1998 WL 248384 (S.E.C. No - Action Letter)

(SEC No-Action Letter)

***1 American**
Re
Corporation

Publicly Available May 15, 1998

SEC LETTER

1934 Act / s 3(a)(10)
1934 Act / s 12
1933 Act / s 5
1933 Act / s 2(a)(1)

May 15, 1998
Publicly Available May 15, 1998

Re: **American Re Corporation** (the “Company”)

Incoming letter dated May 15, 1998

Based on the facts presented, the Division will not recommend enforcement action to the Commission if, in reliance on your opinion as counsel that registration is not required, the Charter Partners program is operated as described in your letter without registration of the Trust Interests (as defined in your letter) or the preferred stock of the Holding Company (as defined in your letter) under the Securities Act of 1933 or the Securities Exchange Act of 1934. In reaching this position, the staff notes, among other things, that (1) no Policyholder (as defined in your letter) will ever be liable for any dollar amount in excess of the premium paid by the Policyholder for insurance; and (2) any dividends distributed to a Policyholder will be allocated pursuant to a predetermined formula and based primarily upon the Policyholder's own loss experience.

This position is based on the representations made to the Division in your letter. Any different facts or conditions might require the Division to reach a different conclusion. Further, this response expresses the Division's position on enforcement action only and does not express any legal conclusion on the question presented.

Sincerely,

Cecilia D. Blye
Special Counsel

May 15, 1998

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William E. Morley, Esq.
Associate Director (Legal)
Division of Corporation Finance
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549Re: **American Re Corporation**

Dear Mr. Morley:

On behalf of **American Re Corporation** ("American Re") and its wholly owned subsidiary American Re-Insurance Company (the "Company"), we are requesting the staff of the Division of Corporation Finance (the "Staff") of the Securities and Exchange Commission (the "Commission") to concur in our opinion that the Charter Partners program, described below, which was developed and is proposed to be marketed by the Company does not constitute a security under Section 2(1) of the Securities Act of 1933, as amended (the "Securities Act") or Section 3(a)(10) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and therefore does not require registration under Section 5 of the Securities Act or Section 12 of the Exchange Act. The Securities Act and the Exchange Act are collectively referred to herein as the "Acts." Alternatively, we request that the Staff will not recommend enforcement action to the Commission under such sections of the Acts with respect to the marketing of Charter Partners.

American Re primarily acts as a holding company for the Company, the second largest property and casualty reinsurance company in the United States. The Company underwrites property and casualty reinsurance on a direct basis in both the domestic and international markets.

I. FACTS:

***2** Charter Partners was developed in response to increased competition in the alternative risk transfer industry. In the past, the alternative risk transfer industry has been accessible only to those businesses large enough to economically self-insure a portion of their predictable high-frequency losses. The industry has developed a variety of products for large insureds, such as captive insurance companies (either owned by the insureds or utilized by multiple insureds, which are referred to as rent-a-captives), risk retention groups, self insurance programs and alternative financing facilities. The benefits of these products to large insureds include lower insurance costs, better financial management, improved claims handling, more effective risk management, customized insurance programs, direct access to the worldwide reinsurance market and greater control over loss prevention.

The concept of Charter Partners is to provide the same benefits to the smaller and middle sized commercial businesses which currently lack the wherewithal to individually self-insure or create a captive. The concept will be marketed to select members of new or existing groups and associations with homogenous risks, such as non-profit trade associations for plumbing and electrical companies. By combining similar types of business risks, the Company plans to create economies of scale and pass the savings through to such participating members that become policyholders in an insurance program that includes lower and more manageable insurance costs, more control over claims and greater incentives to perform effective risk management at the policyholder level (a "Program"). To the extent these efforts generate a reduction in claims costs, some of these savings will be returned to the policyholders.

Each Program will consist of four separate parts which, as described below, work together. The parts are:

i. certain domestic primary insurers, which may be either affiliated or unaffiliated with the Company, will

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provide certain direct insurance coverage to policyholders;[FN1]

FN1. The Company currently expects that most insurers will not be affiliates of the Company.

End of Footnote(s).ii. a “rent-a-captive” reinsurer which is owned by a holding company (the “Holding Company”) and which will reinsure a portion of the liabilities of the primary insurers arising out of the policies issued to the policyholders;[FN2]

FN2. The Company will own all the issued and outstanding shares of common stock of the Holding Company and each individual trust will own one share of preferred stock in the Holding Company. The rent-a-captive will be a wholly owned subsidiary of the Holding Company, although the Company may decide to utilize unaffiliated rent-a-captives. Furthermore, under the terms of the Trust Agreement, the insureds may direct the Trustee to utilize an unaffiliated rent-a-captive. The absence or presence of an affiliation among the Company, the Holding Company and the rent-a-captive will not affect the operation of the Trust or the Association. All rent-a-captives, whether or not an affiliate of the Company, are expected to be organized under the laws of Bermuda.

End of Footnote(s).***3** iii. the Holding Company will receive dividends from the rent-a-captive and distribute those dividends to a trust formed by the participating policyholders (the “Trust”) which will own one share of preferred stock in the Holding Company; and

iv. the Trust will distribute the dividends received, if any, to beneficiaries which have purchased policies from the primary insurers described in item (i) above.

Each Program will target prospective insureds with homogenous risks that are currently insured in traditional insurance markets with little experience in alternative risk-transfer products, such as captives, and who exhibit favorable risk management techniques and low loss experience through structured risk reduction programs. Agents appointed by the primary insurers who participate in the Program will contact these selected insureds to solicit interest and answer questions.[FN3] Insureds with similar business risks who are interested in participating and desire to improve their risk management techniques through collective sharing of information on risk management may come together to form an association or other organization[FN4] (the “Association”) to share insurance related information, e.g., regarding loss control.[FN5] Each Association will act as settlor of a Trust for the benefit of the members of the Association who qualify for and purchase Charter Partners insurance (the “Policyholders” or individually, a “Policyholder”). Policyholders would share cost saving experiences of the other participating members of their Association resulting in a lower cost of financing losses and possibly reduced loss experience of the group.[FN6] A prospective Policyholder will not be induced to participate in the Program through any representation or promise of an expectation of profit or gain that might be realized by such Policyholder from the monetary or resale value of its interest in the Trust. Prospective Policyholders will be encouraged to participate in the Program only as a means to replace existing traditional property/casualty business insurance at a potentially lower ultimate cost while at the same time becoming more adept at loss control.

FN3. Agents participating in the Program will be compensated at standard commission rates. It is possible that one or more agents would form a reinsurance company to which a portion of the Company's insurance risk could be ceded at appropriate and customary terms and conditions.

FN4. The agents and the Policyholders will form the Associations. While the Associations will be formed primarily from the efforts of the agents and the Policyholders, the Company may provide upon request any guidance or advice as a consultant.

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FN5. The Association will not create a joint insurance fund for insuring against the liability of the Policyholders, nor will it create any liability of any type on one Policyholder for the acts, omissions or conduct of any type of any other member. Rather, the Association will form the Trust and provide Policyholders with an administrative convenience.

FN6. Policyholders with an excellent personal loss experience could fail to realize any savings because of a poor overall loss experience of the Association.

End of Footnote(s).***4** The primary insurers will underwrite the primary insurance to each Policyholder and perform customary administrative functions. The primary insurers will cede a portion of the insurance coverage to a Bermuda based rent-a-captive, and the primary insurers will provide an aggregate excess of loss coverage, insulating the rent-a-captive from losses in excess of the ceded premiums and the investment income earned thereon (such reinsurance agreement is hereinafter referred to as the "Treaty").[FN7] No Policyholder will invest any capital in the rent-a-captive. The rent-a-captive will invest premiums received from the primary insurers primarily in cash equivalents and other low risk investments, such as U.S. government-backed instruments and certificates of deposit.[FN8]

FN7. The Bermuda rent-a-captive is governed by Bermuda corporate and insurance law and the domestic primary insurer is subject to state and federal laws. The relationship between the primary insurers and the Bermuda rent-a-captive will not be regulated any differently than typical reinsurance agreements between domestic insurers and foreign reinsurers.

FN8. Princeton Eagle West Insurance Company (the "Reinsurer") is the only rent-a-captive that currently will participate in the Program. Securities will be purchased by the Reinsurer through a management company that is a subsidiary of the Company.

> While a rent-a-captive may be incorporated in Bermuda without special legislation, a private act, such as the Princeton Eagle West Insurance Company Limited Act, 1997 (the "Bermuda Act") is necessary to obtain the benefit of a protected cell. Under the Bermuda Act, the Reinsurer will establish a separate account where required by the terms of a policy, which separate account will be held for the sole purpose of paying all claims arising from the policies of that separate account. Under the terms of the Shareholder Agreement (as defined below), the Trust and the Holding Company will agree that the financial results of the Treaty will be segregated into a separate account of the Reinsurer to the fullest extent allowed by the Bermuda Act. The combined effect of the Bermuda Act and the Shareholder Agreement is to require that the Holding Company maintain each Trust's assets in a separate account in the Reinsurer. By creating these separate accounts, the assets of each Trust will be contained in a protected cell which, under the Bermuda Act, is insulated from all claims and liabilities against any other Trust within the Reinsurer and from the claims and liabilities against the Reinsurer by any other person. In the event another rent-a-captive participates in the Program, the same procedure, structure and manner of operation would be used as in the creation, structure and contemplated operation of the Reinsurer.

End of Footnote(s).Each Trust will purchase one non-voting preferred share in the Holding Company for a nominal amount (e.g., one dollar). The preferred share will grant no voting rights and the affairs of the Holding Company will be conducted by American Re (or one of its affiliates) which will be the sole common stockholder. The preferred stock will be perpetual in duration and will be governed by the terms of a shareholder agreement by and between the Holding Company and the Trust (the "Shareholder Agreement"). The Trust will be restricted from selling, transferring, hypothecating, pledging or otherwise assigning or encumbering the share of

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preferred stock without the consent of the Holding Company, and such restrictions will be noted on the preferred stock certificate.[FN9]

FN9. The Holding Company will not consent to any such transfer or encumbrance.

End of Footnote(s).***5** The Trust will be governed by the terms of a trust agreement (the "Trust Agreement") that, among other things, will: (i) appoint a trustee; (ii) specify the exclusive powers and duties of the trustee; (iii) provide a formula that will govern the distribution of dividends received, if any, on account of the preferred stock of the Holding Company; (iv) restrict the trustee from transferring the preferred stock of the Holding Company; and (v) restrict the Policyholders from transferring their beneficial ownership interests in the Trust.

The Policyholders, as beneficiaries of the Trust, will be entitled only to receive distributions of dividend income from the Holding Company in respect of dividends the Holding Company receives from the rent-a-captive relative to the Association's policies. To the extent funds are available, any distribution from the rent-a-captive to the Holding Company, and the ensuing dividend on the preferred stock of the Holding Company to the Trust, will be determined by a single predetermined formula contained in the Shareholder Agreement.[FN10] Unless there is an overall positive result for a particular Association because of its favorable loss experience under the formula, no distribution will be made to the Holding Company and the Holding Company will not pay a dividend on the preferred stock held by the Trust. If there is a positive result, then dividends will be paid from the rent-a-captive to the Holding Company, and from the Holding Company to the Trust, in accordance with the Shareholder Agreement. All the dividends paid by the rent-a-captive to the Holding Company, less certain administrative expenses, will then be distributed to the Policyholders under a separate formula that will take into account each Policyholder's premium volume and loss experience and will allocate a percentage of the investment income, reinsurance costs and administrative expenses over the period with respect to which the dividend is declared.[FN11] An example of such a distribution formula is attached hereto as Exhibit A. In each case, the distribution formula will be predetermined and will be contained in the Trust Agreement.

FN10. All dividends paid by the rent-a-captive will be passed through to the Trust. The Holding Company may incur certain miscellaneous administrative expenses that will be reimbursed by the Trust.

FN11. To the extent that investment income is available for distribution, the Company and each Association may agree to an indexed rate of return, such as the rate of a three month Treasury Bill, on invested assets, although the rent-a-captive would invest at least 75% of its portfolio in cash equivalents and other low risk investments, such as U.S. government-backed instruments and certificates of deposit. The securities in the portfolio would be of the same type that an insurer or reinsurer would invest in the ordinary course of its business. The Holding Company will have stockholders' equity in excess of $1.2 million which would be available to make up any difference in the event that this indexed rate of return is not achieved.

End of Footnote(s).***6** Upon commutation or termination of a Treaty, the rent-a-captive, the Holding Company and the Trust will have sixty days to wind up the Association's affairs with respect to the Program (e.g., distribute accumulated amounts, if any, held by the rent-a-captive resulting from the favorable loss experience of the Policyholders and incidental investment return (the "Experience Fund") as dividends, pursuant to the Shareholder and Trust Agreements). Subsequent to a distribution and within sixty days of termination of the Treaty, the Holding Company will redeem the Trust's preferred share for the original nominal purchase price and the Trust will terminate upon redemption of all preferred stock issued in connection with the Program.[FN12] In the event of liquidation, dissolution, winding-up or termination of the Holding Company, the share of the preferred stock

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will be senior in priority to the common stock owned by American Re (or one of its affiliates). A Policyholder may voluntarily terminate its membership in an Association (and correspondingly withdraw from the Program),[FN13] and such Policyholder will not be entitled to receive any further distribution from the Trust.

FN12. The beneficiaries of each Trust will be the Policyholders from a single Association. Thus, the termination of any particular Treaty, accompanied by the termination of the corresponding Association and Trust, will have no affect on any other Trust, Association or Treaty. In no event would Policyholders be obliged to make any further payments or have any further liability after the earliest to occur of the termination of a Treaty, a Trust or an Association because such obligation would be an insurance risk of the primary insurer.

FN13. Under certain circumstances, a Policyholder's membership in the Association may be terminated for-cause. Circumstances that may result in a for-cause termination include: (i) failure of a Policyholder to renew its insurance with the primary insurer; (ii) a decision by the primary insurer to terminate a policy; and (iii) failure to establish certain risk reduction programs.

End of Footnote(s).As a result of the application of this formula, a Policyholder with favorable loss experience could expect to receive a higher distribution than one with a high loss experience so long as the group as a whole has a favorable loss experience. Conversely, if the group experiences a poor loss experience, Policyholders may receive little or no return regardless of the individual loss experience.[FN14] The dividends paid to the Trust and allocated among the Policyholders will not be related to the number of preferred shares held by the Trust or the interest in the Trust held by the Policyholder, as is the case with traditional dividends. Instead, the amount the Policyholder may receive will depend on the Policyholder's individual loss experience, resembling a return of premiums under a participating insurance policy, rather than a traditional stock dividend.

FN14. In no event would a Policyholder be liable for any amount in excess of premiums previously paid.

End of Footnote(s).II. ANALYSIS:

***7** Charter Partners does not constitute a security within the meaning of Section 2(1) of the Securities Act or Section 3(a)(10) of the Exchange Act because it is neither stock nor an investment contract.

A. Stock.

The Program is not “stock” within the meaning of the term “security” because the economic reality of this product to a Policyholder is to secure insurance coverage at reduced rates, rather than an investment to which the federal securities laws apply.[FN15] Moreover, the preferred stock and the beneficial interest in the Trust (the “Trust Interest”), individually or in the aggregate: (i) will not give the Policyholders the right to receive dividends contingent upon an apportionment of profits; (ii) will not be transferable; (iii) will not be able to be negotiated, pledged or hypothecated; (iv) will confer no voting rights; and (v) will not appreciate in value. United Housing Foundation v. Forman, 421 U.S. 837 (1975), dealt with whether the instrument in question exhibited a sufficient number of the traditional characteristics of stock so as to constitute a security. There, the Court held that stock in a cooperative housing project was not stock under the definition of “security” because a purchaser would not expect the federal securities laws to apply to such a purchase. The common stock in Forman was non-negotiable, could not be pledged, conferred no voting rights, could not appreciate in value, and did not entitle the holder to receive dividends contingent upon an apportionment of profits.

FN15. SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1946) (“Form was disregarded for substance and emphasis

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was placed upon economic reality"); Tcherepnin v. Knight, 389 U.S. 332, 336 (1967) ("In searching for the meaning and scope of the word 'security' in the Act(s), form should be disregarded for substance and the emphasis should be on economic reality").

End of Footnote(s).In Forman, tenants of a low-income housing project sued a nonprofit housing cooperative alleging fraud and misrepresentation in connection with the sale of a security. The tenants argued that because their interest in the housing cooperative was called "common stock," and the definition of the term "security" in Section 2(1) of the Securities Act included "stock," a literal interpretation would conclude that their interest was a security. The Court rejected this argument and focused instead on the economic realities of the transaction.

We reject at the outset any suggestion that the present transaction, evidenced by the sale of shares called "stock," must be considered a security transaction simply because the statutory definition of a security includes the words "any ... stock." ... Common sense suggests that people who intend to acquire only a residential apartment in a state-subsidized cooperative, for their personal use, are not likely to believe that in reality they are purchasing investment securities simply because the transaction is evidenced by something called a share of stock.[FN16]

FN16. Forman, 421 U.S. at 848-51.

End of Footnote(s).***8** In Charter Partners, the Policyholders will not regard the shares of preferred stock or the Trust Interest as investments because of the absence of any economic return outside of their positive insurance loss experience. These economic considerations should be controlling and the legal formalism of calling it preferred stock or a trust interest should be disregarded. The economic reality is that substantial restrictions are imposed on the preferred stock and the Trust Interest (no dividends based upon an apportionment of profits; no transfer, pledge or hypothecation; no appreciation in value; and no voting rights) which distinguish each of them from a "security."

Furthermore, a Policyholder cannot reasonably expect to have purchased a security when in reality it is participating in an insurance arrangement designed to replace its traditional insurance coverage with alternative coverage that rewards the Policyholder for low loss experience. The Program will be marketed to small and middle-sized companies as an alternative to traditional insurance, not to individuals as an investment opportunity. A Policyholder will view the structure of the Program as a necessary step to secure lower costs on insurance, not as the purchase of an investment security because of the restrictions on dividends, restrictions on transfer, the elimination of any possible appreciation in value and the lack of any voting power. In Forman the benefit of owning the housing project's "stock" came from the right to occupy an apartment. In the case of the Program, the benefit of having the interest in the Trust which owns the share of preferred stock will be the possibility of Trust distributions in the event of low loss experience. Policyholders can expect lower net premiums from their own low loss experience, and not from an investment of capital.[FN17]

FN17. A Policyholder with excellent individual loss experience may not receive a return of premiums if the overall loss experience of the Association is poor.

End of Footnote(s).Moreover, Policyholders will not receive the benefits typically enjoyed by investors. The Forman Court recognized such typical benefits as: (i) the right to receive dividends contingent upon an apportionment of profits; (ii) negotiability; (iii) the ability to be pledged or hypothecated; (iv) the conferring of voting rights in proportion to the number of shares owned; and (v) the capacity to appreciate in value.[FN18]

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FN18. In Landreth Timber Co. v. Landreth, 471 U.S. 681, 686 n.2 (1985), the Court recognized that preferred stock may nevertheless be a security even though it may have different characteristics from common stock. In National Producers Reassurance Company, SEC No-Action Letter, 1988 SEC No-Act. LEXIS 951 (avail. July 28, 1988), the Company successfully argued that its preferred stock was not a security by comparing such stock to what it believed to be the characteristics of preferred stock: (i) dividends contingent upon apportionment of profits or having a fixed cumulative dividend rate; (ii) negotiability; (iii) ability to be pledged or hypothecated; (iv) potential for appreciation in value; and (v) preference over common stock in receiving dividends and distribution on liquidations. SeealsoNBF Acquisition, Inc., SEC No-Action Letter, 1997 SEC No-Act. LEXIS 493 (avail. Apr. 1, 1997) (Class A Common Stock representing membership interests in a corporation operated on a cooperative basis did not possess the characteristics of stock, such as dividend rights, transferability and potential for appreciation); Collision Automotive Repair Services, Inc., SEC No-Action Letter, 1992 SEC No-Act. LEXIS 841 (avail. July 7, 1992) (Class A common stock in a cooperative designed to use the collective purchasing power of its members was not a security because the stock did not possess the characteristics of a security, such as unrestricted transferability or ordinary dividend rights. Any appreciation in the value of the stock is not significant and the stock merely represents membership interests).

End of Footnote(s).***9** First, dividends allocated to each Policyholder will not be the equivalent of ordinary shareholder dividends which share in the overall profitability of the Company because such dividends will be based primarily upon a Policyholder's loss experience and not based upon the Policyholder's allocable portion of the preferred share of the Holding Company. Each Policyholder will only receive an allocation of dividends based upon the total amount they have paid in premiums over a defined period, less their losses, plus an allocable amount of any investment income earned, less allocable reinsurance costs and other expenses over the period. This predetermined formula does not give the Policyholders the right to receive distributions based upon an ownership interest in the Trust or the Holding Company, as would normally be case for a holder of a security.

Second, the Trust cannot negotiate, pledge, hypothecate or otherwise transfer the share of preferred stock without the consent of the Holding Company which does not intend to do so.[FN19] Similarly, the Policyholder cannot negotiate, pledge, hypothecate or otherwise transfer the Trust Interest.

FN19. The Holding Company will not consent to any such transfer or encumbrance.

End of Footnote(s).Third, neither the preferred stock nor the Trust Interest have any voting rights whatsoever. All the common stock of the Holding Company is owned by American Re (or its affiliates) which will conduct the business of the Holding Company. The Holding Company will be bound by the terms of the Shareholder Agreement which will only be modified with the consent of the Holding Company and the Trustee. The Trustee will conduct the business of the Trust and the Policyholders will have no right to control the trustee or to terminate the Trust. The Trust Agreement may only be modified by the written consent of the Association and the trustee.

Finally, the preferred stock cannot appreciate in value because the Holding Company will have a right of redemption at its sole discretion at the original nominal purchase price.[FN20] Likewise, should the Trust terminate, the trustee will offer the preferred stock for redemption to the Holding Company and accumulated amounts in the Experience Fund, if any, will be paid as a dividend to the Trust prior to the redemption of the preferred share.

FN20. In deciding that the shares in the cooperative housing project were not stock within the meaning of the term security, the Forman Court relied in part on the fact that such shares could not appreciate in value because

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the tenants were obligated to sell at the original purchase price. Forman, 421 U.S. at 851.

End of Footnote(s).The trustee's powers under the Trust Agreement will be limited to merely administrative functions, such as distributing dividends received from the rent-a-captive to the Policyholders. The Company currently expects that large national banks, law firms, trust companies, and the like will act as trustee. Finally, neither the Trust nor any Association will be able to incur indebtedness.

***10** In summary, the dividends to which Policyholders will be entitled are not the equivalent of ordinary dividends because the Policyholders' allocation of dividends is based on the individual Policyholder's loss experience, its participation in the Program and the amount it has paid in premiums. Ordinary dividends, on the other hand, are based solely on the pro-rata share of corporate profits allocable thereto and are not dependent on the performance of an individual stockholder as a policyholder with the company or the length of time that particular stockholder has been an owner of a company.

B. Investment Contract

After concluding that stock in a nonprofit housing cooperative was not a traditional security, the court in Forman reviewed the instruments to determine whether they were investment contracts. In SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946), the Court defined an investment contract to require an (1) investment of money (2) in a common enterprise (3) with profits (4) to come solely from the efforts of others. [FN21] The Program will not constitute an investment contract because Policyholders through their own efforts can realize lower costs for their property and casualty insurance coverage, rather than a profit on their premium.

FN21. See n. 15, supra. The presence of all the characteristics is required, and the absence of any one characteristic will prevent a financial interest from being considered a security. SeeDeutsch Energy Co. v. Mazur, 813 F.2d 1567, 1569 (9th Cir. 1987); The Club at Cuscowilla, Inc., Seed Orchard, L.L.C., SEC No-Action Letter, 1997 SEC No-Act. LEXIS 539 (avail. April 18, 1997) (granting no-action relief on the grounds that a membership interest was not a “security” because of the lack of an expectation of profit, even where the request conceded the presence of a common enterprise).

End of Footnote(s).1. Investment of Money

Policyholders will not make an investment of money in the Program but instead will be paying a current expense to limit their business risk exposures. In International Brotherhood of Teamsters v. Daniel, 439 U.S. 551 (1979), the Court concluded that the investment of money prong of Howey was not present in a noncontributory, compulsory pension plan. The Court focused on whether the participant in such plan “chose to give up a specific consideration in return for a separable financial interest with the characteristics of a security.”Daniel, 439 U.S. at 559.

Here, each Policyholder will not receive a “separable financial interest with the characteristics of a security.”Instead, the Policyholder will purchase and consume business insurance. The purchase of the primary insurance will be accounted for as a current expense and neither the share of preferred stock in the Holding Company nor the Trust Interests will appear as an asset on the Policyholder's balance sheet.

***11** 2. Common Enterprise

Courts and legal commentators have analyzed commonality in three ways: horizontal commonality; [FN22] narrow or strict vertical commonality;[FN23] and broad vertical commonality.[FN24] Since Charter Partners does not have one or more attributes required by each of the three judicially recognized tests for commonality, this prong of the Howey test is not met.

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FN22. This analysis was first used in Howey.Seealso, Steinhardt Group Inc. v. Citicorp, 126 F.3d 144, 151 (3rd Cir. 1997) ("Horizontal commonality requires a pooling of investors' contributions and distribution of profits and losses on a pro-rata basis among investors" quoting Maura K. Monaghan, An Uncommon State of Confusion: The Common Enterprise Element of Investment Contract Analysis, 63 Fordham L.R. 2135 (1995)); Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994) (pooling of investors' contributions and distribution of profits and losses pro rata so that the fortunes of each investor depend upon the profitability of the enterprise as a whole); Wals v. Fox Hills Development Corp., 24 F.3d 1016 (7th Cir. 1994) (each investor's interest is pooled with that of the other investors, so that each has an undivided share in a pool of assets rather than an individual asset); Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 622 F.2d 216, 222 (6th Cir. 1980) (individual investors relinquish their claims to any profit or loss attributable to their particular investments and instead make their collective fortunes dependent on the success of a single common enterprise), aff'd456 U.S. 353 (1982).

FN23. The fortunes of the investors need to be linked to the fortunes of the promoter. SeeBrodt v. Bache & Co., 595 F.2d 459 (9th Cir. 1978) (a discretionary commodities trading account was not an investment contract within the definition of the term "security" because the defendant's success or failure did not correlate with the individual's profit or loss).

FN24. The fortunes of the investors need to be linked only to the efforts of the promoter. SeeSEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 479 (5th Cir. 1974) (requisite commonality is evidenced by the fact that the fortunes of all investors are inextricably tied to the efficacy of the promoter).See also, SEC v. Continental Commodities Corp., 497 F.2d 516, 522 (5th Cir. 1974) ("the critical inquiry is confined to whether the fortuity of the investments collectively is essentially dependent upon promoter expertise"); Miller v. Central Chinchilla Group, Inc., 494 F.2d 414 (8th Cir. 1974); SEC v. Glen Turner Enterprise, Inc., 474 F.2d 476, 482 n.7 (9th Cir.), cert. denied, 414 U.S. 821, (1973); Villeneuve v. Advanced Business Concepts Corp., 698 F.2d 1121 (11th Cir. 1983) , aff'd en banc, 730 F.2d 1403 (1984).

End of Footnote(s).***12** There is no distribution of profit or allocation of loss to the Policyholders on a pro rata or proportionate basis as would typically occur under horizontal commonality.[FN25] Narrow or strict vertical commonality is not present because the fortunes of the Policyholder and the Company are not interwoven or mutually dependent; their fortunes do not rise and fall together. Since any rebate a Policyholder may receive is not inextricably linked to the Company's effectiveness, expertise, effort or skill, the essential nexus between investor and promoter required by broad vertical commonality is absent. The common reason underlying each analysis is that the Policyholder's rebate, if any, is determined by its own efforts.[FN26] Even if the other members in the Association have a poor loss experience, the actions of an individual Policyholder, not the Company or anyone else, will determine whether that Policyholder is eligible for a rebate.[FN27] Moreover, the primary insurers could lose a significant amount of money due to poor investment results and/or unfavorable loss history, while the individual Policyholders would not lose any money because they would still have the benefit of the purchased insurance.

FN25. Cf.SEC v. Infinity Group Co., 1998 U.S. Dist. LEXIS 1224 (E.D. Pa. 1998) (unlike the present situation, a pro rata distribution was present because the return to the investors was proportionate to the amount originally invested).

FN26. In Revak, the court concluded that a purchase of condominium units was not a common enterprise because the "[p]laintiffs . . . could make profits or sustain losses independent of the fortunes of other purchasers."

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Revak, 18 F.3d at 88.See also, De Wit v. Firstar Corp., 904 F. Supp. 1476 (N.D. Iowa 1995) (where an arrangement to sell cattle owned by individuals by combining the livestock into more salable lots was not deemed to be a common enterprise because the individuals did not own an undivided interest in the herd, only specific cattle).

FN27. While the Company may provide advice initially to the agents and the Policyholders concerning the formation of an Association, this does not constitute expertise and has no impact on the dividends paid to the Policyholders.

End of Footnote(s).3. Expectation of Profit

Policyholders will not expect a profit from their participation, rather they will expect to pay premiums for property and casualty insurance to more efficiently insure against their business risks. In United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975), the Supreme Court held that common stock in a housing cooperative was not an investment contract because the plaintiffs intended to acquire low cost housing and not to receive a return on their money. In searching for the tenant's motivations, the Court focused upon the promotional materials distributed by the co-op to potential purchasers. These materials did not tout the profitability of the housing cooperative nor did they solicit passive investors. Rather, they emphasized the non-profit nature of the cooperative and the general benefits of living in such a community (favorable family environment, small town atmosphere and low turnover). Furthermore, these materials promised a return of excess rental charges over expenses to the shareholders as a rebate. Balancing these factors, the Court concluded that the shares in the co-op were more like a refundable deposit and not an investment contract. [FN28]

FN28. Loss & Seligman, Fundamentals of Securities Regulation 3d Ed., pg. 191 (1995) ("When the profit-producing purpose is incidental, the purchase will not be denominated a security.").

End of Footnote(s).***13** Similarly, Policyholders will be attracted to the Program as a means to insure their business risks with the prospects of receiving a rebate[FN29] in the form of an allocation of underwriting profit received from favorable loss experiences. Each Program will be marketed to select members of new or existing groups and associations with homogenous risks, such as non-profit trade associations for plumbing and electrical companies. Each Association will require its Policyholders to adopt safety policies, conduct hazard identification surveys and to pool cost saving ideas in order to reduce individual loss experience and the loss experience of the entire group. By combining similar types of business risks, each Program plans to create economies of scale and pass the savings through to the Policyholders. The promotional materials will emphasize and explain the operative agreements: the initial primary insurance policies; the Treaty; the Shareholder Agreement; the Trust Agreement; and the by-laws of the Association. Furthermore, agents will not solicit professional investors nor is the Program designed to compete against any investment product. Rather, each Program will be marketed to small or medium sized commercial businesses which the Company believes will benefit from an alternative risk transfer product that traditionally has only been available to large commercial enterprises.

FN29. For insurance purposes, this is not classified as a rebate.

End of Footnote(s).Even if the Program distributes a portion of the accumulated underwriting profit to the Policyholders, the portion of that distribution representing the earned indexed rate of return

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will be incidental to the primary purpose of the Program. The Forman Court reached its decision even though the housing cooperative generated revenue from commercial activities within the co-operative, such as parking lots and washing machines. The Court concluded that this incidental income used to offset rental charges was not an expectation of profits sufficient to require the application of the federal securities laws. The Court deemed this type of income "far too speculative and insubstantial to bring the entire transaction within the Securities Act."Forman, 421 U.S. at 856.That the users of such facilities were predominately the tenants who lived in the co-op further convinced the Court that any reduction in rent was more like a rebate and not an income generating endeavor.[FN30] The Court also noted that such prospects of income were never mentioned in the defendant's promotional materials and that the primary purpose of the miscellaneous commercial facilities was to provide services to the tenants, not to produce a profit.[FN31]

FN30. The Court viewed the term 'profit' to mean either (i) capital appreciation resulting from development of the initial investment or (ii) a participation in earnings resulting from the use of investors' funds, neither of which were present. Forman, 421 U.S. at 852.Citing to, SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943) (capital appreciation resulting from the development of the initial investment) and Tcherepnin v. Knight, 389 U.S. 332 (1967) (participation in earnings resulting from the use of investors' funds).

FN31. SeeGeneral Public Utilities Corp., SEC No-Action Letter, 1995 SEC No-Act. LEXIS 895 (avail. Sept. 27, 1995) (the potential to generate profit through the sale of excess storage capacity does not lead to the conclusion that there is present an expectation of profit under the Howey test).

End of Footnote(s).***14** Similarly, any investment income allocated to a Policyholder will be incidental to the primary purpose of acquiring insurance and transferring the business risks of the Policyholders. Each Association will have agreed in advance to a indexed rate of return regarding the investment portion of any distribution. Any distributions to Policyholders will be based primarily upon loss experience. Even after accounting for the investment income, a Policyholder is highly unlikely to receive more than the initial premiums paid. Thus, the distributions made to the Policyholders will be comparable to the rebate in Forman.More importantly, the Policyholders will not bear any potential losses experienced by the rent-a-captive beyond the premium paid. In other words, the premiums paid by the Policyholders to the primary insurers will be their only payment in connection with their participation in the Program (other than incidental costs and expenses).

Finally, any investment income generated by the rent-a-captive will not result from capital appreciation of the initial investment nor will it be a participation in earnings resulting from the use of investors' funds. In this regard, the Program will be more like the non-contributory, compulsory pension plan in the International Brotherhood of Teamsters v. Daniel, 439 U.S. 551 (1979), where the court found, interalia, no expectation of profit because the majority of a pension fund's assets were from employer's contributions, not from profits earned on those contributions.[FN32] The Court focused on the fund's ability to account for any shortfall by increasing the employer's contributions. In this case, the rent-a-captive will be protected from any shortfall because the primary insurer provides aggregate excess of loss coverage. Furthermore, should the Program experience losses because of excess claims, it can always increase premiums to be paid by Policyholders, as was the case in Daniel.[FN33]

FN32. Over a 22 year period, 83% of the pension fund assets was derived from employer contributions, while the remaining 17% was earned through investment.

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FN33. One other source of profit that the Policyholders may expect will be the intended tax deduction for the premiums paid to the primary insurers. However, the Forman Court rejected a tax deduction as a form of profit sufficient to require the application of the federal securities laws because the co-op did not tout the tax advantages of purchasing the shares while luring prospective purchasers. Forman, 421 U.S. at 854-55.In this case, the Company has no intention to emphasize any potential tax benefit.

End of Footnote(s).4. Solely From the Efforts of Others

The Program will also not be an investment contract because any distribution to Policyholders will not result solely from the efforts of others. Any returns realized by the Policyholders will primarily depend upon the Policyholders' loss experience and the agreed upon rate of return. Although the Howey Court used the term "solely," such term has not been applied literally where the remedial purpose of the Securities Act would be circumvented. In SEC v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476 (9th Cir.), cert. denied414 U.S. 82 (1973), the court concluded that a scheme whereby the plaintiff purchased tape recordings, written materials and group sessions, with the right to sell such plans to others, was a security notwithstanding the fact that the investor had to exert some effort in order to secure a return. "[T]he word solely should not be read as a strict or literal limitation on the definition of an investment contract, but rather must be construed realistically, so as to include within the definition those schemes which involve in substance, if not form, securities,...and the proper inquiry is whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise."Turner, 474 F.2d at 482.[FN34]

FN34. See alsoSEC v. Koscot Interplanetary, Inc., 497 F.2d 473 (5th Cir. 1974); SEC v. Aqua-Sonic Products, 687 F.2d 577 (2d Cir.), cert. denied sub nom.Hecht v. SEC, 459 U.S. 1086 (1982) (license agreement coupled with a sales agent agreement was an investment contract notwithstanding that the licensees retained certain powers over the selling efforts).

End of Footnote(s).***15** Although the rent-a-captive may invest the ceded portion of premiums at its sole discretion, the return on this investment allocable to Policyholders will be limited to the agreed upon indexed rate of return and a Policyholder's allocable portion of this agreed upon return will depend upon the Policyholder's loss experience, among other factors.[FN35] The Company would be obligated to pay this return regardless of the actual performance of the Company's investments.

FN35. By way of illustration, such other factors may include: (i) the overall loss experience of an Association; (ii) the total premiums paid by a Policyholder; and (iii) the amount of expenses allocated to each Policyholder. See the Distribution Formula attached hereto as Exhibit A.

End of Footnote(s).In SEC v. Life Partners, Inc., 87 F.3d 536 (D.C. Cir. 1996), the Commission sought to enjoin a viatical settlement company from violating the registration requirements of the Securities Act. The viatical settlement company sold fractional interests in life insurance contracts purchased from terminally ill individuals at a discount ("viatical settlements"). Prior to selling these interests, the company evaluated the insured's medical condition, reviewed the insurance policies, negotiated a purchase price and prepared legal documents. After the sale, the company's role diminished substantially and the investors were left to collect on the policy upon the insured's death. The Commission argued that this arrangement was an investment contract under Howey and thus, the company was in violation of Section 5 of the Securities Act.

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> The Court of Appeals disagreed, concluding that the investor's return depended not from the efforts of the company, but rather from the length of time the insured remained alive. “In this case it is the length of the insured's life that is the overwhelming importance to the value of the viatical settlements ....”Life Partners, 87 F.3d at 548.The court went on to hold that the 'solely from the efforts of others' prong of Howey is concerned with a would-be-promoter's activities after the investor parts with his money.[FN36] The company's post-purchase activities in Life Partners had no effect on the investor's return and constituted administrative functions.[FN37] The Commission argued that by providing a secondary trading market in which the investors could buy and sell their fractional interests, the defendant exerted post-purchase discretion over the investor's return (namely, liquidity). The court pointed out, however, that no investor had sought to liquidate its investment prior to the insured's death, and even if they had, the investors had numerous other avenues through which they could sell their interests.

FN36. The Ninth Circuit has held that even where the defendant's activity, pre-or post-purchase, affects investors' profits, no expectation of profit will be found so long as that activity is only minimally related to the profitability of the investment. Noa v. Key Futures, Inc., 638 F.2d 77 (9th Cir. 1980).SeealsoMcCown v. Heidler , 527 F.2d 204 (10th Cir. 1975) (investments in undeveloped land would not have been solely based on the efforts of others, but for the fact that the defendant promised to develop the parcels of land).

FN37. The company's post-purchase activities in Life Partners included holding the policies, monitoring the insured's health, paying premiums, converting a group policy into an individual policy where required, filing the death claim, collecting and distributing the death benefits (if requested) and assisting an investor who might wish to resell his interest.

> End of Footnote(s).***16** The rate of return, if any, that a Policyholder may expect is agreed upon at the outset and does not depend upon the efforts of the Company. The Company, through the rent-a-captive, will invest the premiums in its sole discretion (primarily in cash equivalents and low risk securities), but will return to the Policyholders only the agreed upon indexed rate of return, e.g., a return comparable to that of a three (3) month Treasury Bill. The Company will bear the risk that its investment strategy would fail to yield the agreed upon return. What is of overwhelming importance to the Program is the individual loss experience of the Policyholder, the length of time the Policyholder is a beneficiary and premiums paid; none of which is dependent upon the entrepreneurial efforts of others.[FN38] Participation in the Program is not intended to result in a profit to the Policyholder. Rather, the rent-a-captive will simply place any excess funds mostly into low risk investments, while waiting to cover potential claims. Such an activity should be viewed no differently than if the rent-a-captive placed the premiums into an interest bearing savings account or a short term certificate of deposit.[FN39]

FN38. A Policyholder's return will depend in part upon the loss experience of the other members of the Association.

FN39. In First Capital Surety Corporation, SEC No-Action Letter, 1996 SEC No-Act. LEXIS 721 (avail. Sept. 5, 1996), First Capital argued that any profits derived would not be as a result of the trust's efforts. “Once purchased, a Portfolio [of non-callable U.S. Treasury obligations] will not be subject to change. There will be no reinvestment or management of such Portfolios, nor will there be provisions for any acts which could affect the composition of each Portfolio. Thus, the duties to be performed by the Trust, acting through its trustees or the

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Trust Administrator, are purely ministerial and do not come within the purview of the Supreme Court's requirement of managerial efforts."

End of Footnote(s).The Company's services to Policyholders after their purchase of insurance from the primary insurers will be merely administrative and include such tasks as monitoring the Policyholders' accounts, purchasing the low risk securities[FN40] and providing guidance on risk reduction strategies.[FN41] These ministerial activities are similar to those conducted by the defendant in Life Partners.[FN42] The Company will not use any discretion or judgment to maximize a return to the Policyholders. Rather, the Company's proposed activities will provide a methodology to the Policyholders that encourages reduction in losses through risk management, claims administration and loss control.

FN40. See n. 8, supra.

FN41. The trustee's duties under the Trust Agreement include: (1) to retain without sale or diversification the share of preferred stock of the Holding Company or other securities of the Holding Company that may be transferred to the Trust and any shares of stock or other securities that the trustee may receive in exchange under any plan of consolidation, merger, reorganization, recapitalization or liquidation, or other plan, with respect to the Holding Company; (ii) to assume, perform and discharge any or all obligations and liabilities (whether known, unknown, accrued, absolute, contingent or otherwise) assumed in connection with the acquisition, ownership, holding, management or other dealing with the trust; and (iii) to engage in any carry on any activities related or incidental to any of the foregoing.

FN42. See n. 37, supra.

End of Footnote(s).***17** The heart of why a Program is not an investment contract is that rather than have an expectation of profit from the efforts of others, the Policyholders can only realize lower insurance costs if they, through their own efforts, have a better claims experience individually and collectively, as members of an Association. While the Company, like any insurance company, will provide advice to the Policyholders and the Associations as to how they can lower their loss experience, the decision to do so and the performance of that decision is within the purview of the Policyholders and the Associations.

III. CONCLUSION:

Based upon the foregoing, we respectfully request the Staff to concur in our opinion that Charter Partners does not constitute a security under Section 2(1) of the Securities Act or Section 3(a)(10) of the Exchange Act and does not require registration under Section 5 of the Securities Act or Section 12 of the Exchange Act.

If you have any comments or questions relating to the request, please do not hesitate to contact Joseph M. Boyle at (202) 637-2298, John B. Turner at (202) 637-2297 or the undersigned at (202) 637-2242.

Very truly yours,

John J. Huber
LATHAM & WATKINS
1001 PENNSYLVANIA AVE., N.W.

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SUITE 1300
WASHINGTON, D.C. 20004-2505
TELEPHONE (202) 637-2200

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