1989 WL 245547 (S.E.C. No - Action Letter)

(SEC No-Action Letter)

***1 National Transport Assurance Alliance**
, Incorporated

Publicly Available February 22, 1989

SEC LETTER

1933 Act / s 5

February 22, 1989
Publicly Available February 22, 1989

Re: **National Transport Assurance Alliance**, Inc. (the “Company”)

Incoming letters dated December 13, 1988 and January 12, 1989

Based on the facts presented, this Division will not recommend enforcement action to the Commission if the Company, in reliance upon your opinion that registration is not required, engages in the activities described in your letters without compliance with the registration requirements of the Securities Act of 1933.

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

Sincerely,

Melinda L. Reingold
Attorney Fellow

LETTER TO SEC

December 13, 1988

Office of Chief Counsel
Division of Corporation Finance

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450 5th Street, N.W.
Washington, D.C. 20549Dear Sir/Madam:

I would like a No Action letter from the SEC staff regarding the proposed capitalization plan of **National Transport Assurance Alliance**, Inc. (NTAA). NTAA is an industry-directed insurance company organized under the laws of Barbados, West Indies. The company is fully "fronted" by a domestic insurance company. NTAA will, on behalf of the "fronting" company, issue insurance policies to qualified trucking companies in the United States providing for primary and excess liability coverage. The initial policy will be a one-year policy from the fronting company, but participation in the program requires a five-year commitment. Subsequent policies may continue to be provided by this same fronting company or by a member-owner risk retention group. It is the intent of the organizers to form a risk retention group if it should prove to be advantageous.

Capitalization of the insurance company is being made by a Maryland corporation. Subsequent surplus will be gained through reserve premium payments from each insured participant who joins the program. Each new insured will be required to place a reserve premium with NTAA in an amount equivalent to one-third of its annual premium and in addition to its annual premium. The reserve premium will be held by NTAA for five (5) years, and will be used for the payment of any of the insured's claims which exceed those covered by the annual premium or for the payment of a substantial penalty if the insured participant cancels coverage within the five-year program period or is canceled by the company for nonpayment of premium. The reserve premium will, however, be refunded, without interest, to each insured on the fifth anniversary of the issuance of the policy if the insured has had continuous coverage under the policy.

***2** It is this firm's opinion that the foregoing capitalization plan contemplated by NTAA is exempt from registration with the SEC, as it does not meet the definitional requirements of a security enunciated in SEC v. Howey, 328 U.S. 293 (1946). This is so because insureds who pay the reserve premium in accordance with the terms of the insurance policy make no investment of money and have no reasonable expectation of profit. They are told that the purpose of the reserve premium is to provide a fund which can be utilized in the event an insured's claim exceeds funds available from the collection of annual premiums. Although insured participants are obligated to give up some tangible and definable consideration—money—they do not receive in return a financial interest with the characteristics of a security, i.e. the right to participate in the earnings or distribution of the company. In fact, there is no way for insureds to reap any profit whatsoever from their capital input, as their reserve premium is returned in five years without interest.

Further negating the existence of a security is the fact that an insured may never be refunded the reserve premium he has paid. The refund of the reserve premium is actually dependent on the insured's actions. An insured must not cancel his policy or be canceled by the company for a period of five years prior to receiving his refund. Thus, the principal barrier to an individual insured's receipt of his reserve premium refund is not the financial well-being of the company, but is his own ability to meet the eligibility requirements. This situation is very similar to the one in International Board of Teamsters v. Daniel, 439 U.S. 551 (1979), where the Supreme Court held that an employee's participation in a non-contributory, compulsory pension plan was not a security within the ambit of the Securities Acts. The Court noted that even if it were accurate to describe an employee's pension benefits as a "profit" return on a hypothetical investment by the employee, the profit would be dependent on the employee's efforts to meet the vesting requirements, rather than the plan's investment success. This type of transaction, asserted the Court, was far too speculative and insubstantial to bring it within the registration requirements of the Securities Acts. Likewise, it seems equally clear that the capitalization undertaking proposed by NTAA is far removed from the type of investment contract subject to SEC regulation.

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I would appreciate comment on these conclusions from your office and look forward to your reply. Thank you for your attention to this matter.

Very truly yours,

Elizabeth P. Powell

LETTER TO SEC

January 12, 1989

Melinda Reingold, Esquire
Office of Chief Counsel
Division of Corporation Finance
U.S. Securities & Exchange Commission
450 5th Street, N.W.
***3** Washington, D.C. 20549RE: **National Transport Assurance Alliance**, Inc.

Dear Ms. Reingold:

This letter supplements my letter of December 13, 1988 regarding the issuance of a No Action letter on behalf of **National Transport Assurance Alliance**, Inc. (NTAA). You had requested more information on NTAA's fronting arrangement, as well as further analysis of No Action letters previously issued by the SEC staff involving similar circumstances.

Background
By way of background, NTAA has been formed as an industry-directed trucking insurance company, directed by top motor carrier executives. NTAA's coverage will be written using a policy provided for at least the first of five year's coverage by National Union Fire Insurance Company of Pittsburgh, Pennsylvania. The program is to be managed by Assurance Alliance, Inc., an insurance management company located in Illinois. NTAA was incorporated in Barbados, West Indies, in order to provide a vehicle for the fronting and reinsurance provided by National Union Fire Insurance Company of Pittsburgh.

The objective of NTAA is to provide a stable source of liability insurance for its participants at a reasonable cost. Consideration for participation in NTAA will be limited to Class 1 motor carriers (those with $5 million gross receipts and above), and at least $5 million in assets. The program emphasizes high quality and uniqueness in its underwriting products, demonstrated commitment to safety, and financial stability in its insured base.

Fronting
The fronting arrangement with National Union Fire Insurance Company is tied in to the concept of reinsurance, both of which are very important to the ultimate success and viability of NTAA. Satisfactory reinsurance is in place for the first million in coverage. Additional coverage up to $25 million is available. Since National Union Fire Insurance Company is providing fronting, coverage is technically on a National Union policy with limits between $1 and $5 million. There will be at least four layers in most policies as follows:

1. Many, if not all, motor carriers will want to carry a “deductible.” This will vary, in most cases, from $5,000 to $50,000. (Some companies may desire, and be qualified, to have a much higher “deductible” and do so in order

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to qualify for participation in the high reinsurance layers.)

2. **National Transport Assurance Alliance**, Inc. will retain the first $250,000, inclusive of the trucker's deductible. The initial $250,000 will be in the form of reinsurance of National Union Fire Insurance Company.

3. National Union Fire Insurance Company will be providing coverage of all losses between $250,000 and $1 million. This normally would be **National Transport Assurance Alliance's** primary reinsurance layer.

4. Coverage of the “4 x 1” layer ($4 million in excess of $1 million) will also be provided by National Union Fire Insurance Company. The rate for the Assurance Alliance programs is below that generally available for trucking. Sixty-three percent (63%) of the motor carriers seeking participation in this program have requested coverages up to $5 million or more.

***4** Being fully fronted by National Union Fire Insurance Company means that for the first year of NTAA's operation, the capital required for insurance insolvency purposes is that of National Union, in excess of four (4) billion dollars. National Union has required, however, $500,00 capital in place in the insurance company which has been provided by the NTAA founders.

Reserve Premium
As stated in my earlier letter, each insured is required to contribute to the surplus of the group. This is accomplished through a premium reserve contribution equal to thirty-three percent (33%) of the insured participant's initial annual premium. The reserve premium will be adjusted annually to equal one-third of the annual premium of that year. It will be held for fifty-six (56) months and will be used to pay the last four months' premium in the five-year program. This is a significant change in the reserve premium plan previously contemplated by NTAA. In my letter of December 13, 1988, I informed you that NTAA planned to hold each reserve premium for a period of five (5) years, at the end of which time it would refund the entire amount, without interest, to each insured who has had continuous coverage under their policy. This is no longer the case. There will be no refund, per se, of the reserve premium. Instead, it will be absorbed into the last year's premium payment. The reserve premium will still be used to cover the penalty for early withdrawal from the program, nonpayment of monthly premiums, and/or losses which exceed those covered by the annual premium.

Legal Discussion

An analysis of No Action letters previously issued by the staff of the Securities and Exchange Commission in circumstances similar to NTAA's and involving other offshore mutual insurance companies reveals that the offering of, and participation in NTAA through memberships and the purchase of insurance coverage and policies in the manner set forth above does not involve the sale of “securities” within the meaning of the Securities Act of 1933, as amended.

For example, a No Action letter was issued to Attorneys Insurance Mutual, a mutual insurance company incorporated in Barbados without capital stock, on July 10, 1986. The company was organized to provide professional liability insurance coverage exclusively for United States law firms and was owned by those firms which maintained policies with the Company. The Company provided insurance from the capital and premium contributions of its members. Like NTAA, each member-insured was required to pay a reserve premium to provide for anticipated capital requirements. Unlike NTAA, however, members were liable for retrospective premium assessments and were required to collateralize all or part of their contingent obligation to pay retrospective premiums by obtaining an irrevocable letter of credit for the benefit of the Company. They were also required to obtain

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such a letter of credit as collateral for their obligation to pay future installments of their mandatory reserve premium assessments.

***5** Although the company stated that it did not anticipate dividends or distributions, it did provide that in the event a distribution was declared, each member would be entitled to share in the distribution to the extent of the member's proportionate share of the company's net worth. If any member voluntarily terminated its membership during the first five policy years of its membership, the member was to forfeit 100% of its share of the company's net worth. In the event that the company cancelled a member's insurance during the first five policy years, the member firm was to receive the lesser of the reserve premium previously paid or the member's share of the company's net worth. Policy termination after the fifth policy year, whether voluntary or not, entitled the member to receive a distribution of such member's share of the company's net worth as determined at the date of cancellation and withdrawal.

The SEC staff agreed with Attorneys Insurance Mutual in that the company need not comply with the registration requirements of the Securities Act of 1933, as the offer, sale and delivery of membership in, and the writing of insurance coverage by the company did not constitute the sale of a “security” as that term is defined in Section 2(1) of the 1933 Act. This is so because the company was formed and structured to provide liability insurance, not investment opportunities, to its members. The reserve premium assessment and retrospective premium adjustment were designed solely for the purpose of providing a sound financial basis able to withstand unexpected contingencies. The substance and economic reality of the overall transaction were designed solely for insurance purposes. Prospective members were deemed not to have any expectation of profit, nor could they anticipate any distribution of earnings resulting from the use of their reserve or annual premiums paid to the company. To the extent that any funds exceeded the long-term underwriting needs of the company, the excess was to be reflected in either lower premiums or in higher limits of coverage, or in a combination of both. Only if excessive reserves built up would distributions to members be considered.

Likewise, the SEC staff held that the offering of memberships in another Barbadian insurance company, Energy Insurance Mutual Fund, August 16, 1986, did not involve the purchase or sale of a security as that term is defined in the 1933 Act. Energy Insurance Mutual Fund was organized and funded in order to assess the feasibility of establishing a mutual insurance association that would provide excess insurance coverage for directors and officers liability as well as general liability. Any electric or gas utility meeting the underwriting standards was eligible for membership in the company. In addition to paying an annual premium, each member was also required to pay a reserve premium upon joining the company. Members might also be required to pay an additional reserve premium in the event the member substantially expanded the scope of its activities so as to constitute a material change of risk to the company. The reserve premiums would be used to provide the company with the reserve fund required by Barbados law and the surplus necessary to effectively carry out its insurance business.

***6** The members of the company were entitled to share in any distributions made by the Board of Directors. The company concluded, and the SEC staff agreed, that the company did not engage in the sales of securities under Section 2(1) of the 1933 Act. In addition to a lack of profit motive, the company stressed the fact that its organizational scheme did not meet the definitional requirements of a security because there was no right to receive dividends contingent upon an apportionment of profits. Although distributions could be made to the members in the event the company had more surplus than was necessary to write its insurance business, these distributions were in the nature of reductions in insurance expenses, not dividends.

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Further negating the existence of a security was the fact that memberships in the company were not negotiable and could not be sold or transferred so as to realize an appreciation in value. Further, there were no certificates or other evidence of a security, and members received voting rights based upon the amount of insurance they wrote with the company, not based on share ownership. Finally, the company noted that there was absolutely no anticipation of income or appreciation in value on the members' part. Upon termination of membership, members were to receive no share of the company's earnings or surplus. With regard to the reserve premium, a terminated member would receive back the dollar amount of the reserve premium it contributed, less any amount used to pay losses and expenses. The withdrawing member would not receive any interest on this amount, nor would it receive any other funds from the company as a result of its withdrawal.

In addition to the two companies discussed in detail above, No Action letters have been issued by the staff of the SEC to other offshore mutual insurance companies involved in undertakings similar to those of NTAA. E.g., KFC Mutual Insurance Limited, June 29, 1988; Casualty Excess Assurance Limited, April 28, 1986; McDonald's Owner Operators Insurance Company Ltd., March 26, 1982; The Health Association Mutual Insurance Co., Ltd., October 21, 1981; Hutco Insurance Company, Ltd., May 19, 1981; NECA Insurance Limited, March 12, 1981; 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; Chicago Hospital Council, August 3, 1978; General Assurance Services, Limited, January 16, 1978; Multihospital Mutual Insurance Limited, April 21, 1975; and Nuclear Mutual Limited, October 27, 1971.

Based on 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. We are specifically seeking comment on the reserve premium aspect of the company's proposed capitalization strategy. We feel that NTAA's revised provision for a reserve surplus whereby each member's reserve premium will be held for fifty-six (56) months and will then be used to pay the last four months' premium in the five-year program only serves to negate the expectation of any capital appreciation or distribution, and hence, the existence of a security.

***7** Additionally, it should be noted that member-insureds of the company have no ownership interest in the company. All of the shares of NTAA are currently owned by a Maryland corporation. Thus, members have no voting rights based on share ownership nor will they ever receive dividends contingent upon an apportionment of profits.

I look forward to your opinion as to these matters. I am enclosing for your convenience copies of the Attorneys Insurance Mutual and Energy Insurance Mutual Fund No Action letters discussed in this letter.

Very truly yours,

Elizabeth P. Powell

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