1983 WL 28848 (S.E.C. No - Action Letter)

(SEC No-Action Letter)

***1 Norcal**
Bowling
Proprietors
Mutual Insurance Company, Limited

Publicly Available December 5, 1983

SEC LETTER

1933 Act / s 2(1)

November 4, 1983
Publicly Available December 5, 1983

Re: **Norcal Bowling Proprietors** Mutual Insurance Company, Ltd. (“Company”)

Incoming letter dated September 15, 1983

Based on the facts presented, this Division will not recommend any enforcement action to the Commission if the Company, in reliance upon your opinion as counsel that registration is not required, offers insurance coverage as described in your letter without compliance with the registration requirements of the 1933 Act.

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 a different conclusion. Further, this response only expresses the Division's position on enforcement action and does not purport to express any legal conclusion on the question presented.

Sincerely,

Alan L. Dye
Attorney Adviser

LETTER TO SEC

September 15, 1983

Securities and Exchange Commission
Division of Corporate Finance
450 Fifth Street, Northwest

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Washington, D.C. 20549Re: “No action letter”

Securities Act of 1933, Section 2(1)

Gentlemen:

We act as general counsel for the Northern California Bowling Proprietors Association, a California non-profit corporation (hereinafter denominated “the Association”) and the **Norcal Bowling Proprietors** Mutual Insurance Company, Ltd., a Cayman Island Mutual Insurance Company in the process of formation (hereinafter denominated “Company”).

The Association's principal place of business is located at 8128 Capwell Drive, Oakland, California 94621. It was formed to encourage bowling by all people, to foster and promote bowling as a healthful exercise and recreation, to set up a uniform code of business ethics, and to disseminate information to its membership beneficial to the conduct of their business, namely, the operation of bowling establishments. The Association is affiliated with the Bowling Proprietors Association of America, Inc. The Association's membership on a regular basis includes any bowling establishment (whether such be owned by an individual, firm, corporation, or other entity) located in that portion of the State of California lying northerly of a line having its western terminus at a point approximately three miles south of the city of Pismo Beach, California, which line shall run northeasterly approximately 30 degrees to a point on the easterly boundary of the line of the State of California, together with that portion of the State of Nevada which is contiguous to the above-described portions of the State of California. On an affiliated basis, membership is extended to all bowling establishments located in the States of California or Nevada and may in the future be extended even to a wider area. At present, the Association has 146 regular and affiliated members representing 115 to 120 ownership entities be they individual, corporate, or otherwise.

***2** We request the concurrence of the Division of Corporate Finance in the conclusion set forth below that the intended offering of and the participation in the Company through membership and the purchase of insurance coverage and policies by members of the Association will not involve the sale of a “security” within the meaning of the Securities Act of 1933, as amended (hereinafter referred to as “1933 Act”). We further request the Division's assurance that it would not recommend to the Commission that any action be taken with respect to the proposed offering of participation in the company in the manner indicated without registration thereof under the 1933 Act.

THE COMPANY

As noted above, the Company is in the process of formation. At present, the Memorandum and Articles of Association of the Company have been drawn and are expected to be filed with the Registrar of Companies, Cayman Islands. We expect the issuance of a certificate of insurance by local authority in time for operations to commence on or about January 3, 1984.

For some time the bowling industry has been plagued with increased insurance costs in workman's compensation, as well as other coverages. To mitigate and stabilize those costs, as well as to assure an adequate market for the insurance of bowling establishment associated risks, the Association has proceeded to establish the Company, the membership of which will be comprised of the Association itself [FN*], to members, and those who, as time goes on, may become members of the Association as it expands both within and without its current territorial involvement. It is anticipated that the initial membership in the Company, i.e., insureds, will be 150

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bowling establishments. Each will be required to apply to the Company, meet certain reasonable underwriting and financial responsibility criteria, and purchase insurance. The Company will have no members who are not insured by it, either directly or indirectly. Persons elected to directorial positions with the Company, although technically members of the Company due to their directorship, will have no vote or participation in the Company other than in their directorial capacity.

FN* Although the Association itself does not own a bowling establishment, it does have a limited personnel and office facility which it desires to insure with the Company it intends to sponsor. It will contribute to the Company's premium reserve fund much as any other member and have only one vote in the election of the Board of Directors. The Association's rights and obligations with respect to the Company will be equal to that of any other member bowling establishment and for that reason we have not sought in the body of our letter to differentiate its membership by repeated reference.

No certificate or other evidence of insurance will be issued to the membership of the Company evidencing their participation other than their respective insurance policies. Insurance coverage initially offered by the Company shall include workman's compensation up to the respective statutory limits of each state in which a member does business. Later, the amount of coverage may increase.

***3** To accommodate regulatory requirements, the Company will obtain a cooperation agreement with a U.S. commercial insurance company (hereinafter denominated “U.S. Carrier”) to act as the formal issuer of policies to the Company's members. The U.S. Carrier will be an admitted insurance company in each of the States in which members of the Company are located and do business and will be unrelated to the membership of the Company, the Company itself, or the Association. The policies issued to each member by the U.S. Carrier will only bear on them a legend that the insured has made a premium reserve fund contribution to the Company in a specific amount referred to later in this letter as 20% of the initial premium. Those risks assumed by the U.S. Carrier for Company members will be placed with the Company in the form of reinsurance. Therefore, the U.S. Carrier will be liable on the policies of insurance written to members as the primary carrier while the Company will function as the reinsurer, either solely or in conjunction with other establishment reinsurers. Nevertheless, the Memorandum and Articles of Association and the bylaws of the Company will provide that its members are the insureds and not the U.S. Carrier due to Cayman enabling legislation. Since the Company will be authorized to directly insure the needs of its membership, it may at a later date elect to do so, negating the utility of the U.S. Carrier. At present, there is no desire to adopt this alternate mode of operation.

In order to comply with Cayman insurance regulations and to insure the U.S. Carrier of the Company's economic stability since the U.S. Carrier will look to the resources of the Company for recompense pursuant to the reinsurance agreement, the Company must establish a reserve fund of at least $250,000 almost concurrently with its commencement of operations. Furthermore, the Company will be required to meet a net premium to surplus ratio pursuant to Cayman regulations.

Each member will therefore be required to pay premiums which will vary depending on said members' exposure and at least initially contribute to the premium reserve fund in an amount equal to 20% of their first year's premium. Once the reserves are adequate to accommodate the regulatory requirements, the practice of collecting contributions will be discontinued and the contributions returned to the membership as explained below. Neither the premiums paid nor the initial premium reserve fund contribution will be for stock since as a mutual, the company will issue no capital stock. Members will pay their premium reserve fund contribution to the U.S. Carrier in advance and in cash, together with their premiums which may from year to year be collected on a cash or

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installment basis. The U.S. Carrier will remit to the Company all premiums collected from members and their premium reserve fund contribution less fees agreed upon by it and the Company in the form of reinsurance premiums.

***4** Management of the Company will be by an elected Board of Directors. Each member bowling establishment shall have one vote on a cumulative basis regardless of its ownership or the amount of premium paid for its insurance in electing directors. Ex officio membership on the Board may be granted to the president of bowling proprietors associations affiliated with the Association. Such ex officio members would not be elected but appointed by the elected members of the Board and would not have the ability to vote or pass upon issues involving the Company's business. Their function would be advisory with a view to maintaining the integrated aspects of the Association's affiliations.

Members will not be entitled to profits of the Company in the traditional sense. Nonetheless, they will experience a sufficient reduction in insurance costs to motivate their enrollment through a return of premium based on the Company's profit and investment income for the policy years for which they are insured directly or indirectly particularly in the field of workman's compensation by state regulation of rates. The return of premium practice is in conformity with law and in harmony with a statutory scheme which seeks to inspire good claims profiles for assureds. The consequence here is to reward members in relation to the claims profile, not in relation to the investment or the profitability of the Company alone. Terminating members would also be entitled to receive distributions declared for policy years in which they were directly or indirectly insured by the Company and so much of their initial reserve fund contribution as may not have been paid to them prior to their termination.

No transfer of membership rights in the Company will be permitted except in the event a member is merged, consolidated, or substantially all of the assets used by the subject bowling establishment are acquired and then only in the event that the bowling establishment shall continue as a member of the Association and an insured of the Company.

MEMORANDUM OF PERTINENT LAW

Pursuant to Section 2(1) of the 1933 Act, a “security” is defined as:

> “any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit sharing agreement, collateral trust certificate, pre-incorporation certificate, or subscription, transferrable 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.”

***5** Congress has further elaborated on the application of the definition by enacting Section 3(a)(8) of the 1933 Act exempting insurance policies from registration requirements if such policies are “issued subject to the supervision of the Insurance Commissioner ... of any state ... of the United States....” The exemption, since it is generic is phraseology, would appear to apply to mutual as well as stock companies. Here the Company will offer no more than a policy to its membership—not stock.

The fact that the Company is non-admitted is also of no consequence since the U.S. Carrier facilitating the issu-

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ance of the policies is subject to cursory audit and regulation by varying state administrative bodies and the spirit of the exemption is upheld.

When reflecting upon the exemption and its application to policies issued by a non-admitted insurance company, even Congress concluded it would appear that the exemption was no more than a tautology since insurance policies generally are not regarded as "securities" within the provision of the 1933 Act. See, 1) Loss, Securities Regulation 497 (2d ed. 1961); 2) House Report on the Securities Act (H.R.Rep. 85, 73rd Cons., 1st Sess. (1933) 15); 3) Securities and Exchange Commission Hearings before the Subcommittee of the Senate Committee on Banking and Currency (S. 2408, 81st Cons. 2d Sess. (1950) 33). See Cf. dictum in Tcherepnin v. Knisht, 389 U.S. 322, 342, note 30 (1967).

Notwithstanding Congressional attempted definition, judicial pronouncement has been that no "security" exists within Section 2(1) of the 1933 Act where an acquiror of an insurance policy, or for that matter insurance company stock, is not motivated by profit. United Housing Foundation, Inc. vs. Forman, 421 U.S. 837 (1975). There stock was issued by a housing cooperative to its various tenants as a pre-condition and evidence of their tenancy. The Court, in confirming the longstanding line of federal decisions, Tcherepnin vs. Knisht,infra,SEC v. C.M. Joiner Leasing Corporation, 320 U.S. 44 (1943), and SEC v. W.J. Howey Co., 328 U.S. 293 (1946), said, "The touchstone in defining the security is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepeneurial and managerial efforts of others." (421 U.S. 852). Forman proceeds to list the following indicia of a "security":

a) The right to receive dividends contingent upon apportionment of profits;
***6** b) Negotiability;
c) Voting rights in proportion to the number of shares owned; and
d) An anticipation of income or appreciation in value.
(421 U.S. 851.)

As we have said above, the Company will dividend none of its profits. Profits, if distributed, will take the form of a return of premium calculated not in relation to the amount invested but instead in relation to the good claims experience of the distributee member. Negotiability is grossly limited to new bowling establishments which are both Association members and continue insurance coverage.

In Grenader v. Spitz, 537 F.2d 621 (2d cer. 1976), the Court considered another cooperative apartment case and recognized that a tenant when disposing of his apartment and his shares undoubtedly hoped that the real estate market would afford him a profit. Nonetheless, the Court concluded that no "security" was involved in the issuance of cooperative stock, concluding that a mere sale of a tenant's apartment was not the type of transferability, i.e., negotiability, that is required under Section 2(1) of the 1933 Act.

Voting rights are not in proportion to investment but instead by mere fiat set at one per member. No income is anticipated or appreciation in value available for realization. The sole purpose for membership in the Company is to reduce the cost of insurance, to stabilize the availability of such insurance in the future, and to improve safety programs at the individual bowling establishments which such reduced insurance costs can be expected to fund—not profit.

We opine therefore that our client's intended offering of insurance policies is without the purview of the 1933 Act and non-deserving of Commission enforcement action. We request that in reliance upon the representations set forth above as to the Company's formation and operation that the Division issue the letter requested. If the

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staff has any questions concerning this submission or believes that any additional information is requisite to its findings, please contact the undersigned.

For your reference, we site the following no-act letters issued by the staff of the Securities and Exchange Commission in similar situations: The Health Association Mutual Insurance Co., Ltd., October 21, 1981; Hutco Insurance Co., Ltd., May 19, 1981; McDonalds, March 26, 1982; NECA Insurance Limited, March 12, 1981; Chem-Spec Insurance Inc., April 10, 1980; Nuclear Electric Insurance Limited, February 28, 1980; Medical Device Mutual Assurance and Reinsurance Company, Limited, August 31, 1979; Attorney's Liability Assurance Society, Limited, February 12, 1979; General Assurance Services, Limited, January 16, 1978; Multihospital Mutual Insurance, Ltd., April 21, 1975; and Nuclear Mutual Limited, October 27, 1971.

Yours very truly,

PETER ANDREW NOTARAS of
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