Fed. Sec. L. Rep. P 78,517, 1987 WL 108435 (S.E.C. No - Action Letter)

(SEC No-Action Letter)

***1** Medmarc Insurance Company

Publicly Available October 2, 1987

SEC LETTER

1933 Act / s 2(1)

September 2, 1987
Publicly Available October 2, 1987

Re: **Medmarc Insurance Company Risk Retention Group**, Incorporated (the "Company")

Incoming letter dated April 30, 1987

On the basis of the facts presented, this Division concurs in your interpretation that, if the Company is not a risk retention group under the Liability Risk Retention Act of 1986, (the "Act"), then the offering of, and the participation in the Company through membership and the purchase of insurance coverage will not involve the purchase or sale of "securities" within the meaning of the Securities Act of 1933 (the "1933 Act"). However, based upon the statutory language and legislative history of the Act, this Division does not concur in your view that if the Company is a risk retention group, Section 4(a) of the Act does not make the ownership interests of members in the Company "securities" for purposes of Section 17 of the 1933 Act and Section 10 of the Securities Exchange Act of 1934.

Because this position is based upon the representations made to the Division in your letter, it should be noted that any different facts or conditions might require different conclusions.

Sincerely,

Samuel Wolff
Attorney Adviser

LETTER TO SEC

April 30, 1987

Securities and Exchange Commission
450 Fifth Avenue, N.W.
Washington, D.C. 20549

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Attn: Office of Chief Counsel
Division of Corporation FinanceRe: Medmarc Insurance Company

Risk Retention Group Incorporated

Gentlemen:

We act as counsel for **Medmarc Insurance Company Risk Retention Group** Incorporated (the "Company"), a Vermont mutual insurance company, incorporated under Vermont insurance statutes providing for the formation of a risk retention group as defined in the Liability Risk Retention Act of 1986 (the "Risk Retention Act"). The Company was formed as part of the restructuring of Medical Device Mutual Assurance and Reinsurance Company Limited ("Medmarc Limited") a Bermuda mutual insurance company that reinsured certain product liability and other liability risks of its member companies ("Members"). At December 31, 1986 the Company assumed the assets and liabilities of Medmarc Limited in a restructuring intended to constitute a tax-free reorganization of Medmarc Limited under Section 368 of the Internal Revenue Code of 1954, as amended. Through the restructuring, the Company succeeded to the business of Medmarc Limited, the Members all became Members of the Company and Medmarc Limited was liquidated.

The Company continues to provide a facility for reinsuring the products liability and other liability risks of companies which are in the business of manufacturing medical devices and diagnostic products in the United States. The medical devices manufactured include implantable devices such as cardiac pacemakers and artificial joints, electro-mechanical devices, respirators, incubators and electrocardiographs, disposable devices such as adhesive bandages, insulin syringes and surgeons gloves, and durable medical equipment such as walkers, crutches and canes. Manufactured diagnostic products include clinical laboratory instruments such as multi-channel clinical chemistry analyzers, and laboratory reagent products for measuring levels of chemical constituents in the body such as enzymes, blood sugar and hemoglobin. Medmarc Limited began its operations on January 1, 1979 with more than 30 Members. At present, the Company reinsures the products liability and other liability risks of over 335 Members, all companies in the medical device field.

***2** On November 20, 1978 we wrote to you and on December 28, 1978 you responded advising us that your Division would not recommend any enforcement action to the Securities and Exchange Commission (the "Commission") if the Company used the arrangements described in our letter of November 20, 1978 for the offer, sale and delivery of memberships in the Company and of reinsurance by the Company without compliance with the registration requirements of the Securities Act of 1933 (the "1933 Act"). On June 13, 1979 we wrote to you and on August 31, 1979, you responded advising us that your Division would not recommend any enforcement action to the Commission if the Company used the modified arrangements described in our letter of June 13, 1979 for the offer, sale and delivery of memberships in the Company and of insurance by the Company without compliance with the requirements of the 1933 Act. Copies of these letters and your responses are attached to this letter.

"No Action" Letter Requested
We are requesting the concurrence of the Division of Corporate Finance on two separate issues:

(1) The Company believes it has complied with all of the requirements of the Risk Retention Act and is thus a risk retention group under the Risk Retention Act and as such is entitled to the protections of the Risk Retention Act, and specifically Section 4(a) of the Risk Retention Act. Nevertheless, the Act does not provide for a regulatory body or indeed regulations and thus the Company cannot obtain any regulatory assurance

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that it is in fact a risk retention group. Accordingly, we seek the concurrence of the Division of Corporate Finance that if the Company is not a risk retention group, the offering of, and the participation in the Company, through, membership and the purchase of insurance coverage and policies in the manner set forth below will not involve the sale of a "security" within the meaning of the 1933 Act; and

(2) The Risk Retention Act provides that a risk retention group will not be subject to certain registration provisions of the 1933 Act, but leaves it unclear whether an interest in a risk retention group would be considered a "security" within the meaning of the 1933 Act for other purposes, even though the identical interest would not be a security if the entity was not a risk retention group (See issue 1 above). We do not believe that the Risk Retention Act creates an additional definition of a "security" for the purposes of the 1933 Act and further request the concurrence of the Division of Corporate Finance that if the Company is a risk retention group under the Act, the participation in the Company through, membership and the purchase of insurance coverage and policies in the manner set forth below is not a "security" within the meaning of the 1933 Act and Section 4(a) of the Risk Retention Act does not make it such a "security".

Structure of the Company

A. History

As noted above, the Company was formed as part of the reorganization of Medmarc Limited and assumed the assets and liabilities of Medmarc Limited in a restructuring on January 1, 1987. Medmarc Limited was formed in 1979 to meet the severe crisis in the availability and the cost of products liability insurance for companies in the medical device and diagnostic products industry by insuring the products liability risks of U.S. companies engaged in the manufacture and sale of medical devices and diagnostic products. Between 1979 and 1986, Medmarc Limited insured the products liability risks of its Members, which numbered more than 335 companies in the medical device field by the end of 1986. Medmarc Limited was reorganized and the Company was formed in Vermont as a risk retention group under the Risk Retention Act in late 1986. At December 31, 1986 the Company assumed the assets and liabilities of Medmarc Limited and the Members of Medmarc Limited became Members of the Company.

B. The Present Structure of the Company

***3** The Company is now organized and operates on a basis very similar to its organization and operations when it was founded in 1979. The only differences between the structure and operations of the Company at its founding in 1979 and today are: (1) Medmarc has transferred its domicile from Bermuda to Vermont; and (2) Medmarc is now a risk retention group under the Risk Retention Act. Medmarc continues to reinsure the products liability and other liability risks of its Members, which remain companies in the business of manufacturing medical devices and diagnostic products in the United States. Companies interested in obtaining reinsurance from Medmarc continue to be required to be Members of the Company.

The Company is still controlled exclusively by its Members, who elect a board of directors to manage it. The By-Laws of the Company remain the same as at the formation of the Company, except for those amendments required by local law in connection with the change of domicile (such as the requirement that one director be a Vermont resident), or purely technical changes (such as an amendment entitling each Member to one hundred votes rather than one vote). A U.S. commercial insurance carrier continues to act as the insurance company issuing the insurance policies in order to resolve state insurance regulatory questions, with Medmarc acting as reinsurer of portions of the insurance policies. Medmarc is fundamentally the same company it was at its founding in 1979.

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Legal Discussion

A. Memberships in the Company and Insurance Provided by The Company Do Not Constitute Securities Under the 1933 Act

We are of the opinion that, under the foregoing circumstances, memberships in the Company and the insurance coverage and policies to be provided by the Company would not constitute "securities" within the meaning of Section 2(1) of the 1933 Act.

Section 2(1) defines a "security" as

> "any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a 'security', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

First, insurance policies, including those offered by mutual insurance companies, are not considered securities. Congress has made this clear by both explicitly stating this and by implying it in the 1933 Act. Section 3(a)(8) of the 1933 Act exempts insurance policies from the registration requirements of the 1933 Act if such policies are "issued subject to the supervision of the insurance commissioner ... of any State ... of the United States....". This exemption would apply both to insurance policies issued by stock companies, as well as to those issued by mutual companies, involving, as is the case here, both insurance and membership in a mutual insurance company. As noted above, the Company is licensed by and subject to the supervision of the insurance commissioner of the State of Vermont.

***4** The House Report on the Securities Act (H.R. Rep. 85, 73rd Cong., 1st Sess. (1933) 15) states that the exemption in Section 3(a)(8) merely "makes clear what is already implied in the Act, namely, that insurance policies are not to be regarded as securities subject to the provisions of the Act." 1 Loss, Securities Regulation 497 (2d ed. 1961). Cf. dictum in Tcherepnin v. Knight, 389 U.S. 322, 342 n. 30 (1967). (What is being offered here is clearly an insurance policy and is not within the legislative intent of the definition of a "security.")

Further, there is no profit motive involved here in the purchase of insurance and the obtaining of membership in the Company. What the Member insured is seeking is insurance. Even in cases involving the actual issuance of stock or certificates, the courts have held that no sale of a "security" under Section 2(1) of the 1933 Act was involved where no profit motive existed. In United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975), the United States Supreme Court considered the applicability of the federal securities laws to the sale of stock issued by a housing cooperative. Despite the fact that actual shares existed and were clearly denominated "stock", the court ruled that they did not constitute securities under federal law. Confirming the long-standing line of federal decisions (see Tcherepnin v. Knight, supra; SEC v. CM Joiner Leasing Corp., 320 U.S. 344 (1943); and SEC v. W.J. Howey Co., 328 U.S. 293 (1946)), the Court stated that "the touchstone" in defining a security "is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." 421 U.S. 852.

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The Supreme Court in Forman listed the following characteristics as coming within the concept of a “security”: the right to receive dividends contingent upon an apportionment of profits, negotiability, voting rights in proportion to the number of shares owned, and an anticipation of income or appreciation in value. 421 U.S. 851. In the case of the Company, there are no certificates or other evidence of a security: Each Member insured has one hundred votes in the election of directors and management of the Company, and no funds are to be returned to any Member insured except in proportion to premiums paid in the event of a good experience return. The memberships cannot be sold or transferred so as to realize an appreciation in value. The memberships are not transferable except upon the merger, sale of assets or other reorganization of a Member insured and then at the discretion of the Board of Directors of the Company. We believe that this limited transfer does not make the membership transferable in the ordinary sense of the term since the right to the membership goes with the business being insured and is not separable from the insurance being offered. The sole purpose of participating in the Company as a Member insured is to obtain liability insurance otherwise not available or not available at a reasonable cost.

***5** No-action letters have been issued by the staff of the Securities and Exchange Commission, including two previous no-action letters issued to the Company's virtually identical predecessor, Medical Device Mutual Assurance and Reinsurance Company Limited, in which the staff determined that it would not recommend action if the virtually identical proposed membership and proposed coverages were offered without registration under the 1933 Act. See Medical Device Mutual Assurance and Reinsurance Company Limited, January 29, 1979; Medical Device Mutual Assurance and Reinsurance Company Limited, August 31, 1979. Cf. General Assurance Services, Limited, January 16, 1978; Multihospital Mutual Insurance Ltd., April 21, 1975; Nuclear Mutual Limited, October 27, 1971.

The primary distinction between the previous Medical Device Mutual Assurance and Reinsurance Company Limited letters and this case is that the predecessor company, Medmarc Limited, was formed in Bermuda and was under the supervision of Bermuda insurance authorities while the present Company is formed in Vermont and is under the supervision of the insurance commissioner of the State of Vermont. This brings the present Company even more clearly within the scope of Section 3(a)(8) of the 1933 Act, which exempts insurance policies from the registration requirements of the 1933 Act if such policies are “issued subject to the supervision of the insurance commissioner ... of any State ... of the United States....”

We are thus of the opinion that memberships in the Company and the insurance coverage and policies provided by the Company do not constitute “securities” within the meaning of Section 2(1) of the 1933 Act.

B. Memberships in the Company and Insurance Provided by the Company Do Not Constitute Securities Under the 1933 Act if the Company is Not a Risk Retention Group

Thus, we are of the opinion that, if the Company is not deemed to be a risk retention group under the Risk Retention Act, memberships in the Company and the insurance coverage and policied provided by the Company do not constitute “securities” within the meaning of Section 2(1) of the 1933 Act. If the Company is not deemed to be a risk retention group under the Act, then with the sole exception of the change in domicile from Bermuda to Vermont the Company is virtually identical to the Company which was formed in 1979 and which was the subject of two previous “no-action” letters on this issue. Medical Device Mutual Assurance and Reinsurance Company Limited, January 29, 1979; Medical Device Mutual Assurance and Reinsurance Company Limited, August 31, 1979.

C. Memberships in the Company and Insurance Provided by the Company Do Not Constitute Securities Under

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the 1933 Act if the Company is a Risk Retention Group

We are further of the opinion that, if the Company is deemed to be a risk retention group under the Risk Retention Act, memberships in the Company and the insurance coverage and policies to be provided by the Company would also not constitute “securities” within the meaning of Section 2(1) of the 1933 Act.

***6** Even if the Company is deemed to be a risk retention group under the Risk Retention Act, all other aspects of its structure and operations remain virtually identical to the structural and operations of Medmarc Limited, the Company's predecessor, as it was formed in 1979. Thus memberships in the Company and the insurance coverage and policies provided by the Company would not constitute “securities” within the meaning of Section 2(1) of the 1933 Act. Only if the Risk Retention Act converts what is not a security under the 1933 Act into a security could memberships in the Company and the insurance coverage and policies provided by the Company thus constitute “securities” within the meaning of Section 2(1) of the Act.

We do not believe that Congress intended to convert a membership interest in a mutual insurance company, which is not and has not previously been a security under the 1933 Act, into a security for purposes of the 1933 Act if the mutual became a risk retention group. The purpose of the Risk Retention Act was to reduce regulation rather than to increase regulation. The Risk Retention Act stipulates that “the ownership interests of members in a risk retention group shall be (1) considered to be exempted securities for purposes of [registration under the 1933 Act] and for purposes of [registration under the Securities Act of 1934, as amended (the “1934 Act”)]; and (2) considered to be securities for purposes of [the antifraud provisions of the 1933 Act] and for purposes of [the antifraud provisions of the 1934 Act].”

We believe that the drafters of the Risk Retention Act intended that if the interest in a risk retention group were a security within the meaning of Section 2(1) of the 1933 Act, only the antifraud provisions of the 1933 Act and the 1934 Act would apply to a risk retention group. Thus the Act exempted the ownership interests of members of the risk retention group from certain provisions of the 1933 Act and the 1934 Act. We believe that the basis for this intent was the drafters' understanding that ownership interests in a group-owned insurance company would be a “security”. Here, however, the participation in the Company is not a “security” under well established interpretation by the staff of the Commission.

We believe that in the Risk Retention Act Congress intended to reduce rather than increase regulation, and intended to provide the protections of the antifraud provisions only to interests which would otherwise be considered securities under the 1933 Act. The Risk Retention Act thus served to retain the protections of the antifraud provisions for interests which would previously have been considered securities under the 1933 Act, and to eliminate other requirements under the securities laws.

* * *

Based upon the foregoing, we are of the opinion that the offering of, and the participation in the Company through, membership and the purchase of insurance coverage and policies in the manner set forth in this letter would not constitute the sale of a “security” within the meaning of the 1933 Act if the Company were deemed not to be a risk retention group under the Risk Retention Act, and that the interest held by a Member in the Company would not constitute a “security” within the meaning of the 1933 Act if the Company were deemed to be a risk retention group under the Risk Retention Act.

***7** Please do not hesitate to contact the undersigned or Mark Sidel of this office if you have any questions about

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this matter.

Very truly yours,

James Cameron

Fed. Sec. L. Rep. P 78,517, 1987 WL 108435 (S.E.C. No - Action Letter)

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