

INSURANCE: Advances or loans to a Surplus As  
MUTUAL COMPANIES: Regards Policyholders of a mutual  
POLICYHOLDERS: insurance company should be paid  
SURPLUS: before any part of said surplus is  
distributed to the policyholders  
as owners of the mutual company.

Opinion No. 383

December 31, 1964



Honorable Ralph H. Duggins  
Superintendent  
Division of Insurance  
Jefferson Building  
Jefferson City, Missouri

Dear Mr. Duggins:

By letter dated November 13, 1964, you requested an official opinion from this office as follows:

"Motorist Mutual Casualty Insurance Company, organized pursuant to the provisions of Sections 379.205 through 379.310 RSMo., and Covenant Security Insurance Company, a joint stock casualty insurance company, have submitted to the Division of Insurance a plan of consolidation and reinsurance pursuant to Section 376.520 RSMo., seeking approval by a commission convened under Section 376.520 (4) RSMo.

"Motorist Mutual, as of May 31, 1964, by its books indicated a 'Surplus as Regards Policyholders' of \$104,398.26, made up of unassigned funds of \$54,398.26, and two \$25,000.00 Guaranty Fund Certificates representing funds paid to the mutual under Section 379.270 RSMo. to meet the guaranty fund requirements of Section 379.235 (3) RSMo. As of September 21, 1964, according to an interim audit report,

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this surplus now stands at approximately \$66,000.00, the unassigned funds being reduced to \$16,000.00.

"Under the plan of consolidation under consideration, the surviving company is to distribute to the policyholders of Motorist Mutual the surplus of the company to which they are entitled.

"The consolidating companies maintain that the distributable surplus is limited to the \$16,000.00 referred to above, and that \$50,000.00 must be paid to the holders of the Guaranty Fund Certificates. The Guaranty Fund Certificates provide that Motorist Mutual is to pay interest at the rate of ten percent (10%) per annum and return the principal to the certificate holders:

"' . . . when the surplus of said company (Motorist Mutual) remaining after providing for all other reserves and other liabilities shall be sufficient to pay the same provided that neither the said principal nor the interest thereon shall be a liability or a claim against the company or any of its assets.'

"In determining whether the interest of the policyholders of Motorist Mutual are properly protected by the plan of consolidation, as is required by Section 376.520 RSMo., I request your opinion as to how the 'Surplus as Regards Policyholders' should lawfully be distributed, that is, in its entirety (\$66,000.00) to the policyholders of Motorist Mutual, or, \$16,000.00 to such policyholders and \$50,000.00 to the holders of the two Guaranty Fund Certificates."

In addition to the facts recited in your letter we have been furnished a pro-forma balance sheet which reflects the actual financial condition of the two companies as of September 21, 1964, and the resulting balance sheet reflecting the financial condition of the consolidated company. This pro-forma balance sheet is set out below:

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"PRO-FORMA BALANCE SHEET

SEPTEMBER 21, 1964

|   | <u>Covenant<br/>Security<br/>Insurance<br/>Company</u> | <u>Motorist<br/>Mutual<br/>Casualty<br/>Insurance<br/>Company</u> | <u>Adjustments<br/>See Notes</u> | <u>Consolidated<br/>Balance<br/>Sheet</u> |
|---|--|---|----------------------------------|---|
| <u>ASSETS</u>   |  |   |                                  |   |
| Bonds-Amortized value   | \$365,792.98   | \$106,503.79  |                                  | \$ 472,296.77                             |
| Cash and bank deposits  | 83,439.55  | 411,212.74  |                                  | 494,652.29                                |
| Agents balances   |  | 168,867.75  |                                  | 168,867.75                                |
| Less-Ceded reinsurance<br>balance payable                     |  | (27,538.04)   |                                  | (27,538.04)                               |
| Interest due and accrued                                      | 3,216.29   | 1,324.49  |                                  | 4,540.78                                  |
| Exchange receivable   |  | 100.29  |                                  | 100.29                                    |
| <u>TOTAL ADMITTED ASSETS</u>                                  | <u>\$452,448.82</u>                                    | <u>\$660,471.02</u>   |                                  | <u>\$1,112,919.84</u>                     |
| <u>LIABILITIES, SURPLUS AND OTHER FUNDS</u>                   |  |   |                                  |   |
| Reserve for losses  |  | \$152,960.00  |                                  | \$ 152,960.00                             |
| Reserve for loss<br>adjustment expenses                       |  | 9,363.36  |                                  | 9,363.36                                  |
| Accrued other expenses  | \$ 6,243.96  | 21,811.00   | \$19,895.00(B)                   | 8,159.96                                  |
| Accrued taxes, licenses<br>and fees                           |  | 17,387.33   |                                  | 17,387.33                                 |
| Reserve for unearned<br>premium                               |  | 392,691.07  |                                  | 392,691.07                                |
| Due to Motorist Mutual<br>Insurance Company Policy<br>Holders |  |   | 16,258.26(C)                     | 16,258.26                                 |
| <u>TOTAL LIABILITIES</u>                                      | <u>\$ 6,243.96</u>                                     | <u>\$594,212.76</u>   |                                  | <u>\$ 596,819.98</u>                      |
| Capital paid-up   | \$200,000.00   |   | 19,895.00(B)<br>50,000.00(A)     | \$ 269,895.00                             |
| Guaranty Fund Certifi-<br>cates                               |  | \$ 50,000.00  | 50,000.00(A)                     |   |
| Unassigned surplus funds                                      | 246,204.86   | 16,258.26   | 16,258.26(C)                     | 246,204.86                                |
| <u>SURPLUS AS REGARDS TO<br/>POLICY HOLDERS</u>               | <u>\$446,204.86</u>                                    | <u>\$ 66,258.26</u>   |                                  | <u>\$ 516,099.86</u>                      |
| <u>TOTAL LIABILITIES AND<br/>SURPLUS</u>                      | <u>\$452,448.82</u>                                    | <u>\$660,471.02</u>   |                                  | <u>\$1,112,919.84</u>                     |

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NOTES:

- (A) Exchange of \$50,000.00 of Guaranty Fund Certificates for \$50,000.00 of common stock of Covenant Security Insurance Company.
- (B) Payment to Casualty Management Company in common stock of Covenant Security Insurance Company for \$19,895.00 of current liabilities due to them.
- (C) Transfer of Unassigned Surplus Funds of Motorists Mutual Casualty Insurance Company as a liability of Covenant Security Insurance Company."

It appears that the Guaranty Fund Certificates represent a low-grade unsecured debt capital in Motorist Mutual Casualty Insurance Company. As stated in your letter, the Guaranty Fund Certificates represent funds advanced (or loaned) to the mutual company to meet reserve requirements under Section 379.235, RSMo 1959. This debt capital was paid into the company pursuant to Section 379.270 and the legal status of the Guaranty Fund Certificates must be determined by the provisions of this section which are as follows:

"1. Any director, officer or member of any such company, or any other person, may advance to such company any sum or sums of money necessary for the purpose of its business or to enable it to comply with any of the requirements of the law, and such moneys and such interest thereon as may have been agreed upon, not exceeding ten per cent per annum, shall be payable only out of the surplus remaining after providing for all reserves and other liabilities, and shall not otherwise be a liability or claim against the company or any of its assets."

Thus, upon a dissolution of the mutual company the Guaranty Fund Certificates are payable only after all other liabilities of the company have been fully satisfied. Upon satisfaction of all liabilities, and in particular upon satisfaction of all liabilities to policyholders under the provisions of the policies, payment of the Guaranty Fund Certificates can be made. After all liabilities of the company have been met any surplus remaining would be distributed to the policyholders because the policyholders are the owners of the mutual company. However, the Guaranty Fund Certificates represent a claim against any remaining surplus

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which would be available for distribution to the policyholders and payment of such Guaranty Fund Certificates should be made before any remaining surplus is distributed to the policyholders.

However, rather than being dissolved the mutual company is being consolidated with a joint stock company. The disposition of the Surplus as Regards Policyholders (which includes funds realized from the Guaranty Fund Certificates) upon consolidation must be made with with reference to the following provisions of the statutes:

Section 376.520, RSMo -- "6. Said commission, if satisfied that the interests of the policyholders of such company or companies are properly protected, and that no reasonable objections exist thereto, may approve and authorize the proposed consolidation or reinsurance, or of such modification thereof as may seem to it best for the interests of the policyholders, and said commission may make such order with reference to the distribution and disposition of the surplus assets of any such company thereafter remaining as shall be just and equitable.

"7. . . it shall be the duty of said commission to guard the interests of the policyholders of any such company or companies proposing to consolidate . . . ."

Pursuant to the cited statutory provisions the commission can make such order concerning the distribution and disposition of a surplus in a consolidation proceeding as shall be just and equitable after the commission is satisfied that the interests of the policyholders are properly protected and safeguarded.

An examination of the pro-forma balance sheet set out above reflects that under the proposed plan of consolidation disposition of the Surplus as Regards Policyholders of the mutual company would be made by issuing common stock of the consolidated company to the holders of the Guaranty Fund Certificates in the amount of \$50,000.00 and by transferring the balance in the amount of \$16,258.26 to a special surplus reserve to be held for the policyholders of the mutual company. It appears that thereafter the special surplus reserve in the amount of \$16,258.26 can be distributed to such policyholders at any time. However, the \$50,000.00 advanced to the mutual company by the holders of the Guaranty Fund Certificates will remain in the consolidated company as permanent capital and will be represented by common stock issued to the holders of the certificates. Therefore, the distribution of surplus in

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the amount of \$50,000.00 to the holders of the Guaranty Fund Certificates is a bookkeeping transaction only and the funds represented by the certificates remain in the consolidated company as permanent capital. Thus, the interests of the policyholders (as policyholders and not as owners of the mutual company) are protected and safeguarded by accretion to the permanent capital in the amount of the Guaranty Fund Certificates.

CONCLUSION

It is the opinion of this office that in a plan of consolidation for a mutual company and a joint stock company under Section 376.520, RSMo 1959, lawful distribution and disposition of a Surplus as Regards Policyholders in the mutual company may be made by issuing common stock of the consolidated company to the holders of Guaranty Fund Certificates in the amount of funds advanced by said holders to said surplus and by distributing the balance of said surplus to the policyholders of the mutual company.

The foregoing opinion, which I hereby approve, was prepared by my Assistant Thomas J. Downey.

Yours very truly,

  
THOMAS F. EAGLETON  
Attorney General