1993 WL 393361 (S.E.C. No - Action Letter)

(SEC No-Action Letter)

***1 Construction**
Trades
Purchasing
Group
, Inc.

Publicly Available October 1, 1993

SEC LETTER

1933 Act / s 2(1)

October 1, 1993
Publicly Available October 1, 1993

Re: **Construction Trades Purchasing Group**, Inc. (the "Purchasing Group"); Construction Trades Insurance Company (the "Company")

Incoming letters dated May 25, 1993 and September 27, 1993

Based on the facts presented, the Division will not recommend any enforcement action to the Commission if the Purchasing Group and the Company, in reliance on your opinion as counsel that registration is not required, engage in the activities described in you letters without registration under the Securities Act of 1933 or the Securities Exchange Act of 1934. In reaching this position, the staff notes that the Purchasing Group and Company are not risk retention groups under the Liability Risk Retention Act of 1986.

Because this position is based upon the representations made to this Division in your letters, it should be noted that any different facts or conditions might require a different conclusion. Moreover, this response expresses the Division's position regarding enforcement action and does not purport to express any legal conclusions with respect to the questions presented.

Sincerely,

Larry M. Spirgel
Attorney Advisor

May 25, 1993

Office of the Chief Counsel

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Division of Corporation Finance
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549Re: **Construction Trades Purchasing Group**, Inc.

Construction Trades Insurance Company

Gentlemen:

We are special counsel to Construction Trades Insurance Company, a Vermont mutual captive insurance company (the "Company"), and **Construction Trades Purchasing Group**, Inc., a New York not-for-profit corporation (the "Purchasing Group").

The Company was formed for the purpose of reinsuring policies of insurance covering members (the "Members") of the Purchasing Group, which was organized as a trade association to permit its Members to purchase commercial general liability insurance and commercial automobile liability insurance coverages on a group basis as a purchasing group as contemplated by the Liability Risk Retention Act of 1986, as amended. Members of the Purchasing Group are required to be construction contracting firms.

REQUEST

We hereby respectfully request that the Division of Corporation Finance of the Securities and Exchange Commission (the "Commission") agree not to recommend any enforcement action to the Commission upon the offering of, and the participation in the Purchasing Group and the Company through, memberships in the manner set forth below without registration or exemption under either the Securities Act of 1933 (the "1933 Act") or the Securities Exchange Act of 1934 (the "1934 Act"). As more fully described below, this request is based on the position that membership interests in the Purchasing Group and in the Company will not involve the sale of a "security" and do not constitute "securities" within the meaning of the 1933 Act or the 1934 Act.

STATEMENT OF FACTS

A. Background

***2** In 1986, the Product Liability Risk Retention Act of 1981 was amended and renamed the "Liability Risk Retention Act of 1986" (the "Risk Retention Act"), to facilitate, in difficult market situations, the placement of liability insurance by groups of sophisticated commercial insurance buyers engaged in the same type of business enterprise.

The Risk Retention Act contemplates the formation of purchasing groups, which are associations of commercial enterprises engaged in similar businesses, the principal purpose of which is the purchase of liability insurance on a group basis. Purchasing groups may purchase such liability insurance on a group basis from both U.S. licensed insurers and, subject to certain qualifications, insurers that are not licensed in the U.S., and are permitted greater flexibility in procuring such insurance than would otherwise be the case. Purchasing groups also are able to provide their members with risk management and loss control services because of the homogeneous nature of such groups.

B. The Insurance Program

The Purchasing Group was incorporated on December 20, 1989, as a trade association that would function as a

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purchasing group under the Risk Retention Act. The Company was incorporated in Vermont as a stock insurance company on February 16, 1990, and authorized to transact business as an “industrial insured captive insurance company” under Vermont law on February 26, 1990. The Company is regulated by the Department of Banking, Insurance and Securities of the State of Vermont.

The Purchasing Group and the Company were organized for the primary purpose of enabling qualified construction contracting firms to participate in a program of commercial general liability insurance and commercial automobile liability insurance (the “Insurance Program”) designed specifically for that industry.[FN1]

FN1 Members of the Purchasing Group must also become Members of the Company.

The Insurance Program was designed to provide members of the Purchasing Group with a stable and cost effective liability insurance program on terms and conditions made favorable by the purchasing power and privileges generally available to purchasing groups and to enable those members to benefit from effective risk management and a creative premium structure. Insurance Program policies are underwritten and issued by various U.S. insurance companies (collectively, the “Insurers”) licensed in all jurisdictions in which the Members of the Purchasing Group are located.

The Company was formed to participate as a reinsurer of the Insurance Program and has entered into reinsurance agreements with the Insurers pursuant to which the Company provides “stop-loss” reinsurance to the Insurers. The reinsurance agreement requires the Insurers to pay to the Company reinsurance premiums in an amount equal to five percent (5%) of the gross annual premium paid to the Insurers by Members.

The Company was originally organized as a stock insurance company, and in October, 1990, commenced an offering of shares pursuant to a claim of exemption from registration afforded by Section 4(2) of the 1933 Act and Rule 506 promulgated thereunder by the Commission.

***3** In accordance with a determination made by the Board of Directors and shareholders of the Company that a mutual form of organization would be more suitable to the Members, a Plan of Conversion was submitted to the Commissioner of Banking, Insurance and Securities of the State of Vermont. The Plan of Conversion was approved by Order of the Commissioner dated January 29, 1993,[FN2] and became effective as of February 4, 1993. As of the effective date, shareholders [FN3] of the Company became Members of the Company and received credit against their obligation to make Reserve Premium Contributions (defined below) for amounts previously contributed for the purchase of capital stock.

FN2 The Commissioner waived a hearing on the Plan of Conversion after all shareholders consented to such waiver.

FN3 As of the effective date there were 12 shareholders.

C. Membership

Membership in the Purchasing Group and in the Company is limited to those construction contracting firms that (a) are publicly owned, or owned privately and managed predominantly by persons who are also shareholders of such firms; (b) demonstrate management excellence, including a commitment to quality control; (c) are involved principally in the construction contracting business (i.e., more than 50% of the firm's gross annual revenues are derived from construction contracting); and (d) meet the underwriting criteria established for the Insurance Program by the Insurers. Each Member will purchase a commercial liability policy and, if applied for, a commercial

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automobile policy. Once a Member has purchased its liability policy, such Member will be guaranteed membership in the Purchasing Group for the term of such policy, provided premiums have been paid to the Insurers. Continuation of a Member's membership in the Purchasing Group is conditioned on the ability of such Member to meet the Purchasing Group's eligibility criteria, including the underwriting criteria of the Insurers for the Insurance Program, in existence at the time such Member's policy is renewed, as well as payment of all Initial Fees, Annual Fees, Reserve Premium Contributions, Loss Control and Risk Management Fees and premiums (as these terms are defined below).

1. Fees and Reserve Premium Contributions

(a) Initial Fees

Each Member is required to pay to the Purchasing Group an initial, non-refundable organizational fee ("Initial Fees") currently set by the Purchasing Group's Board of Directors at (i) $2,500 for any Member having gross annual revenues of $25,000,000 or less for the most recently completed fiscal year, or (ii) $5,000 for any Member having gross annual revenues exceeding $25,000,000 for the most recently completed fiscal year. Initial Fees will be used to reimburse Atlantic Star Intermediaries, Inc.,[FN4] which provides certain management and administrative services to the Purchasing Group and the Company, for expenses such as legal fees, accounting fees, advertising costs and loss control and risk management fees that it has incurred in connection with the organization of the Purchasing Group and the Company. Initial Fees are non-recurring fees.

FN4 Partial reimbursement of Atlantic Star Intermediaries, Inc. has been made out of Initial Fees paid by entities that were Members of the Purchasing Group prior to the conversion of the Company.

(b) Annual Fees
***4** Each Member must also pay an annual fee ("Annual Fees") of approximately $50 per year, which will be used to defray the costs of operating the Purchasing Group on an ongoing basis. Annual Fees currently are subject to a limit of $250 per Member.

(c) Reserve Premium Contributions
Each Member of the Purchasing Group is required, as a condition of membership, to become a Member of the Company and to contribute each year to the surplus of the Company by making reserve premium contributions ("Reserve Premium Contributions"). The Reserve Premium Contribution required of each Member is three percent (3%) of such Member's gross annual premium for insurance coverage under the Insurance Program.

An estimated Reserve Premium Contribution based upon estimated gross annual premium is due and payable to the Company by each Member at the time of inception of insurance coverage, subject to increase or decrease depending upon actual gross annual premium determined for each such Member by the Insurers as a result of the annual premium audit, which is generally completed within three months following the conclusion of an insured's policy year. After the completion of the premium audit by the Insurers for each year, any additional Reserve Premium Contribution due will be paid and any excess contribution will be refunded.

At the time of each renewal of its coverage, each Member will be required to make an additional Reserve Premium Contribution to the Company. The additional Reserve Premium Contribution required for each annual renewal will be an amount equal to three percent (3%) of estimated gross annual renewal premium and will be subject to increase or decrease upon completion of the premium audit, as described above.

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(d) Loss Control and Risk Management Fees
In addition to the Reserve Premium Contributions described above, each Member of the Purchasing Group is required to pay to the Company an amount equal to two percent (2%) of such Member's gross annual premium for insurance coverage under the Insurance Program for loss control and risk management services ("Loss Control and Risk Management Fees"). The Loss Control and Risk Management Fee is payable on an estimated basis at the same time the payment of the estimated Reserve Premium Contribution is required, subject to increase or decrease based upon the Insurers' determination of final gross annual premium after completion of the premium audit.

The Company may provide such loss control and risk management services directly or may enter into contractual arrangements with one or more firms that specialize in providing such services. It is expected that once the underlying total gross annual premiums payable to the Insurers under the Insurance Program reach $25,000,000, the aggregate amount payable to the Company by Members for risk management and loss control services will be capped at two percent (2%) of total gross annual premiums of $25,000,000, and any portion of each Member's two percent (2%) payment remaining after all payments for risk management and loss control services will be treated as an additional Reserve Premium Contribution.

(f) Membership Agreements
***5** Each Member will be required to sign and submit a membership application and agreement ("Membership Agreement") to each of the Purchasing Group and the Company, respectively. In signing the Membership Agreements, Members undertake to comply with the above requirements as to Initial Fees, Annual Fees, Reserve Premium Contributions and Loss Control and Risk Management Fees.

2. Distributions
No gains or profits will be distributed to Members of the Purchasing Group. Indeed, as a not-for-profit corporation organized under the laws of New York, the Purchasing Group will not legally be able to pay dividends or make distributions to Members except upon dissolution. See N.Y. Not-for-Profit Corporation Law § 515. Members of the Company will be entitled to share in distributions to the extent declared by the Board of Directors, but the Company does not intend to declare any distribution for the foreseeable future. Rather, the Company intends to accumulate additional surplus, and may expand coverages or reduce premiums.

Members that terminate their memberships have no rights to a return of any portion of the Reserve Premium Contributions made by such Members or to a return of any portion of Initial Fees, Annual Fees or Loss Control and Risk Management Fees paid by such Members.

3. Transferability
The membership interests in the Purchasing Group and the Company are not transferrable, except in limited circumstances when a Member is merged or consolidated with, or all or substantially all its assets are sold to, another entity, and only with the approval of the Purchasing Group and the Company, respectively.

4. Voting
Each Member will be entitled to cast one vote at any meeting of the Members of the Purchasing Group or the Company.

DISCUSSION

Based on the foregoing facts, it is our opinion that membership interests in the Purchasing Group and the Com-

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pany, respectively, do not constitute "securities" as that term is defined in Section 2(1) of the 1933 Act and Section 3(a)(10) of the 1934 Act because a membership interest has none of the key characteristics traditionally associated with the concept of security.

Section 2(1) of the 1933 Act defines a "security" as follows:

> 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 a 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.

***6** A membership interest in a risk purchasing group or a mutual insurance company appears not to be a "security" on its face as that term is defined in Section 2(1) of the 1933 Act. However, certain non-traditional interests or other arrangements have been found to be investment contracts. Accordingly, an analysis of whether such a membership interest constitutes a "security" under the 1933 Act turns on whether the membership interest is an "investment contract."

In SEC v. Joiner Leasing Corp., 320 U.S. 344 (1943), the Supreme Court indicated that the substance of a transaction would control whether a particular instrument is a "security," and not the particular form or name of such instrument. Following the general approach set forth in Joiner, the Supreme Court articulated the criteria necessary for determining the existence of an "investment contract" in SEC v. W.J. Howey Co., 328 U.S. 293 (1945). Under the Howey test, an arrangement constitutes an investment contract when it involves "an investment of money in a common enterprise with profits to come solely from the efforts of others."328 U.S. at 299.

The transactions proposed do not meet the criteria for "investment contracts" set forth by the Supreme Court in Howey.The first criterion of the Howey test is that there be an "investment" of money. As discussed above, the Purchasing Group and the Company were organized to assist construction contracting firms in procuring commercial general liability insurance and commercial automobile liability insurance. The Initial Fees, Annual Fees, Reserve Premium Contributions and Loss Control and Risk Management Fees to be paid by the Members will not be paid with any profit-making, profit-sharing or investment intent and thus do not represent investments. Second, the membership interests will not be marketed as investments. Marketing efforts will focus exclusively on explaining to construction contracting firms the Insurance Programs to be offered. Third, the construction contractors must qualify and be accepted as insureds by the Insurers of the Purchasing Group. Such qualification is an independent requirement that must be satisfied on the basis of objective underwriting criteria. Because insurance coverage is not transferable and because membership interests in the Purchasing Group and the Company, by virtue of provisions in their respective by-laws, are nontransferable (except in the limited circumstances described above), there is little chance prospective Members will regard them as investments. In substance, such contributions are more similar to insurance premiums than to an investment.

The second criterion of Howey is that the participants have an expectation of profits to come from the efforts of others. The Initial Fees, Annual Fees, Reserve Premium Contributions and Loss Control and Risk Management Fees will not be paid by Members with an expectation of profit and the benefits to accrue to a particular Member

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will not be due primarily to the efforts of others. Rather, the sole purpose of participating in the Purchasing Group and the Company as a Member is to obtain the benefits made available under the Insurance Program. The traditional profit-making attributes of a security are absent from the membership interests in the Purchasing Group and the Company because such interests are not, except in the limited circumstance described above, transferable, and therefore cannot be sold for profit.

***7** Based on the foregoing, it is our opinion that membership interests in the Purchasing Group and the Company, and the Membership Agreements to be entered into by construction contracting firms, do not meet the Howey test as "investment securities" and, accordingly, are not "securities" under Section 2(1) of the 1933 Act.

Securities Exchange Act of 1934
Although the Purchasing Group and the Company may ultimately have more than 500 members and $1,000,000 in assets, neither will, in our opinion, be subject to the registration requirements of Section 12(g) of the 1934 Act. Section 12(g) of the 1934 Act provides that certain "issuers" with total assets exceeding $1,000,000 and a class of "equity securities" held of record by 500 or more persons must register such securities under the 1934 Act. However, Section 3(a)(8) of the 1934 Act defines "issuer" as "any person who issues or proposes to issue any security ..." and Section 3(a)(11) of the 1934 Act defines "equity security" as including "stock or similar security" and certain other instruments or rights, each of which must, in itself, be a security.

Thus, to be subject to registration pursuant to Section 12(g) of the 1934 Act, a person must issue "securities." The definition of "security" in Section 3(a)(10) of the 1934 Act is in all pertinent respects identical to the definition of that term in Section 2(1) of the 1933 Act. (See discussion of the 1933 Act above.) Consequently, we believe that the membership interests in the Purchasing Group and the Company, and the Membership Agreements to be entered into by construction contracting firms, are not "securities." The Purchasing Group and the Company, therefore, will neither be "issuers" nor have any "class of equity securities." Accordingly, the Purchasing Group and the Company will not be subject to the registration requirements of Section 12(g) of the 1934 Act.

CONCLUSION

In consideration of the foregoing facts and discussion we respectfully request that the Staff concur in our conclusions as set forth herein and advise us that it would not recommend enforcement action to the Commission if the Purchasing Group and the Company proceed in the manner described above without registration under the 1933 Act or the 1934 Act. We believe that, under the circumstances described herein, it would be appropriate for the Staff to take a position similar to that taken in several no action letters issued by the Staff in the past, including Subway Owners' Mutual Insurance Company, (avail. August 21, 1992); KFC Mutual Insurance Limited, (avail. May 20, 1988); Refuse Insurance Mutual Liability Limited, (avail. July 27, 1987); Energy Insurance Mutual Limited, (avail. July 16, 1986); Casualty Excess Assurance Limited, (avail. April 28, 1986).

The Staff's prompt attention to this request will be greatly appreciated. If you have any comments or questions relating to the request, please do not hesitate to contact the undersigned. In the event that you anticipate formulating a response not consistent with any interpretation or position stated in the request, we would appreciate the opportunity to discuss the matter with the Staff prior to any final decision.

***8** Very truly yours,

Martin J. Nilsen
LEBOEUF, LAMB, LEIBY & MACRAE

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125 West 55th Street
New York, NY 10019–5389
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September 27, 1993

Mr. Larry Spirgel
Room 3064
Mail Stop 3–5
Division of Corporation Finance
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549Re: **Construction Trades Purchasing Group**, Inc.

Construction Tradee Insurance Company

Dear Mr. Spirgel:

This letter will respond to the questions you raised in the course of our telephone conversation concerning our letter of May 25, 1993, requesting that the Division of Corporation Finance of the Securities and Exchange Commission (the "Commission") agree not to recommend any enforcement action to the Commission upon the offering of, and the participation in, **Construction Trades Purchasing Group**, Inc. (the "Purchasing Group") and Construction Trades Insurance Company (the "Company") through, memberships without registration under either the Securities Act of 1933 (the "1933 Act") or the Securities Exchange Act of 1934 (the "1934 Act"). Unless otherwise indicated, capitalized terms used herein have the meaning as defined in our original letter.

First, you have asked what the minimum capital and surplus requirements are for the Company and the Purchasing Group, respectively. The Company is a captive insurance company organized under the Vermont Insurance Code and is licensed to transact the business of insurance and reinsurance as a mutual "industrial insured" captive insurance company. As such, the Company is required to maintain a free surplus of at least $500,000 at all times. "Industrial insured" captives that are organized under Vermont law as stock companies are similarly required to have $500,000 in capital and surplus. The Purchasing Group was organized as a trade association under the New York Not-for-Profit Corporation Law, and functions as a purchasing group under the Liability Risk Retention Act of 1986. No capital and surplus requirements are imposed on purchasing groups as they do not bear risk.

Second, you have asked what the sources of capital and surplus are. The initial capital of the Company was provided by Atlantic Star Intermediaries, Inc., a New York licensed reinsurance broker ("Atlantic Star"), prior to the conversion of the Company from stock to mutual form. Atlantic Star originally purchased 200,000 shares of the redeemable preferred stock of the Company for $500,000 and 500 shares of the common stock of the Company for $500. The preferred shares held by Atlantic Star were redeemable at the purchase price paid therefor by Atlantic Star as, common shares were purchased by construction contracting firms that became Members of the Purchasing Group. Upon conversion [FN1] of the Company (and pursuant to the Plan of Conversion adopted unanimously by the shareholders and approved by the Commissioner of Banking, Insurance and Securities of Vermont), the remaining preferred shares and the common shares of the Company owned by Atlantic Star were redeemed, and were replaced by a letter of credit provided by Atlantic Star.

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FN1 At the time of conversion, 60,000 preferred shares had been redeemed.

***9** Third, you have asked whether the contributions made by Members (either original investments or the various membership fees discussed on pages four to six of our original request) make up in whole or in part the capitalization of the Purchasing Group or the Company, and, if so, whether this constitutes risk capital under Silver Hills Country Club v. Sobieski, 361 P.2d 906 (1961).

As organized, the Purchasing Group is not subject to any minimum capital and surplus requirements. As indicated in our original request, each new Member (membership in the Purchasing Group is limited to construction contracting firms) is required to pay an Initial Fee (either $5,000 or $2,500, depending upon the revenues of the Member) upon commencement of membership in the Purchasing Group. These Initial Fees are intended to be utilized to reimburse Atlantic Star for the expenses it incurred in connection with the organization of the Company and the Purchasing Group and do not constitute capital or surplus contributions. Thereafter, Members are required to pay Annual Fees to the Purchasing Group to offset the cost of ongoing operations of the Purchasing Group, to the extent determined by the Board of Directors (subject to a maximum of $250 per year). These Annual Fees similarly do not constitute capital or surplus contributions.

Each Member of the Purchasing Group is required to make Reserve Premium Contributions yearly to the surplus of the Company in an amount equal to three percent (3%) of the annual premium paid by that Member to the Insurer. The letter of credit provided and maintained by Atlantic Star for the benefit of the Company will gradually be reduced as the Reserve Premium Contributions are made and the surplus of the Company increases. Thereafter, the Reserve Premium Contributions are intended to increase the surplus of the Company as a necessary part of the Insurance Program. Reserve Premium Contributions should not, however, be viewed as risk capital because continued participation by those benefitting from insurance coverage is a required element in any successful captive insurance company. Indeed, the Reserve Premium Contributions should not be considered capital investments because Members are not entitled to any return thereof, either directly or indirectly through transfer of a membership. Rather, the payment, which must be made annually, is in reality a component of the cost of obtaining insurance.

The Company was organized as a captive insurance company for the purpose of enabling construction contracting firms that are Members of the Purchasing Group to establish stability in the cost of insurance as a part of the bidding process for construction jobs. This is accomplished by means of the reinsurance coverage provided by the Company to the Insurers. The Reserve Premium Contributions will provide funds for the Company to enable it to pay its reinsurance claims. Construction contracting firms participate in the Purchasing Group and the Company in order to help stabilize the cost of insurance coverage in the construction bidding process. They are seeking insurance coverage and not making an investment.

***10** The proposed arrangement is distinguishable in several respects from that in the Sobieski case, where the partners in a venture sold memberships in a country club in order to obtain funds to finance construction of the country club facilities and to conduct their own business for profit. The memberships that were sold gave the members of the country club various rights to use its facilities (except the golf course, which required a separate membership). Such memberships were transferable. The court reasoned that only by the purchaser risking his capital with the capital of other purchasers would there be a chance that the benefits of membership would materialize. The promoters of the club would benefit from the profitability if the club were successful based on the risk capital provided by the members. Members would benefit from use of the facilities and presumably from any proceeds obtained upon sale of the membership in the club. Indeed, in finding that a security was involved

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the court explicitly relied upon a section of the California statute involving “transferable” interests.

The arrangement proposed by the Company and the Purchasing Group is considerably different. First, as noted above, there is no transferable interest in either the Company or the Purchasing group upon by which a profit can be obtained. Second, the payments are fixed annual amounts which are better viewed as part of the regular cost of obtaining insurance. Third, to the extent the operations of the Company result in an increase in surplus, such surplus will inure to the benefit of the Members by increasing the assets of the Company which, in turn, will enable the Company to increase the reinsurance it provides and lower insurance costs. Unlike the partners in the Sobieski case, Atlantic Star, the organizer of the Company, has no ownership interest in the Company, but has entered into contracts with each of the Purchasing Group and the Company to provide administrative services.

In addition we do not see the applicability of this 1961 California case, applying state securities law, to the federal issues raised in connection with structure of a Vermont captive insurance company organized solely for the benefit of its Members. Even the California decision recognized that other states had held the sale of membership in an organization in which members had no interest in the assets or profits is not a sale of securities. As we indicated in our original letter, the Staff has in several no-action letters issued in the past taken a similar position to that requested in our letter. If the Staff were to conclude that a captive insurance company organized as proposed by the Company and the Purchasing Group is engaged in the [non-exempt] sale of securities, we believe the advice given in several other instances would be called into question.

Finally, we also wish to advise you that each Member of the Company is also required to pay to the Company Loss Control and Risk Management Fees in the amount of two percent (2%) of such Member's annual premiums for lose control and risk management services to be provided by the Company. These Loss Control and Risk Management Fees do not constitute capital or surplus contributions for the reasons given above.

***11** Fourth, you have asked what happens on dissolution of the Company and the Purchasing Group. The by-laws of the Company provide that upon dissolution (pursuant to the provisions of the Vermont Insurance Code) the surplus of the Company would be distributed by the liquidator to the Members, after the payment of all claims and expenses, in the manner approved by Commissioner of Banking, Insurance and Securities of Vermont. The by-laws of the Purchasing Group provide that, upon dissolution, its assets would be distributed in accordance with the provisions of the New York Not-for-Profit Corporation Law. The organizing documents of the Company and the Purchasing Group do not provide for a termination date and do not contemplate dissolution. Similarly, the respective boards of directors of the Company and the Purchasing Group have indicated no intention to dissolve the Company or the Purchasing Group. Any such dissolution of the Company would be a process that would be likely to last over a period of several years because of regulatory restraints and would not be an efficient mechanism to distribute any capital.

Fifth, you asked what rights Members have to any return of original contributions in the former stock company, plus interest. Prior to the conversion of the Company to mutual form, shareholders had the right, upon termination of membership in the Purchasing Group and the Company, to redemption of their shares in the Company at a redemption price equal to $.10 per common share (the equivalent of ten percent of the purchase price of $1.00 per share) pursuant to the terms of a shareholders agreement. Under the Plan of Conversion of the Company, as unanimously approved by the shareholders of the Company, all amounts previously contributed to the capital of the Company were deemed Reserve Premium Contributions, and under the amended and restated by-laws of the Company, also as unanimously approved by the shareholders of the Company, Members withdrawing from

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membership in the Purchasing Group and the Company will not be entitled to a return of any Reserve Premium Contributions. Accordingly, former shareholders of the Company (now Members) are not entitled to either a return of their contributions or any interest thereon.

Finally, you have asked if the Company is a “risk retention group” as defined in the Risk Retention Act and, if it is a risk retention group, that we distinguish the circumstances as described in our original letter from the no-action letter issued regarding Medmarc Insurance Company Risk Retention Group Incorporated (avail. October 2, 1987).

The Company was not organized as a risk retention group because, as a result of the involvement of the direct U.S. Insurer, there was no reason to be concerned with the issue of solicitation by an unlicensed insurer. In addition, the insurance department of one state in which Members are located takes the position that a risk retention group must be a direct writer of insurance and cannot be a reinsurance company. Accordingly, the analysis under Medmarc that, if Medmarc were not a risk retention group under the Risk Retention Act, then the offering of, and participation in the Company through membership and the purchase of insurance coverage, would not involve the purchase or sale of “securities” within the meaning of the Securities Act of 1993, is relevant to the the circumstances involving the Company and the Purchasing Group.

***12** In further support of our view, we refer to the two previous no-action letters issued by the Commission to the predecessor of Medmarc, Medical Device Mutual Assurance and Reinsurance Company Limited (“Medical Mutual”), wherein the Staff took the position that it would not recommend action if virtually identical memberships and insurance coverages to those that were the subject of Medmarc were offered without registration under the 1933 Act. See Medical Device Mutual Assurance and Reinsurance Company Limited (avail. January 29, 1979; Medical Device Mutual Assurance and Reinsurance Company Limited (avail. August 31, 1979). In the case of Medical Mutual a prospective member had a fixed premium obligation to Medical Mutual of $30,000 (consisting of an initial payment of $7,500 plus an obligation to pay an additional $22,500 at the direction of the board of directors), all of which would be allocated to the reserve fund. In addition, members were to pay annual premiums to the U.S. insurance company for the insurance coverage provided (and for which Medical Mutual was to provide reinsurance) by Medical Mutual. The Reserve Premium Contributions required of Members of the Company are the equivalent of the $30,000 reserve fund obligations of the members of Medical Mutual in that both provide the Company and Medical Mutual, respectively, with sufficient funds with which to pay reinsurance obligations to the direct insurers in the United States. In each case, insurance premiums are paid to a direct insurer by the members of a mutual reinsurance company.

Based on the above, we would appreciate your advising us whether the staff agrees with our opinion, as expressed in our original request dated May 25, 1993, that the offer of, and the participation in the Purchasing Group and the Company through, memberships would not constitute the sale of a security within the meaning of the 1933 Act or the 1934 Act.

Please do not hesitate to contact the undersigned at the above telephone number in the event you desire any additional information.

Very truly yours,

Martin J. Nilsen

1993 WL 393361 (S.E.C. No - Action Letter)

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