

BEFORE THE INSURANCE COMMISSIONER OF THE STATE OF IOWA

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In the matter of the joint application	)	
of the Joint Plans of Conversion	)	<b>FINDINGS OF FACT,</b>
and Merger for the Demutualization	)	<b>CONCLUSION OF LAW,</b>
of NORTHERN CASUALTY	)	<b>AND ORDER</b>
COMPANY (MUTUAL) and	)	(Iowa Code chapter 515G)
Merger with and into MERCHANTS	)	
NATIONAL BONDING, INC.	)	
	)	

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**I. INTRODUCTION**

Northern Casualty Company (Mutual) (“Northern Mutual”) is an Iowa domestic mutual insurance company. Northern Mutual wishes to convert from an Iowa-domiciled mutual insurance company into an Iowa-domiciled stock insurance company and immediately merge with and into Merchants National Bonding, Inc. (“Merchants National”) an Iowa domestic stock insurance company. Northern Mutual and Merchants National (collectively known as “Applicants”) have jointly filed an Iowa Code chapter 515G (2011) application with the Iowa Insurance Commissioner (“the Commissioner”) for permission to do so under a plan of conversion and merger (“the Plan”). Northern Mutual and Merchants National are licensees in good standing with the Division, and have current financial statements on file with the Division.

Pursuant to Iowa Code section 515G.7 a public hearing was held on June 5, 2012, at the Iowa Insurance Division (“the Division”) for the purpose of determining whether (1) the Plan complies with all provisions of law, and (2) the Plan is fair to the mutual insurer and its policyholders, and (3) the reorganized company will have the amount of capital and surplus deemed by the Commissioner to be reasonably necessary for its future solvency.

If the Plan is approved, Northern Mutual will demutualize and merge with and into Merchants National effective July 1, 2012. Upon completion of the merger, Merchants National will be the surviving corporation and continue its corporate existence under the laws of the state of Iowa under the name “Merchants National Bonding, Inc.”<sup>1</sup>

**II. JURISDICTION**

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<sup>1</sup> This transaction will not result in a change of control of Merchants National Bonding, Inc.

The Commissioner has jurisdiction over this matter pursuant to Iowa Code section 515G.7.

### **III. EVIDENCE PRESENTED**

In support of the application, Applicants submitted documentary and testimonial evidence regarding the proposed demutualization of Northern Mutual and simultaneous merger with and into Merchants National. Applicants submitted the testimony of Lawrence Taylor, President of Merchants Bonding Company (Mutual) and Vice-President of Northern Mutual; William Warner, Corporate Secretary of Merchants Bonding Company (Mutual) and Merchants National and President of Northern Mutual.

The Iowa Insurance Division submitted the testimony of Ronald E. Nielsen, a partner with CliftonLarsonAllan, LLP. Mr. Nielsen also gave his opinion on the reasonableness of Northern Mutual's value.

At close of the hearing, the administrative record was left open for receipt of the Affidavit of Policyholder Approval for the Joint Plans from Northern Mutual. The Commissioner received the Affidavit of Policyholder Approval for the Joint Plans on June 7, 2012 and the administrative record was formally closed.

All evidence was admitted without objection and is part of the record considered by the Commissioner in issuing the following findings, conclusions, and order.

No one appeared at the hearing to oppose Applicants' request, or otherwise offer evidence to contradict or question Applicants' submission of evidence required under 515G.

### **IV. FINDINGS OF FACT**

The statutory requirements the Applicants' Plan must meet are relatively straightforward. Iowa Code section 515G.7 requires a showing by the Applicants that the facts and circumstances supporting its plan meet three standards.

Applicants must establish that (1) the Plan complies with all provisions of law, (2) the Plan is not unfair to the mutual insurer and its policyholders, and (3) the reorganized company will have the amount of capital and surplus deemed by the Commissioner to be reasonably necessary for its future solvency. If Applicants establish that the Plan

meets these standards, section 515G.7 requires the Commissioner to approve the application.

The Plan has been authorized and approved by the boards of directors of both Northern Mutual and Merchants National. Northern Mutual's members voted to approve the demutualization and merger during a special policyholder member meeting on April 28, 2012.

After applying the relevant section 515G standards to the record when viewed as a whole, including but not limited to Applicants' application, the Plan and attached exhibits, witness testimony at the hearing, and all other filings of record relevant to this matter, the Commissioner finds the following facts:

**A. THE APPLICANTS' PLAN TO CONVERT NORTHERN MUTUAL FROM A MUTUAL INSURANCE COMPANY TO A STOCK INSURANCE COMPANY AND SIMILTANEOUSLY MERGE WITH AND INTO MERCHANTS NATIONAL COMPLIES WITH ALL PROVISIONS OF LAW.**

Iowa Code section 515G.7 requires a plan of conversion to "compl[y] with all provisions of law." To satisfy this requirement under the facts presented, Applicants must essentially establish that they have complied with the relevant provisions of Iowa Code chapter 515G.

Consistent with 515G requirements, Applicants filed the Plan, retained a consultant to evaluate the fairness of the ultimate economic value placed on Northern Mutual and Merchants National at the time of conversion, provided appropriate policyholder notices, and secured Board and eligible policyholder approval of the Plan.

The record taken as a whole establishes that Applicants have complied with the requirements of chapter 515G relevant to the Plan. The Applicants Plan for Northern Mutual to convert from a mutual insurance company to a stock insurance company and merge with and into Merchants National complies with all provisions of law.

**B. THE PLAN IS FAIR AND EQUITABLE TO NORTHERN MUTUAL AND ITS POLICYHOLDERS.**

Iowa Code section 515G.7 requires a plan of conversion be fair and equitable to the mutual company and its policyholders.

1. **The Plan is fair and equitable to Northern Mutual.** The Plan provides that Northern Mutual shall demutualize and simultaneously merge with and into Merchants National. Merchants National shall be the survivor. The record demonstrates that Northern Mutual was established and capitalized personally by W.W. Warner to provide reinsurance to Merchants Bonding Company (Mutual).<sup>2</sup>

Merchants National is a domestic stock insurance company whose ultimate controlling person is Merchants Bonding Company (Mutual). Both companies are well capitalized. Mr. Taylor testified that following the merger, Merchants National will continue to retain an insurance license. *Trans.* at 24.

Mr. Taylor also testified that Northern Mutual was formed to provide small amounts of reinsurance to Merchants Bonding Company (Mutual). *Trans.* at 14. Merchants Bonding Company (Mutual) has moved its primary reinsurance treaties to large global reinsurers with Northern Mutual's amount of reinsurance now only proving a minor benefit. *Trans.* at 15.

The Commissioner finds that following the demutualization and merger Merchants National, will satisfy Iowa licensure requirements and its ability to continue writing existing lines of insurance for which it is presently licensed will be unimpaired.

2. **The Plan is fair and equitable to Northern Mutual policyholders as to the proposed value.** The fair economic value to be distributed to policyholders has been divided into two components. First, each policyholder will receive \$50 as compensation for their voting rights. *Joint Plans of Conversion and Merger* §2.6. Secondly, each policyholder will receive 15,672 shares of the common stock of Merchants National representing approximately one-third of the outstanding shares. *Id.* The remaining two-thirds of stock in Merchants National will be owned by Merchants Bonding Company (Mutual). *Trans.* at 22.

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<sup>2</sup> Merchants Bonding Company (Mutual) and Northern Mutual have inter-locking boards of directors. Merchants Bonding Company (Mutual) is the ultimate controlling person of Merchants National.

If the conversion and merger is approved, Northern Mutual policyholders will exchange their Merchants National stock with the stock of Merchants Bonding Group, Inc.<sup>3</sup> The same ratio of stock ownership that applied to the conversion will apply to ownership of Merchants Bonding Group, Inc. *Trans.* at 22-23.

Northern Mutual's policyholders unanimously voted to approve the Plan. *Joint Plans of Conversion and Merger* §§ 2.7-3.8.

Northern Mutual's value will be distributed upon conversion to its policyholders. Northern Mutual has only eight policyholders. *Trans.* at 15. The policyholders will receive approximately \$2.7 million as the fair economic value of their membership rights. *Trans.* at 30. This represents approximately 33.40 percent of the total value of Merchants National. *Joint Plans of Conversion and Merger* §2.5. After completion of the conversion and merger, Merchants Bonding Company (Mutual) will retain the remaining 66.60 percent of the total value of Merchants National. *Id.*

The Boards of Merchants National and Merchants Bonding Mutual retained Leslie G. Fenton, KPMG Corporate Finance, LLC to provide valuation services. KPMG determined that Northern Mutual policyholder interests were valued at \$2,757,033, representing 33.40 percent of the Merchants National's total value of \$8,254,402. *Joint Plans of Conversion and Merger* § 2.5. Additionally, KPMG determined the value of Merchants Bonding Company (Mutual's) interest is \$5,497,369, which represents 66.60 percent of the total value of Merchants National.<sup>4</sup> *Id.*

The Division retained Ronald Nielsen, CliftonLarsonAllen, LLP to independently value Northern Mutual and Merchants National and identify their respective values as it relates to the demutualization and merger and the percentage of ownership that should be allocated to each entity. Mr. Nielsen concluded that as of December 31, 2011, Northern Mutual had a value of \$2,714,997 and Merchants National was valued at \$5,309,270. *Trans.* at 30. The respective ownership percentages totaled 33.8 percent for Northern Casualty and 66.2 percent for Merchants National. *Id.* As of March 31, 2012, the ownership percentages changed from 33.4 percent for Northern Casualty and 66.6 percent for Merchants National. *Id.* Mr. Nielsen opined that his independent valuation was consistent with that provided by the Applicants.

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<sup>3</sup> Merchants Bonding Group, Inc. is a newly created holding company that is a wholly owned subsidiary of Merchants Bonding Company (Mutual).

<sup>4</sup> Merchants Bonding Company (Mutual) is the ultimate controlling party of Merchants National Bonding, Inc.

The record on this issue is substantial: The consideration component of the Plan is fair and equitable to Northern Mutual policyholders.

**C. THE REORGANIZED COMPANY WILL HAVE THE AMOUNT OF CAPITAL AND SURPLUS DEEMED NECESSARY BY THE COMMISSIONER TO BE REASONABLY NECESSARY FOR ITS FUTURE SOLVENCY.**

Iowa Code section 515G.7 requires a plan to evidence that the “reorganized company will have the amount of capital and surplus deemed by the Commissioner to be reasonably necessary for its future solvency.”

As of March 31, 2012, Northern Mutual had surplus of \$2,833,655 and Merchants National had capital and surplus of \$5,650,149 pursuant to quarterly financial statements filed with the Division.

Based upon this information, the Commissioner is satisfied that the conversion and merger of the reorganized company with and into Merchants National is adequate to meet the statutory solvency requirement.

The Commissioner has carefully considered all testimony and comments elicited at the hearing, and all documents of record, whether specifically addressed herein. The record establishes that the proposed conversion of Northern Mutual from a mutual insurance company to a stock insurance company and merger with and into Merchants National meets the requirements of Iowa Code chapter 515G (2011). The Commissioner finds that the Plan complies with all provisions of law, the Plan is not unfair to the mutual insurer and its policyholders, and the reorganized company will have the amount of capital and surplus deemed by the Commissioner to be reasonably necessary for its future solvency. No reasonable objection to the conversion exists under the record presented.

**V. CONCLUSION OF LAW**

The legislature has vested discretion in the Commissioner not only to hold hearings and make factual findings, but also to interpret and apply the law. Iowa Code section 515G.7, requires the Commissioner approve the plan if the Commissioner finds the plan complies with all the provisions of law, the plan is fair and equitable to the mutual insurer and its policyholders, and that the reorganized company will have the amount of capital and surplus deemed by the commissioner to be reasonably necessary for its future solvency.

After a careful review of all evidence submitted, the Commissioner concludes, upon substantial evidence, that the Plan submitted by the Applicants satisfies the relevant Iowa Code requirements, including Iowa Code section 507B.14. The Plan complies with all provisions of law, is fair and equitable to Northern Mutual and its policyholders, and Merchants National will have the amount of capital and surplus deemed by the Commissioner to be reasonably necessary for its future solvency.

## ORDER

**IT IS THEREFORE ORDERED** that:

The joint application of Northern Casualty Company (Mutual) and Merchants National Bonding, Inc., for the joint plans of conversion and merger for the demutualization of Northern Casualty Company (Mutual) and merger with and into Merchants National Bonding, Inc. is **APPROVED**.

This Order shall be considered final agency action for the purposes of Iowa Code chapter 17A. Any action challenging the Order shall comply with the requirements of Iowa Code chapter 17A.

Any application for rehearing shall comply with the requirements of Iowa Code chapter 17A.

**DATED** this 29<sup>th</sup> day of June, 2012.

\_\_\_\_\_/s/\_\_\_\_\_  
SUSAN VOSS  
Iowa Insurance Commissioner

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