarely within a literal reading of the statutory definition of insurance company under the Dodd-Frank Act.

Given the process by which a mutual insurance holding company is formed from a converted mutual insurance company, the continuing interest of the policyholders of the converted mutual insurance company in both the converted mutual insurance company, as its customers, and the mutual insurance holding company, as holders of its membership interests, the extensive regulation of the mutual insurance holding company by the insurance commissioner of its domiciliary state, and the inclusion of the mutual insurance holding company and its assets in the liquidation of the converted mutual

[4] 12 U.S.C. 5383(e)(1).

[5] 12 U.S.C. 5381(a)(13).

insurance company, the Final Rule's treatment of a mutual insurance holding company, under certain circumstances, as an insurance company for the purpose of Section 203(e) of the Dodd-Frank Act is consistent with the intent of the Dodd-Frank Act.

II. Summary of the NPR

The NPR proposed that a mutual insurance holding company would be treated in the same manner applicable to insurance companies under Section 203(e) of the Dodd-Frank Act, which provides that "if an insurance company is a covered financial company or a subsidiary or affiliate of a covered financial company, the liquidation or rehabilitation of such insurance company, and any subsidiary or affiliate of such company that is [an insurance company], shall be conducted as provided under applicable State law."[6] This proposed treatment was limited to mutual insurance holding companies whose largest United States subsidiary (as measured by total assets as of the end of the previous calendar quarter) is an insurance company or an intermediate insurance stock holding company, and whose investments are limited to the securities of an intermediate insurance stock holding company, the securities of the converted mutual insurance company and other assets and securities of the type authorized for holding and investment by an insurance company domiciled in its state of incorporation. The NPR also proposed that this treatment apply only to mutual insurance holding companies that are regulated by and are subject to the insurance company insolvency laws of their states of domicile, and that are not subject to bankruptcy proceedings.

The public comments on the NPR were supportive of the FDIC's goal to treat mutual insurance holding companies as insurance companies under Section 203(e) of the

[6] 12 U.S.C. 5383(e)(1).

Dodd-Frank Act. The comments offered several suggestions to the text of the proposed regulation to conform it to current insurance industry practice and applicable state law. Certain of these changes, which the FDIC has included in the Final Rule, are: (a) modifying the definition of mutual insurance holding company to provide that this company could own a "majority" of the stock of the intermediate insurance stock holding company and the converted mutual insurance company instead of the specific threshold of "at least 51%" proposed in the NPR; (b) clarifying the definition of the intermediate insurance stock holding company to indicate that it could be organized either at the time of or after the organization of the mutual insurance holding company and could hold "a majority" rather than "all" of the stock of the converted mutual insurance company; and (c) clarifying the definition of the mutual insurance company to reflect that it is organized as a non-stock mutual *corporation*, not an association, in which its policyholders hold the *surplus*, not "equity." Other comments, which the FDIC has not included in the Final Rule are: (a) permitting the mutual insurance holding company to hold the voting stock of the intermediate insurance stock holding company directly or indirectly; (b) permitting the intermediate insurance stock holding company to hold the voting stock of the converted mutual insurance company directly or indirectly; (c) removing the term "voting rights" in the definition of mutual insurance company and substituting the term "membership interests"; (d) deleting subsection (b) of the Final Rule that requires that the mutual insurance holding company is not subject to a bankruptcy proceeding; and (e) revising subsection (d) of the Final Rule to refer to assets and investments of the mutual insurance holding company "permitted under applicable State law."

III. Summary of Final Rule

The Final Rule modifies Part 380 of Title 12 of the Code of Federal Regulations and provides generally that a mutual insurance holding company that meets the requirements of the Final Rule will be treated as an insurance company pursuant to Section 203(e) of the Dodd-Frank Act.

The Final Rule adds three definitions to Section 380.1 of Title 12 of the Code of Federal Regulations: intermediate insurance stock holding company; mutual insurance company; and mutual insurance holding company. The definition of mutual insurance holding company has been modified in the Final Rule based on industry comments to provide that the company could own a "majority" of the stock of the intermediate insurance stock holding company and the converted mutual insurance company instead of the specific threshold of "at least 51%" included in the Proposed Rule. The definition of the intermediate insurance stock holding company was also modified in the Final Rule to delete an unnecessary introductory phrase "For purposes of this subpart" and to indicate that such company could be organized either at the time of or after the organization of the mutual insurance holding company and could hold "a majority" rather than "all" of the stock of the converted mutual insurance company. In addition, the definition of the mutual insurance company was amended to reflect that it is organized as a non-stock mutual corporation, not an association, and that its policyholders hold the surplus, not "equity" in this company.

The Final Rule adds Section 380.11 to provide that a mutual insurance holding company shall be treated as an insurance company under Section 203(e) of the Dodd-

Frank Act, 12 U.S.C. 5383(e); provided that: (a) it is subject to the insurance laws of the state of its domicile, including specifically and without limitation, a statutory regime for the rehabilitation or liquidation of insurance companies that are in default or in danger of default; (b) it is not subject to bankruptcy proceedings under Title 11 of the United States Code; (c) its largest United States subsidiary (as measured by total assets as of the end of the previous calendar quarter) is an insurance company or an intermediate insurance stock holding company; and (d) its investments are limited to the securities of an intermediate insurance stock holding company, the securities of the converted mutual insurance company and other assets and securities of the type authorized for holding and investment by an insurance company domiciled in its state of incorporation.

The first proviso requires that the mutual insurance holding company be subject to the insurance laws of the state of its domicile, including specifically and without limitation, a statutory regime for the rehabilitation or liquidation of insurance companies that are in default or in danger of default. This provision is included in the Final Rule to conform to two of the three prongs of the definition of "insurance company" contained in Section 201(a)(13) of the Dodd-Frank Act. The reference to companies that are "in default or in danger of default" ensures that the state resolution process will be applicable in a time and manner comparable to the Title II orderly liquidation process, which applies to financial companies that are in default or in danger of default under Section 203(b)(1) of the Dodd-Frank Act.

The second proviso requires that the mutual insurance holding company is not subject to bankruptcy proceedings under Title 11 of the United States Code and is included to emphasize that the mutual insurance holding company must not only be

subject to the applicable state insurance law but must also be resolved under the applicable state insurance law. Certain industry comments requested deletion of this requirement because of an ambiguity in bankruptcy law about whether a mutual insurance holding company is an insurance company and thus not an eligible debtor under the Bankruptcy Code. The FDIC rejected this suggestion; thus, the Final Rule ensures that there is no ambiguity or conflict with respect to the determination of which insolvency regime is applicable to a mutual insurance holding company. To the extent that any such ambiguity or conflict exists, it is the intent of the Final Rule that the ambiguity be resolved in favor of allowing resolution under Title II of the Dodd-Frank Act even if the mutual insurance holding company may be an eligible debtor under Title 11 of the United States Code.

The third proviso, which requires that the mutual insurance holding company's largest United States subsidiary (as measured by total assets as of the end of the previous calendar quarter) is an insurance company or an intermediate insurance stock holding company, ensures that, if a mutual insurance holding company covered by the Final Rule is placed in orderly liquidation under Title II of the Dodd-Frank Act, the Director of the Federal Insurance Office would participate in making the recommendation to take such action in accordance with the provisions of Section 203(a)(1)(C) of the Dodd-Frank Act.[7] In addition, this requirement emphasizes that an insurance company subsidiary of the mutual insurance holding company must be its most significant subsidiary by asset size.

The final proviso requires the mutual insurance holding company to limit its investments to the securities of the intermediate insurance stock holding company, the

[7] 12 USC 5383 (a)(1)(C)

securities of the converted mutual insurance company and other assets and securities of the type authorized for holding and investment by an insurance company domiciled in its state of incorporation. The FDIC rejected a public comment to alter these investment requirements because the FDIC believes that this proviso ensures that the mutual insurance holding company is operating purely as a holding company and is not itself actively engaged in operating non-insurance businesses.[8]

CONCLUSION

The Final Rule clarifies that the liquidation and rehabilitation of a covered financial company that is a mutual insurance holding company will be conducted in the same manner as an insurance company under Section 203(e) of the Dodd-Frank Act. The Final Rule also harmonizes the treatment of mutual insurance holding companies under the Dodd-Frank Act with the treatment of such companies under state insolvency laws. The Director of the Office of Complex Financial Institutions recommends that the Board of Directors approve and adopt the Final Rule and authorize its publication in the *Federal Register*. The General Counsel concurs in such recommendation.

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[8] The investments of the intermediate insurance stock holding company, however, are not restricted in this manner because, under the Final Rule, the intermediate insurance stock holding company is not treated as an insurance company for the purpose of Section 203(e) of the Dodd-Frank Act.