


November 15, 2011

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--Notice of Proposed Rulemaking

RECOMMENDATION

The attached Notice of Proposed Rulemaking (“NPR” or “Proposed 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 Office of Complex Financial Institutions recommends that the Board of Directors approve and adopt the NPR and authorize its publication in the *Federal Register* with a 60-day comment period. The General Counsel concurs in such recommendation.

EXECUTIVE SUMMARY

Comments to earlier rules promulgated implementing the orderly liquidation authority provided in Title II of the Dodd-Frank Act requested clarification of 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 created under

insurance regulatory regimes in most states, is created through the restructuring of a mutual insurance company in a manner that is designed to preserve the benefits of a mutual form of organization while allowing the converted mutual insurance company access to capital markets. 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

The Proposed Rule would make clear that a mutual insurance holding company would be resolved under state law in the 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.”² This treatment would be 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 Proposed Rule also would provide that this treatment applies only to mutual insurance

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 12 U.S.C. 5383(e)(1).

holding companies that are regulated by and are subject to the insurance company resolution laws of their states of domicile, and that are not subject to bankruptcy proceedings.

The Proposed Rule is promulgated pursuant to Section 209 of the Dodd-Frank Act, and is intended to harmonize 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 Proposed Rule and a draft of the regulatory text were provided to members of the Financial Stability Oversight Council (“FSOC”) and were discussed at a meeting of the FSOC Resolutions Committee on October, 19, 2011, and the term sheet was circulated to the FSOC Deputies on November 8, 2011.

DISCUSSION

I. Background

On July 15, 2011, the FDIC published in the *Federal Register* a final rule (“Final Rule”) regarding certain orderly liquidation authority provisions under Title II of the Dodd-Frank Act.³ In response to the notice of proposed rulemaking⁴ and interim final rule⁵ that preceded the issuance of the Final Rule, commenters from the insurance industry urged the FDIC to treat mutual insurance holding companies as insurance companies for purposes of Title II of the Dodd-Frank Act.

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

³ 76 FR 41626 (July 15, 2011).

⁴ Notice of Proposed Rulemaking, 75 FR 64173 (October 19, 2010).

⁵ Interim Final Rule, 76 FR 4207 (January 25, 2011).

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, initially, the mutual insurance holding company owns 100% of the intermediate insurance stock holding company, and the intermediate insurance stock holding company owns 100% 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 is owned 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.⁶

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 such company that is [an insurance company], shall be conducted as provided under applicable State law.”⁷

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.”⁸ 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

⁶ *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).

⁷ 12 U.S.C. 5383(e)(1).

⁸ 12 U.S.C. 5381(a)(13).

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 equity holders, 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 insurance company, it is consistent with the intent of the Dodd-Frank Act to treat a mutual insurance holding company, under certain circumstances, as an insurance company for the purpose of Section 203(e) of the Dodd-Frank Act.

II. Summary of Proposed Rule

The Proposed Rule would modify Part 380 of Title 12 of the Code of Federal Regulations, and would provide generally that a mutual insurance holding company that meets the requirements of the Proposed Rule will be treated as an insurance company for the purpose of Section 203(e) of the Dodd-Frank Act.

The Proposed Rule would add 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 Proposed Rule would add Section 380.11 to provide that a mutual insurance holding company shall be treated as an insurance company for the purpose of 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, and is included in the Proposed Rule to be consistent with two of the three prongs of the definition of “insurance company” set forth 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 it 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. Thus, the Proposed Rule would ensure that there is no ambiguity or conflict with respect to the determination of which insolvency regime is applicable to a mutual insurance holding company.

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, is included to ensure that, if a mutual insurance holding company covered by the Proposed 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. In addition, this requirement is intended to emphasize that an insurance company subsidiary of the mutual insurance holding company must be its most significant subsidiary by asset size.

The final proviso, which requires the mutual insurance holding company to limit its investments to the securities of the 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, is intended to ensure that the mutual insurance holding company is operating as a pure holding company and is not itself actively engaged in operating non-insurance businesses.⁹

⁹ The investments of the intermediate insurance stock holding company, however, are not restricted in this manner because, under the Proposed 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.

CONCLUSION

The Proposed Rule would clarify 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. The Proposed Rule is intended to harmonize 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. The Office of Complex Financial Institutions recommends that the Board of Directors approve and adopt the NPR and authorize its publication in the *Federal Register* with a 60-day comment period. The General Counsel concurs in such recommendation.

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