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1971 Senate Bill 469 **Date published: April 29, 1972**

CHAPTER 260, Laws of 1971

AN ACT to repeal 102.31 (2), (5) and (6), 200.03, 200.06, 200.07, 201.02, 201.025, 201.05 (1) to (2m), 201.07, 201.10 to 201.13, 201.14, 201.17 (2) and (3), 201.24 (5) (a) 4, 201.25, 201.29 to 201.301, 201.32 to 201.42, 201.61, 201.62, 201.63 (1) to (3), (5) to (9), (11) to (13) and (15) to (18), 202.095, 203.03, 203.16, 203.29 to 203.31, 204.02, 204.041, 204.05, 204.06 (2), 204.22, 204.24, 204.25, 205.01 (3), 206.01 (5), 206.02 (1), (3) to (6) and (8) to (11), 206.04 to 206.12, 206.14 to 206.16, 206.34, 206.35, 206.38, 206.385 (1) to (7), 206.386, 206.62, 209.13, 601.02 (2) and (4) to (11), 617.02, 645.03 (1), (5), (6), (14), (16) and (18) and 646.01 (3); to renumber 102.31 (3), (7) and (8), 201.05 (3) to (7), 204.06 (3) and (4), 206.02 (7) and 206.385 (8) to (10); to amend 66.07 (6), 76.37 (1), (3) and (4), 102.31 (2), as renumbered, 201.05 (title), and (2), as renumbered, 201.08, 201.09, 201.24 (1), 202.06 (6), 206.22, 206.385 (1), as renumbered, 208.03 (5), 209.04 (9) (aa), 219.01 (intro.), 219.05 (1), 219.06 (1) and (2), 219.07, 601.01 (title), 601.31 (10) and (11), 601.64 (5), 645.21 (1), 645.31 (8), 645.61 (1), 645.68 (8) (e) and (f) and 646.01 (title); to repeal and recreate 200.26 (4), 201.01, 201.03, 201.045, 206.02 (2), 551.27 (13), 601.31 (1) (a) to (h), (2) (a) to (f), (3), (5), (7) and (15) (c), 601.72 (1) (b) and (c), 645.68 (9) and (10); and to create

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102.31 (3), 201.04 (20), 201.24 (8), 551.22 (16), chapters 600, 610, 611, 618, 620 and 623 (title), 623.11, 623.12, 631.01, 645.54 (1) (c), 645.63 (6) and 645.68 (8) (g) and (11) of the statutes, relating to a general revision of the insurance law relating to insurance company law.

The people of the state of Wisconsin, represented in senate and assembly, do enact as follows:

SECTION 1. 66.07 (6) of the statutes is amended to read:

66.07 (6) If the municipality has revenue or mortgage bonds outstanding relating to such utility plant and which by their terms may not be redeemed concurrently with the sale or lease transaction, an escrow fund with a domestic bank as trustee may be established for the purpose of holding, administering and distributing such portion of the sales or lease proceeds as may be necessary to cover the payment of the principal, any redemption premium and interest which will accrue on the principal through the earliest retirement date of the bonds. During the period of the escrow arrangement such funds may be invested in securities or other investments as described in s. 201.25 (1) (a), (b), (dm) and (j) of the 1969 statutes, and in deposits or certificates of deposit with any state or national bank doing business in this state.

SECTION 2. 76.37 (1), (3) and (4) of the statutes are amended to read:

76.37 (1) Every license issued pursuant to ss. 76.30 to 76.37 ~~, 201.045 and 201.34~~ and chs. 200 to 212 and 600 to 649 shall certify that payment of the license fee or tax and the fee required by s. 601.31 (2) has been made, be signed by the commissioner of insurance, and be in such form as is approved by the attorney general.

(3) No action shall be commenced to compel the issuance of the certificate of authority provided for by ~~s. 201.045 or 201.34~~ chs. 200 to 212 and 600 to 649 until the license fee imposed by ss. 76.30 to 76.37, and the fees under s. ~~200.13~~ 601.31 have been fully paid.

(4) It is the duty of the attorney general to institute suit in the circuit court for Dane county to recover any such license fees or tax not paid within the time prescribed by ss. 76.30 to 76.37, and the fees required by s. ~~200.13~~ 601.31. Nothing in this subsection shall be construed as amending or modifying in any respect the provision of ch. 285.

SECTION 3. 102.31 (2), (5) and (6) of the statutes are repealed.

NOTE: Sub. (2) is replaced by s. 611.19 (4) (d), with a limitation to the assessable mutual form. That limitation was previously unspecified but was implicit in the language of the provision.

Sub. (5) is not soundly conceived. Ch. 611 provides an adequate range of ways to organize special risk insurers as subsidiaries, and does not forbid the use of syndicates or pools of authorized insurers. See s. 611.26 and note.

Sub. (8) is continued without change. It is not part of the insurance law.

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SECTION 4. 102.31 (3), (7) and (8) of the statutes are renumbered 102.31 (2), (5) and (4), respectively, and 102.31 (2), as renumbered, is amended to read:

102.31 (2) The department may examine from time to time the books and records of any ~~insurance company~~ insurer insuring liability or compensation for an employer in this state. Any such ~~company~~ insurer that ~~shall refuse or fail~~ refuses or fails to allow the department to examine its books and records ~~shall have its license revoked~~ is subject to enforcement proceedings under s. 601.64.

> NOTE: This amendment subjects an insurer that refuses access to its books and records to the department of industry, labor and human relations to the whole range of sanctions available under the insurance code.

SECTION 5. 102.31 (3) of the statutes is created to read:

102.31 (3) If any insurer authorized to transact workmen's compensation insurance in this state fails promptly to pay claims for compensation for which it is liable or fails to make reports to the department required by s. 102.38, the department may recommend to the commissioner of insurance, with detailed reasons, that enforcement proceedings under s. 601.64 be invoked. The commissioner shall thereupon furnish a copy of the recommendation to the insurer and shall set a date for a hearing, at which both the insurer and the department shall be afforded an opportunity to present evidence. If after the hearing the commissioner is satisfied that the insurer has failed to live up to all of its obligations under this chapter, he shall institute enforcement proceedings under s. 601.64; otherwise he shall dismiss the complaint.

SECTION 6. 200.03 of the statutes is repealed.

> NOTE: S. 200.03 is incorporated into ch. 618, substantially changed in form.

SECTION 7. 200.06 and 200.07 of the statutes are repealed.

> NOTE: Ss. 200.06 and 200.07 are no longer necessary because of the different substantive rules of ch. 611 and enforcement techniques of ch. 601.

SECTION 8. 200.26 (4) of the statutes is repealed and recreated to read:

200.26 (4) SUBJECT TO INSURANCE LAWS FOR CERTAIN PURPOSES. Such organizations and their agents, plans and contracts are subject to s. 201.045 relating to licensing, ch. 207 relating to unfair methods of competition and unfair or deceptive acts or practices, s. 209.04 (11) relating to agents, ch. 601 relating to the administration of the insurance laws, ch. 620 relating to investments, and to ch. 645 relating to delinquency proceedings, to the same extent and in the same manner as if such organizations were domestic insurance corporations. Such organizations are also subject to s. 201.18 (1) relating to premium reserves except that where risks are written for more than one month and the premium or fee is paid on a monthly basis, the reserve shall be computed at 50% of the monthly premium or fee received each month.

> NOTE: This continues the existing law with corrected references and with one substantive change. Subjection to the investment laws is complete, without the former specific grandfather provision for investments lawful when made under the old law prior to November 6, 1959. There is sufficient flexibility in ch. 620 to make that additional leeway unnecessary and quite unjustified.

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SECTION 9. 201.01 of the statutes is repealed and recreated to read:

201.01 DEFINITION. In statutes relating to insurance companies, unless the context requires otherwise, "mutual benefit society" has the meaning attributed to it by ch. 208.

SECTION 10. 201.02 and 201.025 of the statutes are repealed.

SECTION 11. 201.03 of the statutes is repealed and recreated to read:

201.03 CONSOLIDATION OR MERGER OF DOMESTIC TOWN MUTUALS INTO DOMESTIC MUTUALS. (1) Any mutual which is organized or operating under ch. 611 may absorb by merger or consolidation any domestic town mutual, or wholly reinsure all of the risks of any such town mutual. To effect any such merger, consolidation or total reinsurance it is necessary:

(a) That the boards of each of the corporations pass a resolution prescribing the terms and conditions of the proposed action;

(b) That 2 certified copies of the resolution provided in par. (a) be filed with the commissioner by each of the companies and the commissioner shall, within 10 days, give his written approval or disapproval of the proposed action to each of the companies. In case the commissioner disapproves the proposal he shall state his reasons therefor;

(c) That when the proposed action is approved by the commissioner, a meeting of the members of the town mutual shall be held on notice mailed to each of the members of the company at least 30 days prior to the holding thereof, which shall embody a copy or the summary of the resolution adopted by the board as provided in par. (a); and

(d) That a two-thirds majority of the members of the town mutual present at the meeting, by resolution, approve and ratify the action of their directors and vote to carry out the proposed action. Within 10 days after the adoption of the resolution, 2 copies thereof, with the affidavit of the president and secretary showing compliance with the law, shall be forwarded to the commissioner by the town mutual. The procedure for certifying and recording of amendment of articles required by s. 202.01 (4) shall be followed by the corporations losing their identity as a result of the merger, consolidation or total reinsurance.

(2) Any merger, consolidation or total reinsurance of a town mutual by or into any mutual organized or operating under ch. 611 approved by a two-thirds vote of the members present at an annual meeting of the members of the town mutual prior to July 1, 1961, and approved by the commissioner is hereby validated to the same effect as though accomplished in accordance with this election.

NOTE: This section continues s. 201.03 (10). It is temporary and will be replaced by one in ch. 612.

SECTION 11m. 201.04 (20) of the statutes is created to read:

201.04 (20) LEGAL EXPENSE INSURANCE. Against expense for the professional services of licensed lawyers.

SECTION 12. 201.045 of the statutes is repealed and recreated to read:

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201.045 CERTIFICATE OF AUTHORITY; FEE. (1) SCOPE. This section applies to all insurers incorporated or organized under any law of this state except ch. 611, and to nonprofit service plans as defined by s. 200.26.

(2) REQUIREMENT OF LICENSE. No insurer or plan subject to this section may transact insurance business in this state without having in effect a certificate of authority.

(3) LICENSING. The commissioner shall issue to any insurer or plan subject to this section a certificate of authority authorizing it to transact the business of insurance in this state if he is satisfied that it has met all requirements of law and that its methods and practices and the character and value of its assets will adequately safeguard the interests of its insureds and the public in this state. Each certificate shall be issued for a period of no longer than one year and shall expire on May 1. It may be renewed from year to year.

(4) FEES. Except town mutuals, every insurer or plan obtaining or renewing its certificate shall pay the fee required by s. 601.31 (2) or (3).

SECTION 13. 201.05 (title) of the statutes is amended to read:

201.05 (title) **COMBINATION OF KINDS OF INSURANCE.**

SECTION 14. 201.05 (1) to (2m) of the statutes are repealed.

SECTION 15. 201.05 (3) to (7) of the statutes are renumbered 201.05 (1) to (5), and 201.05 (2), as renumbered, is amended to read:

201.05 (2) Notwithstanding any other provision of the statutes to the contrary, any insurer authorized to insure property against all of the perils specified in s. 201.04 (1), may also write the kinds of insurance specified in s. 201.04 (5), (10), (11) and (18), when written in one policy and as a part of or supplemental to the insurance specified in s. 201.04 (1) ~~, without additional surplus being required therefor if, as respects the insurance specified in s. 201.04 (5), the obligations assumed or liabilities incurred are assumed by another licensed insurer meeting the surplus requirements of sub. (2m) and the fact of such assumption of liability is shown on the policy or by endorsement thereon; or, if, as respects the insurance specified in s. 201.04 (5), the obligations assumed or liabilities incurred are fully reinsured with another licensed insurer meeting the surplus requirements of sub. (2m)~~.

> NOTE: These provisions will be replaced by other chapters of the revision.

SECTION 16. 201.07 of the statutes is repealed.

SECTION 17. 201.08 of the statutes is amended to read:

201.08 Every ~~insurance corporation and every~~ mutual benefit society shall adopt bylaws and prescribe the manner in which ~~the same~~ they may be amended. A copy of ~~such~~ the bylaws and of any amendments thereto, accompanied by the certificate of the president and secretary stating that ~~the same~~ they have been duly adopted and that ~~such~~ the copy is true and complete, shall be filed with the commissioner ~~of insurance~~ within 30 days after ~~such~~ adoption.

SECTION 18. 201.09 of the statutes is amended to read:

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201.09 The treasurer of any ~~insurance company, including~~ mutual benefit ~~societies,~~ society shall be required to furnish a fidelity bond in an amount not less than $5,000 in a surety company duly licensed to do business in ~~the~~ this state ~~of Wisconsin~~.

NOTE: This section, as amended, will eventually be replaced by ch. 614.

SECTION 19. 201.10 to 201.13 of the statutes are repealed.

SECTION 20. 201.14 of the statutes is repealed.

SECTION 21. 201.17 (2) and (3) of the statutes are repealed.

SECTION 22. 201.24 (1) of the statutes is amended to read:

201.24 (1) No domestic ~~insurance company~~ insurer organized or operating under any general law other than ch. 611 shall, directly or indirectly, deal in goods or commodities, excepting such as it may have insured and are claimed to be damaged by the risk insured against, and excepting such as may be permitted by s. ~~201.05 (7)~~ 201.05 (5).

SECTION 23. 201.24 (5) (a) 4 of the statutes is repealed.

NOTE: The definition in s. 201.24 (5) (a) 4 is replaced in s. 600.03.

SECTION 24. 201.24 (8) of the statutes is created to read:

201.24 (8) Subsections (1) to (6) do not apply to corporations organized or operating under ch. 611.

NOTE: Sub. (8) is proposed since chs. 611 and 620 replace the whole of s. 201.24 as applied to domestic insurance corporations, except for sub. (1) which will be dealt with in another chapter.

SECTION 25. 201.25 of the statutes is repealed.

SECTION 26. 201.29 to 201.301 of the statutes are repealed.

SECTION 27. 201.32 to 201.42 of the statutes are repealed.

NOTE: Ss. 201.32 to 201.37 are replaced by ch. 618. S. 201.39 is replaced only in part. No domestic reciprocals are authorized under ch. 611, but nondomestic reciprocals may be admitted under ch. 618. Ss. 201.41 and 201.42 are replaced by ch. 618.

S. 201.42 is an extremely important section, the substance of which has been retained although many changes have been made in its form. The importance of the section may make useful the following description of the way in which it has been dismembered and transferred to ch. 618 and elsewhere.

201.42 (1). The first sentence of this purpose clause is partly unnecessary because it is provided for by s. 262.05 (10); in part it is covered in ss. 601.71 to 601.73, and in part it is incorporated in s. 618.01 (1). The second sentence is covered by s. 262.05 (10). The remainder of sub. (1) contains purposes partly incorporated in s. 618.01 (1); beyond that it is an essay that is unnecessary except as a commentary on s. 618.01 (1), where it is inserted. It has no operative provisions.

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201.42 (2) (a). The venue provision is not necessary. Venue is adequately dealt with by s. 261.01 (5). The definitions of "insurer" and of "doing business" are in s. 600.03. The exception for salaried employes noted in s. 201.42 (2) (a) 6 is found in the same place.

201.42 (2) (b). Subd. 1 is dealt with by s. 618.41, subd. 2 by s. 610.11 (2) (a), subd. 3 by s. 618.45, subd. 4 by s. 618.42, and subd. 5 by s. 618.02 (3).

S. 201.42 (3) is dealt with by s. 610.11 (1), so far as it needs to be continued.

S. 201.42 (6) has become s. 618.47.

S. 201.42 (7) has become s. 618.48.

S. 201.42 (8) has become s. 618.44 and is slightly modified.

S. 201.42 (9) (a) has become s. 618.49.

S. 201.42 (10) has become s. 618.50.

S. 201.42 (11) and (12) have been much modified and have become s. 618.43, except for sub. (12) (b) which has become unnecessary.

S. 201.42 (15) is repealed. It gives special treatment to one insurance company organized to provide service for personnel of academic and other nonprofit institutions. However meritorious the performance of the one company may have been, there is justification for no more than exemption of that insurer's contracts from form regulation. That has been provided, somewhat broadened in scope, by s. 631.01 (4), which is contained in this draft.

SECTION 28. 201.61 and 201.62 of the statutes are repealed.

SECTION 29. 201.63 (1) to (3), (5) to (9), (11) to (13) and (15) to (18) of the statutes are repealed.

NOTE: S. 201.63 was the surplus lines law. It has been largely incorporated in ch. 618 with much alteration. Following is a description of the way it has been disposed of.

201.63 (1). So far as it is still necessary to describe them, the purposes provisions of sub. (1) have been incorporated in s. 618.01 (1). In large part it is an essay that does not need incorporation in the law since it has no operative provisions. It is inserted as a comment on s. 618.01 (1).

S. 201.63 (2), defining "surplus lines agent" and "surplus lines insurer" is omitted as unnecessary.

S. 201.63 (3) is partly incorporated in s. 618.41. Economic incentives (through taxation) related to the cost of surveillance have replaced the hard-to-enforce restrictions of s. 201.63 (3). These restrictions may be reinstituted under s. 618.41 (6) (b), however, if the commissioner concludes that they are needed.

S. 201.63(4) is replaced by s. 618.41 (7).

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S. 201.63 (5) is deleted as not justifiable and in any event difficult to enforce. The tax incentive related to regulatory costs is a better kind of control over surplus lines placement than the ascertainment of availability of a market. This change frees up the market where needed without putting authorized insurers at a disadvantage. The tax rates can be adjusted as necessary and as justified to achieve the necessary control. As indicated the former kind of control can be reinstituted under s. 618.41 (6) (b).

S. 201.63 (6) (a) is no longer needed because of the change in the approach to control; par. (b) is continued in s. 618.41 (10). Par. (c) is not necessary, since the commissioner may require the information under his general powers. Par. (d) is continued so far as necessary in s. 618.41 (10). Par. (e) is unnecessary.

S. 201.63 (7) has become s. 618.41 (9) (a).

S. 201.63 (8) has become s. 618.41 (8).

S. 201.63 (9) is covered by s. 618.44, but somewhat altered.

S. 201.63 (11) is unnecessary. It is covered by ss. 601.72 and 601.73 and should have been, but was inadvertently not, repealed by ch. 337, Laws of 1969.

S. 201.63 (12) is covered by s. 618.43, much modified.

S. 201.63 (13) is covered by s. 618.41 (3).

S. 201.63 (15) is to be handled by a rule.

S. 201.63 (16), (17) and (18) are repealed. They are unnecessary.

SECTION 30. 202.06 (6) of the statutes is amended to read:

202.06 (6) They may transact by direct insurance any or all of the kinds of insurance authorized by s. 201.04 (5), (10), (11) and (18), if such transactions are written in one policy and as a part of or supplemental to the standard town mutual policy and the obligations assumed or liabilities incurred in such transactions for multiple peril insurance are assumed or fully reinsured by another licensed insurer meeting the surplus requirements of s. 201.05 (2m) ss. 611.19 and 623.11 and the fact of such assumption of liability is stated in the policy or attached endorsement; provided that as a condition precedent to engaging in the writing of said kinds of insurance, the town mutual shall have a minimum surplus as regards policy holders policyholders of $50,000.

SECTION 31. 202.095 of the statutes is repealed.

SECTION 32. 203.03 of the statutes is repealed.

SECTION 33. 203.16 of the statutes is repealed.

SECTION 34. 203.29 to 203.31 of the statutes are repealed.

SECTION 35. 204.02 of the statutes is repealed.

SECTION 36. 204.041 of the statutes is repealed.

SECTION 37. 204.05 of the statutes is repealed.

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SECTION 38. 204.06 (2) of the statutes is repealed.

SECTION 39. 204.06 (3) and (4) of the statutes are renumbered 204.06 (2) and (3).

SECTION 40. 204.22 of the statutes is repealed.

SECTION 41. 204.24 and 204.25 of the statutes are repealed.

SECTION 42. 205.01 (3) of the statutes is repealed.

SECTION 43. 206.01 (5) of the statutes is repealed.

SECTION 44. 206.02 (1), (3) to (6) and (8) to (11) of the statutes are repealed.

SECTION 45. 206.22 of the statutes is amended to read:

206.22 Every life insurance company, organized under the laws of any foreign country, shall as one of the conditions of renewal of its license, maintain within the United States as trust deposits with public officials having supervision over insurers, or with trustees, public depositories, or trust institutions approved by the commissioner, assets available for discharge of its United States insurance obligations, which assets shall be in an amount not less than the outstanding reserves and other liabilities of the insurer arising out of its insurance transactions in the United States. ~~These trust deposits shall be in addition to the requirements of s. 201.32 (6) (a) relating to the deposits of corporations organized under the laws of foreign countries.~~

SECTION 46. 206.02 (2) of the statutes is repealed and recreated to read:

206.02 (2) CONDITIONS FOR DOING BUSINESS. No life insurer may do business in this state, nor may any person act as his agent in receiving or procuring applications for life insurance except as provided in s. 611.14 (2) (a), nor in any manner aid in transacting such business for any such corporation until it has first procured a license therefor from the commissioner and has paid the license fee required by s. 76.34 and the fees required by s. 601.31.

SECTION 47. 206.02 (7) of the statutes is renumbered 206.02 (1).

SECTION 48. 206.04 to 206.12 of the statutes are repealed.

SECTION 49. 206.14 to 206.16 of the statutes are repealed.

SECTION 50. 206.34 and 206.35 of the statutes are repealed.

SECTION 51. 206.38 of the statutes is repealed.

SECTION 52. 206.385 (1) to (7) of the statutes are repealed.

SECTION 53. 206.385 (8) to (10) of the statutes are renumbered 206.385 (1) to (3), and 206.385 (1), as renumbered, is amended to read:

206.385 (1) Any contract issued under ~~this section~~ s. 611.25 which provides for payment of benefits in variable amounts shall contain a statement of the essential features of the procedure to be followed by the company in determining the dollar amount of ~~such~~ the variable benefits and shall contain nonforfeiture provisions appropriate to such a contract in lieu of those under s. 206.181. Any ~~such~~ individual contract and any group certificate issued under ~~any~~

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~~such~~ a group contract shall state that ~~such~~ the dollar amount may decrease or increase and shall contain on its first page, in a prominent position, a statement that the benefits thereunder are on a variable basis. No person ~~shall~~ may sell ~~such~~ variable benefit contracts in this state except a licensed life insurance agent whose qualification to do so has been certified by the commissioner. The commissioner shall certify only those agents who pass a written examination prescribed by the commissioner.

SECTION 54. 206.386 of the statutes is repealed.

SECTION 54m. 206.62 of the statutes is repealed.

SECTION 55. 208.03 (5) of the statutes is amended to read:

208.03 (5) Sections ~~206.385, 206.386 and~~ 206.39 , 611.24 and 611.26 shall apply to fraternal benefit societies.

SECTION 56. 209.04 (9) (aa) of the statutes is amended to read:

209.04 (9) (aa) The certificate of registration or license of any agent who does any unauthorized act of an insurance business as set forth in s. ~~201.42 (2)~~ 618.02 (2) shall be suspended for a period of not less than 90 days and such agent shall not be permitted to do business until all liability for such violation is discharged. Whenever the commissioner receives notice of an unauthorized act of an insurance business he shall forthwith make an inspection of the books and records of such agent and upon his refusal to permit such inspection the commissioner shall revoke his license.

SECTION 57. 209.13 of the statutes is repealed.

SECTION 58. 219.01 (intro.) of the statutes is amended to read:

219.01 (title) **LOANS, ADVANCES OF CREDIT, INVESTMENT IN SECURITIES, INSURED OR GUARANTEED BY SPECIFIED AGENCIES.** (intro.) Credit unions, savings and loan associations, investment associations, state banks, savings banks, trust company banks, land mortgage associations, ~~insurance corporations, including life companies, and fraternal benefit societies,~~ executors, guardians, trustees, administrators, and other fiduciaries, except where it is contrary to the will or other instrument of trust, the state of Wisconsin and its agencies and its municipalities, districts, and other subdivisions, and all institutions and agencies thereof, and all other persons, associations, and corporations, subject to the laws of this state, are authorized:

SECTION 59. 219.05 (1) of the statutes is amended to read:

219.05 (1) The investment by any ~~title insurance company, stock fire insurance company, stock marine insurance company, stock fire and marine insurance company, stock casualty insurance company, stock life insurance company, domestic mutual casualty insurance company, mutual life insurance company, mutual fire insurance company,~~ credit unions; or the investment of funds of any ~~state insurance fund,~~ state sinking fund, state school fund, firemen's relief and pension fund, police pension fund, or other pension fund; or the investment by any savings and loan association; or by any federal savings and loan association; or by any administrative department, board, commissioner or officer of the state, authorized by law to make investments of funds in the custody or under the control of such department, board, commission or officer; or by any guardian, trustee or other fiduciary; or by any school district, drainage district, village, city, county or town, in savings accounts in savings and loan associations doing business in Wiscon-

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sin in an amount not exceeding the maximum insurance coverage of their accounts by the federal savings and loan insurance corporation as fixed by an act of congress; or in savings accounts in any other institution within or without the state, to the extent to which such accounts now are, or may hereafter be, insured by the federal savings and loan insurance corporation, under acts of congress of the United States now in effect or which may hereafter be enacted is lawful.

SECTION 60. 219.06 (1) and (2) of the statutes are amended to read:

219.06 (1) The state and all public officers, municipal corporations, political subdivisions, and public bodies, all banks, bankers, savings and loan associations, credit unions, trust companies, savings banks and institutions, investment companies ~~, insurance companies, insurance associations~~ and other persons carrying on a banking ~~or insurance~~ business, and all executors, administrators, guardians, trustees and other fiduciaries, may legally invest any sinking funds, moneys or other funds belonging to them or within their control in any bonds or other obligations issued by a housing authority created by or pursuant to the housing authorities law of this state or issued by any public housing authority or agency in the United States, when such bonds or other obligations are secured by a pledge of annual contributions to be paid by the United States government or any agency thereof or by the city or county in which operates the housing authority issuing such bonds or other obligations. Such bonds and other obligations shall be authorized security for all public deposits and shall be fully negotiable in this state.

(2) The purpose of this section is to authorize any of the foregoing to use any funds owned or controlled by them, including but not limited to sinking, ~~insurance,~~ investment, retirement, compensation, pension and trust funds, and funds held on deposit, for the purpose of any such bonds or other obligations.

SECTION 61. 219.07 of the statutes is amended to read:

219.07 All banks, trust companies, bankers, savings banks and institutions, building and loan associations, ~~saving~~ savings and loan associations, credit unions, investment companies, ~~insurance companies, insurance associations~~ and other persons carrying on a banking ~~or insurance~~ business, all executors, administrators, guardians, trustees and other fiduciaries, and the state and all public officers, municipal corporations, political subdivisions, and public bodies , except those under ch. 210, may legally invest any sinking funds, moneys, or other funds belonging to them or within their control in any bonds or other obligations issued by a redevelopment authority created by s. 66.431, or issued by any redevelopment authority or urban renewal agency in the United States, when such bonds or other obligations are secured by an agreement between the issuer and the federal government in which the issuer agrees to borrow from the federal government and the federal government agrees to lend to the issuer, prior to the maturity of such bonds or other obligations, moneys in an amount which (together with any other moneys irrevocably committed to the payment of principal and interest on such bonds or other obligations) will suffice to pay the principal of such bonds or other obligations with interest to maturity thereon, which moneys under the terms of said agreement are required to be used for the purpose of paying the principal of and the interest on such bonds or other obligations at their maturity. Such bonds and other obligations shall be authorized security for all public deposits. It is the purpose of this section to authorize any persons, political subdivisions and officers, public or private, to use any funds owned or controlled by them for the purchase of any such bonds or other obligations. Nothing contained in this section

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with regard to legal investments shall be construed as relieving any person of any duty of exercising reasonable care in selecting securities. This section shall apply notwithstanding any restrictions on investments contained in other provisions of the statutes.

NOTE on SECTIONS 58 to 61 of bill: These deletions do not change the law, but remove all investment laws for insurers from any chapter other than ch. 620.

SECTION 62. 551.22 (16) of the statutes is created to read:

551.22 (16) Contribution notes issued under s. 611.33 (2) (b), and any debt securities approved by the commissioner of insurance and issued under s. 611.75 (2) in connection with the conversion of a stock to a mutual corporation.

NOTE: These securities have little interest for the securities commissioner. They represent really a conversion of the shareholders' equity interest into a subordinated debt in connection with a conversion of the insurer. Further explanation will be found in the comment on s. 611.75.

SECTION 63. 551.27 (13) of the statutes is repealed and recreated to read:

551.27 (13) (a) Securities issued or guaranteed by an insurance, surety or other company supervised by the commissioner of insurance, or by a person whose business consists principally of owning or controlling the securities of any such company, may not be registered without the prior approval of the commissioner of insurance. Issuance of an organization permit under s. 611.13 constitutes such approval for the securities described in the permit, and also precludes application of s. 551.28 (1) (d) and (i).

(b) No issuer which is being organized in this state or elsewhere solely or partly for the purpose of organizing a corporation under ch. 611 may register or sell its securities in this state unless it obtains an organization permit under s. 611.13. No security may be registered or sold in this state if there is any representation that an insurer will be organized or purchased in this state with the proceeds of the sale, unless the issuer obtains an organization permit under s. 611.13.

NOTE: An explanation of this proposal will be found in the note under s. 611.31.

SECTION 64. Chapter 600 of the statutes is created to read:

CHAPTER 600.
GENERAL PROVISIONS.

600.01 SCOPE OF APPLICATION OF CODE. (1) GENERAL. Unless otherwise expressly provided, this code does not apply to:

(a) Reinsurance;

(b) Death and disability benefits provided by an organization the principal purpose of which is not to provide such benefits but charitable, educational, social or religious objectives not related thereto, if the organization does not incur a legal obligation to pay a specified amount;

(c) Group or blanket insurance covering risks in this state if:

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1. The policyholder exists primarily for purposes other than to procure insurance;

2. The policyholder is not a Wisconsin corporation or other resident and does not have its principal office in Wisconsin;

3. No more than 25% of the certificate holders or insureds are resident in this state;

4. On request of the commissioner, the insurer files with him a copy of the policy and a copy of each form of certificate; and

5. The insurer agrees to pay taxes on the Wisconsin portion of the business on the same basis it would do if authorized to do business in this state, and provides the commissioner with such security as he deems necessary for the payment of such taxes;

(d) Group or blanket insurance covering risks mainly outside this state if:

1. The policyholder exists primarily for purposes other than to procure insurance;

2. The policyholder is not a Wisconsin corporation or other resident and does not have its principal office in Wisconsin; and

3. Any Wisconsin residents insured under the policy are covered because their principal place of employment is outside the state.

(e) Other business specified in rules promulgated by the commissioner if the transaction of such business in this state does not require regulation for the protection of the interests of Wisconsin insureds or public or for which it would be impracticable to require compliance with this code, when necessary expenses and efforts are compared with the possible benefits.

(f) Transactions independently procured through negotiations under s. 618.42, except as they are subject to taxation under s. 618.43.

(2) EXCEPTIONS. After a hearing, the commissioner may order an insurer to transfer the Wisconsin portion of the business under sub. (1) (c) or (d) to an authorized insurer if it is written by an unauthorized one, or may subject any insurance under sub. (1) to this code, if he finds that the foregoing conditions are not satisfied or that any circumstances require that the insurer be authorized to do business in this state or that the transactions be subject to this code in order to provide adequate protection to Wisconsin insureds and public. Coverage of a resident of this state is the doing of an insurance business in this state and subjects the insurer to the jurisdiction of the commissioner and of the courts of this state.

NOTE: Certain transactions should be free from insurance regulation in general, though certain specific provisions may be made applicable to them. Sub. (1) lists those transactions.

Sub. (1) (a) exempts reinsurance. This does not mean that reinsurance is totally free from control, as many specific provisions will show, but in general the arms-length relationships of insurance companies do not require control.

Sub. (1) (b) exempts certain social activities that look like insurance but do not need regulation because they

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do not purport to create legal relationships. It would apply, e.g., to religious or fraternal societies under chs. 187 and 188, if in addition to their regular activities they provide death (burial) benefits to their members without incurring any legal obligation to do so. The decision whether the organization is dominated by the insurance business or by the other purposes and activities may sometimes be difficult, but legal obligation constitutes a relatively simple test. It is impossible to draw the line once and for all by statutory standards of the kind employed in s. 208.03 (1), since they are not meaningful in relation to the purposes for which regulation is instituted.

Sub. (1) (c) makes it legitimate to write group or blanket insurance covering some Wisconsin insureds without a certificate of authority and without regulation of the contract.

Sub. (1) (d) excludes from coverage under the code group or blanket contracts written on foreign policyholders some of whose employes are resident in but are employed outside the state. Both pars. (c) and (d) will be refined in connection with chs. 631 and 632 of this code.

Sub. (1) (e) should be used, inter alia, to expand the exemptions contained in subs. (1) (c) and (d), where regulation seems unnecessary or inappropriate in situations not now foreseen.

Sub. (1) (f) exempts independently procured insurance from regulation but not from taxation.

Sub. (2) will make it possible for the commissioner to find that circumstances exist that require Wisconsin regulation for the protection of Wisconsin group or blanket insureds. Such circumstances might include domicile in a jurisdiction without effective regulation, or a concern for the solidity of the insurer, wherever domiciled. There have not been many but there have been a few insolvencies of life insurers and there have been many more mergers or bulk reinsurance transactions involving life insurers too weak to be trusted with the protection of Wisconsin insureds. This provision is an effort to balance the desirability of permitting insurers not authorized in all states to compete for nation-wide group business on the one side, and on the other the need not to abandon Wisconsin residents to the tender mercies of inadequate foreign insurers, of which there are many.

600.02 INTERPRETIVE RULES. In this code, unless the context indicates otherwise:

(1) "Includes" means "including but not limited to".

(2) Statements that a term "includes" or "excludes" something else are not definitions.

(3) References in s. 600.03 to particular sections only indicate where a term is especially relevant, and do not limit its application to such sections.

600.03 DEFINITIONS, USAGES, SYNONYMS AND ABBREVIATIONS. In this code, unless the context indicates otherwise:

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(1) "Affiliate" of a person means any other person who controls, is controlled by, or is under common control with, the first person. A corporation is an affiliate of another corporation, regardless of ownership, if substantially the same group of persons manage the 2 corporations.

(2) "Alien insurer" means an insurer domiciled outside the United States. See also "nondomestic insurer". Compare "foreign insurer".

(3) "Articles" is synonymous with "articles of incorporation", which includes the original articles or special law or charter corresponding thereto, and all amendments, and includes restated articles. See also "bylaws". See s. 611.12.

(5) "Board" is synonymous with "board of trustees" and "board of directors", and means the group of persons vested with the management of a corporation, by whatever name designated.

(6) "Business plan" means the aggregate of the information that would have to be supplied to the commissioner under s. 611.13 (2) (j) and (k) if the corporation were seeking to organize under ch. 611.

(7) "Bylaws" means the rules, other than articles, adopted for the regulation or management of a corporation's affairs, by whatever name designated. See also "articles". See s. 611.12.

(8) (a) "Minimum capital" is the capital that a stock insurance corporation is required by statute or administrative determination to have and constantly to maintain. See s. 611.19.

(9) "Certificate of authority" is synonymous with "license".

NOTE: Sections dealing with insurers use "certificate of authority", while "license" is used for agents and other persons subject to insurance regulation. The two terms are interchangeable, however.

(10) "This code" or "the insurance code" means chs. 200 to 212 and 600 to 649.

(11) "Commissioner" means the "commissioner of insurance" of this state, or the equivalent supervisory official of another jurisdiction.

(12) "Consultant" means a person who gives advice about insurance without acting either as agent or broker, who does not sell or place insurance and who does not get any direct or indirect compensation from an insurer, insurance agent or broker for advice given to a 3rd person.

(13) "Control" means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, by common management or otherwise. A person having a contract or arrangement giving him control is deemed to be in control despite any limitations placed by law on the validity of the contract or arrangement. There is a rebuttable presumption of control if a person directly or indirectly owns, holds with the power to vote or hold proxies to vote more than 10% of the voting securities of another person, except that no person shall be presumed to control another person solely by reason of holding an official position with that person. "Control" has the same meaning in the terms "controlling", "controlled by" and "under common control with". See also "affiliate".

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(14) (a) "Corporation" means "insurance corporation".

(b) "Stock corporation" means "stock insurance corporation".

(c) "Mutual" means "mutual insurance corporation".

(15) "Creditor" means a person having any claim, whether matured or unmatured, liquidated or unliquidated, secured or unsecured, absolute, fixed or contingent.

(16) "Director" is synonymous with "trustee".

(17) "Domestic insurer" means an insurer organized under the laws of this state.

(18) "Domiciliary state". See under "state".

(19) "Foreign country" means territory not in any state.

(20) "Foreign insurer" means an insurer domiciled in another state. See also "nondomestic insurer". Compare "alien insurer".

(21) "Form" means a policy or application prepared for general use and does not include one specially prepared for use in an individual case. See also "policy".

(23) "Independently procured insurance" means insurance procured under s. 618.42.

(24) "Insolvency" means:

(a) For an insurer organized under ch. 202, the inability to pay any loss within 30 days after the due date specified in the first assessment notice issued under s. 202.11 after the date of the loss, or any other uncontested debt as it becomes due.

(b) For any other insurer, that it is unable to pay its debts or meet its obligations as they mature or that its assets do not exceed its liabilities plus the greater of: 1) any capital and surplus required by law to be constantly maintained; or 2) its authorized and issued capital stock. For purposes of this paragraph "assets" includes one-half of the maximum total assessment liability of the policyholders of the insurer, and "liabilities" includes reserves required by law. For policies issued on the basis of unlimited assessment liability, the maximum total liability, for purposes of determining solvency only, is the amount that could be obtained if there were 100% collection of an assessment at the rate of 10 mills.

(25) "Insurance" includes:

(a) Risk distributing arrangements providing for compensation of damages or loss through the provision of services or benefits in kind rather than indemnity in money;

(b) Contracts of guaranty or suretyship entered into by the guarantor or surety as a business and not as merely incidental to a business transaction.

(26) "Insured" means any person to whom or for whose benefit an insurer makes a promise in an insurance policy. The term includes policyholders, subscribers, members and beneficiaries. This definition applies only to chs. 600 to 649 and does not apply to the use of the word in insurance policies.

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(27) (a) "Insurer" means any person or association of persons doing an insurance business as a principal, and includes fraternal benefit societies, donor annuity societies, title guaranty corporations, cooperative associations organized under s. 185.981, 1969 stats., and voluntary benefit plans organized under s. 185.991, 1969 stats. It also includes any person purporting or intending to do an insurance business as a principal on his own account.

(b) "Alien insurer" means an insurer domiciled outside the United States.

(c) "Domestic insurer" means an insurer organized under the laws of this state.

(d) "Foreign insurer" means an insurer domiciled in another state.

(e) "Nondomestic insurer" means a foreign or alien insurer.

(f) "Unauthorized insurer" means any insurer not holding a valid certificate of authority to do an insurance business in this state, and any insurer holding a valid certificate, with respect to business not authorized by the certificate. "Unauthorized insurer" includes a surplus lines insurer.

(28) "Interest of the insured" when used in an insurance policy includes the interest of the named insured and of his spouse whenever the property insured is owned in joint tenancy.

(29) "Member" means a person having membership rights in a corporation. Any person may be a member of a corporation unless the law specifically provides otherwise. See also "insured".

(30) "Minimum capital" is the capital that a stock insurance corporation is required by statute or administrative determination to have and constantly to maintain. See s. 611.19.

(31) "Mutual" means "mutual insurance corporation".

(32) "Nondomestic insurer" means a foreign or alien insurer. Compare "domestic insurer".

(33) "Nonprofit service plan" means any organization authorized under s. 148.03 (medical service plans), 182.032 (hospital service plans), 447.13 (dental care plans), 449.15 (optometric service plans), 450.13 (pharmaceutical prescription plans) or similar organizations authorized under the laws of other states.

(34) "Office" means "office of the insurance commissioner" of this state.

(35) (a) "Principal officers" of a corporation means the officers designated under s. 611.12 (3) or corresponding sections of other chapters.

(37) "Policyholder" means the person who owns or otherwise controls the policy by ownership, payment of premiums or otherwise. See also "insured".

(38) "Premium" means any consideration for an insurance policy, and includes assessments, membership fees or other required contributions or consideration, however designated.

(39) "Proceedings" includes "actions" and "special proceedings" under ss. 260.02 and 260.03.

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(40) "Principal officers" of a corporation mean the officers designated under s. 611.12 (3), or corresponding sections of other chapters.

(41) "Reciprocal" means any unincorporated association of persons, operating through an attorney in fact and exchanging insurance contracts with one another, which provide insurance coverage to each other thereunder.

(42) (a) "State" means the same as in s. 990.01 (40) and in this code also includes the Panama Canal Zone.

(b) "Domiciliary state" means, except in ch. 645, the state in which an insurer is incorporated or organized or, in the case of an alien insurer, the state through which the insurer has made its entry into the United States.

NOTE on (b): This definition is related to that in s. 645.03 (7) but has a somewhat more restricted meaning for alien insurers than in that chapter.

(43) "Stock corporation" means "stock insurance corporation".

(44) (a) "Subsidiary" of a person means a stock corporation more than one-half the voting shares of which are owned by the person either alone or with its affiliates.

(b) "Wholly owned subsidiary" of a person is a subsidiary all of the voting shares of which are owned by the person either alone or with its affiliates, except for the minimum number of shares required by the law of the subsidiary's domicile to be owned by directors or others.

(45) (a) "Surplus" means the excess of assets over the sum of capital and liabilities.

(b) "Compulsory surplus" is the amount of assets in excess of liabilities an insurer is required to have under s. 623.11.

(c) "Initial surplus" is the sum of minimum permanent surplus and initial expendable surplus.

(d) "Initial expendable surplus" is the amount of surplus in addition to capital or minimum permanent surplus or both that an insurer obtains in its organizational process in accordance with s. 611.19 and is not required to maintain thereafter.

(e) "Minimum permanent surplus" is the surplus that an insurance corporation is required by statute or administrative determination to have and constantly to maintain in accordance with s. 611.19.

(f) "Security surplus" is the amount of assets in excess of liabilities needed by a particular insurer to satisfy s. 623.12.

(46) "Town mutual" means "town mutual insurance corporation".

(47) "Trustee" is synonymous with "director".

(48) "Unauthorized insurer". See sub. (27) (f).

600.12 CONSTRUCTION. Unless otherwise provided, chs. 600 to 649 shall be liberally construed to achieve the purposes stated therein. Unless expressly provided otherwise or clearly appearing from the context the purposes stated shall constitute an aid and guide to interpretation but not an independent source of power.

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NOTE: This replaces numerous provisions in particular chapters to the same effect.

600.13 ORDERS RELAXING RESTRICTIONS. (1) ISSUANCE. After notice under sub. (2) and a hearing, the commissioner may issue an order freeing a person from any requirement of this code otherwise applicable to him if the commissioner finds that the interests of insureds, creditors and the public will not be endangered thereby.

(2) PUBLICATION. Unless the order is issued under specific authorization of another section of this code, the notice preceding the hearing under sub. (1) and any such order shall be published as a class 1 notice, under ch. 985, in the official state newspaper before it is effective.

NOTE: The commissioner should have a generally formulated dispensing power from the requirements of the insurance laws, but should not, in general, be able to exercise it without public notice.

SECTION 65. 601.01 (title) of the statutes is amended to read:

601.01 (title) **TITLE AND PURPOSES.**

SECTION 66. 601.02 (2) and (4) to (11) of the statutes are repealed.

NOTE: Sub. (2) is made unnecessary by ch. 625. The remaining definitions are replaced by s. 600.03.

SECTION 67. 601.31 (1) (a) to (h), (2) (a) to (f), (3), (5), (7) and (15) (c) of the statutes are repealed and recreated to read:

601.31 (1) (a) Domestic and nondomestic insurers, $100;

(b) Rate service organizations, $100;

(c) Motor clubs, $100; and

(d) Insurance premium finance companies, $400.

(2) (a) Domestic and nondomestic insurers, $100;

(b) Rate service organizations, $100; and

(c) Motor clubs, $100.

(3) Annually for continuation of certificate of authority:

(a) Domestic and nondomestic insurers, $25;

(b) Rate service organizations, $100; and

(c) Motor clubs, $25.

(5) For filing a copy of amendments to the articles of a nondomestic insurer, $10. If the amendment is filed more than 60 days after it has become effective in its domiciliary state, the corporation shall pay to the commissioner a penalty of $25.

(7) For filing a copy of articles of merger of a nondomestic insurer, other than with a domestic corporation, $10.

(15) (c) Agents authorized to place business under s. 618.41, $100.

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SECTION 68. 601.31 (10) and (11) of the statutes are amended to read:

601.31 (10) For filing an application for withdrawal and final report of a ~~foreign or alien insurance company~~ nondomestic insurer, $25.

(11) For filing an application by a ~~foreign or alien insurance company~~ nondomestic insurer for amended certificate of authority to transact business in this state, $5.

SECTION 69. 601.64 (5) of the statutes is amended to read:

601.64 (5) Whenever a licensee of the office other than a ~~domestic~~ an insurer persistently or substantially violates the insurance law or an order of the commissioner under s. 601.41 (4), ~~or if there are grounds for delinquency proceedings against him under ch. 645,~~ or if the licensee's methods and practices in the conduct of his business endanger, or his financial resources are inadequate to safeguard, the legitimate intersts of his customers and the public, the commissioner may, after a hearing, in whole or in part revoke, suspend, limit or refuse to renew the license ~~or certificate of authority~~.

NOTE: The amendment removes nondomestic insurers from the purview of this section. Revocation of a nondomestic insurer's license is now governed by s. 618.37.

SECTION 70. 601.72 (1) (b) and (c) of the statutes are repealed and recreated to read:

601.72 (1) (b) For all insurers as to any proceeding arising out of any contract that is permitted by s. 618.41, or out of any certificate, cover note or other confirmation of such insurance; and

(c) For all unauthorized insurers or other persons doing an unauthorized insurance business in this state as to any proceeding arising out of the unauthorized transaction.

SECTION 71. Chapter 610 of the statutes is created to read:

CHAPTER 610.
INSURERS IN GENERAL.

610.001 PURPOSES. The purposes of chs. 611 to 614 are:

(1) To provide an orderly procedure by which insurers may be created, governed and dissolved;

(2) To provide for procedures to merge, consolidate or convert various kinds of insurers;

(3) To provide for structure and management that will maximize democratic participation in the operation of insurers; and

(4) To prevent or control self-dealing by management in order to protect the interests of shareholders, policyholders, members, subscribers and the public.

PREFATORY NOTE: The following definitions have special relevance for the provisions concerning the corporate affairs of insurance corporations, as contained in chs. 610 to 620. Any that have even broader application and are used consistently in other contexts are in s. 600.03, which contains the definitions for terms to be

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used with the same meaning throughout the entire insurance law.

610.01 DEFINITIONS. In chs. 610 to 620, unless the context requires otherwise:

(1) "Officer" does not include "director".

(2) "Director" includes "trustee".

(3) "Promoter stock" means shares issued by a domestic stock corporation under ss. 611.18 (2) (a) 2 and 611.32 (1), and shares issued within 5 years after the initial issuance of the certificate of authority, to incorporators, directors, principal officers, members of the families of any of these persons, and to any corporations controlled by, or any trustee acting in behalf of, any of these persons.

NOTE: Sub. (1) is necessary to avoid the consequences of s. 990.01 (25) which defines "officer" to include "director". In these chapters on insurance corporations, officers and directors must be distinguished and treated separately.

In sub. (3), stock "issued" of course does not include stock transferred from another person to a promoter; that is clear from the usage of "issued" in s. 180.02 (7) and (8), which are part of ch. 611 by virtue of s. 611.01 (1).

It has not seemed necessary to define "capital stock", "mutual bond" or "contribution note" which seem clear enough from s. 611.33, nor "stock" or "mutual" corporation which are defined by the whole of ch. 611.

610.11 QUALIFIED INSURERS. No person may do an insurance business as defined in s. 618.02 (2) on his own account in this state, either in person, or through agents or brokers, or through the mail or any other method of communication, except:

(1) An insurer authorized to do business in this state, within the limits of its certificate of authority; or

(2) An insurer doing business under s. 618.41.

NOTE: Regulated insurance must be done by authorized insurers or under s. 618.41. Insurance done under s. 618.42 is not done in this state and thus is not regulated at all (though it is taxed). See s. 600.01 (1) (f).

610.21 OTHER BUSINESS. (1) PROHIBITION FOR DOMESTIC INSURERS. No domestic insurer may engage, directly or indirectly, in any business other than insurance and business reasonably incidental to its insurance business, except as specifically authorized by s. 611.26 (4) or any other statute of this state.

(2) PROHIBITION FOR NONDOMESTIC INSURERS. No nondomestic insurer may engage in this state in any business forbidden to a domestic insurer, nor may the insurer engage in such business elsewhere if:

(a) The law of the insurer's domicile forbids an insurer to engage in such business; or

(b) The statutes of this state specifically prohibit a nondomestic insurer to engage in such business elsewhere; or

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(c) The commissioner orders it to cease doing such business upon finding that doing such business is not consistent with the interests of its insureds, creditors or the public in this state; or that it gives the insurer a substantial competitive advantage in relation to domestic insurers.

(3) INCIDENTAL BUSINESS. "Incidental business" includes:

(a) The business of preparing and selling abstracts of title and related documents, if done by an insurer authorized to transact title insurance;

(b) Business that could be done through ancillary subsidiaries authorized under s. 611.26 (3), or, in the case of a nondomestic insurer, through corporations that would be so authorized if the insurer were domestic.

NOTE: This section implements the general idea that, because of the importance of solidity, the insurance business should not be mixed with other unrelated business activities. The idea is expressed in ss. 201.04, 201.24 (1) and 201.34 (4). The restriction is qualified by the freedom allowed under s. 611.26 (4) to own subsidiaries in unrelated businesses within the limits imposed by s. 620.22 (8).

Sub. (3) (a) continues s. 201.04 (8).

610.41 TRANSITION PROVISIONS FOR DOMESTIC INSURANCE CORPORATIONS UNDER CHAPTER 611. (1) EFFECTIVE DATE OF CH. 611. Except as otherwise provided in subs. (2) and (3), ch. 611 applies to domestic stock and mutual insurance corporations on the day after its publication (1971).

(2) EXISTING STOCK AND MUTUAL INSURANCE CORPORATIONS. (a) Continuance of authorization. A domestic stock or mutual insurance corporation holding a valid certificate of authority on the effective date of ch. 611 (1971) continues to be authorized within the limits of its certificate of authority, subject to par. (c).

(b) Inapplicable provisions. Except under par. (c), ss. 611.11 to 611.22 and 611.32 do not apply to existing stock and mutual insurance corporations. Sections 611.31 (1) to (3) and 611.33 do not apply to securities already issued.

(c) Delayed effect. Sections 611.12 (1) (c), (2) (c) to (e), (3) and (4), 611.42, 611.51 to 611.53, 611.56 and 611.57 become applicable 2 years after the effective date of ch. 611 (1971). Any existing stock or mutual insurance corporation may elect to comply with such provisions at an earlier date. The requirement of s. 611.51 (3) is not applicable until 4 years after the effective date of ch. 611 (1971), if the corporation classifies directors. So far as such provisions are not yet applicable, the corresponding provisions of the law applicable to that corporation prior to the effective date of ch. 611 (1971) continue to apply.

(d) Date of issuance Whenever a provision refers to the date of the initial issuance of the certificate of authority, that date is the date of issuance of the original certificate of authority under prior law for any corporations holding a valid certificate of authority on the effective date of ch. 611 (1971).

(e) Extension of business. If an existing stock or mutual insurance corporation wishes to extend its business beyond the limits of its certificate of authority in effect as of the effective

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date of ch. 611 (1971), it shall apply for a new certificate of authority which shall be issued upon substantial compliance with the procedural and substantive requirements of s. 611.20.

(3) EXTENSION OF ADJUSTMENT PERIOD. If timely adjustment to the requirements of ch. 611 would cause an existing stock or mutual insurance corporation hardship, disproportionate expense or serious inconvenience, the commissioner may, upon the corporation's request, grant an additional delay for compliance with specified requirements if the interests of insureds and of the public are not endangered, but in no case for more than 2 years beyond the effective dates otherwise applicable.

NOTE: This section provides the necessary transitional provisions for making ch. 611 effective.

610.42 TRANSITION PROVISIONS FOR CORPORATIONS NOW IN THE PROCESS OF ORGANIZING. Corporations in the process of organization on the effective date of ch. 611 (1971) that do not obtain a certificate of authority within one year after the effective date generally applicable to ch. 611 (1971), as specified in s. 610.41 (1), shall make appropriate refunds and reimbursements to subscribers, incorporators and creditors in accordance with a plan approved by the insurance commissioner, which shall also specify the date upon which the legal existence of the corporation shall terminate.

NOTE: This section is new. It is designed to fix a cutoff date for corporations which have not yet obtained a certificate of authority. Under present law, such inchoate corporations may remain in a state of limbo indefinitely.

610.45 TRANSITION PROVISIONS FOR NONDOMESTIC INSURERS. Except as otherwise provided, ch. 618 applies on the day after its publication (1971).

NOTE: The starting assumption is that the dates on which particular provisions of the new law should be made effective is the same for nondomestic as for domestic insurers. Any special treatment for the former should be specifically justified for each provision.

610.47 TRANSITION PROVISIONS FOR MISCELLANEOUS UNINCORPORATED INSURERS. Except for nonprofit service plans under s. 200.26 or associations under ss. 185.981 and 185.991, and except as otherwise provided in this code, all unincorporated domestic insurance associations, societies or organizations shall be reorganized as corporations under ch. 202, 208 or 611 before January 1, 1973, or the commissioner shall thereupon petition for and the court shall forthwith issue an order for liquidation under s. 645.31 on the ground of failure to incorporate as here required.

NOTE: Any miscellaneous insurers that may exist, if there are any, should be required to convert to corporations under the appropriate authorizing provisions within the reasonable time specified in this section, or they should be liquidated forthwith. There is sufficient flexibility under ch. 645 to authorize the commissioner in his capacity as receiver to rehabilitate by reorganizing if that seems appropriate, or to reinsure fully if he can find another insurer willing to assume the burdens. The possibility of essentially unregulated unincorporated insurers is distressing to contemplate, though it is certainly no major social problem. But the total insurance market should be under the surveillance of the commissioner.

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610.51 SPECIAL CHARTER CORPORATIONS. Any insurance corporation organized under any special law is subject to all the provisions applicable to like corporations organized under the general law. Prior to January 1, 1973, the board, without approval by the shareholders or policyholders, may adopt articles of incorporation restating the charter, as amended, which conform to the general law. Such restated articles shall be filed with the commissioner promptly upon adoption and may be disapproved by him if changes are made from the charter that are not necessary or appropriate to make the articles conform to the general law.

NOTE: This section brings all specially chartered corporations under the general law. There is no question of the legislature's power to enact such a provision. See Wisconsin Constitution Art. XI, Sec. 1, which has been continuously in effect, without change, since the Constitution of 1849. No existing domestic insurance corporation, so far as can be determined, antedates the provision.

The remainder of the section after the first sentence is intended to facilitate and encourage quick adaptation of the charters to the new law, with the minimum of burden upon the companies affected, but also without more than the necessary changes. Any other changes should be made under ordinary procedures.

This section would apply to fraternal benefit societies. However, it does not apply to fraternals the provisions of ch. 611 but the provisions of ch. 208. This follows from the word "like" in the first sentence.

SECTION 72. Chapter 611 of the statutes is created to read:

CHAPTER 611.
DOMESTIC STOCK AND MUTUAL INSURANCE CORPORATIONS.

PREFATORY NOTE: Relation to General Corporation Law. This bill recognizes the fact that both stock and mutual insurance corporations are first corporations, and second, insurance companies, distinguished from other corporations by their particular business purpose. They should be subject to general corporation law, except to the extent that the public interest in insurance, the special needs of their insureds for protection, and the special nature of an insurance enterprise require variations from general corporation law. This has always been true and most of the variations from chs. 180 and 181 found in this bill merely continue the existing pattern. But these interests and needs led to several changes in existing statutes to strengthen the protection accorded insureds in particular and the public in general. They are not fundamentally new departures, though they are important. The considerations in support of specific changes are discussed in the comments to particular sections. It may be helpful here, however, to summarize and perhaps tie together the basic pattern of the various proposals for change.

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Organization.

The provisions concerning the organization of both stock and mutual corporations sharpen and refine the existing procedures for organizing insurers. Their purpose is to give the commissioner control over the organizational process from beginning to end (ss. 611.11 to 611.22) without burdening him with unmanageable tasks and without imposing pointless burdens on organizers. The provisions also introduce control over the issuance of stock to insiders (s. 611.32), and emphasize control over the capital structure of a new company, an important aspect of insurance regulation (ss. 611.31 to 611.35).

The basic assumption of the rules on organization is that only those businessmen should be permitted to organize an insurance company who have or can command expertise in the field, who are of good character and who are able and willing to make a substantial and long-term investment in the business. The interests of the insureds, of other members of the public who may eventually be claimants, and of the investing public, require that the unscrupulous, the amateurs, the speculators, the manipulators interested in quick stock profits not be allowed to organize insurance corporations. This business is too complex and the risk to others is too great to permit the unscrupulous or the inexperienced to operate. On the other hand, the requirements must not be so stringent as to prevent entry of new insurers into the market, prevent needed market capacity from developing, or hinder competition.

This chapter reflects the effort to balance these considerations, with heavy emphasis on the interests of the public and insureds but with an eye to the desirability of reasonably free entry into the business. The detailed requirements will assist bona fide promoters by forcing them to anticipate and prepare for the organizational and operational difficulties confronting a new insurance venture. But they should also serve to deter the inexperienced and the mere stock promoter and make their entry into Wisconsin unattractive.

Sections on subsidiaries (s. 611.26) and segregated asset accounts (ss. 611.24 and 611.25) deal with the structural or organizational aspects of those subjects. They have other dimensions as well, to be dealt with in other chapters. Thus each has some special investment characteristics, to be dealt with in ch. 620.

Section 611.19 provides for the specification of initial capital and surplus requirements, which is a vitally important aspect of the organizational process.

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Management.

The initial assumption about management is that the nature of the industry and the interests of the public make it desirable for the business to be in charge of large boards of directors not dominated by management or persons affiliated with management (s. 611.51). Consistent with the outsider control and large board requirement, cumulative voting for directors is proposed to give minority stock interests an opportunity to be represented (s. 611.52) and contracts in which directors are adversely interested are subjected to full independent scrutiny (s. 611.60).

In controlling potential abuses, conflict of interest provisions loom large (ss. 611.60 and 611.61). Some degree of continuing supervision of the selection of management personnel of an insurer is also provided (s. 611.54). These restrictions seek to prevent abuses, but with a minimum of restraint on legitimate enterprise, particularly after it has matured.

Sections 611.66 and 611.67 provide an approach to the question of abdication of managerial responsibility in insurance corporations. No management should be able to achieve permanent control of an enterprise against the wishes of its owners. The Gordon Sinykin and Shirley S. Abrahamson Report on Study of Management Contracts of Wisconsin Insurance Corporations (1965), p. 58, found that a principal purpose of such contracts was to enable management to perpetuate itself. The view of the Insurance Laws Revision Committee is that management contracts are too susceptible to abuse to be permitted even with close regulatory scrutiny. Consequently these contracts are prohibited in any form. Exclusive agency agreements come in for similar treatment for essentially the same reasons.

Changes in Corporate Structure.

In connection with changes in the organization of the corporation or its capital structure, mergers and consolidations (ss. 611.72 and 611.73), voluntary dissolution of solvent corporations (s. 611.74), dividends (s. 611.69), repurchase of shares (s. 611.34) and reduction of capital (s. 611.35) the code gives insurance corporations essentially the same rights as industrial corporations under chs. 180 and 181, subject to an explicit reporting requirement in some instances, so that the commissioner may ascertain in advance whether the proposed transaction fully complies with the law or endangers insureds. Reporting requirements are not in themselves an independent source of regulatory power, however. A requirement of prior approval is not to be inferred unless it is specifically provided, as it is in some cases. Instead, the requirements give the commissioner the information he needs to regulate under other provisions of the statutes. Within the statutory limits of chs. 180 and 181, of these sections, and of the restrictions to be imposed in the part of the insurance code concerning permitted investments and required reserves, the owners of insurance corporations have the right to make management decisions in accordance with their best business judgment and proprietary interest, like any other owner of a business. In reality, of course, the decisions are usually made by management rather than by the "owners".

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Problems of Control.

The absence of shareholders creates special corporate problems for the mutuals, which are not solved merely by calling the policyholders "owners". These problems, in lesser degree, are shared with stock corporations. The mere existence of shareholders does not create anything resembling corporate "democracy". In a widely held stock corporation, shareholder control is only in degree less illusory than policyholder control of a large mutual.

For neither mutuals nor stock corporations does existing corporate machinery create entirely satisfactory procedures for lodging meaningful control in policyholders or shareholders, or for making management "responsible" to someone else. The "management revolution" of which Burnham spoke long ago, the separation of "ownership" from "control" which Berle and Means (and others) have described, has transformed the corporate world to a point where the old cliches and platitudes cannot be taken seriously. With large, widely held corporations, we are no longer dealing with owners running their own businesses, but with complex and sometimes enormous independent political bureaucracies periodically going through rituals called "annual meetings", which have only the slightest relationship to the realities of power in the stucture. This is true for both mutuals and stock corporations, and for insurance as well as for all other branches of business enterprise.

For stock corporations, the bill proposes few fundamental changes - the problem of making power responsible is little different than for widely held corporations in other industries. Only when special insurance considerations appear to be present are changes suggested. In dealing with mutual corporations, however, the arguments based on consistency with general corporation law have less weight, and the inadequacy of control by "owners" is more apparent. Where policyholder control is a realistic possibility it should be encouraged; where it is not there should be recognition of that fact and no reliance should be placed upon it, even if the facade is left undisturbed. The commissioner must be the ultimate protector of the policyholder and of the public, equally for mutual and for stock corporations. His duty should be clearly formulated, the more so since probably nothing meaningful can take his place in the regulation of management.

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Special Problems of Mutuals.

Mutual insurance corporations are very important in insurance. Some are numbered among the largest single corporations, both in the life and in the fire-casualty field, and in the aggregate they serve an important share of the insurance market. As we ordinarily think of them, mutuals are commercial insurance corporations, serving a free-enterprise economy, and hardly to be distinguished from stock corporations in their day-to-day business practices. Some mutuals exist to meet specialized market needs, usually with a very limited group of customers, but occasionally as large special-purpose organizations. Others are outside what we tend to think of as the "marketplace"; they provide a mechanism for "mutual aid" among members. Mutual insurance organizations have much greater variety than do stock companies. In addition to the "ordinary" or commercial mutual insurance corporations dealt with in chs. 201 and 206, there are the town mutuals of ch. 202, the fraternal benefit societies of ch. 208, the non-profit service corporations of s. 200.26 and the reciprocals or inter-insurance exchanges of s. 201.39. The latter are mutual but no corporate. Each kind has been provided by the unique historical circumstances surrounding its emergence with an independent set of statutory provisions governing its formation and management.

This law deals only with the "commercial" mutuals, operating as ordinary business corporations in the main stream of the American economy. The mutuals that have historically been treated separately will receive separate consideration later.

Origins of mutuals.

Mutual insurance developed quite independently of entrepreneurial insurance. The latter - now mainly represented by stock corporations - has its roots in capitalism - it is free enterprise offering services for a chance at a profit and at risk of a loss. On the other hand, mutual insurance is precapitalist in origin though now fully and effectively adapted to a modern market economy. Modern mutual life insurance can claim as an ancestor the guild of the middle ages which, as a supplement to its main purpose, sometimes established techniques for the support of members in case of disaster. In course of time, the compensation schemes became independent, the connection with the guild structure almost completely disappeared and is now discernible only in the fraternal benefit societies. However muted in most respects, there is historically something distinctive in the "mutual idea", and some different rules appropriately result from that fact. The true mutual idea should be fostered and encouraged, where it is feasible to get substantial member involvement in governance of the corporation.

Historical facts may not be determinative of the way a statute should be drafted for the needs of today's society, but it is relevant that the mutual enterprise historically is different from entrepreneurial insurance. It was not originally designed, as it has occasionally been used lately, as a way to transact an insurance business for a profit without meeting the initial capital requirements prescribed for stock corpora-

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tions. Despite some recent illustrations of such use as another convenient vehicle for the exploitation of a market to the profit of its organizers and managers, it does not seem justifiable for it to be so used. It is justified as a separate form of enterprise only if some of the original meaning of "mutuality" can be preserved - only if it is in reality as well as in theory a non-profit and cooperative venture to serve its policyholders, rather than to make a profit for someone else.

Nature of the policyholder's interest in mutuals.

The best way to describe the practical difference between a stock corporation and a mutual is a negative one: it is the absence in the mutual of stockholders who have invested their money in the enterprise in the expectation of getting profitable returns on their investment.

It would be wrong to conclude, however, as is so often concluded, that in the absence of shareholders the policyholders are the "owners" of the corporation, if "owner" is used with its usual connotation. For instance, there is no market where the policyholder can sell his ownership interest. Unlike a shareholder, he does not ordinarily invest money in the enterprise for profit; he only buys "insurance", intending to pay his fair share of the cost of risk spreading, in no way essentially different from the way a policyholder in a stock corporation pays his premium. He is especially like a participating policyholder in a stock corporation, and a little like the holder of a variable annuity. No sharp lines are possible - there is a continuum from shareholder through variable annuity holder, through participating policyholders of various kinds to nonparticipating policyholder in a stock corporation, so far as owner-like characteristics are concerned. Life insurance is not the same here as property-liability insurance. As a rough generalization, the mutual policyholder is more like a customer than an owner. Since the policyholder has made little or no investment, unlike the stockholder he can scarcely lose any. Moreover, it misstates the situation to say that mutual insurers are run for the "profit" of the policyholders. Rather, the true conception is that they shall be run without profit.

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Genesis of special problems of control of mutuals.

It is the absence of shareholders (i.e. the absence of "true owners" with an unalloyed profit-seeking motivation) that creates a distinctive corporate problem for the mutual - a problem of providing for control and responsibility. For small localized mutuals and for mutuals which are part of or associated with other membership associations with representative government, that problem can sometimes be solved easily and satisfactorily. But most mutuals subject to this chapter are of a kind produced by modern industrial society and not consistent with the original mutual conception. Some commercially oriented mutuals are very large, with wide-ranging operations little different from those of stock corporations. They take their attitudes and practices from the profit-seeking market society of which they are an integral part. Moreover, some of the largest mutual insurance corporations were originally stock corporations and were then converted into mutuals. It is not surprising, therefore, that in some respects this form that was originally conceived for cooperation, not profit, has come to act so much like a profit-seeking entrepreneurial form that only with great effort can its distinctive characteristics and its unique contribution be preserved. Sometimes they continue in a kind of mystique that can be felt, if not described, among the personnel of the corporation. But even so, the distinctive features should be fostered, for they "justify" the mutual as a separate form of enterprise.

The problem of providing appropriate control for the mutual enterprise has many roots; some of them are listed below:

(a) The interest of the individual policyholder in the mutual and its activities decreases with the growing size of the enterprise. The individual is swallowed by the mass. This phenomenon, common to all large groups, but especially pronounced in the mutual, cannot generally be counteracted even when matters of great moment are at stake, unless by some special independent mechanism through which policyholders can and will communicate with each other and combine forces. A mutual which insures only the members of a specific association or the employes of a specific enterprise may sometimes be in such a situation.

(b) Even without regard to the size of the operation, the financial stake of the mutual policyholder in his company is seldom sufficient by itself to lead him to develop an active interest in its affairs. His main interest is the performance of his insurance contract; and that is better assured by effective insurance regulation than by policyholder participation in management.

(c) While it would be possible, theoretically, to stimulate mutual policyholder interest in management by large-scale public relations campaigns, the cost of such efforts would consume a large part of the surplus that otherwise could be distributed among policyholders. Even then it would probably be ineffective. The cost would be disproportionate to the gain. There is no virtue in participation for its own sake.

(d) Finally, even if sufficient interest existed or could be developed among policyholders, their wide

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dispersion across the country would not allow any substantial number of them to attend a meeting at a cost that would bear a reasonable relation to their financial stake in the outcome. Even mail voting of a large percentage would often be too expensive and too ineffective in relation to the anticipated gain, though under some circumstances it is feasible.

It is not surprising, therefore, that real policyholder control of management in all but the smallest mutuals has generally been nonexistent. Statutes maintain the principle that every policyholder has a vote in the election of directors, but qualify the right in such a way that self-perpetuation of the existing management is virtually guaranteed. Of course, this merely nominal control by the persons to whom management is theoretically responsible is different only in degree from the case in widely held stock corporations, although in the latter situation the existence of a market for the stock at least makes management responsive to the market behavior of the stock. The shareowner has a "market out" - he can sell his shares. This is an indirect control that does not exist for mutuals. The mutual policyholder can depart only by abandoning whatever it is that he "owns" in the mutual. On the property-liability side, he can often be forced out, via cancellation or nonrenewal, which is an anomalous subjection for an "owner". On the other hand, there are often large shareholders who can exercise influence on or even dominate management. A corresponding situation only rarely exists with mutuals.

The somewhat larger involvement of shareholders in stock corporations is easy to exaggerate, too; in all ordinary cases it is nominal and at most leads to an awkward annual meeting day through which management must suffer periodically, without leading to any real threat to continuity of its control.

If it is considered important that management of an important enterprise, whether mutual or stock, be really controlled by and effectively responsible to its owners, then significant modifications need to be made in the political process by which the control is exercised. Undoubtedly one of the roots of demands for control over the insurance enterprise by the public (as is also true of other enterprise) is the feeling that in many instances management is not effectively responsible to anybody but itself, and that when managements speak of management prerogatives in disputes over the extension of public control, they mean exactly that, without any qualifications. In view of the absence of effective control over management in most instances, prerogatives are for practical purposes those of management and not those of "owners".

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An approach to solution of the problem of control over mutuals.

The notion that no major center of power should be permitted to develop in a democratic society that is not responsible to someone else is a postulate. It should be as applicable to insurers as to banks, oil companies, labor unions, or government itself. This led to the suggestion that some directors in mutual corporations might appropriately be appointed in some fashion by public authority. The idea might appropriately be considered for even more extensive application - to stocks as well as to mutuals, and to businesses other than insurance. It is worth full and deliberate exploration. However, this law does not provide for compulsory public directors. The arguments against public control rest on the notion that policyholder control is adequate in mutuals. If that is relied on, steps would be desirable to make policyholder control effective, if that is possible.

But no practicable means of making policyholder participation meaningful has been unearthed. Equally clearly, the use of public directors is no panacea, even if it is a step in the right direction. We need to know more about their use, and this law proposes the use of public directors as an optional device, not as a substitute for real policyholder participation, but in the hope that some experimenting will be done with this promising device.

SUBCHAPTER I.
GENERAL PROVISIONS.

611.01 DEFINITIONS. In this chapter, unless the context requires otherwise:

(1) STOCK CORPORATIONS. The definitions in s. 180.02 (3) to (13) and (15) apply to stock corporations; and

(2) MUTUAL CORPORATIONS. The definitions in s. 181.02 (3) to (6) and (8) apply to mutuals.

611.02 SCOPE AND PURPOSES. (1) SCOPE. (a) Domestic insurers. This chapter applies to all insurance corporations organized under the laws of this state, except those expressly governed by other chapters.

(b) Nondomestic insurers. Except as expressly provided, this chapter does not apply to nondomestic insurers.

(2) PURPOSES. The purposes of this chapter are:

(a) To provide a complete, self-contained procedure for the formation of insurance corporations;

(b) To assure the solidity of insurance corporations by providing an organizational framework to facilitate sound management, sound operation and sound regulation; and

(c) To strengthen internal corporate democracy through as much stockholder and policyholder participation as is practicable.

NOTE: In most respects the corporate aspects of insurance corporations are the same as for business corporations generally. Consequently, a basic assumption of this bill is that the general corporation laws should

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apply except where the special nature of the insurance enterprise makes departure from the general rules desirable in the interest of the public, of insureds, or of investors.

The "comprehensive study of the state insurance laws for the protection of the public welfare and interest, especially with respect to insurance policyholders and shareholders...", called for by s. 13.84, has led to recommendation of some departures from chs. 180 and 181. Each change is separately discussed.

Accordingly, this chapter states explicitly which sections of ch. 180 or 181 are fully applicable to insurance corporations and which are applicable as modified by this chapter. Some sections involve basic departures from the provisions of ch. 180 or 181, because of the nature of the insurance enterprise. The applicable sections of chs. 180 and 181 are incorporated in the chapter in appropriate places to facilitate the use of this chapter as a readable and accessible corporation law for insurance corporations.

It would be unnecessary duplication to repeat in full here a group of sections substantially identical to those in chs. 180 and 181. On the other hand, a general statement that ch. 180 or 181 provisions apply to insurance corporations "to the extent not inconsistent with this chapter" would be unsatisfactory because of inevitable differences of opinion on whether a particular provision is "inconsistent". That approach would multiply uncertainty and litigation.

611.03 ORDERS IMPOSING AND RELAXING RESTRICTIONS. (1) ORDERS IMPOSING RESTRICTIONS. The commissioner may subject an individual corporation not otherwise subject thereto to some or all of the restrictions of ss. 611.28, 611.29 (2), 611.32 (5), 611.33 (1) (a) and (2) (a) 1 and 2, 611.34, 611.54 (1) (b) and 611.69 (2), if he finds that its financial condition, management or other circumstances requires such additional regulation for the protection of the interests of insureds or the public.

(2) ORDERS ELIMINATING RESTRICTIONS. The commissioner may free a new corporation from any or all of the restrictions generally applicable only to new corporations under ss. 611.28, 611.29 (2), 611.32 (5), 611.33 (1) (a) and (2) (a) 1 and 2, 611.34, 611.54 (1) (b) and 611.69 (2), if he is satisfied that its financial condition, management or other circumstances give assurance that the interests of insureds and the public will not be endangered thereby.

NOTE: This is a new provision designed to increase the flexibility of the regulatory process. Many of the provisions of this chapter place special regulatory safeguards on the operations of new companies. In special circumstances they may be appropriate for older corporations as well. Sub. (1) permits the commissioner to make any of these safeguards applicable to an insurer regardless of age. Any such action by the commissioner would be subject to judicial review, under s. 601.62 (3) and ch. 227. Conversely, a new insurer may be freed from special restrictions, under sub. (2), in keeping with the general philosophy of the revision.

611.07 GENERAL CORPORATE POWERS AND PROCEDURES. (1) POWERS. Section 180.04 (1) to (12), (15) and (17) applies to stock corporations and s. 181.04 (1) to (12), (14) and (15) applies to mutuals.

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(2) ULTRA VIRES. Section 180.06 applies to stock corporations and s. 181.05 applies to mutuals.

(3) OMISSION OF SEAL. Section 180.861 applies to stock corporations and s. 181.665 applies to mutuals.

(4) WAIVER OF NOTICE AND INFORMAL ACTION. Sections 180.89, 180.895 and 180.91 apply to stock corporations and ss. 181.70 and 181.72 apply to mutuals.

(5) INFORMAL ACTION BY SHAREHOLDERS OR DIRECTORS. Section 180.91 applies to stock corporations and s. 181.72 applies to mutuals.

(6) POWER TO HOLD ASSETS AS TRUSTEE. A life insurance corporation may hold assets under s. 206.39 as trustee or as general corporate assets.

SUBCHAPTER II.
ORGANIZATION OF CORPORATIONS.

611.10 RESERVATION OF CORPORATE NAME. Section 180.08 applies to stock corporations and s. 181.07 applies to mutuals.

611.11 INCORPORATORS. (1) GENERAL. Any number of corporate or adult natural persons may organize a corporation under s. 611.13.

(2) CLOSELY HELD, SUBSIDIARY AND AFFILIATED CORPORATIONS. One to 15 corporate or adult natural persons may organize a corporation under s. 611.22.

(3) MUTUAL REINSURANCE CORPORATIONS. A mutual reinsurance corporation having the exclusive purpose of providing reinsurance for its member corporations may be organized by 15 or more mutuals under ch. 611 and town mutuals under ch. 202. The commissioner may exempt the corporation from any of the requirements of ss. 611.12 to 611.20 if he considers them unnecessary for the protection of the members.

NOTE: S. 201.02 (1) requires 15 incorporators. One object is to give some assurance of reliability to the project by involving a substantial number of persons. However, little is accomplished in ensuring the reliability of the promotion by having a substantial number of promoters that cannot be better achieved by other devices. Thus the requirement of a substantial investment of incorporators' money guarantees the seriousness of the proposal for a stock corporation. A single incorporator may supply it, or it may come from any number of incorporators in any amounts from each, so long as it aggregates the amount specified in s. 611.32 (1).

Moreover, under this chapter, incorporators of a stock corporation are not limited to the ministerial function they normally perform under ch. 180. They are personally liable for organizational expenses (s. 611.18 (1)); among them, they are required to purchase $100,000 worth of shares (s. 611.32 (1)); and they are restricted in the disposition of their shares (s. 611.32 (3)). The intended effect of these provisions is to require the identification to the commissioner of all persons behind the promotion of the company, and impose responsibility on them. There should be no hidden interests in the enterprise. Similar provisions are tailored to apply to mutuals.

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Sub. (1) is adapted from s. 180.44, which is practically alone in this country in permitting a corporation to be organized by a single incorporator. However unique the rule, it is sound, as previously explained in this comment.

In general corporation law one corporation may not usually be an incorporator of another. This section proposes to eliminate the pure fiction of inserting natural persons as formal incorporators where in reality corporate investors are involved. If the law permits corporate stockholding, it is unwise to insist on this needless, purposeless and patent fiction, and this bill eliminates it. There is merit in naming the real incorporator rather than some surrogate.

Sub. (2) limits the number of incorporators in a closely held corporation, for which an accelerated organization procedure is provided in s. 611.22, in order to avoid complications under the securities law. See note on s. 611.22.

Adult is defined in s. 990.01 (3).

Sub. (3) makes possible an inexpensive form of cooperative or mutual spread loss reinsurance along the lines of the existing Mutual Spread Loss Association, which was examined by the office of the commissioner in 1966 and 1969 but has not heretofore been listed as an insurer. It operates as a hybrid banking-reinsurance operation - banker for purposes of its dealings with its members, but reinsurer for purposes of their accounting practices. The nature of the operation is unobjectionable apart from unsound accounting conventions, but it is entirely unsatisfactory for it to be operating outside the law as an unincorporated association. It should be incorporated as an insurance corporation under this chapter and be regulated as such. The process of transition is made very simple by this subsection.

611.12 ARTICLES AND BYLAWS. (1) STOCK CORPORATIONS. Section 180.45 applies to the articles of a stock corporation, except that:

(a) The name of the corporation shall include the word "insurance" or a term of equivalent meaning, and shall comply with s. 180.07 (3);

(b) Authorized shares shall conform to s. 611.33 (1); and

(c) The purposes of the corporation shall be limited to those permitted by s. 610.21.

(2) MUTUALS. Section 181.31 applies to the articles of a mutual except, that:

(a) The name of the corporation shall include the words "mutual" and "insurance" or terms of equivalent meaning and shall comply with s. 181.06 (3);

(b) The articles shall include provision for mutual bonds if any are to be authorized, which shall conform to s. 611.33 (2) (a);

(c) The purposes of the corporation shall be limited to those permitted in s. 610.21;

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(d) If assessable policies are permitted, the articles shall contain general provisions respecting assessment liabilities and procedures, including a provision specifying the classes of business on which assessment may be separately levied; and

(e) The articles may specify those classes of persons who may be policyholders, or prescribe the procedure for establishing or removing restrictions on the classes of persons who may be policyholders, and the articles shall state that each policyholder is a member of the corporation.

(3) PRINCIPAL OFFICERS. Section 180.41 applies to stock corporations and s. 181.25 (1) and (2) apply to mutuals. The articles or bylaws shall specifically designate 3 or more offices, the holders of which shall be the principal officers of the corporation. The principal offices shall be held by at least 3 separate natural persons.

(4) BYLAWS. The bylaws of a domestic corporation shall comply with this chapter, and a copy of the bylaws and any amendments thereto shall be filed with the commissioner within 60 days after adoption. Subject to this subsection, to ss. 611.13 (2) (d) and (5) and 611.22 (4), s. 180.22 applies to stock corporations and s. 181.13 applies to mutuals.

NOTE: Generally, the articles should follow the pattern of the general corporation law. Only minor modifications are needed.

S. 180.45 (1) as qualified by the "other business" provision in s. 610.21 permits the corporate purposes of any insurer to include complete all-line underwriting powers, including life and all other specialized branches. Limitations on corporate activity can better be made a part of the substantive regulation of insurers than a limitation of their general corporate powers; the limitation would be expressed in the certificate of authority rather than in the articles except to the extent that the corporation itself wishes the limitation in the articles. This approach reduces the necessity for amendment of the articles. It also minimizes diversity of corporate powers - a prolific source of confusion. However, it should be completely optional with the corporation whether it wishes to restrict its activities in the articles, in accordance with the traditional "kinds" or "lines" of insurance or in other ways.

Regulation is not being made less effective by shifting the focus of control from the articles to the certificate of authority. The Wisconsin commissioner can easily exercise any necessary control over expansion by Wisconsin insurers in other states in ways that go beyond the certificate granted in Wisconsin. Under his general powers, he could require each domestic insurer asking for a new or enlarged certificate of authority in another state to file a copy of the request with him. This would give him sufficient information on which to act. Annual reports would reveal any violations.

Sub. (3) solves the problem of defining "principal officers", a term of considerable importance, by letting the corporation designate who they shall be. The designation itself will help to fix the prime centers of power and locations of reponsibility; that is useful to do. It would be possible to prescribe also that they should in fact have the highest authority in corporate affairs, but that could not be effectively enforced.

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611.13 ORGANIZATION PERMIT AND CERTIFICATE OF INCORPORATION. (1) PERMIT REQUIRED. No person may, in the case of a stock corporation, solicit subscriptions for its securities, or in the case of a mutual, solicit applications for qualifying insurance policies or subscriptions for mutual bonds or contribution notes, until the commissioner has issued an organization permit.

(2) APPLICATION FOR PERMIT. The application for an organization permit shall be signed and acknowledged by or on behalf of each incorporator, and shall include or have attached:

(a) The names, and for the preceding 10 years all addresses and all occupations of all incorporators and proposed directors and officers;

(b) For all corporate incorporators, their articles and bylaws, a list of the names, addresses and occupations of all directors and principal officers, and for the 3 most recent years their annual financial statements and reports;

(c) The proposed articles which shall be signed and acknowledged by or on behalf of each incorporator, and the proposed bylaws;

(d) All agreements relating to the corporation to which any incorporator or proposed director or officer is a party;

(e) The amount and sources of the funds available for organization expenses and the proposed arrangements for reimbursement and compensation of incorporators or other persons;

(f) The proposed compensation of directors and officers;

(g) The plan for solicitation of applications for qualifying insurance policies and for the corporation's securities;

(h) The forms to be used for stock subscriptions, certificates for shares, applications for qualifying insurance policies, subscriptions for mutual bonds and contribution notes, and the forms for bonds and notes;

(i) The proposed capital, or the proposed minimum permanent surplus, and the proposed initial surplus;

(j) The plan for conducting the insurance business, including:

1. The geographical area in which business is intended to be done in the first 5 years;

2. The types of insurance intended to be written in the first 5 years;

3. The proposed marketing methods;

4. To the extent requested by the commissioner, the proposed method for the establishment of premium rates;

(k) A projection of the anticipated operating results of the corporation at the end of each of the first 5 years of operation, based on reasonable assumptions of loss experience, premium and other income, operating expenses and acquisition costs; and

(L) Such other relevant documents or information as the commissioner reasonably requires.

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(3) ISSUANCE OF ORGANIZATION PERMIT AND OF CERTIFICATE OF INCORPORATION. The commissioner shall issue an organization permit and a certificate of incorporation if:

(a) He finds that all requirements of law have been met;

(b) He is satisfied that all natural persons who are incorporators, the directors and principal officers of corporate incorporators, and the proposed directors and officers of the corporation being formed are trustworthy and competent and collectively have the competence and experience to engage in the particular insurance business proposed; and

(c) He is satisfied that the business plan is consistent with the interests of the corporation's potential insureds and of the public.

(4) CONTENTS OF PERMIT. The organization permit shall specify the minimum capital or minimum permanent surplus required under s. 611.19, and may contain such other information as the commissioner deems necessary.

(5) LEGAL EXISTENCE. Upon the issuance of the certificate of incorporation the legal existence of the corporation shall begin, the articles and bylaws shall become effective and the proposed directors and officers shall take office. The certificate shall be conclusive evidence of compliance with this section, except in a proceeding by the state against the corporation.

NOTE: It is a principle of this law that insurance corporations should be subjected to the general corporation law so far as possible with special rules only where the peculiar characteristics of insurance require it. The incorporation procedure is a point at which different treatment from ordinary corporations is imperative, but where the provisions should be closely parallel for stock and mutual corporations. This section continues the fundamental notion of s. 201.10 (1) and (2), that the organizational process is divided into 2 stages. The first stage leads only to a permit to organize and to solicit stock subscriptions, or, in the case of mutuals, subscriptions for mutual bonds and contribution notes and applications for qualifying insurance policies. Nevertheless, full information must be given to, and full scrutiny be exercised by, the commissioner before the organization permit is issued. The certificate of authority to do business is issued at the end of the organizational process, upon evidence that sufficient funds have been raised to satisfy the capital and surplus requirements for launching a new corporation. Until then, these funds are held in escrow, to be refunded to subscribers in large part, according to statutory provisions, if the corporation fails to obtain a certificate of authority. Many details of the procedure have been adapted from the patterns of Washington s. 48.06.040 and New York s. 48.

Under this procedure the principal evaluation of the proposed business is made by the commissioner before the incorporators are permitted to solicit subscriptions or applications from the public. Besides protecting subscribers and applicants for insurance, this procedure guarantees that the commissioner will be fully informed at a very early stage, and gives him the opportunity to require any changes necessary to comply with the law. This is also in the interest of the incorporators, since they can make necessary adjustments while it is still

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easy and inexpensive to do so. If they comply, issuance of a certificate of authority at the end of the process should become a formality.

The requirements of sub. (2) serve several purposes. They will provide the commissioner with complete information for the important decisions he has to make in the interest of both security holders, future insureds and the public. The commissioner's right to be informed is and must be virtually unlimited, including a right to verify any statement by an examination under s. 601.43. Sub. (2) also compels the promoters to think carefully about and plan realistically for problems likely to be encountered in the early stages of the development of the business, helping to eliminate defects and oversights in the proposed operation. They do not impose an unreasonable burden on either incorporators or the insurance department. If would be quite sufficient under sub. (2) (k) 4, for example, to say that certain bureau-filed policy forms and rates are to be used. But sometimes an incorporation is undertaken to take advantage of a special opportunity in the market. If so, the planners should demonstrate that they have thought their way through their problems and know what they are doing. This is not asking too much in an era of sophisticated business planning. The requirements operate as a screening process, rejecting projects where the incorporators themselves have only vague ideas and no calculated plan. To receive the commissioner's attention and support, a plan must give evidence that it is conceived and calculated on a sound technical basis and in accordance with established principles of insurance management.

Sub. (2) (a) will furnish the commissioner the information necessary to evaluate the personal qualifications and the relationships of incorporators, directors, and officers as authorized in sub. (3) (b). Similar provisions exist in many states. It would be inconsistent with, and might entirely defeat, this control to leave it to the shareholders to elect the initial board immediately after the corporation is organized. Thus the initial board is named by the incorporators. Of course, the named board may be removed immediately by the shareholders under their general removal power, but this is unlikely to occur in a corporation which has just been organized. If it did happen, however, the new personnel would also have to be approved by the commissioner. See s. 611.54 (1) (b).

Sub. (2) (d) is intended to open up for the commissioner's consideration all "side" agreements among or involving incorporators respecting future control of the corporation. Not only will this make it more difficult for dishonest and untrustworthy people to be involved, but it will also protect the participants, through the operation of estoppel, against later claims that there are side agreements.

Other listed items, especially in sub. (2) (k), concern the legal and technical bases of the insurance business to be operated. In these areas, full information and careful evaluation is necessary before a license should be issued, especially where the projected operation is intended to plough new ground.

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The purpose of sub. (2) (j) 1 is to inform the commissioner not only of the states, but of the areas within any state, in which the insurer intends to operate initially. The area chosen might under many circumstances favorably or adversely affect the solidity of the operation and therefore is something the commissioner must know. This provision does not authorize the commissioner to require or forbid the insurer to operate in any particular area, and he would be abusing his authority if he attempted to do so on the strength of this provision alone. Elsewhere, for other than regulatory reasons, the law might specifically compel or prohibit such operations.

The projection in sub. (2) (k) does not bind anyone, nor can it be a guarantee of success. However, it is no more than responsible businessmen now do, and enables the commissioner to see whether the projected enterprise has some prospect for survival and success. A requirement of a pro forma projection is not novel. See, for example, Mass. ch. 175, s. 49.

"...the commissioner shall not approve the articles of organization of a company...until he is satisfied, by such examination as he may make and such evidence as he may require, that...(4) the actuarial projections, policy forms, rates, dividends, commissions and other expenses contemplated, as well as reinsurance, market and taxes are sound and reasonable."

The Wisconsin commissioner already requires information of this type, even though the statute has not expressly directed him to do so.

Sub. (3) is the counterpart to s. 180.46. It continues the thrust of s. 201.045 (1), 1969 stats. which directs the commissioner to issue a certificate of authority "upon satisfying himself that...its methods and practices and the character and value of its assets will be such as to adequately safeguard the interests of its policyholders and the people of this state." The draft requirement is applied to the organization permit stage, however, making the commissioner's fundamental determination of the merits of a promotion come earlier. The corporation also comes into existence at the first stage. Sub. (5).

Sub. (3) (c) provides for evaluation of the business plan. The idea of the business plan is by no means new. Something like it, though less fully articulated, is frequently encountered in state statutes. See e.g. Mich. s. 24.15024 (1), requiring the organizing company to file "a statement showing in full detail the plan upon which the company proposes to transact business...." See also the paragraph from Mass. ch. 175, s. 49 quoted above.

The term "business plan", used in this paragraph, is a technical term defined in s. 610.01 (10). It is a complex, though limited, set of proposals to be evaluated in deciding whether the nascent enterprise is viable. While the commissioner's surveillance over a successfully operating company should be relatively limited, over a new company it should be more extensive. With his staff, he will be more expert than some of the relatively inexperienced entrepreneurs whose introduction into the business he supervises. To make the initial

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evaluation meaningful, the insurer must be bound to adhere to the plan during the early years of the corporation's life, and amendments must be subject to disapproval by the commissioner. This is provided by s. 611.28.

The business plan may be understood more clearly by illustrative mention of its contents. The amount of capital and surplus to be raised is fundamental to successful operation. The minimum capital and surplus is prescribed by s. 611.19; the data which is part of the plan will enable the commissioner to set specific figures under s. 611.19.

The business plan also includes the "types" of insurance to be written. The word "types" is chosen because it is not a term of art and has a general meaning. "Kinds" or "lines" would be too limiting. This should involve, and the commissioner can require it to involve, information about coverages in such detail as seems relevant to the decision to be reached at this stage. The types of insurance are thus subject to limited evaluation by the commissioner in the organizational stage. The commissioner may refuse to issue an organization permit if he finds that the proposed coverages would violate the law or endanger the business. This provision is not intended to subject new insurers to a filing or approval requirement for policy forms prior to organization, except where solicitation of applications for policies is a part of the organizational process, but if a proposal is based on impermissible contracts the proposal should be altered at the earliest possible date. Filing and review of policy forms will be treated in the chapter on insurance contracts.

Marketing methods are another important part of the business plan. To enable the commissioner to protect the interests of future insureds it is relevant for him to know how the insurance will be sold. This has clear relevance to the viability of the projected operation. For example, the presence of some preexisting and related organization to assist in developing a marketing mechanism may mean the difference between success and failure.

Sub. (4) provides that the organization permit shall specify capital or surplus requirements. By relying on rules, guidelines and informal consultation the incorporators will in all ordinary cases propose amounts under sub. (2) (i) that are at least equal to what the commissioner is likely to specify under sub. (4).

Sub. (5) provides for the time at which the existence of the corporation begins and makes it clear that the proposed directors and officers chosen by the incorporators take office without an election, and that the articles and bylaws are effective at once without further action. Issuance of the certificate gives some protection to the organizers against captious objections.

Some special observations are required respecting mutuals. Traditionally one of the requirements for organization of a mutual has been the solicitation of a certain number of applications for insurance prior to completion of the organization. Thus s. 201.03 (1) (a) required 400 bona fide applications for each of the kinds of insurance for which the company is organized.

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This chapter retains a similar formula for organization of assessable mutuals only. The requirement is so closely related in function to capital and surplus requirements that it is dealt with in s. 611.19.

The method of organizing mutuals under the former law involved, in addition to obtaining applications from prospective policyholders, the raising of "cash contributions" from "applicants [for insurance policies] and contributors." S. 201.03 (1) (a). This draft continues that procedure, except that mutual bonds are added to contribution notes. The disclosure requirements for shareholders in stock corporations appear equally applicable to persons investing capital in mutuals, and hence mutual bonds are securities for purposes of ch. 551. Contribution notes are essentially private loans and are not subject to ch. 551. The former law spoke also of "surplus notes". The latter do not differ in any important respect from contribution notes and the term "surplus note" has been abandoned in this law.

611.14 POWERS UNDER ORGANIZATION PERMIT. (1) STOCK CORPORATIONS. While its organization permit is in effect a stock corporation may:

(a) Register stock under s. 611.31, solicit subscriptions subject to s. 180.13 (1) and receive payment therefor in cash or, with the approval of the commissioner, in other property constituting a permitted investment under ch. 620, and issue receipts for such payment at values approved by the commissioner, but no certificates for shares may be issued until a certificate of authority is issued; and

(b) Transact all other business necessary and appropriate for the organization of the planned insurance enterprise.

(2) MUTUALS. While its organization permit is in effect a mutual may:

(a) Register mutual bonds under s. 611.31, solicit applications for qualifying insurance policies under s. 611.19 (2) (b) and subscriptions for mutual bonds and contribution notes and receive payment therefor in cash or, with the approval of the commissioner, in property constituting a permitted investment under ch. 620, and issue receipts for such payment at values approved by the commissioner, but no policies or bonds may be issued until a certificate of authority is issued; and

(b) Transact all other business necessary and appropriate in the organization of the planned insurance enterprise.

611.15 DEPOSIT OF PROCEEDS OF SUBSCRIPTIONS. All funds, and the securities and documents representing interests in property, received by a stock corporation for stock subscriptions or by a mutual for applications for insurance policies or for mutual bond or contribution note subscriptions shall be deposited in the name of the corporation with a depository approved by the commissioner, subject to an escrow agreement approved by the commissioner under which withdrawals may be made only with his approval.

NOTE: This continues the substance of s. 201.10 (2), with appropriate modifications. The deposit is released when a certificate of authority is issued under s. 611.20 (2) (a). After that, incorporators may receive reimbursement for their expenses according to s. 611.18 (2) and the prospectus.

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611.16 TERMINATION OF ORGANIZATION PERMIT AND PAYMENT OF ORGANIZATION EXPENSES. (1) TERMINATION. The organization permit shall terminate upon:

(a) Issuance of a certificate of authority under s. 611.20;

(b) Revocation under sub. (2); or

(c) Expiration of one year after issuance unless a good faith application for a certificate of authority has been filed with the commissioner. The commissioner may grant a reasonable extension if he reasonably expects that the corporation will be able to satisfy the requirements for a certificate of authority within the extended period.

(2) REVOCATION. The commissioner may revoke an organization permit if:

(a) He finds, after a hearing, that because of changes in circumstances, or because the facts were not as represented in the application, the conditions for issuance of a permit are no longer satisfied; or

(b) He denies an application for a certificate of authority and finds that the corporation cannot reasonably be expected to satisfy the requirements for a certificate of authority within the remaining term of the organization permit or any extension thereof under sub. (1) (c).

(3) REIMBURSEMENTS AND REFUNDS. (a) General. Except in cases under pars. (b) and (c), if the organization permit is revoked or expires before a certificate of authority is granted, incorporators who have advanced money for the reasonable and authorized expenses of organization, including underwriting expenses, may be reimbursed in cash from the proceeds of shares or mutual bond or contribution note subscriptions under the organization permit, on itemized receipts audited by the commissioner. The total reimbursement shall not exceed 5% of the amount received from such sources. The remainder in the escrow account shall thereupon be distributed among such subscribers in proportion to their contributions, valued as of the time the contributions were made.

(b) Violation of law. Reimbursement may be refused to any incorporator under par. (a) if the commissioner finds that in connection with the organization of the corporation the incorporator has wilfully or negligently violated in a material way any provision of this chapter.

(c) Assessable mutuals. No reimbursement may be made to any incorporator of a mutual under par. (a) until all advanced premiums collected under s. 611.19 (2) (b) have been repaid in full.

(4) END OF LEGAL EXISTENCE. The legal existence of the corporation shall terminate upon completion of the payments under sub. (3).

NOTE: This section provides for the event that the corporation does not, for any reason, obtain a certificate of authority under s. 611.20 (2). Sub. (1) enumerates the ways termination occurs. Par. (c) provides for a year to raise the money necessary to meet the capital requirements. That is sufficient time. The commissioner has discretion to grant an extension where it appears that the organization probably could be completed within the extension. However, before approaching the commissioner for the first time, the incorpo-

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rators should invest as much care in planning the financing as in planning the organization and management of the business. A longer period, e.g. 2 years, as provided by Washington s. 48.06.070 (1), risks rendering the business plan obsolete by the time the certificate of authority is granted, and subjects subscribers to added risk of loss.

Sub. (2) (a) provides for revocation of the organization permit for what is, in effect, material misrepresentation.

Sub. (3) gives assurance that nearly all the funds collected from outsiders under the organization permit will be refunded to the subscribers. The refund requirement is similar to Washington s. 48.06.170. It is a necessary consequence of the organizers' inability to qualify to transact the business for which the corporation is being organized. Since no insurance claims are yet involved, the winding up may follow the simplest and most expeditious procedure. The commissioner only needs to make sure that no reimbursements are made except those proper under this section and that all remaining funds held in the escrow account are refunded.

This section requires a refund to investors in full, except for out-of-pocket expenses. The basis of this requirement is that the purchasers of stocks and bonds intend to run the risk of the unsuccessful operation of an insurance venture, and only to a limited extent that of an unsuccessful promotion. The latter is an altogether different risk which the investing public should not be asked to assume in full, because it is a risk concerning which no intelligent decision can be made on the basis of information disclosed in the prospectus. To deny a substantially full refund to the investors permits the promoters to shift an unduly large portion of the costs of the unsuccessful stock promotion to an investor who was invited to buy shares in an insurance enterprise, and encourages uneconomic operations.

Requiring a nearly complete refund will further discourage the unscrupulous promoter, and aid the responsible promoter. The latter can justifiably assure potential stock subscribers that they are being invited to invest in an insurance corporation, and that if for any reason the corporation should not become authorized to transact an insurance business in Wisconsin, their money will be refunded in full, except for limited and audited actual expenses. If the promotion is successful, the promoters will gain their reward. Sub. (3) (c) continues former law, which already provided that "no part of the premiums contributed upon organization shall be used for promotion expense." S. 201.03 (3). This requires refund in full of all advance premiums collected in the formation of a mutual and should be equally applicable in the case of an assessable mutual under s. 611.19 (2) (b) 2. Mutual bonds under s. 611.33 (2) (a), however, bear great resemblance to the shares of a stock corporation, and there is little reason to treat the subscribers differently than stock subscribers. As to contribution notes under s. 611.33 (2) (b), their holders will in all ordinary cases be among the incorporators themselves and as such participate automatically in any loss. They are included in proposed sub. (3) (a) only for the rare and exceptional case that a contribution note has been issued to a person who is not an incorpo-

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rator. He should then be in no better or worse position than a stock subscriber.

611.18 INCORPORATORS' LIABILITY AND ORGANIZATION EXPENSES. (1) LIABILITY. The incorporators shall be jointly and severally liable for all organizational and promotional expenses and liabilities incurred prior to the issuance of the certificate of authority.

(2) REIMBURSEMENT AND COMPENSATION. (a) Stock corporations. 1. "Expenses." After issuance of the certificate of authority, incorporators of a stock corporation who have advanced money or incurred obligations for the reasonable and authorized expenses of organization including underwriting may be reimbursed in cash from the proceeds of shares subscribed to under the organization permit, on itemized receipts audited by the commissioner. Their total reimbursement may not exceed 10% of the amount received from subscribers.

2. "Personal services." Incorporators may be compensated for the reasonable value of personal services actually performed by the issuance to them of shares not exceeding in value in the aggregate 10% of the amount received from the subscription for shares under the organization permit.

3. "Aggregate expenses and remuneration." The aggregate payment under subds. 1 and 2 may not exceed 15% of the amount received for shares subscribed to under the organization permit, including the shares purchased under s. 611.32 (1) or (2), and shall conform to the statement made under s. 611.13 (2) (e).

(b) Mutuals. After issuance of the certificate of authority, incorporators of a mutual who have advanced money or incurred obligations for the reasonable and authorized expenses of organization may be reimbursed in cash from the proceeds of subscriptions for mutual bonds and contribution notes, on itemized receipts audited by the commissioner. The total reimbursement may not exceed 15% of the amount received for the bonds and notes.

NOTE: The formulation of this section represents an attempt to provide treatment of promoters of insurance corporations that will be stringent enough to prevent insurance from being a happy hunting ground for the shooter whose specialty is pigeons, without being so stringent that it will be unreasonably difficult to form new insurance corporations in this state. Nothing is needed less in the insurance world than spellbinders to tout wild new schemes. New insurers are desirable, but they should be carefully planned by experienced and serious businessmen who are interested in a long-term business venture and have resigned themselves to some delay in taking their profits. Insurance is not an appropriate industry for reckless speculation. The public interest in solid insurance takes priority over freedom to float stocks. Promoters of an insurer should be prepared to invest substantial amounts of their own time and money in it and to wait a reasonable time for profits.

Mutual incorporators receive somewhat different treatment than do incorporators of a stock corporation. Promoters seeking profit would of course normally seek to organize a stock corporation. The motivation for organizing a mutual should ordinarily be different. Either the incorporators are seeking a better market for their own insurance needs, or they seek to perform a public service for their communities by providing a needed

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market, or they represent an existing organization seeking to provide a nonprofit insurance market for its members. Of course a purely or partly entrepreneurial motivation could be the basis for such a promotion, since the promoters might well look forward to becoming the new company's management. It would be theoretically possible for the law to compensate them for personal services rendered in the promotion by issuing them mutual bonds, in a way analogous to stock corporation promoters. However, it is better to exclude the purely pecuniary motivation for such organizations by only allowing reimbursement of expenses which, however, is raised to 15% because of the lesser surplus with which a mutual is likely to start. The great likelihood of achieving control is potentially a substantial additional compensation.

611.19 INITIAL CAPITAL AND SURPLUS REQUIREMENTS. (1) MINIMUM CAPITAL AND PERMANENT SURPLUS. The commissioner shall specify the minimum capital for a stock corporation or the minimum permanent surplus for a nonassessable mutual being organized under this chapter. It shall be sufficient, in accordance with sound business practices, to provide for the needs of the proposed business, but in no case except a segregated account bearing no risks that are not assumed by the corporation's general account shall it be less than $200,000, nor shall it be more than $2,000,000. In specifying the amount, the commissioner shall take into account all the information in the business plan, the projection supplied under s. 611.13 (2) (k), the general economic situation, the reinsurance market available to the proposed corporation and any other factors relevant to its needs for capital and surplus.

(2) INITIAL EXPENDABLE SURPLUS. A corporation organized under this chapter shall have an initial expendable surplus, after payment of all organizational expenses, of at least 50% of the minimum capital or minimum permanent surplus specified under sub. (1), or such smaller percentage as the commissioner specifies.

(3) AMOUNT OF STATED CAPITAL. Section 180.16 applies to stock corporations.

(4) ASSESSABLE MUTUALS. (a) Reduced permanent surplus. An assessable mutual organized under this chapter need not have a permanent surplus if the assessment liability of its policyholders is unlimited. If assessments are limited to a specified amount or a specified multiple of annual advance premiums, the minimum permanent surplus shall be the amount that would be required under sub. (1) if the corporation were not assessable, reduced by an amount that reasonably reflects the value of the policyholders' assessment liability in satisfying the financial needs of the corporation.

(b) Initial expendable surplus. An assessable mutual organized under this chapter shall have an initial expendable surplus of at least $100,000, after payment of all organizational expenses.

(c) Initial applications; general. Except under pars. (d) and (e), no certificate of authority shall be issued to an assessable mutual until it has at least 400 bona fide applications for insurance from not less than 400 separate applicants on separate risks located in this state in each of the classes of business upon which assessments may be separately levied. A full year's premium shall be paid with each application and the aggregate premium shall be at least $50,000 for each such class. If at any time while the corporation is an assessable mutual, the business plan is amended to include an additional class of business on which assessments may be separately levied, identical requirements shall be applicable to each additional class.

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(d) Same: workmen's compensation. Five employers or more may join in the formation of an assessable mutual to write only workmen's compensation insurance if, instead of the requirements of par. (c), policies are simultaneously put into effect that cover at least 1,500 employes, counting no more than 300 for any employer. A full year's premium shall be paid by each employer, aggregating at least $100,000.

(e) Initial surplus in lieu of initial applications. In place of initial applications and premium payments for any class of business, the corporation may provide the minimum permanent surplus and initial expendable surplus that the commissioner would require for a nonassessable mutual organizing to do that class of business under like conditions. The class of business shall nevertheless be assessable until conversion under s. 611.77 (1).

(5) MUTUALS WITH OPEN CONTRACTS. A mutual organized under this chapter need not have a permanent surplus if it issues only contracts the benefits of which may be reduced by action of the board if assets are not sufficient to provide the protection specified in the contracts. The terms and format of any such open contract provision must be approved by the commissioner before the mutual is given a certificate of incorporation.

(6) PROVIDERS' CONTRACTS. Any corporation under this chapter which promises in its policies to supply services in lieu of or in addition to indemnity, on a basis giving the insurer no option whether it will supply services or pay indemnity, shall maintain such contracts with providers that it can be reasonably expected that services will be provided as promised in its contracts.

NOTE: The devising of minimum capital and surplus requirements is difficult. No adequate scientific study has yet been made of this very complex subject. Of course, the factors involved in determination of the appropriate amount are fairly clear. This section names them as guides to the commissioner's exercise of discretion and then seeks to confine his discretion within reasonable bounds.

Because adequate research has not yet been done on this difficult subject, and because of the nature of the problem, the inclination of commissioners has often been, whenever they have considered the question, to take the obvious path to make their own task simpler by indiscriminately pushing up the statutory capital requirements. This is an undesirable practice. Many satisfactory companies have been formed and have prospered with modest initial capital resources, where little risk was involved. Our society has an interest in encouraging the relatively small entrepreneur and permitting him to make such contribution to our economy as he can. Moreover, great size alone is no guarantor of soundness, as the Penn-Central debacle most recently demonstrated. The important thing is that the resources be adequate for what the organizers propose to do, which may be modest or ambitious. It follows, therefore, that much discretion should be left to the commissioner to set minimum capital and surplus requirements for an individual corporation based on its own plans.

The specific financial requirements now existing in the United States are very difficult to evaluate and to compare, because of the ambiguity of the statutes and because of the discretionary authority often vested in the commissioner. The usual pattern consists of a mini-

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mum capital which must be provided and maintained as a guarantee fund throughout the life of the corporation, with the effect that if ever the sum of the capital and all liabilities exceeds the assets, the corporation is considered insolvent and therefore subject to liquidation. In mutuals a permanent surplus is required instead of capital. The capital or permanent surplus must be supplemented by a minimum initial expendable surplus. This is a necessary consequence of the guarantee function of the capital or permanent surplus in an insurance enterprise. Without an adequate initial surplus, the company would find itself in a state of insolvency within the first weeks of doing business. Expendable surplus requirements are usually related to the minimum capital or permanent surplus requirement, with 50% and 100% being widely used ratios. In some states, the required initial surplus exceeds the minimum capital. The function of the initial surplus is to support the insurer's operations until it is in a position to operate profitably. That means that unlike the minimum capital it can be expended and need not be perpetually maintained in order to keep the insurer solvent. However, some states also require a stock corporation to maintain a permanent surplus, which is therefore no different from capital for practical purposes, and the statutes providing for such surplus are misconceived. Traditionally, capital and surplus requirements have been established separately for the various lines of insurance. See former s. 201.11.

The maximum amount of $2,000,000 for capital or permanent surplus is more than is required by most other states. However, if minimum capital and initial surplus are taken together, the aggregate outlay for starting a broadly conceived multiple-line operation is not greater than it would be in some other states. E.g., under Connecticut s. 38-93, the maximum would be $1,500,000 capital and $1,500,000 surplus. There is no reason to assume the commissioner will demand the maximum where it is not needed, in view of the clear directives of this section. On the contrary, the clear and unmistakable purpose of this section is to encourage the commissioner to demand only so much as is needed, and no more. But he must have the power to demand adequate capital or permanent surplus for all reasonable needs. What this provision does is to replace the rigid statutory requirements by a discretionary power that is as broad as necessary but still is confined within reasonable limits.

One of the problems in determining the capital needs of an insurance corporation is that these needs not only differ widely at the time of organizing the company, according to the nature of the proposed business, but also that they change constantly as the insurer keeps developing and expanding its operations. This has long been recognized by the industry, by financial analysts and by regulators. A certain ratio between the volume of business and the insurer's capital and surplus (the so-called "policyholders'" surplus) has been regarded as desirable or necessary as a matter of sound management. Although some discussion has taken place on the subject and some bills have even been introduced, there is unfortunately as yet no general statutory adoption of such a notion. Elsewhere in the world, for example in the European Common Market and in Finland, the idea of fluctuating "margin of solvency" is farther advanced.

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Sections 623.11 and 623.12 contain a compulsory requirement and a security surplus standard which would depend for their amounts upon both the volume and the riskiness of the insurer's business. An insurer is required to have the former in order to escape rehabilitation proceedings under s. 645.41 (4), for being in a condition that makes its further operation hazardous to policyholders. It is not ordinarily required to have the latter, though failure to do so would subject it to extra surveillance. The proper place for such surplus requirements is a chapter dealing with the general financial standards for insurers, rather than in this chapter on corporate organization. Once the commissioner is authorized to require a surplus commensurate with the corporation's fluctuating needs, it is easier for him to stay within modest limits in fixing the minimum capital and initial surplus, since he need take into account only the relatively short-term needs of the new corporation. The increased needs resulting from an expansion of the business can be met by increase in the compulsory surplus.

Under ss. 601.41 (3) and 227.014 (2), the commissioner may promulgate rules specifying such standards for capital and surplus requirements as can be made the subject of a general statement. Concerning the comparative range of the commissioner's discretion, see s. 215.07 (2), where the discretion of the savings and loan commissioner and his advisory committee is much greater.

Sub. (4) recognizes that assessability is in part a substitute for capital. The required initial expendable surplus of $100,000 will provide some working funds even where assessment is expected to take care of both losses and expenses. There will be extra costs in the initial phases of the corporation's life.

The old classifications of insurance by kinds or lines are less significant under the proposed revision. Par. (c) conceives of the possibility of combining initial applications in some classes of business with surplus in others in starting an assessable insurer. Of course all policies would still be assessable until conversion under s. 611.77. The section avoids the necessity of using the technical terms "kinds" or "lines" by letting the corporation classify its own business in deciding on breakdown for purposes of assessment, subject to the commissioner's approval. See s. 611.12 (2) (d).

Sub. (5) is new. There may be circumstances where reduction of benefits is a preferable alternative to assessment. Such mutual should receive close scrutiny by the commissioner, and special care should be taken to see that policyholders are not misled. But no public policy justifies a blanket prohibition of their formation.

Sub. (6) is a generalized version of s. 185.983 (2). The commissioner can promulgate rules giving more specificity to the requirement.

611.20 CERTIFICATE OF AUTHORITY. (1) APPLICATION. The corporation may apply for a certificate of authority at any time prior to the expiration of its organization permit. The application shall include a statement by a principal officer of any material changes that have already taken place or are likely to take place in the facts on which the issuance of the organization permit was

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based, and if any material changes are proposed in the business plan, the additional information about such changes that would be required if an organization permit were then being applied for.

(2) ISSUANCE. (a) The commissioner shall issue a certificate of authority, if he finds:

1. That cash or property authorized under s. 611.14 (1) (a) has been received sufficient to satisfy the requirements of s. 611.19;

2. That there is no basis for revoking the organization permit under s. 611.16 (2); and

3. That all other applicable requirements of the law have been met.

(b) The certificate of authority shall specify any limits placed on the insurance business that may be carried on by the corporation and may, within the powers given the commissioner by law, specify limits on its methods of operation.

(3) EFFECT. Upon the issuance of the certificate:

(a) The board shall authorize and direct the issuance of certificates for shares, bonds or notes subscribed to under the organization permit, and of insurance policies upon qualifying applications made under the organization permit; and

(b) The commissioner shall authorize the release to the corporation of all funds held in escrow under s. 611.15.

(4) ALTERATION OF CERTIFICATE OF AUTHORITY. (a) Upon application. A corporation may at any time apply to the commissioner for a new or amended certificate of authority, removing, altering or adding limits on its business or methods of operation. The application shall contain or be accompanied by so much of the information in s. 611.13 (2) as the commissioner reasonably requires. The commissioner shall issue the new certificate as requested if he finds:

1. That the corporation's capital and surplus are adequate to support the proposed operations under the new certificate; and

2. That the proposed business would not be contrary to the law or to the interests of insureds or the public.

(b) By commissioner. If the commissioner issues a summary order under s. 645.21 against a corporation, he may also revoke the corporation's certificate and issue a new one with such limits as he deems necessary.

NOTE: This section prescribes the procedure for obtaining the certificate of authority, sometimes referred to as a license. This second stage of the organizational procedure may be combined with the first stage whenever the incorporators of a stock corporation themselves purchase the entire stock issue and therefore need no public solicitation. In such cases the certificate may be issued immediately upon receiving evidence that the minimum capital and initial expendable surplus are available in the required form. A mechanism for simplifying the organization of stock corporations, as well as mutuals in analogous situations, is provided by s. 611.22.

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This section ties the commissioner's decision on the certificate to the earlier decision on the organization permit. If the facts on which the permit was based remain unchanged, he has little to do but make sure that the actual financing satisfies the requirements of the law and the organization permit. If the facts have changed materially since issuance of the permit, the commissioner has to make a new evaluation.

Sub. (2) (b) does not give the commissioner discretion to impose upon insurers any limits he might fancy. Rather, he will simply reiterate in the certificate the limits that are imposed otherwise either by statute or by the insurer's own business plan as contained in its application. The most important limit will be with respect to types of business, though not necessarily in terms of the traditional classification of kinds of insurance reflected in s. 201.04 or lines as reflected in the annual statement. If appropriately capitalized, insurers should be authorized to operate on a very wide scale. But since the financial requirements under s. 611.19 can be made significantly lower for limited operations, all such special conditions should be reflected in the certificate. Some statutory limits will still be necessary, in connection with specialized kinds of insurance like life and mortgage guaranty, but perhaps even these limitations could be surmounted by the use of segregated asset accounts. Apart from limitations on kinds of business, the most likely restriction would be a requirement that separate or segregated asset accounts be kept not only for life insurance as formerly required under s. 201.05 (2) but on a more varied basis. See s. 611.24 and ch. 620.

It is not contemplated that the certificate be limited in time as under the last sentence of s. 201.045 (1). This change reflects the principle that supervision of insurers should be exercised continuously rather than intermittently. As long as an insurer operates satisfactorily and with little change in scope of operation, the regular renewal of its license is a purposeless formality. A weak or unsound insurer should be watched carefully and proper action taken as soon as necessary, without waiting for the next license renewal date. Regular renewal of licenses tempts the commissioner to delay necessary action until a renewal date, and also tempts the commissioner to try, illicitly, to shift the burden of proof to an insurer by withholding a renewal license instead of taking affirmative remedial action. Appropriate powers and procedures are provided by ch. 645 on delinquency proceedings. See especially s. 645.41 (9) which calls for liquidation whenever an insurer no longer satisfies the requirements for initial authorization. Thus this bill contains no provisions for the renewal of a certificate of authority. N.Y. s. 40 (5) and Mich. s. 432 also provide for permanent rather than annual licenses.

611.22 ACCELERATED ORGANIZATION PROCEDURE. (1) GENERAL REQUIREMENTS. The incorporators may apply for determination of the minimum capital or minimum permanent surplus under s. 611.19 and for a certificate of authority without first obtaining an organization permit if:

(a) Their number is not more than 15; and

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(b) They purchase for their own accounts all the shares proposed to be issued in the case of a stock corporation, or in the case of a mutual they supply all the minimum permanent surplus and initial expendable surplus by contribution notes or otherwise.

(2) CONTENTS OF APPLICATION. The application for a certificate of authority shall be accompanied by proof that the purchase price for the shares or the proceeds of contribution notes have been deposited on behalf of the proposed corporation or if other than money are held in trust for the proposed corporation and by so much of the information in s. 611.13 (2) as the commissioner reasonably requires.

(3) ISSUANCE OF CERTIFICATES OF INCORPORATION AND AUTHORITY. The commissioner shall issue both a certificate of incorporation and a certificate of authority if:

(a) He finds that all requirements of law have been met;

(b) He is satisfied that all natural persons who are incorporators, the directors and principal officers of corporate incorporators, and the proposed directors and officers of the corporation being formed are trustworthy and competent and collectively have the competence and experience to engage in the particular insurance business proposed; and

(c) He is satisfied that the business plan is consistent with the interests of the corporation's potential insureds and of the public.

(4) LEGAL EXISTENCE. Upon the issuance of the certificate of incorporation the legal existence of the corporation shall begin, the articles and bylaws shall become effective and the proposed directors and officers shall take office. The certificate shall be conclusive evidence of compliance with this section, except in a proceeding by the state against the corporation.

NOTE: This section deals with several separate but related situations. One is the organization of an insurance company by a small group of persons who among themselves are able to subscribe the full amount of required capital or minimum permanent surplus and initial expendable surplus. There is no reason to prevent such a group of qualified and privately financed persons from launching an insurance enterprise with a minimum of red tape. A second situation is the subsidiary, the entire capital for which will be supplied by its corporate parent. A third is formation of a corporation where the capital is supplied partly by corporate "parents" and partly by related persons. A fourth is organization of a mutual by corporate "siblings", who advance the necessary funds but who do not intend to "own" it. Such a corporation might become a constituent part of a "mutual" complex, related to and affiliated with its corporate siblings, but not "owned" by them. Interlocking or identical top management would be probable.

These situations have in common the important fact that the public is not to be invited to invest in the enterprise. Since the venture is privately financed there is no need for the state to be concerned with protecting the investing public. The magic number 15 conforms to the blue sky law which requires registration of securities if more than 15 purchasers are involved. S. 551.23 (10). The figure is chosen on purely practical grounds. Where the number of purchasers is so small, regulation

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for the purpose of protecting those investing in the enterprise is less feasible administratively, is harder to justify as a matter of public interest or policy and would be unduly expensive.

This section does contain one restriction not contained in s. 551.23 (10). All purchasers or suppliers of surplus by contribution notes must also become incorporators. The complexity of the insurance venture suggests the desirability of keeping all the stock or notes sold without an organization permit within the circle of knowledgeable insiders. Of course, this does not protect the person who permits himself to become an incorporator and buys stock or lends on a contribution note without knowing or understanding what is going on. The gullible, uninformed promoter must run the risks of liability and loss arising from his own carelessness, as does the uninformed director. See DePinto v. Provident Security Life Insurance Co., 374 F. 2d 37 (9th cir. 1967). Public regulation of the promotion and sale of securities can realistically aim to protect the public investor, but not persons who presume to play the role of insider in a closely held corporation.

Similar considerations apply in the organization of a closely held corporation, all of the stock of which is to be issued to other corporations. There is no reason why several corporations should not join to own an insurance corporation, nor indeed why part of the capital should not also be supplied by related natural persons. The controlling factor is that the public is not being asked to invest in the enterprise. Of course, if the parents are publicly held, the public is indirectly investing in the insurance venture. But the decision to invest the parent's funds in an insurance enterprise is not significantly different from any other business decision which the board of directors of the parent makes. The shareholders are protected through their power to remove the directors, and through the laws of fraud and the fiduciary duty of the directors and officers. The same considerations apply to lending through contribution notes.

Of course, the situation changes if the corporate owners seek to sell the new corporation's shares to the public. For this reason these shares are treated as promoter stock under s. 611.32.

There is a further question of how many incorporators an insurance corporation should be permitted to have when some of them are corporate. Fifteen seems the correct number as a limit, because where more than 15 purchasers are involved, the issue of securities is a public one as much as if all the purchasers were individuals. There is no reason why control should not be shared among an even larger number of corporate joint venturers, if organization goes the normal route under s. 611.13.

This section applies only to the initial stock issue, of course; subsequent issues are governed by the same rules as for corporations organized under s. 611.13.

611.24 SEGREGATED ACCOUNTS IN GENERAL. (1) MANDATORY SEGREGATED ACCOUNTS. A corporation shall establish segregated accounts for the following classes of insurance business, if it also does other classes of insurance business:

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(a) Mortgage guaranty insurance; and

(b) Life insurance including fixed and variable annuities. Disability insurance may be included in a life insurance account.

(2) OPTIONAL SEGREGATED ACCOUNTS. With the approval of the commissioner, a corporation may establish a segregated account for any part of its business. The commissioner shall approve unless he finds that the segregated account would be contrary to the law or to the interests of any class of insureds.

(3) SPECIAL PROVISIONS FOR SEGREGATED ACCOUNTS. (a) Capital and surplus. The commissioner may specify in the certificate of authority of a newly organized corporation the minimum capital or the minimum permanent surplus and the initial expendable surplus to be provided for each segregated account. If a segregated account is established after a certificate of authority has been issued, the commissioner may require the corporation to allocate an adequate amount of capital and surplus to the segregated account.

(b) Identification. The income and assets attributable to a segregated account shall always remain identifiable with the particular account but unless the commissioner so orders, the assets need not be kept physically separate from other assets of the corporation. The income, gains and losses, whether or not realized, from assets attributable to a segregated account shall be credited to or charged against the account without regard to other income, gains or losses of the corporation.

(c) Charges. Except under par. (e), assets attributable to a segregated account shall not be chargeable with any liabilities arising out of any other business of the corporation, nor shall any assets not attributable to the account be chargeable with any liabilities arising out of it, except under par. (i).

(d) Incidental business. Incidental business done by a corporation under s. 610.21 may be done under the general account or under any segregated account approved by the commissioner. Expenses and income for such business shall be allocated among the general account and all segregated accounts in accordance with generally accepted accounting principles.

(e) Delinquency proceedings. Each segregated account shall be deemed an insurer within the meaning of s. 645.03 (3). A liquidation order under s. 645.42 for the general account or for any segregated account shall have effect as a rehabilitation order under s. 645.32 for all other accounts of the corporation. Claims remaining unpaid after completion of the liquidation under ch. 645 shall have liens on the interests of shareholders, if any, in all of the corporation's assets that are not liquidated, and the rehabilitator may transform the liens into ownership interests under s. 645.33 (5).

(f) Ownership. Assets allocated to segregated accounts are the property of the corporation, which is not and shall not hold itself out to be a trustee of the assets.

(g) Common assets. A corporation may own a particular asset in determinate proportions for segregated accounts, for its general account or as a trustee when acting as such within its legal powers.

(h) Transfer. The corporation may by an identifiable act transfer assets for fair consideration among the segregated accounts, the general account and any trust accounts of the corporation.

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(i) Expenses and services. The general account of the corporation, or any segregated account, may for a fair consideration provide guarantees in connection with, perform services for or reinsure other accounts, subject to rules promulgated by the commissioner. Generally accepted accounting principles and realistic actuarial tables may be considered to ascertain what is a fair consideration.

NOTE: Some branches of the insurance business are much riskier than others. Traditionally, it has been considered desirable for certain kinds of business to be transacted by separate companies, so that adverse experience or failure in the more hazardous venture would not endanger the policyholders in the more stable types of business. On the other hand, the needs of the market have produced a combination of coverages. This has helped develop fleets or groups of corporations under common management. With more refined actuarial and management techniques, reducing the risk of failure even in the more hazardous types of business, and the growing demand for a combination of coverages in a single policy, the traditional requirements of a separation of lines have been substantially relaxed in recent decades. Under s. 201.05 (1), all lines may be transacted by a single corporation, with the single exception of mortgage guaranty insurance, and the requirement of s. 201.05 (2) that for life insurance a "separate" account has to be maintained if other insurance is also written. Sub. (1) continues this idea that insurers should not be forced to form separate corporate entities if they do not want to. Of course, insurers have, for a variety of reasons, often found it desirable to establish separate corporations for certain divisions of their business, even within a single line. High risk automobile business is an illustration.

Despite this liberalization, it is not yet possible to abandon completely the notion that the fortunes of policyholders in hazardous and secure types of insurance should be separated. One of the secure lines is life insurance. It should be kept apart from any other business, lest the life policyholders have to subsidize other business in times of stress. On the merits, this should perhaps include separation from the more hazardous forms of disability insurance. This could be achieved in this law by deleting the exception of sub. (1) (b). However, in view of the long history of combined life and disability insurance operation, this law continues to permit the combination without qualification.

Mortgage guaranty insurance has long been regarded as a particularly hazardous type of business, based primarily on bad experience in the 1930's. Whether it is still hazardous with modern techniques is questionable. Perhaps sub. (1) (a) could be deleted. This law no longer requires a separate corporate entity for such insurance but, taking a cautious approach, continues the requirement of segregation of assets. The peculiar characteristics of the business may justify the separation irrespective of the question of hazard.

Sub. (2) provides for optional segregated accounts under any circumstances the corporation wishes, if the separation meets the commissioner's approval. This in effect extends to all insurance the liberality of former s. 206.385 (1), but protects insureds by requiring the

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commissioner's approval. S. 206.385 (1) is continued expressly (with minor changes) for life insurers in s. 611.25 (2).

The basic idea behind segregated accounts is that different operations can be kept independent without formally creating a separate corporation. A segregated account is in some respects like a "corporation within a corporation". Its legal nature and treatment is prescribed in sub. (3). Sub. (3) (a) requires that a segregated account be equipped with an adequate share of the corporation's capital and surplus. This is indispensable if the account is to be expected to function and survive like a separate corporation. If it carries no risks not assumed by the corporation's general account, the commissioner may set the required figure at zero under s. 611.19 (1). There is no reason why a corporation which could create a subsidiary under s. 611.26 (2) for any portion of its insurance business should not be permitted to achieve the desired separation by establishing a segregated account, provided it is adequately capitalized to make it independently viable, and the commissioner approves its creation.

Sub. (3) (b) continues former s. 206.385 (3) but without the reference to the contract. The law should provide for such attribution of income, gains and losses without regard to the contract. Otherwise, segregation has little meaning. This would not prevent transfers to other parts of the corporation to pay designated expenses, in accordance with sound accounting principles.

Sub. (3) (c) continues s. 206.385 (5m) but makes the immunity bilateral instead of unilateral. This does not prevent the corporation in its general account from underwriting, for a price that will be under supervision under par. (i), such things as the mortality experience or the expense load assumed in the premiums charged the segregated account policyholder.

Sub. (3) (d) is necessary to accommodate the collateral activities contemplated by s. 611.26.

Sub. (3) (e) is new. It recognizes that for a variety of reasons, the general account or some segregated accounts may fail. It should then be possible to liquidate it without disturbing the other segregated operations of the corporation, except to subject the ownership interests of shareholders to the costs of the failure in any part of the corporation's operation. Though the typical segregated account could not fail because of a decline in the value of its portfolio of assets, it could fail if the assets were embezzled or stolen without proper insurance against those risks. Such an event is improbable but should be contemplated by the law.

Sub. (3) (f) continues s. 206.385 (5), in edited form. It makes clear an important, but sometimes misunderstood principle, that an insurance corporation is not a trustee of assets but a debtor on insurance contracts. A quasi-trust notion is often used to justify regulation, or at least particular aspects of regulation. But there is no true "trust" relationship, although the separation of assets in segregated accounts provides an additional similarity to the true trustee-beneficiary relationship.

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Sub. (3) (g) is new. There is no reason assets cannot be held jointly by different accounts in the same corporation, so long as the corporation's records make it always determinable how they are held.

Sub. (3) (h) continues s. 206.385 (7), slightly elaborated. The transfer should be by an identifiable act, to lessen any chance of manipulation of assets for improper purposes. The fair consideration requirement is presently implicit in s. 206.385 (7) (the rule-making power) and s. 206.385 (6) (prohibiting unfair discrimination). Explicit reference to it as a standard seems desirable.

Sub. (3) (i) continues s. 206.385 (6). It recognizes that the general account of a corporation may insure the mortality assumptions and expense loading of a segregated account, for a fair consideration.

611.25 SPECIAL PROVISIONS FOR SEPARATE ACCOUNTS FOR VARIABLE CONTRACTS. (1) TERMINOLOGY. Separate accounts under this section form a special category of segregated accounts and may be designated by any appropriate name the corporation wishes to use.

(2) FORMATION. With the approval of the commissioner, any corporation may establish one or more separate accounts and allocate to them any amounts paid or remitted to or held by the corporation under designated contracts or classes of contracts which amounts are to be applied to provide benefits payable partly or wholly in variable dollar amounts. Such amounts may also be applied to provide benefits in fixed and guaranteed dollar amounts and other incidental benefits.

(3) SPECIAL RIGHTS AND PROCEDURES. To the extent necessary to comply with the federal investment company act of 1940, as now or later amended, or any rules issued thereunder, the corporation may adopt special procedures for the conduct of the business and affairs of a separate account, and may, for persons having beneficial interests therein, provide special voting and other rights, including special rights and procedures relating to investment policy, investment advisory services, selection of certified public accountants, and selection of a committee, the members of which need not be otherwise affiliated with the corporation, to manage the business and affairs of the account.

(4) APPLICABLE GENERAL PROVISIONS. Separate accounts under this section are subject to s. 611.24 (3).

NOTE: Sub. (1) makes clear that "separate accounts" used by life insurers are within the meaning of segregated accounts in s. 611.24.

Sub. (2) follows former s. 206.385 (1) except that it requires the commissioner's approval for creation of separate accounts. The language of former s. 206.385 (1) is so broad as to permit any desired portion of the insurer's business to be in separate accounts.

Sub. (3) follows s. 206.385 (5c), in order to enable a separate account to satisfy Securities and Exchange Commission requirements, established pursuant to the federal investment company act of 1940.

Sub. (4) makes it clear that s. 611.24 (3) applies to the variable value separate account, as a special category of segregated accounts.

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611.26 SUBSIDIARIES. (1) INSURANCE SUBSIDIARIES. An insurance corporation may form or acquire subsidiaries to do any lawful insurance business. There is no limit on the amount of investment in such subsidiaries except that for purposes of ss. 623.11 and 623.12, the total value of the outstanding shares of such a subsidiary shall be deemed to equal the amount of surplus possessed by the subsidiary in excess of its security surplus, as determined by the commissioner under s. 623.12.

(2) INVESTMENT SUBSIDIARIES. An insurance corporation may form or acquire subsidiaries to hold or manage any assets that it might hold or manage directly. There is no limit on investment in such subsidiaries except that imposed by s. 620.23 (3).

(3) ANCILLARY SUBSIDIARIES. (a) Authorization. An insurance corporation may form or acquire subsidiaries to perform functions or provide services that are ancillary to its insurance operations. It may have up to 10% of its assets invested in such subsidiaries.

(b) Purposes. Subsidiaries are ancillary subsidiaries if they are engaged principally in one or more of the following:

1. Acting as an insurance agent.

2. Investing, reinvesting or trading in securities, or acting as a securities broker, dealer or marketing representative, for its own account or for the account of any affiliate.

3. Managing of investment companies registered under the federal investment company act of 1940, as amended, including related sales and services.

4. Providing investment advice and services.

5. Acting as administrative agent for a government instrumentality performing an insurance, public assistance or related function.

6. Providing services related to insurance operations, including accounting, actuarial, appraisal, auditing, claims adjusting, collection, data processing, loss prevention, premium financing, safety engineering and underwriting services.

7. Holding or managing property used by the corporation alone or with its affiliates for the convenient transaction of its business.

8. Providing such other services or performing such other activities as the commissioner may declare ancillary by rule.

9. Owning corporations which would be authorized as subsidiaries under subds. 1 to 8 and under subs. (1) and (2).

(4) OTHER SUBSIDIARIES. An insurance corporation may form or acquire other subsidiaries than those under subs. (1) to (3). The investment in such subsidiaries may be counted toward satisfaction of the compulsory surplus requirement of s. 623.11 and the security surplus standard of s. 623.12 to the extent that the investment is a part of the leeway investments of s. 620.22 (8).

(5) NOTICE TO COMMISSIONER. An insurance corporation shall notify the commissioner promptly of the formation or acquisition of any subsidiary under this section.

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NOTE: This section defines the limits within which a domestic insurer may operate through the use of legally independent but economically captive corporations. The subsidiary may be looked at as an investment, or as an extension of the parent's business operations. To the extent that the subsidiary is an investment, it is subject to the general diversification requirements of the investment chapter, as well as to any restrictions the law may place on control of other enterprises. This section provides justified exceptions where the subsidiary is conceived of as merely an extension of the parent's own operation.

Where subsidiaries are permitted as special categories of investments, control is not only permitted but insisted upon. See the definition of subsidiary in s. 600.03. This is because it is important, where substantial investments are made in dependent, nonpublic, corporations, that the insurer be immune from the whims of its partners in the enterprise. A falling out of the partners would leave the minority shareholders vulnerable because of the lack of a market for the stock of a closely held corporation. An insurer might thus be locked into an unprofitable arrangement with no effective market out. An arrangement of that sort may still be made at the insurer's option as an investment, but a corporation that wishes to invest without acquiring control should be limited by ch. 620. Thus investments may be made within the limits of ch. 620 in any kinds of corporations, but investments that exceed the restrictions of that chapter for general investments may be made only in the kinds of corporations described here and in conformity to the special limits prescribed therefor. Cooperative formation of subsidiaries by several unrelated insurers is not permitted, except under the leeway clause or with excess surplus.

The basic reason for the restrictions of this section and of ch. 620 is one inherent in the purposes of insurance regulation: the financial soundness of the insurance enterprise and its protection, in the interest of the insureds, against lack of solidity. It has been a rule for many years that an insurer may not transact any noninsurance business, lest its solvency with respect to its insurance obligations suffer from more risky ventures in other fields. Financial breakdown and bankruptcy, the traditional regulating forces of the free marketplace, cannot be permitted to operate with full force in the field of insurance, because they threaten the very foundation of the insurance business - security. Therefore, the insurance business must be kept separated from other enterprises, with the exceptions permitted by this section and by the investment laws. Even within the insurance business, it has traditionally been required that the more hazardous kinds of insurance be separated from the more secure kinds. This bill permits domestic insurers to write all kinds of insurance within the same corporate entity. But it continues some elements of the traditional cautious approach. Assets employed in life insurance and mortgage guaranty insurance must be segregated from those in other lines. See. s. 611.24.

There is nothing in modern economic development to justify a departure from the basic principles proposed for subsidiary formation. Nor would it be justified to permit insurers to do through subsidiaries what they are

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not allowed to do directly. "Diversification" by acquisition of unrelated business enterprises may be an appropriate method to mitigate economic risks in other areas of business - it is suspect where the fortunes of a multitude of policyholders are engaged. The opinion in 56 OAG 62 (1967), holding unlawful the acquisition by a domestic nonlife insurance company of a controlling interest in a corporation operating a garage and new car dealership, reflects a sound principle for insurance law, except to the extent that the investment is a minor one (from the viewpoint of the insurer) and conforms to the restrictions of s. 620.22 (8).

The only types of subsidiary corporation that appear to be justified without reference to the limitations of ch. 620 are insurance and investment subsidiaries for which special rules are applicable, and ancillary subsidiaries established by the insurer primarily for the more convenient transaction of its own business. See Report of the Special Committee on Insurance Holding Companies to the Superintendent of Insurance of the State of New York 15-18 (1968). Sub. (1) provides for the valuation of insurance investments in subsidiaries. It is new. Major insurance investments, as in subsidiaries, can properly be valued only at the surplus in excess of security surplus, for determining solidity. If greater value is given them to determine the strength and solidity of the investor, then the surplus is being used twice, to support two separate insurance operations, thus weakening the policyholders' position without appearing to do so. In the case of a subsidiary operating with approximately security surplus, or less, ownership should be given only nominal value for ascertaining the condition of the parent under s. 623.11 or 623.12. This is not a "balance sheet" valuation. The balance sheet value of the subsidiary to its parent may be much greater, approximating the sum of capital and surplus, depending on the quality of the business on the books and the quality of management. Exclusion of the security surplus of the subsidiary in determining the solidity of the parent does not involve its exclusion for other purposes.

A limit of 10% of assets is imposed for all investments in ancillary subsidiaries. The problem at this point consists in finding a reasonable definition of the corporations that are permissible "extensions" of the parent insurer, as opposed to those allowed only as investments. The problem has been approached by listing the functions that make a subsidiary an ancillary one, and by defining, in s. 600.03, the minimum financial interest needed to make another corporation sufficiently dependent to be regarded as a subsidiary and subject to reliable control.

For ancillary subsidiaries this section follows fairly closely the recommendations of the Report of the Special Committee on Insurance Holding Companies to the Superintendent of Insurance of the State of New York 15-20 (1968). Formation and acquisition of subsidiaries should be as simple as possible. The formation of domestic insurance subsidiaries is regulated in s. 611.22, the acquisition of a domestic insurance subsidiary in s. 611.71. Formations and acquisitions not involving Wisconsin insurance corporations are not within the scope of this code but are part of general

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corporation law. This section does not require that the subsidiaries be Wisconsin corporations.

While formation or acquisition of authorized subsidiaries should be simple, regulation should be as complete as necessary to protect the interests of insureds. In most cases regulation will be perfunctory but the power should be broad. Powers given by ch. 645 and elsewhere are probably sufficient protection to insureds.
Complaint has been made about the limited possibilities offered by this section to stock fire and casualty companies "by way of using additional surplus in really profitable adventures rather than insurance." That language implies that there are surplus assets in insurance companies not needed for the operation of the insurance business and that the management wants to employ them for the transaction of unrelated enterprises, rather than pay them out to shareholders as dividends or use them for extending the insurance business.

One natural view is that any stock corporation should retain only such funds as are needed - for current operation, for expansion, for contingencies like fluctuating losses or market conditions or to ensure continuing ability to pay reasonable dividends. All surplus not thus needed should be distributed to the shareholders, who should decide, rather than management, in what type of adventure they wish to reinvest it. Of course, this is inconsistent with established corporate practice. Business corporations traditionally have accumulated surplus far beyond actual need for the principal business activity and for tax and other reasons shareholders have not complained. The accumulation has then been used to diversify.

It is quite a different question, however, whether insurance corporations should have unlimited choice among the most profitable adventures that are available for the investment of surplus assets. The financial solidity of insurance corporations is a matter of far greater public concern than that of other business enterprises. Maximum profitability is not always compatible with adequate security.

611.28 CHANGES IN BUSINESS PLAN. (1) DEVELOPMENT STAGE. Within 5 years after the initial issuance of a certificate of authority no substantial change, alteration or amendment may be made in the business plan and the insurer may not substantially deviate from it unless notice of the proposed change is filed with the commissioner 30 days in advance of the proposed effective date. The commissioner may defer the effective date for an additional period not exceeding 30 days by written notice to the corporation before expiration of the initial 30-day period. He may, within the 30-day period or its extension, prohibit the proposed action if it is contrary to law or to the interests of insureds, creditors or the public in this state.

(2) CONTINUING CONTROL. The commissioner may by rule or order specify portions of the business plan to which the requirement of sub. (1) shall apply even after the initial 5-year period, if he finds after a hearing that it is required to protect the interests of insureds, creditors or the public in this state.

NOTE: During the early years of the enterprise, changes in any part of the business plan that were reported to the commissioner at the time of organization may be

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effected only with the acquiescence of the commissioner. His actual approval should not be necessary, however. The difficulties which attend this formative period justify close surveillance in the interests of insureds and the public. Thereafter it is appropriate to allow management full freedom, subject to applicable provisions of law. An order under s. 611.02 may, however, overcome the presumption in either direction. Where a restricted business plan has resulted in a limited certificate of authority, more regulatory scrutiny is necessary. See. s. 611.20 (4) (a).

Sub. (2) gives the commissioner express authority to extend operational controls over the business plan that relate to basic regulatory objectives. They should not be frozen into statutory language. For example, controls relating to the size of any risk assumed now appear in statutory language. See s. 204.10. Such continuing control is reasonable, but so many variables are involved, and company-by-company application may require such tailoring, that the matter is best left to the flexibility of rule and order, after hearing.

611.29 AMENDMENT OF ARTICLES. (1) RIGHT TO AMEND ARTICLES. A stock corporation may amend its articles under ss. 180.50 to 180.53 and 180.55 and a mutual may amend its articles under ss. 181.35 to 181.37 and 181.39, subject to sub. (3), in any desired respect including substantial changes of its original purposes. No amendment may be made contrary to s. 611.12 (1) to (3).

(2) FILING. For 5 years after the initial issuance of a certificate of authority, proposed amendments of the articles which are not changes in the business plan shall be filed with the commissioner at least 30 days before the amendment is submitted to the shareholders or policyholders for approval, or if such approval is not required, at least 30 days before the effective date.

(3) ARTICLES OF AMENDMENT; MUTUALS. In addition to the requirements of s. 181.37, the articles of amendment of a mutual shall, if mail voting is used, state the number of policyholders voting by mail and the number of such policyholders voting for and against the amendment.

(4) FILING OF ARTICLES OF AMENDMENT. No amendment may become effective until the articles of amendment have been filed with the commissioner.

(5) EFFECT OF AMENDMENT OF ARTICLES. Section 180.57 applies to stock corporations and s. 181.41 applies to mutuals.

SUBCHAPTER III.
SECURITIES OF DOMESTIC INSURANCE CORPORATIONS.

611.31 SECURITIES REGULATION. (1) REGISTRATION. No securities issued by a domestic insurance corporation may be sold by or for the corporation unless they are registered or exempt from registration under ch. 551.

(2) APPROVAL BY COMMISSIONER. Securities of a domestic insurance corporation may not be registered under ch. 551 without prior approval of the commissioner of insurance. Issuance of an organization permit under s. 611.13 constitutes such approval for the securities described in the permit.

(3) HOLDING COMPANIES. No issuer of securities which is being organized in this state or elsewhere solely or partly for the purpose of organizing a corporation under this chapter may register

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or sell its securities in this state unless it obtains an organization permit under s. 611.13. No security may be registered or sold in this state if there is any representation that an insurer will be organized or purchased in this state with the proceeds of the sale, unless the issuer obtains an organization permit under s. 611.13.

(4) INSIDER TRADING OF SECURITIES. (a) Every person who is directly or indirectly the beneficial owner of more than 10% of any class of any equity security of a domestic stock insurance corporation, or who is a director or officer thereof, shall file in the office of the commissioner within 10 days after he becomes such a beneficial owner or a director or officer, and within 10 days after the close of any calendar month thereafter in which there has been a change in his ownership or office, a statement in the form prescribed by the commissioner, of his office and of all equity securities of the company of which he is the beneficial owner, and of all changes in either.

(b) For the purpose of preventing the unfair use of information which may have been obtained by such a beneficial owner or by a director or officer because of his relationship to the corporation, any profit realized by him from any purchase and sale or sale and purchase of any equity security of the corporation within any period of less than 6 months, unless the security was acquired in good faith in connection with a debt previously contracted, shall be recoverable by the corporation, irrespective of any intention by the beneficial owner, director or officer in entering into the transaction to hold the security purchased or not to repurchase the security sold for a period exceeding 6 months. Suit to recover the profit may be instituted in any court of competent jurisdiction by the corporation, or if the corporation fails to bring suit within 60 days after request or fails to prosecute it diligently thereafter by the owner of any security thereof, in the name and in behalf of the corporation; but no such suit may be brought more than 2 years after the date the profit was realized. This paragraph does not cover any transaction where the beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, nor does it cover any transaction which the commissioner by rule exempts as not comprehended within the purpose of this paragraph.

(c) It is unlawful for any director or officer, or any beneficial owner subject to par. (a), to sell any equity security of the corporation, directly or indirectly, unless he or his principal owns the security sold and either delivers it within 20 days after the sale or deposits it within 5 days after the sale in the mails or other usual channels of transportation. A person has not violated this paragraph if he proves that despite the exercise of good faith he was unable to deliver or deposit his securities within the specified times, or could only have done so with unreasonable inconvenience or expense.

(d) Par. (b) does not apply to a purchase and sale or sale and purchase and par. (c) does not apply to a sale of any equity security of a domestic stock insurance corporation not then or earlier held by him in an investment account, by a dealer in the ordinary course of his business and incident to his establishment or maintenance of a primary or secondary market (otherwise than on an exchange as defined in the federal securities exchange act of 1934) for the security. The commissioner may by rule define and prescribe terms and conditions with respect to securities held in an investment account and transactions made in the ordinary course of business and incident to the establishment or maintenance of a primary or secondary market.

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(e) Pars. (a) to (c) do not apply to foreign or domestic arbitrage transactions unless made in contravention of rules the commissioner adopts in order to carry out this subsection.

(f) Pars. (a) to (c) do not apply to equity securities of a corporation if:

1. The securities are registered, or are required to be registered, pursuant to s. 12 of the federal securities exchange act of 1934, as amended; or

2. The corporation did not have any class of its equity securities held of record by 100 or more persons on the last business day of the year preceding the year in which equity securities of the corporation would otherwise be subject to pars. (a) to (c).

(g) In this subsection "equity security" means any stock or similar security; or any security convertible, with or without consideration, into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any other security which the commissioner deems to be of similar nature and designates as an equity security by rules promulgated in the public interest or for the protection of investors.

(5) PROXY SOLICITATION. No person may, in contravention of rules the commissioner promulgates for the protection of investors or the public, solicit or permit the use of his name to solicit any proxy or consent or authorization in respect of any equity security of a domestic stock corporation having 100 or more shareholders of record.

(6) EFFECT OF RELIANCE ON COMMISSIONER'S RULE. No provision of sub. (4) imposing any liability applies to any act done or omitted in good faith in conformity with any rule of the commissioner, even if the rule is, after the act or omission, amended or rescinded or determined by judicial or other authority to be invalid.

(7) EFFECT OF VIOLATION. A contract for subscription to or the purchase of shares in any corporation made in violation of this chapter or of ch. 551 is valid and enforceable against but not in favor of the corporation or the insider, except that the contract is valid and enforceable in favor of the corporation against an insider.

NOTE: This section continues dual responsibility for the securities issues of insurers, as now provided in the insurance and securities laws. The insurance commissioner's principal concern is with the insurer's capital structure and its relationship to the solidity of the insurer. In order to ensure that he has plenary power over the issuance of securities by insurers, present s. 551.27 (13), which requires his approval as a prerequisite to registration, has been retained with some minor amendments of a technical nature.

Some existing provisions of the insurance laws fall far outside the insurance commissioner's principal concern and clearly within the main interests of the securities commissioner. It is proposed that they simply be repealed and the task of surveillance be left altogether to securities regulation. S. 201.10 (6) is the prime example, and is repealed.

This law assumes that the elaborate inquiry contemplated under s. 611.13 before an organization permit is issued makes it pointless for the securities commissioner to

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make a duplicate inquiry; it would be a waste of administrative effort and would delay decision for no good reason.

The purpose of the commissioner's inquiry is the protection of investors as well as of the public and future policyholders, through assuring the solidity of the proposed enterprise. Solidity of an enterprise includes a reasonable expectation of profit. The commissioner will not issue a permit where he believes the venture is not likely to succeed; and its ability to succeed is dependent upon its ability to produce earnings.

Further, some of the organizational requirements of this chapter inure to the direct and immediate benefit of the investor - for example, the commissioner's inquiry into the competence and integrity of the proposed management and the requirement that proceeds of the solicitation be placed in escrow.

Thus issuance of an organization permit should be deemed to satisfy the requirements of s. 551.28 (1) (d) and (i). Beyond that the ordinary procedures of the securities laws should apply.

The only securities a stock corporation may issue initially are a single class of voting common stock and a single class of preferred stock. This simple capital structure eliminates some of the frequent sources of difficulty in securities regulation. In connection with initial issues the commissioner would not be handicapped by lack of familiarity with the more intricate and sophisticated problems of securities.

Sub. (1) applies both to mutual bonds and contribution notes and to stock corporation shares or debt securities. Inclusion of mutual bonds seems reasonable to protect investors if the bonds are offered to the public as investments. They are not now used and may never be used extensively but are certainly legitimate financing devices, appropriately made available for use whenever circumstances make the bonds saleable. That may not be often, but it is not any the less desirable to permit their sale. There is no less reason for securities regulation to try to ensure that buyers are not misled, than for shares of stock or other kinds of bonds.

Contribution notes are different. They do not belong to the public market for securities. There is no public market for them under the existing laws. They are issued infrequently and in large amounts. The former statutory minimum for surplus notes was $1,000. S. 201.17 (2). There is no justification for 2 separate kinds of such notes and this law assimilates them, calling them all "contribution notes". The term "surplus notes" is dropped. Contribution notes were referred to in ss. 201.03 (1) (a) and 201.17 (2) but not very clearly handled there. The occasional issuance of either kind of note in large amounts, where the public is not invited to invest, should be exempt from registration under the securities law. The appropriate control for such special financing is control by the insurance laws, provided under s. 611.33 (2).

The purpose of sub. (3), which is duplicated in the addition of s. 551.27 (13) (b), is to prevent evasion of the requirements of this chapter through organization of

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a holding company. Promoters may attempt to market shares in a corporation organized under ch. 180 or similar statutes by stating that the purpose of the corporation is to organize an insurance corporation in this state after the necessary funds have been raised by the public sale of securities. Indirect entry into the insurance business by this route defeats the policy of this chapter which imposes close supervision upon the new venture from the start in the interests both of the investing public and of future insureds. So far as practicable, this subsection will prevent evasion of the organizational procedures of this chapter. Structurally the provision belongs in ch. 551 but for ease of access is exactly duplicated here, as an integral part of the insurance laws revision.

This section does not attempt to prevent the sale of securities in other states for the purpose of subsequently forming an insurance corporation in Wisconsin or elsewhere. This is beyond Wisconsin's regulatory concern. Funds may be raised from Illinois investors, for example, for the purpose of forming a Wisconsin insurer. In that case, Wisconsin's regulatory concern begins when the attempt is made to form the Wisconsin insurance corporation. At that point, the Illinois holding company could subscribe to all of the stock and the organization would proceed under s. 611.22. Since there is no public Wisconsin offering, the commissioner, if satisfied on the other requirements, would issue a certificate of authority. Even in that case, of course, the stock taken by the holding company is required to be escrowed for 5 years. See s. 611.32 (3).

Subs. (4), (5) and (6) were originally enacted by ch. 113, laws of 1965, in order to preserve the insurance exemption from the Securities Exchange Act provided when that Act was amended in 1964. See 15 U.S.C. ss. 78 1 (g) (2) G and 78 p. These provisions are fundamentally uniform throughout the country and have not been altered here, except by minor editing.

Sub. (7) is adapted from s. 201.10 (8), but somewhat expanded in application.

611.32 PROMOTER STOCK. (1) MANDATORY PURCHASE. During the period of effectiveness of the organization permit the incorporators, directors, and principal officers of a stock corporation shall among themselves subscribe and pay, at the public offering price, at least $100,000 in cash or in property of equivalent value approved by the commissioner, for shares offered by the corporation under the organization permit.

(2) RESTRICTIONS ON ISSUANCE. (a) No person may subscribe for promoter stock on terms more favorable than those on which subscriptions are being solicited from the general public.

(b) Except under this section and s. 611.18 (2) (a) 2, and except for stock dividends, no promoter stock may be issued for 5 years following the initial issuance of the certificate of authority, without the approval of the commissioner which may be granted by the commissioner only if he finds that:

1. The corporation is in need of additional capital; and

2. The value proposed to be given for the stock is fair to existing shareholders and has a reasonable relation to the current value of the outstanding shares.

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(c) This subsection shall not affect the exercise of pre-emptive rights.

(3) RESTRICTIONS ON TRANSFER. (a) Deposit in escrow. Certificates representing shares of promoter stock and any stock received thereon as the result of a stock dividend, stock split or exercise of preemptive rights shall be deposited in escrow with a depository satisfactory to the commissioner under an agreement providing that the shares may not be transferred without the approval of the commissioner.

(b) Release from escrow. If the corporation issues any life insurance policies, any shares subject to this section shall be released from escrow 5 years after issuance of the certificate of authority. In other cases, the shares shall be released from escrow 3 years after issuance of the certificate of authority.

(4) APPROVAL. Approval of the transfer of promoter stock under sub. (3) (a):

(a) Shall be granted upon request if the corporation has made an addition to earned surplus in each of the 2 immediately preceding years of at least 6% of the capital raised by the sale of shares under the organization permit; and

(b) May be granted upon a showing of hardship by the shareholder or his estate or legatee, if the release from escrow of the shares or a portion thereof would not, in the commissioner's opinion, endanger the interests of insureds or the public.

(5) OPTIONS TO PURCHASE STOCK. For 3 years after the issuance of the certificate of authority, an option to purchase stock may be issued only pursuant to a plan approved by the commissioner.

NOTE: Abuses in the promotion of new insurance enterprises have centered around promoters' stock, or stock sold to insiders. Various devices have been used to create and inflate an active market in the stock of the new enterprises in which unscrupulous insiders then proceed to dump their stock. The proposed statute attempts to meet this problem without imposing undue hardship on legitimate organizers.

The hypothesis of sub. (1) is that a legitimate promotion will not be hindered by a requirement that the insiders make a substantial investment which is irrevocably committed to the business for the first years of its operation. Such a provision merely requires them to exhibit good faith by subjecting their own assets to the risks they have invited others to run. There are provisions of this general type in the statutes of other states. See, e.g., Iowa s. 506.1.

Sub. (2) (a) seeks to ensure that the terms on which promoters acquire their stock are fair. There is naturally no objection to the promoters' purchase of additional shares from other investors in a secondary market, if they do not sell again within 6 months.

After the enterprise is launched, management should devote all its energies to the operation of the insurance business, rather than to stock manipulation or dealing. When the business begins to prosper, the insiders should not be able to appropriate to themselves a larger share of the prosperity by issuing further

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shares to themselves on favorable terms. This prosperity belongs to the initial investors who took their chances at the beginning. Protection of this pro rata interest in the enterprise cannot safely be left to the uncertainty of the law relating to preemptive rights, because insurance corporations, like corporations organized under ch. 180, are free to restrict or deny preemptive rights under s. 180.45 (1) (h). Sub. (2) (b) seeks to prevent this abuse during the critical early years of the business, when insiders have sometimes manipulated stock prices for personal gain. After this initial period, the provisions of general corporate law are applicable, and stock insurance corporations are accorded the same treatment as industrial corporations. During the first 5 years of operation, however, under this provision the price at which additional shares may be issued to insiders is subject to supervision by the commissioner to prevent unfairness to existing shareholders, whether or not preemptive rights are denied in the articles. There is no comparable restriction in ch. 180, but there is some precedent for judicial control to prevent the watering of outstanding shares and exploitation of existing shareholders. See, e.g. Ross Transp. Inc. v. Crothers, 185 Md. 573, 45 A. 2d 267 (1946). The Wisconsin Supreme Court has also expressed concern over the fairness of prices at which additional shares are offered. See Steven v. Hale-Haas Corp., 249 Wis. 205, 23 N.W. 2d 620 (1945). More recently, the court has approved a broad interpretation of the preemptive rights doctrine, and a restrictive view of its exceptions. See Fuller v. Krogh, 15 Wis. 2d 412, 113 N.W. 2d 25 (1961).

Dumping of stock by insiders is prevented during the crucial early years by sub. (3); sub. (4) provides an escape from the harshness of an unqualified prohibition of transfer through approval of the commissioner. The possibilities for abuse are especially great in the insurance industry because rapid growth of insurance in force through careless risk selection coupled with under-reserving can create an illusion of prosperity while really exposing the venture to serious risk of insolvency. The degree to which appearances may be deceptive is perhaps greater in this business that in any other, and the possibilities of prompt detection are fewer. In this setting the chance to resell, at a profit, stock known by insiders to be overpriced by the market may encourage management practices which jeopardize the long-range interests of the enterprise. One practical device, adopted here, is to remove the quick stock profit temptation from the formative period of the enterprise. Thereafter, some further protection is given by the insider trading provisions of s. 611.31, though the rules are not stringent.

The restrictions on the transfer of promoter stock are a necessary part of the proposed statutory scheme to minimize speculative motivations during the early years of an insurer's operation. Iowa s. 506.1 (enacted by Laws of 1963, ch. 506) permits the commissioner to promulgate rules governing transfers. The most stringent rules permitted under the Iowa law are similar to the rules proposed here.

The stock option device is important to acquire and keep good management and technical personnel, but it is especially subject to abuse, and should not be used indiscriminately, especially in early years. A con-

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siderable protection against the abuse of disapproval power over stock options is the commissioner's natural desire to have domestic corporations succeed, once he has permitted them to be launched.

A possible control that would be more stringent is to forbid stock options altogether during the early years. However, a more serious danger then appears, of disabling the corporation from competing for executive talent of high quality to make the new enterprise "go". Thus, even during the formative years, it is important that stock options be possible, with the commissioner's approval. After a reasonable period, reasonable stock option plans should be possible without the commissioner's approval. Use of stock options does not in itself pose a threat to the solvency of the company, except that it may encourage unsound operational practices to which the stock market will or may react favorably. For this reason such plans are subject to the requirements of s. 611.63. See particularly s. 611.63 (2) and the comment to s. 611.63 (2).

611.33 AUTHORIZED SECURITIES. (1) STOCK CORPORATIONS. (a) Classes of shares. The articles of a stock corporation may authorize any kind of shares permitted by s. 180.12, except that:

1. Until one year after the initial issuance of a certificate of authority, the corporation may issue no shares and no other securities convertible into shares except for a single class of common stock and, with the approval of the commissioner, on terms that he considers fair, a single class of preferred stock for sale to no more than 15 shareholders;

2. After the first year and within 5 years after the initial issuance of a certificate of authority, no additional classes of shares may be issued, except after approval of the commissioner, who may approve only if he finds that existing shareholders will not be prejudiced.

(b) Fractional shares or scrip. No fractional shares may be issued. Subject thereto, s. 180.19 applies.

(c) Consideration and payment for shares and certificates representing shares. Sections 180.14 (1), (2) and (4), 180.15 (2) and 180.18 apply.

(d) Liability of subscribers and shareholders for unpaid subscriptions and status of stock. Section 180.20 applies.

(e) Shareholders' preemptive rights. Section 180.21 applies.

(f) Liability to employes. Section 180.40 (6) applies.

(2) MUTUALS. (a) Mutual bonds. The articles of a nonassessable mutual may authorize mutual bonds of one or more classes and shall specify the amount of each class of bonds the corporation is authorized to issue, their designations, preferences, limitations, rates of interest, relative rights and other terms, subject to the following provisions:

1. During the first year after the initial issuance of a certificate of authority, the corporation may issue only a single class of bonds with identical rights;

2. After the first year but within 5 years after the initial issuance of a certificate of authority, additional classes of bonds may be authorized after approval of the commissioner, who shall

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approve if he finds that policyholders and prior bondholders will not be prejudiced;

3. The rate of interest shall be fair and reasonable; and

4. The bonds shall bear a maturity date not later than 10 years from the date of issuance, when principal and accrued interest shall be due and payable, subject to par. (d).

(b) Contribution notes. Any mutual may issue contribution notes if the commissioner approves. He may approve only if he finds that:

1. The notes will not be issued in denominations of less than $500, and no single issue will be sold to more than 15 persons;

2. No discount, commission or other fee will be paid or allowed;

3. The notes will not be the subject of a public offering;

4. Their terms are not prejudicial to policyholders, holders of mutual bonds or of prior contribution notes; and

5. The mutual's articles or bylaws do not forbid their issuance.

(c) Prohibited transactions. No mutual may:

1. If it has any outstanding obligations on mutual bonds or contribution notes, borrow on contribution notes from, or sell bonds to, any other insurer without approval of the commissioner; or

2. Make any loan to another insurer except a fully secured loan at usual market rates of interest.

(d) Repayment. Payment of the principal or interest on mutual bonds or contribution notes may be made in whole or in part only after approval of the commissioner. Approval shall be given if all financial requirements of the issuer to do the insurance business it is then doing will continue to be satisfied after payment and if the interests of its insureds and the public are not endangered. In the event of liquidation under ch. 645 unpaid amounts of principal and interest on contribution notes shall be subordinated to the payment of principal and interest on any mutual bonds issued by the corporation at any time.

(e) Other obligations. Nothing in this section prevents a mutual from borrowing money on notes which are its general obligations, nor from pledging any part of its disposable assets therefor.

NOTE: This bill permits stock corporations to issue stock without par value, despite the possibility of speculative flotations. A restriction to par value stock seems unnecessary - the commissioner must approve all stock issues under ss. 611.31 and 551.27 and may thus control speculative activity.

There are explicit restrictions on the capital structure of stock corporations only during the initial years of corporate existence. After the initial organization period, the desirability of issuing additional classes of securities should be left to the management and the shareholders, subject, of course, to a residual power in the commissioner to disapprove a stock issue that would violate the law. Abandonment of the restriction on

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types of shares immediately after a certificate of authority is issued could lead to the same abuses as in the initial public sale of stock. Five years seems a reasonable time after which to end the restriction. For a doubtful company it can be continued by an order under s. 611.02, under appropriate circumstances. Conversely restrictions on even a new company can be removed by an order under s. 611.02.

The reasons for limiting initial use of preferred stock are two. The first is to prevent insiders from reserving to themselves a class of voting shares for the purpose of maintaining control, while selling nonvoting shares to the public. The present practice of the office of the securities commissioner with respect to the public sale of nonvoting stock is consistent with this rule. The general approach of that office is that the public should receive control in proportion to its investment.

Second, a preference in an initial financing is inherently deceptive, given the difficulties that attend the launching of a new insurance enterprise. Issuance of a 5% cumulative participating preferred, for example, is reasonably understood to represent that the enterprise is expected to earn 5% almost at once. Clearly, this implicit representation makes preferred inappropriate as an ordinary investment device for initial insurance financing because of the long delay before profits are ordinarily earned and could properly be paid. Theoretically this could be handled adequately by required statements in the prospectus but as a practical matter that seems unsatisfactory, given the lack of sophistication of most of the investors who would be the likely targets for solicitation. When the placement is essentially private, the problem is more likely to be that the senior position is given to insiders who can assess the risks best.

Later, additional capital may appropriately be raised by selling preferred stock after the common shareholders approve the amendment of the articles to create the new stock. In this connection it may be noted that preferred stocks are not now widely used in the insurance industry, and are often associated with financial difficulty. See, e.g. United States Investor, Dec. 2, 1968, pp. 35-38. Some insurance departments, notably New York's, are much more restrictive than this law in attitude toward the use of preferred. It is worthy of note, therefore, that the New York Special Committee on Insurance Holding Companies recommended much greater flexibility in the financing of insurance companies. Report, pp. 27-30 (1968). This bill contemplates no significant limitation on financing devices except in the beginning stages of the enterprise.

Fractional shares are rarely used in modern stock corporations. Their use introduces unnecessary complexities in voting and dividends, without offsetting benefits. Sub. (1) (b) thus eliminates a potential minor nuisance at no perceptible cost. It does not affect the issuance of scrip, rights or warrants, under s. 180.19.

Financing for mutuals is fundamentally different than for stock corporations. It can only be from debt securities. Except for ordinary commercial borrowing

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under sub. (2) (d), which is adapted from s. 201.17 (3), for special purposes, such debt securities will have to be subordinated to all policyholder and third-party claims and all ordinary corporate obligations or else the money obtained will not improve the financial position of the company. Only a "below-the-line" liability - a quasi-capital account - will do that. Sub. (2) (b) basically continues former law with respect to contribution and surplus notes, except that the term "surplus notes" has been dropped, there being no difference substantial enough to support the use of 2 terms. The reason for the liberal treatment of this form of subordinated debt financing is that it is usually supplied by promoters or other insiders or related financial institutions. These are essentially private transactions involving substantial amounts, and the lenders in such cases can generally be left to protect their own intersts. In such situations imposition of the registration requirement under ch. 551 would be an unreasonable and unnecessary burden on the parties. The real danger is to existing bondholders who may be prejudiced by unfairly generous conditions for the "insiders". That danger is minimized by sub. (2) (b) 3 and (d).

This law does not directly control the interest rates payable on contribution notes; it seems better to provide more flexibility by requiring approval by the commissioner.

The requirement of former law that surplus notes must not be issued in amounts of less than $1,000 (contribution notes $500) limited drastically the sources of capital available to mutual companies. This law enlarges those sources by permitting a security which under certain circumstances might be competitive in the money market. That security is styled a mutual bond, and can be issued in small denominations. Contribution notes may still be used but only for quite large amounts. They perform a different function, not one of tapping the general capital market but of providing a conduit for contributions by closely associated and vitally interested persons. As a result, they are free from securities registration. Mutual bonds, however, are not.

Use of mutual bonds immediately suggests the applicability of all of the considerations present in sales of corporate debt and equity securities. The insider trading provision in s. 611.31 (4) does not apply to mutual bonds, however, since insider trading in debt securities is not regulated at present, and it is doubtful whether the public interest requires such control of trading in mutual bonds. On the other hand, there is no reason for authorizing an exclusion from the usual rules respecting sellers of securities to the public. Under these conditions, persons selling mutual bonds are subject to the requirements of ss. 551.31 to 551.34. Whether or not these sections require the sellers to register as dealers depends upon the interpretation of the term "dealer". See s. 551.02 (2), (3) and (7).

611.34 CORPORATE REPURCHASE OF SHARES. No stock corporation may repurchase any of its own shares within 5 years after initial issuance of the certificate of authority, except pursuant to a plan for the repurchase which has been approved by the commissioner. After 5 years a stock corporation may repurchase its own shares under s. 180.385, but within 10 days after the end of any

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month in which it purchases more than one per cent of any class of its outstanding shares the corporation shall report the price and the names of the registered shareholders from whom the shares are acquired and of any other persons beneficially interested, so far as the latter are known to the corporation. The corporation shall make a like report within 10 days after the end of any 3-month period in which it purchases more than 2% of any class of its outstanding shares or within 10 days after the end of any 12-month period in which it purchases more than 5% of any class of its outstanding shares. Section 180.14 (3) applies to such shares.

NOTE: This section subjects corporate reacquisition of shares to requirements in addition to those imposed under s. 180.385. Repurchase of shares presents the same problems as dividends. The risk of improper distributions, whether by dividends or repurchases, is a more serious threat to the public interest in the case of insurers than in the case of ordinary corporations. For this reason, the commissioner must be promptly notified of substantial stock reacquisitions. If the repurchase raises questions about solidity, he has a chance to take action promptly.

Notice of repurchase will also provide information that may make visible other potential abuses peculiar to reacquisitions of stock. One is the risk that management may use available surplus to buy shares for its own purposes, including buying off critics, or giving special treatment to favored insiders or their relatives. A few recent cases have brought the problem of buying off critics into sharp focus. Although it is a matter of some importance for insurers, it is a problem of general corporate law in which there are few special insurance considerations. Therefore the insurance and general corporation codes should be as nearly in agreement as possible. The only justifiable difference is the special interest in solidity, leading to the requirement of immediate notice. The notice given to the commissioner may enable him to act under his general powers to get further information which will reveal the abuses in detail.

Shares repurchased under this section should be treated in the accounts as a deduction from the capital stock account, not as assets. That provision belongs in a rule relating to accounting practices.

It has been urged that the commissioner should be given a limited time to act under the first sentence of this section. This is plausible but unsound. It would be unsound to compel him to act until he had all relevant information and it would be impossible to define for all circumstances the information he should be entitled to demand before having to act. He has a general duty to act promptly under s. 601.41 (1). As a practical matter no more can be done without, in effect, compelling him to act on inadequate information under certain circumstances.

611.35 REDUCTION IN CAPITAL. No stock corporation may reduce its capital under ss. 180.59 and 180.60 unless the commissioner is notified of the proposed reduction at least 60 days prior to the effective date. The commissioner may disapprove the reduction within 45 days after the notice if he finds that it would violate the law or would be contrary to the interests of the insureds.

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NOTE: As in the case of repurchase of shares (s. 611.34) and payment of dividends (s. 611.69), the philosophy of this law is that within broad limits management should make financial decisions without interference from the commissioner. This is a less restrictive point of view than is found in the existing law. Thus s. 200.07 provides for the reduction of capital only when impaired in excess of 25%. In such cases, the commissioner might determine that a reduction would not be contrary to the public interest, and the shareholders might then vote a reduction. The reduction might not be to an amount less than the statutory minimum, and no part of the surplus so created (if any) was distributable. This law, on the contrary, merely calls for notification and delay before effectuating the decision. It does not contemplate that the commissioner should have power to disapprove unless some specific law is violated or the interests of the insureds are demonstrably jeopardized.

This liberalized viewpoint assumes that basic control over the financial condition of the insurer, at least for property-liability insurers, will be exercised in relation to the total of capital and surplus which will be required to be sufficient to support safely the insurers' actual operations. If that test is satisfactorily met, it makes no difference how the difference between total assets and liabilities is apportioned between capital and surplus, so long as there are enough spare assets to meet the financial requirements imposed by law.

If surplus before or after the reduction of capital is in excess of what is required for policyholders' protection, it may be distributed under s. 611.69, which also requires notice to the commissioner. If the distribution is not from earned surplus, it would be subject to s. 180.39 as a distribution in partial liquidation.

S. 201.02 (2) restricted increase in the authorized capital stock by requiring approval of the necessary amendment by three-fourths of the outstanding shares. This law abandons that restriction altogether. No interest of the insureds, shareholders or public is compromised by increase in capital.

SUBCHAPTER IV. MANAGEMENT OF INSURANCE CORPORATIONS.

611.40 SHAREHOLDERS' MEETINGS. (1) MEETINGS, NOTICES AND QUORUMS. Sections 180.23, 180.24 and 180.28 apply to stock corporations.

(2) CLOSING OF TRANSFER BOOKS AND FIXING RECORD DATE AND VOTING LISTS. Sections 180.26 and 180.29 apply to stock corporations.

(3) VOTING TRUST. Section 180.27 applies to stock corporations.

(4) VOTING REQUIREMENTS OF ARTICLES. Section 180.90 applies to stock corporations.

611.41 COMMUNICATIONS TO SHAREHOLDERS OR POLICYHOLDERS AND COMMISSIONER'S ATTENDANCE AT MEETINGS. (1) COPIES OF COMMUNICATIONS. The commissioner may by rule prescribe

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that copies of specified classes of communications circulated generally by a corporation to shareholders or policyholders shall be communicated to him at the same time.

(2) ATTENDANCE AT MEETINGS. The commissioner has the right to attend any shareholders' or policyholders' meeting.

(3) EXCEPTION. Subsection (2) and, so far as it relates to communications to shareholders, sub. (1) do not apply to stock corporations all of whose voting shares are owned by a single person, or all of whose shareholders are either members of the board or are represented on it.

NOTE: As the public official responsible for effective regulation of insurers, the commissioner should be able to observe directly and at first hand the operation of the management at the level of shareholder or policyholder communications and meetings. The shareholders or policyholders act on various matters which are of direct concern to the commissioner, and subject to regulation by him (e.g. mergers and conversions). Aside from these special cases, the public has a substantial stake in the regularity of such routine matters as the election of directors. It seems appropriate, therefore, to permit the presence of the commissioner at meetings which, in the case of widely held corporations at least, are in effect public meetings anyway. His role there would be that of an observer. In fact, the commissioner has sometimes attended such meetings without special statutory authority.

The objections that this provision is an implicit criticism of the bona fides of the industry and "looks bad", and that the commissioner might mistake the right for a duty to attend all meetings, are captious. It is desirable to open the doors of those meetings at which the commissioner's presence is needed. In the other cases covered by the section, it can do no harm. The commissioner has too much to do to waste his time at meetings where there is no good reason for him to appear.

The exception to the section for wholly owned subsidiaries is inserted not because they need regulation less but because the crucial decisions will never be exposed in that way.

611.42 MUTUAL POLICYHOLDERS' VOTING RIGHTS. (1) GENERAL. Subject to this section, ss. 181.14, 181.15 and 181.17 apply to mutuals. Subject to this section and s. 611.53, s. 181.16 applies to mutuals.

(2) VOTING RIGHTS. (a) Mandatory voting rights. Policyholders in all mutuals have the right to vote on conversion, voluntary dissolution, amendment of the articles and the election of all directors except public directors appointed under s. 611.53 (1). Directors may be divided into classes, and in that case one class shall be elected at least every 4 years for terms not exceeding 6 years.

(b) Optional voting rights. The articles of any mutual may give the policyholders additional voting rights.

(3) VOTING PROCEDURES. The articles or bylaws shall contain rules governing voting eligibility consistant with sub. (2) and voting procedures. No amendment to the rules may be effective until at least 30 days after it has been filed with the commissioner.

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(4) MEETINGS AND ELECTIONS. (a) The articles may provide for regular or special meetings of the policyholders, or elections in lieu of meetings.

(b) Notice of the time and place of regular meetings or elections shall be given to each policyholder by printing it conspicuously on each policy or in such other reasonable manner as the commissioner approves or requires.

(5) REPRESENTATIVE ASSEMBLY. The articles may provide that representatives or delegates be selected by the policyholders to represent specific geographical districts, or otherwise to represent defined classes of policyholders, determined on a reasonable basis. After the representative assembly has been selected by the policyholders, the assembly may choose replacements for members unable to complete their terms, if the articles so provide. The vote of a representative shall be treated as the vote of the policyholders he represents.

NOTE: The law makes no assumption that either policyholder voting or public directors will adequately protect the policyholders. Neither has that potential. It is the commissioner who must do that because it is only the commissioner who can do that, both for mutuals and stock corporations. This is one reason, indeed, that insurance is a closely regulated industry.

Nevertheless, sub. (2) (a) continues the long-standing right of policyholders in mutuals to vote for directors, and adds certain other major decisions on which they must be given a vote.

Sub. (2) (b) provides for optional voting on any additional decisions specified in the articles.

Sub. (3) provides for adoption of procedural rules appropriate to a particular corporation. The requirement for reporting of the rules to the commissioner is intended to make the rules fully public, even more than they would be as an inconspicuous part of the articles or bylaws. Ordinarily, amendments to the bylaws need not be reported for 60 days after they are effective. See s. 611.12 (4).

Sub. (5) permits a company to substitute a meeting of elected representatives for the all-policyholders meeting. It was adapted from s. 206.64 (3) which authorized this procedure for certain life companies. It should be available wherever there is a situation that allows the meaningful election of local delegates. This law adopts the principle of s. 181.175. However, there is merit in giving even greater flexibility than s. 181.175 provides, and under this bill, the company may work out its own rules, including replacement of members unable to complete their terms by the assembly itself.

611.43 ANNUAL REPORT TO MUTUAL POLICYHOLDERS. Every domestic mutual shall send to each policyholder requesting it an annual report which shall contain basic financial and operating data, information about important business and corporate developments, and such other information as the corporation wishes to include or as the commissioner by rule requires to be included in order to keep policyholders properly informed.

NOTE: If policyholder control is to be continued and is to be exercised in any meaningful way, at least a reasonable amount of information should be available to

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the purported "owners" of the corporation. It is hard to see why it should not be full enough to enable a careful reader to form some judgments by which to inform his vote.

This section requires reports only where policyholders request it.

611.51 BOARD OF DIRECTORS. (1) GENERAL. Subject to this section, s. 180.30 applies to stock corporations and s. 181.18 applies to mutuals.

(2) NUMBER OF DIRECTORS. (a) General. Except under pars. (b) and (c), a corporation shall have at least 9 directors.

(b) New corporations. During the first 5 years after initial issuance of a certificate of authority, a corporation shall have at least 5 directors.

(c) Exception. The commissioner may by order reduce the number of directors required under this subsection, if he finds that it would be an unreasonable burden on the corporation to comply with the requirement and that the interests of policyholders and shareholders can be otherwise protected.

(3) INSIDE DIRECTORS. Employes and representatives of a corporation may not constitute a majority of its board.

(4) SUBSIDIARIES AND CLOSELY HELD CORPORATIONS. Subs. (2) (a) and (3) do not apply to an insurance subsidiary authorized under s. 611.26 (1) nor to a stock insurance corporation more than 95% of whose outstanding shares entitled to vote are owned by a single person or all of whose voting shareholders are either members of or are individually represented on the board.

(5) CLASSIFICATION OF DIRECTORS. If directors of a corporation are divided into classes by the articles or the bylaws, no class may contain fewer than 3 members. Subject thereto, s. 180.33 applies to stock corporations.

(6) UNLAWFUL DELEGATION. The board of a corporation shall manage the business and affairs of the corporation and may not delegate its power or responsibility to do so, except to the extent authorized by ss. 180.41 (2), 181.25 (2) and 611.56.

(7) QUORUM OF DIRECTORS. Section 180.35 applies to stock corporations and s. 181.22 applies to mutuals except as specifically provided otherwise.

(8) PLACE AND NOTICE OF DIRECTORS' MEETINGS. Section 180.37 applies to stock corporations.

(9) BOOKS AND RECORDS. (a) Section 180.43 applies to stock corporations. Section 181.27 applies to mutuals, but inspection of the records of the names and addresses of policyholders of mutuals entitled to vote shall be permitted only for the purpose of communicating with other policyholders with regard to the nomination and election of candidates for the board or other corporate matters which may be submitted to a vote of the policyholders. No person may, directly or indirectly, use any information so obtained for any other purpose.

(b) Any books, records or minutes may be in written form or in any other form capable of being converted into written form within a reasonable time.

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(c) Any provision of this chapter or of any articles or bylaws of a mutual, which requires the keeping of records concerning the names and addresses of policyholders entitled to vote shall be deemed to be complied with by the keeping of a record of the names of policyholders and the names and addresses of insureds or persons paying premiums. Any such provision which requires the mailing or sending of notices, reports, proposals, ballots or other materials to policyholders shall be deemed to be complied with if mailing thereof is made to the insured or the person paying premiums on the policy for delivery to the policyholder.

NOTE: Insurance corporations are subject to the general rule that the company's business is to be managed by its board of directors as stated in ss. 180.30 and 180.36 for stock corporations and ss. 181.18 and 181.23 for mutuals, and as confirmed by sub. (6).

One of the abuses in the organization of some new insurance enterprises has been the manipulative and fraudulent promotion and operation of such companies for the purpose of making a quick profit from stock sales. This chapter tries to prevent this abuse in various ways, one of them in sub. (2). The provision confronts any unscrupulous promoter with the difficult task of presenting to the scrutiny of the commissioner under s. 611.13 (4) (b) at least 5 good men and true as directors, including some who have substantial insurance experience, instead of the 3 unqualified men of the general corporation law. S. 180.32 (1). Making a larger number of persons directors, subject to criminal and civil liabilities as such, will increase substantially the difficulty of implementing a fraudulent scheme, since the commissioner may reject an application by a company whose proposed directors are straw men.

The requirement is no serious barrier to organization of legitimate companies. There are much more stringent requirements in effect elsewhere. For example, New York s. 56 requires 13 directors for mutuals. In the financial and insurance industries there is a tradition of large boards of directors. The basis of this tradition is that institutions in the business of handling "other people's money" or selling financial security should be headed by a sizeable group of men of recognized business acumen and experience. This is part of the process of acquiring and maintaining public confidence which is essential to the success of such enterprises. There is much to be said for even larger boards than 9, but it is also desirable not to place excessive burdens on smaller companies. Sub. (2) (b) and (c) provide safety valves.

The purpose of the large outside board requirement is twofold: first, to give a somewhat broader base of varied business experience to the board's deliberations, and second, to limit insider control, and require management to submit its proposals to a board it does not completely dominate. The fact that managements of publicly held stock corporations have some interests which are distinct from and potentially adverse to those of the shareholders underscores the wisdom of having such a board. _A fortiori_ is thus true in mutuals where policyholder "ownership" is very much attenuated. To the extent that management does in fact control the board, the latter cannot perform adequately its intended supervisory function. This section therefore seeks to provide for a large and powerful board, with a chance to be

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independent, without at the same time putting unduly heavy burdens on companies.

The comprehensive study by Gordon Sinykin and Shirley S. Abrahamson, Report on Study of Management Contracts of Wisconsin Insurance Companies (December 31, 1965), p. 157, recommended that:

A majority of the board of an insurance company should be composed of outside, independent directors - in fact and not in name only. This has been recommended to insurance companies by the Insurance Department in recent years. Such a rule or policy is prevalent among corporations in other fields whose stock is publicly held. It is at least as essential in a business affected with a public interest. A truly independent board can provide a constructive check and balance system and strengthen protection of the interests of the insurance company and its policyholders.

The potential personal liability of insurance company directors is also a real and increasingly important deterrent to misconduct. See DePinto v. Provident Security Life Insurance Co., 374 F. 2d 37 (9th Cir. 1967). This would be true even if the liability were insured against, as under s. 611.62 (3).

The restriction on the number of insiders who may be directors is consistent with the best regulation elsewhere. See for example, N.Y. s. 56 (3) (applying to mutuals). The board should be controlled by persons who are not employes or representatives of the insurer.

Where the insurer is a subsidiary, the protective device is less effective. The smaller the shareholding minority, the more it needs protection. A small or fragmented minority is helpless and the possibility of oppression of the minority is clearly present, as numerous cases and common sense indicate. See generally O'Neal and Derwin, Expulsion or Oppression of Business Associates (1961). Sound policy would try to structure the board in order to protect them, if possible.

The requirement of a large board of directors not dominated by the operating management has somewhat different functions in mutuals than it does in stock corporations. Mutual policyholders are not the owners of the company in the same sense that shareholders are owners. They are basically customers, with residual quasi-ownership rights on dissolution and some rights of control that are mostly theoretical, not actual. An additional purpose of the large independent board requirement for mutuals, therefore, is to secure on the board to which management is responsible wider representation of the interests of policyholders, more as customers than as "owners". While management and policyholder interests are often concurrent, there are many important subjects on which they are or may be adverse. The independence of the board is an effort to provide in the legal structure of mutuals a method for the expression of policyholder (and public) interests without disrupting the operation of the company.

611.52 ELECTION AND REMOVAL OF DIRECTORS OF STOCK CORPORATIONS. (1) VOTING OF SHARES. Section 180.25 applies to stock corporations.

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(2) ELECTION. At each annual meeting of shareholders, the shareholders shall elect directors to hold office until the next succeeding annual election except as provided in sub. (3) or under s. 180.33. Each director shall hold office for the term for which he is elected and until his successor shall have been elected and qualified if qualification is required.

(3) REMOVAL. Section 180.32 (3) applies to stock corporations.

NOTE: Sub. (2) is s. 180.32 (2), modified as necessary to conform to the organizational procedures for insurance corporations under this chapter.

611.53 SELECTION AND REMOVAL OF DIRECTORS AND OFFICERS OF MUTUALS. (1) PUBLIC SELECTION OF DIRECTORS. The articles of a mutual may provide that any number of the directors shall be public directors chosen under a plan proposed by the corporation and approved by the commissioner. The plan shall be designed to assure true public representation on the board. The persons to be nominated as directors shall be persons whose insurance business or general experience qualifies them to serve responsibly and impartially.

(2) ELECTION OF DIRECTORS. Directors not to be chosen under sub. (1) shall be elected by the policyholders.

(3) REMOVAL. A director may be removed from office for cause by an affirmative vote of a majority of the full board at a meeting of the board called for that purpose.

(4) VACANCIES AND REMOVAL OF OFFICERS. Subject to subs. (1) to (3), ss. 181.21 and 181.26 apply.

NOTE: The reasons for creating the possibility of appointment of "public" members by this section are discussed in the general introduction to this chapter. An optional provision for public directors can do no harm and may prove to be of great value.

Experience with public directors in this country is very limited, and there is some thought that the experience has not been altogether good. See, e.g. Schwartz, Governmentally Appointed Directors in a Private Corporation - The Communications Satellite Act of 1962, 79 Harv. L. Rev. 350 (1965). The Comsat experience, however, is very specialized and therefore of limited precedential value. Some years ago an informal inquiry in Sweden, where such a system exists for some insurance companies, revealed that it works satisfactorily there. As an *a priori* matter, there is much to be said against a system in which a group of people can acquire significant power without being responsible to anyone else, as is true under present corporation law in widely held corporations, and *a fortiori* in large mutual insurance corporations. Public directors would help make management responsible to someone and thus the idea is worth experimenting with. It is offered here, not as an ultimate solution for all cases, but as an option that might be tried under certain circumstances, with possible beneficial results. Where it has been tried, in New Jersey, it was reportedly authorized at the request of the Prudential, the only company affected. In any case a few experiments would greatly increase our knowledge about the nature of the device, and no harm can be done by making it a possible method to be adopted at the insurer's option.

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The role of the publicly appointed director should not be antithetical to the business interests of the company. In most respects the interests of a mutual company and of its potential market will coincide. The public director is not expected to represent some vague public interest; once appointed he has the same duties as all other directors - to make the corporation succeed and serve the interests of its "owners" - the policyholders.

Sub. (3) treats all directors alike. It is therefore possible for even publicly appointed directors, if there are any, to be removed by a majority of the board. There seems little likelihood of abuse of this removal power. Management and directors would undoubtedly act with caution and responsibility in exercising it. Removal of a publicly appointed director by the full board is a useful means of reacting to a grossly improper exercise of the selection power, or abuse of the office by the appointee. The public directors would participate in the removal process.

Removal is authorized under this provision only for cause. Under s. 611.52 (3), making s. 180.32 (3) applicable, directors of stock corporations may be removed at will by vote of the required number of shareholders. The right of shareholders to remove directors stems from the fact that the shareholders own the company, and are entitled at all times to have as managers persons in whom they have confidence.

This subsection does not confer upon mutual policyholders the same right to remove directors, even though they may have elected them, and even though, in some attenuated and modified sense, they "own" the company. This power does not exist by statute under the existing law. It is even less realistic to expect that a meaningful exercise of any removal power can be achieved by policyholders, even in companies of moderate size, than it is to suppose that election by policyholders is meaningful. Moreover, this bill would permit voting by mail. A reasonably adequate hearing on the merits of whether a director ought to be removed is an impossibility there, even if not in a meeting. Even in stock corporations, where the shareholder as owners have historically had an unquestioned right to remove directors for cause, the implementation of this right in widely held companies is impracticable, and the right has fallen into almost total disuse. For an example of the complexities of an attempted exercise of the removal power in a publicly held company, see Campbell v. Loew's Inc., 134 A. 2d 852 (Del. Ch. 1957). Nothing of consequence is lost by denying the right of removal to policyholders.

611.54 SUPERVISION OF MANAGEMENT CHANGES. (1) REPORT OF SELECTION. (a) General. The name of any person selected as a director or principal officer of a corporation, together with such pertinent biographical and other data as the commissioner requires by rule, shall be reported to the commissioner immediately after the selection.

(b) New corporations. For 5 years after the initial issuance of a certificate of authority to a corporation, the commissioner may within 30 days after receipt of a report under par. (a) disapprove any person selected who fails to satisfy him that he is trustworthy

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and has the competence, experience and freedom from conflict of interest necessary to discharge his responsibilities.

(2) REPORT OF REMOVAL. Whenever a director or principal officer of a corporation is removed under s. 180.42, 181.26 or 611.53 (3), the removal shall be reported to the commissioner immediately together with a statement of the reasons for the removal.

(3) REMOVAL BY COMMISSIONER. If the commissioner finds, after a hearing, that a director or officer has a conflict of interest, is incompetent, untrustworthy or has wilfully violated this code, a rule promulgated under s. 601.41 (3) or an order issued under s. 601.41 (4), and that the conflict of interest, incompetence or the violation endangers the interests of insureds or of the public, he may order that the director or officer be removed.

NOTE: This section supersedes, for insurance corporations, s. 180.795 which requires the reporting of the initial board and officers and subsequent changes to the secretary of state. The special public concern with insurance corporation management justifies somewhat more stringent controls than in unregulated industries. N.Y. s. 198-a goes a little farther for stock life companies, requiring advance notice of the election, instead of immediate notice afterward. In general, while the commissioner should be fully informed about important personnel changes, as quickly as possible, the notification requirement should not result in delay of normal corporate processes. Sub. (1) (a) seeks to balance the conflicting interests.

Sub. (1) (b) provides for close supervision over management personnel during the formative years of the enterprise. The considerations that justify careful administrative scrutiny of the qualifications of promoters apply equally to new management brought into a young enterprise. The concept is by no means new. See, e.g., former s. 201.03 (5), applying to initial officers and directors of mutual corporations. After the corporation is firmly established and successfully operating, close supervision is less urgent, and shareholders may elect directors subject to reporting and to ordinary regulatory controls. The reporting may give the commissioner his first clue to dangerous developments in an insurer. The 5-year cutoff point is arbitrary but reasonable. It is made more flexible by s. 611.02.

Sub. (2) is not strictly necessary because of s. 601.42, but this slight amount of repetition has value in educating both management and regulator. Moreover, this is information the commissioner should get without having to ask.

One of the commissioner's most important powers, though one seldom to be exercised, is that given in sub. (3). His power to remove top level insurance company personnel from office when they are corrupt or incompetent is important for regulation. The commissioner of banks has this power over banks (s. 220.04 (4)) and credit unions (s. 186.24). So also does the savings and loan commissioner. S. 215.02 (15).

The power of removal cannot be given lightly nor exercised without careful supervision. It too easily injects the commissioner into the role of the manager, rather than the regulator. The banking or savings and

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loan commissioner acts only in conjunction with the relevant advisory board, which does not exist in the case of insurance. But to act under this section the commissioner must hold a hearing and the decision is judicially reviewable. It is a carefully circumscribed power, not likely to be abused in practice.

A similar, though indirect, way to force removal of executive personnel exists already in s. 645.31 (4). The provision in sub. (3) gives the commissioner the power in clear and direct terms. The commissioner's order can be enforced like any other order under s. 601.41 (4).

611.55 CONTINUITY OF MANAGEMENT IN EMERGENCIES. (1) PURPOSE. The legislature declares it to be desirable for the general welfare and in particular for the welfare of insurance beneficiaries, policyholders, claimants and others that the business of domestic insurance corporations be continued even in a national emergency. The specific purpose of this section is to facilitate the continued operation of such corporations if a national emergency is caused by an attack on the United States or by a nuclear, atomic or other disaster which makes it impossible or impracticable for a corporation to conduct its business in strict accord with applicable provisions of law, its articles, bylaws or its charter.

(2) EMERGENCY BYLAWS. The board of any corporation may at any time adopt emergency bylaws, subject to repeal or change by action of those having power to adopt regular bylaws, which shall be operative during such a national emergency and which may, notwithstanding any different provisions of the regular bylaws, or of the applicable statutes or of the corporation's articles or charter, make any provision that may be reasonably necessary for operation during the emergency.

(3) EMERGENCY AUTHORIZATIONS. If the board of a corporation has not adopted emergency bylaws, the following provisions shall become effective upon the occurrence of a national emergency:

(a) Three directors shall constitute a quorum for the transaction of business at all meetings of the board.

(b) Any vacancy on the board may be filled by a majority of the remaining directors, though less than a quorum, or by a sole remaining director.

(c) If there are no surviving directors, but at least 3 officers of the corporation survive, the 3 officers with the longest term of service shall be the directors and shall possess all of the powers of the previous board and such powers as are granted herein or by subsequently enacted legislation. By majority vote such emergency board may elect other directors. If there are not at least 3 surviving officers, the commissioner shall appoint 3 persons as directors who shall possess all of the powers of the previous board and such powers as are granted herein or by subsequently enacted legislation, and these persons by majority vote may elect other directors.

(4) SUCCESSION LIST. At any time the board of a corporation may, by resolution, provide that in the event of such a national emergency and in the event of the death or incapacity of specified officers of the corporation, such officers shall be succeeded by the persons named or described in a succession list adopted by the board. The list may be on the basis of named persons or position titles, shall establish the order of priority and may prescribe the conditions under which the powers of the office shall be exercised.

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(5) HOME OFFICE. At any time the board of a corporation may, by resolution, provide that in the event of such a national emergency the home office or principal place of business shall be at a location named or described in the resolution. The resolution may provide for alternate locations and establish an order of preference.

NOTE: This section is essentially the same as s. 201.025, slightly modified in language but not in substance. It was introduced into the legislature in 1965 at the request of the late Commissioner Manson. It was supported in the hearing by a number of persons and opposed by none, and was passed by the legislature without dissent at any stage.

This provision is unobjectionable. It can be argued that it is unnecessary, since in any emergency serious enough to call it into operation the survival of insurance corporations would be irrelevant. However, that proposition would be impossible to demonstrate and may not be true in imaginable circumstances. The section is continued with only editorial changes.

611.56 COMMITTEES OF DIRECTORS. (1) APPOINTMENT. If the articles or bylaws of a corporation so provide, the board by resolution adopted by a majority of the full board may designate one or more committees, each consisting of 3 or more directors serving thereon at the pleasure of the board. The board may designate one or more directors as alternate members of any committee to substitute for any absent member at any meeting of the committee. The designation of a committee and delegation of authority to it shall not relieve the board or any director of responsibility imposed upon it or him by law.

(2) DELEGATION; MAJOR COMMITTEES. When the board is not in session, a committee satisfying all of the requirements for the composition of a board under s. 611.51 (2) to (4) may exercise any of the powers of the board in the management of the business and affairs of the corporation, including action under ss. 611.60 and 611.61, to the extent authorized in the resolution or in the articles or bylaws.

(3) DELEGATION; ORDINARY COMMITTEES. When the board is not in session, a committee not satisfying the requirements of sub. (2) may exercise the powers of the board in the management of the business and affairs of the corporation to the extent authorized in the resolution or in the articles or bylaws, except action in respect to:

(a) Compensation or indemnification of any person who is a director, principal officer or one of the 3 most highly paid employes, and any benefits or payments requiring shareholder or policyholder approval;

(b) Approval of any contract required to be approved by the board under s. 611.60 or 611.61, or of any other transaction in which a director has a material interest adverse to the corporation;

(c) Amendment of the articles or bylaws;

(d) Merger or consolidation under s. 611.72 or 611.73, stock exchanges under s. 611.71, conversion under s. 611.75 or 611.76, voluntary dissolution under s. 611.74 or transfer of business or assets under s. 611.78;

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(e) Any other decision requiring shareholder or policyholder approval;

(f) Amendment or repeal of any action previously taken by the full board which by its terms is not subject to amendment or repeal by a committee;

(g) Dividends or other distributions to shareholders or policyholders, other than in the routine implementation of policy determinations of the full board;

(h) Selection of principal officers; and

(i) Filling of vacancies on the board or any committee created under sub. (1) except that the articles or bylaws may provide for temporary appointments to fill vacancies on the board or any committee, the appointments to last no longer than the end of the next board meeting.

(4) SUBSEQUENT REVIEW. The full board or a major committee of the board authorized to do so under sub. (2) shall specifically review any transaction in which an officer has a material financial interest adverse to the corporation, at the next meeting following action by any ordinary committee.

NOTE: This section is adapted from s. 180.36 and applies to mutuals as well as stock corporations. The committee system may be used to defeat the objectives of the proposed statutory requirements of a large board. To prevent an inside minority from arrogating the board's power to itself contrary to the large board policy of the proposed statute, and to assure the active participation of the full board in management, it is desirable to expand the list of specific limitations on the authority of committees stated in s. 180.36. That is done in sub. (3). Some of the specific limitations are new, drawn in part from New York B. C. L., s. 712, and from the Model Corporation Act, s. 38. Exceptionally, however, plenary power may be delegated to a major committee under sub. (2).

The last sentence of sub. (1) corresponds to s. 180.36. It is doubtful if it does anything common law would not do. In any case there seem to be no special insurance considerations respecting this provision; consequently it is continued intact.

The committee device may be used to permit insiders or promoters to approve transactions for their personal benefit. For this reason transactions in which directors are interested adversely to the corporation must be presented to the full board and to the commissioner if they fall under proposed s. 611.60 (1). If officers who are not directors are interested, the full board must at least review the transaction under sub. (4). This represents an extension of control over insider dealing, but should not impose any real burden. It merely calls for an additional procedural safeguard for transactions that should in any event be subjected to close scrutiny.

Sub. (2) is new. When a board is very large, it often ceases to perform the management role ordinarily played by a board and becomes an assembly of an altogether different sort. Such a board should be able to delegate its real management powers to a smaller and less unwieldy body, without limitation. It can be argued that boards should not be allowed to become so large,

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but that judgment is one that should be left to the corporation itself.

611.57 INTERLOCKING DIRECTORATES AND OTHER RELATIONSHIPS. No person may simultaneously be a director or officer in one insurance corporation and a director, officer, employe or agent for another insurer if the effect is to lessen competition substantially or if the 2 insurers have adverse interests.

NOTE: This section follows in part the language of the Illinois statute, s. 155.01, which reads as follows:

"Any person may be a director in two or more companies which are competitors, provided no person at the same time shall be a director in two or more companies where the effect may be to substantially lessen competition generally or tend to create a monopoly. Whenever the Director has reason to believe that there is a violation of this Section, the Director shall proceed with respect to any person or company deemed by him to be in violation of this Section, in accordance with the provisions of Article XXIV and shall have power to issue an order directing such person or company to cease and desist from such violation within such time, or extension thereof, as may be specified by the Director. Any such order of the Director shall be subject to review in accordance with the provisions of Article XXIV."

It is not really necessary to include the first clause of the Illinois statute. If general corporation law permits interlocking directorates, this draft does; if general corporation or antitrust law of this state does not, this draft should not. Enforcement machinery does not need to be provided; it is provided in general terms in ch. 601.

The subject of interlocking directorates, and especially the Illinois treatment of the subject, raises also "antitrust" questions. But the broad problem, while one to be faced in this revision, is complex and difficult. Moreover, other states are necessarily involved in any decision made by Wisconsin. These considerations dictate that it be treated separately, at the highest level of social and economic public policy as it relates to insurance. The provisions of this chapter, on the other hand, are concerned mainly with the technical operation of the corporate machinery.

Consequently, in this law, antitrust considerations are not dealt with explicitly, though the law is constructed so that they can be "plugged in" when a separate chapter dealing directly with problems of competition and monopoly is prepared and enacted. Some provisions of this chapter do actually reflect existing antitrust policy, of course.

This section, though it has broader antitrust implications, is an obvious application and implementation of a level of antitrust policy about which there is no doubt.

611.60 TRANSACTIONS IN WHICH DIRECTORS AND OTHERS ARE INTERESTED. (1) VOIDABLE TRANSACTIONS. Any material transaction between an insurance corporation and one or more of its directors or officers, or between an insurance corporation and any other person in which one or more of its directors or officers or

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any person controlling the corporation has a material interest, is voidable by the corporation unless:

(a) The transaction at the time it is entered into is reasonable and fair to the interests of the corporation; and

(b) The transaction has, with full knowledge of its terms and of the interests involved, been approved in advance by the board or by the shareholders; and

(c) The transaction has been reported to the commissioner immediately after such approval.

(2) QUORUM AND VOTING. Directors whose interest or status make the transaction subject to this section may be counted in determining a quorum for a board meeting approving a transaction under sub. (1) (b), but may not vote. Approval requires an affirmative vote of a majority of those present.

(3) RESTRICTED TRANSACTIONS. The commissioner may by rule require that for any classes of transactions subject to sub. (1) which by their nature tend to be unreasonable or unfair to the interests of the corporation the report under sub. (1) (c) shall be submitted to him in advance of the proposed effective date. Such a transaction shall not be carried out even though approved under sub. (1) (b), until the commissioner approves the transaction, or does not disapprove it for failure to comply with sub. (1) (a) within 30 days after receiving the report under sub. (1) (c).

(4) EXCEPTED TRANSACTIONS. This section does not apply to transactions subject to s. 611.61, nor to transactions made between an insurance corporation and its wholly owned subsidiary, nor to policies of insurance, other than reinsurance, issued in the normal course of business. Nothing in this section deprives any person of any rights accruing under a policy of insurance written at usual terms, other than reinsurance. The commissioner may by rule exempt other classes of transactions from the reporting requirement of sub. (1) (c), to the extent that the purposes of this section can be achieved without the report.

NOTE: The only provision relating to this general subject in the Wisconsin corporation law is s. 180.31, which deals only with the specific question of directors' compensation. Case law on the question of interested directors' contracts suggests that the Wisconsin Supreme Court takes a strict view of the director's duty of loyalty. Federal Mtge. Co. v. Simes, 210 Wis. 139, 245 N.W. 169 (1933); Davies v. Meisenheimer, 254 Wis. 419, 37 N.W. 2d 93 (1949). The Wisconsin cases are reviewed in Note, 8 Wis. L. Rev. 342 (1933).

This section was enacted essentially as it stands here by ch. 235, Laws of 1969. The language of that statute was copied with only slight alterations from an earlier draft of this section and s. 611.61. Ch. 235 has been left in effect in its application to domestic corporations other than those covered by ch. 611.

The enactment of ch. 235 was sought because the section as drafted is more lenient than at least the literal interpretation of former s. 201.24 (4) (b), which seems to prohibit "any...purchase or sale of property, loan, deposit or investment in which a director is "pecuniarily interested... directly or indirectly." Such a strict rule would prevent an insurer from depositing funds in a bank with which it "shared" a director, or buying automobiles for company purposes through a dealer

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who is a member of its board, or even from buying a car manufactured by an automobile manufacturer one of whose officers or directors is also a member of the insurer's board. A prohibition so stringent is inconsistent with the policy of this chapter to encourage the presence on the board of experienced outsiders. If there is full disclosure to and approval by a large and disinterested board, and the possibility of avoidance for unfairness is clear, the dangers of abuse are substantially reduced. Furthermore, when boards are dominated by outsiders, who as businessmen may be in a position to make advantageous transactions available to the insurer, an absolute prohibition would be unnecessarily harsh and might be disadvantageous to the insurer. As a precaution, transactions in which directors have a substantial financial interest are always required to be reported to the commissioner by sub. (1) (c) as a condition of not being voidable, except in the limited classes under sub. (4), of which the most important category is policies of insurance (other than reinsurance) issued in normal course of business. Reinsurance contracts within this section must be reported; they are especially subject to abuse.

It has been suggested that the assets of insurers are so vast that any transactions should be absolutely prohibited through which even a minute percentage of each transaction might make one or a few men rich. A small share in a stock and bond brokerage business, for example, might make a man rich if all the stock and bond investments of a major insurer were channeled through the one firm. This might also tempt a key person to encourage churning to produce a high turnover rate, and it may provide the temptation for outright dishonesty. But a sweeping prohibition is still undesirable. The requirement that the transaction be fair and reasonable from the viewpoint of the corporation should limit compensation to a figure based on cost. If that is impossible because of contrary legal rules or institutional practices such as in the securities business, the commissioner will be in a position at least to scrutinize the contracts and discover and discourage objectionable arrangements.

Furthermore, the commissioner may in effect under sub. (3) prohibit any class of contracts that are especially susceptible to abuse. If such discretion is worrisome to insurers the alternative is to return to the flat and unqualified prohibition of former s. 201.24 (4) (b). If the commissioner cannot be entrusted with discretion in order to liberalize the law, the law should remain rigid to preclude the possibility of abuse of contracts with interested persons.

The immediate report to the commissioner is necessary to allow quick action to prevent the dissipation of assets, if the interests of insureds are endangered by the transaction. Such a danger will ordinarily exist only if the contract leads to a weakening of the company's financial position below statutory limits. It does not seem justified to give the commissioner a general power to disapprove or avoid contracts under this section. That power might too easily be misinterpreted to let him be the judge of the question of fairness or equity. He is not the guardian of the shareholders, except in egregious cases, but should be concerned mainly with the interests of insureds. The reporting requirement is,

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however, a device that encourages self-discipline, and if the transaction is otherwise illegal or undesirable the commissioner may have other powers under which he can act, including the power under sub. (3) to develop rules to deal with undesirable classes of transactions.

In case of open disregard of corporate interests, the directors involved have proved themselves to be untrustworthy, and the commissioner may request that they be removed. If they are not removed, he may sometimes remove them himself under s. 611.54 (3) or he may be able to institute delinquency proceedings under s. 645.31 (4). And if the corporation's solvency is actually endangered, the commissioner may proceed under s. 645.41 (2).

The importance of clearly articulated and high standards of fiduciary duty is greater in the case of insurance corporations than in most other types of business. This justified the special treatment under s. 201.24 (4) (b) and justifies it under this liberalized section.

This statute is stricter than the 1961 New York model from which it is adapted. That statute provides that, despite nondisclosure of a director's personal interest, a contract may not be avoided by the corporation if it is "fair and reasonable as to the corporation at the time it is approved by the board". New York B.C.L. s. 713 (a) (3). The rationale is that the corporation can have no equity in upsetting a contract which is "fair and reasonable". In theory that is a sound but in practice it is a foolish rule. It encourages nondisclosure of adverse interests, for there is nothing to lose. If the transaction turns out to be "fair", as viewed by hindsight, the failure to disclose the interest is retroactively legitimized. The desirable rule in this sensitive area is the one that would encourage disclosure. There can never be a legitimate reason for nondisclosure of adverse interests. This section permits avoidance for nondisclosure without any showing of unfairness, thus encouraging full disclosure in all cases.

Disclosure may not be enough to protect the interest of the corporation against unfair contracts with its own directors. A disinterested majority, because of misplaced confidence, friendship, or negligence may approve the transaction anyway. Hence this section requires both disclosure and fairness. Even then not all problems disappear.

There may be full disclosure, and yet be serious difficulty in determining what is "fair". Courts have been reluctant to second-guess the business decisions of directors by imposing personal liability upon them. The business judgment rule, in at least some of its variations, denies any liability for erroneous but good faith management decisions. See Feuer, Personal Liabilities of Corporate Officers and Directors 20 (1961). The unworkability of a "fairness" standard in determining the validity of a transaction is discussed in Hetherington, "Trends in Legislation for Close Corporations: A Comparison of the Wisconsin Business Corporation Law of 1951 and the New York Business Corporation Law of 1961", 1963 Wis. L. Rev. 92, 149-51. Of course, in egregious cases courts have upset unfair contracts, despite full disclosure. Thus, even where the adverse

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interest was fully disclosed and the interested director refrained from voting, it was held in New York that the director did not adequately discharge his duty to the corporation where the contract was seriously detrimental to its interests. Globe Woolen Co. v. Utica Gas Co., 224 N.Y. 483, 121 N.E. 378 (1918). The difficulty with the ascertainment of reasonableness and fairness strongly supports the reporting requirements to the commissioner - at least in egregious cases he may be able to act.

This section differs from the New York model in one other respect: it requires transactions in which members are interested to be approved by the entire board, not merely a committee. This is consistent with the policy of requiring full airing of the important affairs of insurers by large boards. It applies with particular force where members of management are interested in the transaction involved. If the board is very large, the approval may be by a major committee under s. 611.56 (2).

This rule should be a substantial deterrent, and make it unnecessary to prohibit contracts with interested persons. Nor is the rule unfair to the interested director. Only his fellow directors, a shareholder in a derivative suit, an occasional creditor, or a liquidator, will challenge the transaction and none is likely to do so casually.

For the meaning of the term "person" as used in sub. (1), see s. 990.01 (26), which is applicable.

This section does not confer upon policyholders of mutual corporations any power of approval of contracts between directors and the corporation. It is unreasonable to expect policyholders to undertake a meaningful review of conflicts of interest problems in contracts with directors. Policyholders have no such rights under existing law. This reduces the possibility (remote in any event) of particularly advantageous contracts with directors under the special circumstances that the technical requirement under subs. (1) (b) and (3) of approval by a disinterested majority of a quorum cannot be satisfied because too many directors are interested. But the loss is inconsequential and the protection against milking substantial.

611.61 TRANSACTIONS OF STOCK INSURANCE CORPORATIONS WITH AFFILIATES. (1) RESTRICTED TRANSACTIONS. No transaction may be entered into between a stock insurer authorized to do business in this state and any affiliate unless:

(a) The transaction at the time it is entered into is reasonable and fair to the interests of the insurer;

(b) The books, accounts and records of each party to the transaction are kept in a manner that clearly and accurately discloses the nature and details of the transaction and in accordance with generally accepted accounting principles permits ascertainment of charges relating to the transaction; and

(c) If the transaction is a reinsurance transaction, it is reported to the commissioner immediately if the insurer is a domestic corporation.

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(2) VOIDABILITY. Transactions entered into by domestic corporations in violation of sub. (1) are voidable by the corporation.

NOTE: Transactions with controlling persons present special dangers of manipulation and of pyramiding of economic power. This section is directed in part to the development of adequate devices for regulating interrelationships within multicorporate complexes.

This section is designed, by virtue of the definition of control in s. 600.03, to apply both to the corporate parent and the controlling shareholder who is a natural person; it also covers a contract between the insurer and another corporation where both contracting parties are under the control of a third person. It assumes no legal restrictions on control of insurers by a single individual or by a corporate parent, subject to the controls proposed here. Even if it were considered desirable to prevent insurers from being thus controlled, the problem is one of national scope; Wisconsin cannot effectively move alone. This section provides a reasonable method for regulating dealings between insurers and their parents.

Reinsurance is a case where manipulation is easy unless the reinsurer and reinsured are really operating at arms' length. Hence, immediate reports of reinsurance contracts of affiliates must be made to the commissioner. Under s. 611.02 (2), the commissioner can dispense with reports he does not want.

Unlike unfair transactions under s. 611.60 (1), the transactions made in violation of sub. (1) are not only voidable, as provided by sub. (2), but also illegal. As a consequence, they represent "illegal conduct" under s. 645.31 (2) and thus can trigger delinquency proceedings.

This section does not apply to mutuals, which cannot be controlled except under a management or exclusive agency contract, which are forbidden under this draft. Cases of de facto control should be caught up by s. 611.60, under the broad definition of control in s. 600.03.

This section tracks s. 617.22 (1) exactly so far as nondomestic insurers are concerned. It goes somewhat farther for domestic corporations.

611.62 DIRECTORS' LIABILITY AND INDEMNIFICATION. (1) LIABILITY. Section 180.40 (1) to (4) applies to stock corporations and s. 181.29 applies to mutuals.

(2) INDEMNIFICATION. Sections 180.04 (14) and 180.407 apply to stock and mutual corporations but no indemnification may be made until at least 30 days after notice to the commissioner, containing full details about the proposed indemnification.

(3) INSURANCE. Notwithstanding the limitations of sub. (1), an insurance corporation may arrange and pay for lawful insurance on behalf of any person subject to sub. (1) against any liability incurred by him in connection with his service to the corporation, whether or not the corporation could lawfully indemnify him.

(4) SHAREHOLDERS' DERIVATIVE ACTIONS. Section 180.405 applies to stock corporations.

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NOTE: Indemnification is permitted both for stock corporations and mutuals under ss. 180.04 (14) and 180.407 but additional restriction upon the indemnification of corporate executives or employes is justified by the importance of giving the commissioner a chance, prior to expenditure of the funds, to ascertain its probable effect upon the corporation's solidity, and to take appropriate steps if any danger appears.

There is, generally speaking, no public policy against allowing purchase of insurance and permitting the corporation to pay for it; indeed, it should be encouraged. There is, however, a strong public policy against destroying the policyholders' and shareholders' protection against a catastrophic default of directors or officers. Sub. (3) is adapted from s. 4A (g) of the Model Business Corporation Act. See also Pennsylvania Title 15 s. 410 (g) (Purdon 1969).

Sections 645.54 and 645.68 (8) are also appropriately amended to keep indemnification claims subordinated in relation to claims of other creditors and to make completed indemnification voidable as a preference. See SECTIONS 56 and 57 of this bill.

611.63 EXECUTIVE COMPENSATION. (1) GENERAL POWER. Subject to this section, ss. 180.04 (16) and 180.31 apply to stock and mutual corporations.

(2) APPROVAL OF BOARD ACTION BY SHAREHOLDERS. Any benefits or payments to any director or officer on account of services rendered to a stock corporation more than 90 days before the agreement or decision to give the benefit or make the payment, and any new pension plan, profit-sharing plan, stock option plan or any amendment to an existing plan which so far as it pertains to any director or officer substantially increases the financial burden on the corporation shall be approved by a vote of the shareholders.

(3) NOTICE TO COMMISSIONER. Any action taken by the board of a mutual insurance corporation on any of the subjects specified in sub. (1) shall be reported to the commissioner within 30 days.

(4) ANNUAL REPORT TO COMMISSIONER. The amount of all direct and indirect remuneration for services, including retirement and other deferred compensation benefits and stock options, paid or accrued each year for the benefit of each director and each officer and employe whose remuneration exceeds an amount established by the commissioner, and for all directors and officers as a group shall be included in the annual report made to the commissioner.

(5) PROHIBITED CRITERIA. No arrangement for compensation or other employment benefits for any director, officer or employe with decision-making power may be made if it would:

(a) Measure the compensation or other benefits in whole or in part by any criteria that would create a financial inducement for him to act contrary to the best interests of the corporation; or

(b) Have a tendency to make the corporation depend for continuance or soundness of operation upon continuation in his position of any director, officer or employe.

(6) EFFECT OF REHABILITATION AND LIQUIDATION PROCEEDINGS. If an order of rehabilitation or liquidation is issued under s. 645.32 or 645.42, the contractual obligations of the insurer for unperformed services of any director, principal officer

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or person in fact performing similar functions or having similar powers is thereupon terminated.

NOTE: This section supplements and qualifies s. 180.31 which is made applicable to stock insurance corporations in this revision.

Sub. (2) proceeds on the familiar tenet of corporate theory that management is the servant of those who own the corporation, the shareholders. In practice, of course, management is not in any meaningful sense responsible to the shareholders in widely held corporations, but except under the most unusual circumstances, is self-selected, self-perpetuating, and self-employed; it is not responsible for its conduct or decisions to anyone. For that reason, though overreaching management is far less frequent than honest and conscientious management, the latter should be willing to bear modest burdens to help protect shareholders against the small minority who abuse the system. The burdens imposed by this section are not heavy. In fact, honest and conscientious management will probably find that the procedures proposed will help to protect them from criticism, provide a worthwhile discipline on their decision-making process, and regularize what is considered by many to be sound practice even in the absence of any legal requirement.

Management compensation is a subject in which the interest of managers is in its nature adverse to the interest of their employers. It is also a subject on which management is very sensitive to publicity. Compensation therefore seems a subject on which it is particularly appropriate to require managerial self-dealing to be reported to and approved by those on whose behalf the corporation is, presumably, run and who pay the bill. Consequently various compensation arrangements are made subject to explicit shareholder approval.

Shareholder control: Corporation law has never required shareholder approval of direct compensation of top management; corporation law has assumed that directors and officers are effectively under the control of shareholders. The assumption in publicly held companies is, however, a fiction, in almost all such companies, almost all of the time.

Managerial prerogatives. Concern has been expressed that shareholder ratification of pension and related schemes unjustifiably invades "management prerogative". The law concerning the extent of managerial prerogatives and the limits of shareholder authority is surprisingly undeveloped. Most of the activity on the subject has occurred under the federal proxy rules which permit, subject to some limitations, shareholder proposals on matters that are "proper subjects" for shareholder action under state law. See generally 2 Loss, Securities Regulation 902-12 (2d. ed. 1961). But there is no basis for the view that any decision of management about compensation arrangements should not be an appropriate subject for shareholder action if the statutes so provide. Management is the servant of the owners and has no inherent prerogatives at all. The very mention of management prerogatives suggests the need for more attention to shareholder prerogatives.

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Considerations of policy. There is really only one question - whether shareholder approval is desirable as a matter of policy. The unavoidable conflict of interest is a strong argument that it is. Recent legal developments suggest increased concern about advantages taken of their official positions by corporate insiders. See SEC v. Texas Gulf Sulphur, 401 F. 2d 833 (2d Cir. 1968) (an insider trading case). Approval solely by the management group of any arrangements of which top management are the principal beneficiaries, is unavoidably exposed to criticism on similar grounds.

The requirement of a board of directors on which outsiders are a majority is helpful, but does not eliminate the desirability of having at least some remuneration plans put before the shareholders. Because remuneration is sensitive, it may be difficult for outsiders to question such plans effectively within the board without creating tension and dissension. Further, the proposed subsection may encourage both outsiders and insiders to review such plans, which must go before the shareholders bearing the seal of the directors' approval.

It is unlikely that shareholders will disapprove plans submitted to them under this provision. This does not prove that submission is not useful nor even necessary. Management will not wish to generate a substantial dissenting vote or run the risk of bad publicity. Its possibility will encourage management self-discipline.

Special insurance considerations. A final point concerns the desirability of providing special rules for stock insurance companies that are not applicable to stock corporations in general. Objection to such special rules challenges the assumption that there should be a special corporation law for insurance corporations. In general that is true and this chapter incorporates most of chs. 180 and 181. But the general corporation law no longer performs any significant regulatory function. These statutes have become enabling and permissive. See Katz, The Philosophy of Midcentury Corporation Statutes, 23 Law & Contemp. Prob. 177 (1958). Regulation of business activities has largely been left to other statutes. In insurance there has been a supplementary corporation law, to regulate the corporation for the protection of owners as well as insureds. See e.g. the excessively detailed provisions of ss. 206.04 to 206.12. The function of proposed sub. (2) is well within that tradition. The only question to be asked is whether the controls are desirable. It is not in question whether they are legitimate.

Limited application. The proposal is intended to limit the approval requirement to cases where the foregoing considerations are of particular importance and and where counterbalancing considerations are not more weighty. It is limited to top managerial remuneration in the form of stock options, pension and profit-sharing plans, and to ex post facto bonuses.

Salaries. Salaries might seem the most obvious case for a requirement of approval. They are not included, however, for weighty counterbalancing reasons. The requirement would inhibit negotiation for new executives from outside. Besides, they are not set pursuant to any fixed plan or scheme, but on an individual basis.

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Except for long-range employment contracts they do not involve amounts of money comparable to the amounts involved in pension and profit-sharing plans. In view of these considerations and of the absence of precedent, this section does not subject salaries to the shareholder ratification requirement. This section even removes the control now present under s. 206.15. Only in the event of rehabilitation or liquidation is there a limit and that is imposed by law, under sub. (6).

Bonuses. Retroactive compensation must be approved, for periods more than 90 days prior to decision. The 90-day period permits a reasonable practice of salary adjustments on a fiscal year basis somewhat after its beginning, but does not permit compensation arrangements that would milk off whatever profits have been made over a longer period.

Stock options. In order for stock options to have preferential income tax treatment under the Internal Revenue Code, shareholders' approval must be obtained. Hence, this law imposes no additional burden in practice. This does not justify omitting stock options from the law. The insurance code ought not to rely upon the federal tax laws to perform a regulatory function, but should be independent and self-contained. If sound regulatory considerations dictate shareholder approval, it is immaterial that for other reasons the federal tax law requires the same practice. State law should confirm the shareholders' right to pass upon this aspect of top management compensation despite the existence of related federal rules.

Pension and profit-sharing plans. Qualified pension and profit-sharing plans are not required by the Internal Revenue Code to be approved by the shareholders, though that Code does impose other significant restrictions. Hence, this section does impose an obligation not previously required of stock corporations. However, the considerations previously advanced for stock option approvals justify the requirement.

Stock options and pension plans perform similar functions: they provide tax deferred compensation, particularly important for top management. Further, the amounts received under these arrangements usually are substantial. In the case of stock options there may be some dilution of the shareholder's equity, and in the case of pension and profit-sharing schemes there is a long-term direct loss of revenue. But the main point is that the subject concerns the remuneration of individuals who are the servants of the shareholders. There is no reason why this class of servants should enjoy the privilege - unique to them among employes - of determining their compensation without even formal ratification or review by those whose servants they are. General considerations of management responsibility have led a number of large industrial firms to adopt the practice of having pension and profit-sharing schemes approved by the shareholders. The element of self-dealing inherent in such transactions suggests the appropriateness of this practice of shareholder approval, which has a long and respectable corporate history. See e.g. Rogers v. Hill, 289 U.S. 582 (1933) (involving a profit-sharing scheme approved by shareholders of the American Tobacco Company in 1916. The company at that time had 40,000 shareholders).

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Sub. (3) provides a substitute control for mutual corporations where shareholders are not available to exercise it. The power of the board in mutual corporations cannot be made directly subject to any supervision by owners comparable to the shareholder approval requirement of sub. (2), in view of the lack of real policyholder participation in corporate affairs. Some restraining influence against possible abuse may be expected from the fact that, under the present draft, boards will be less management-dominated.

Growth oriented compensation. The purpose of sub. (5) (a) is to prevent growth-oriented or other incentive compensation schemes that may lead to unsound management practices. Incentive compensation arrangements are often desirable, but unwise ones may be disastrous. For example, underwriting officials should not have their compensation tied solely to premium volume. This subsection prohibits such arrangements. A specific list of forbidden compensation arrangements could be worked out. Mass. ch. 175, s. 75 has a specific prohibition, forbidding an "officer or other person whose duty it is to determine the character of the risks... [to] receive as any part of his compensation a commission upon the premiums..." Such specification is unnecessarily limiting, and this section leaves the prohibition in general terms, to cover any new arrangements that are invented.

Sub. (5) (b) is intended to prevent or discourage any development by which an officer or employe gets "chains" on the company through the employment contract. No employe should be allowed to get into such a position that his loss inevitably destroys the company.

Long-term contracts. Although officers are elected by the board and serve at its pleasure, the corporation may enter into a binding employment contract with an officer or other employe. If discharged in violation of the contract, he has an action for breach of contract. See ss. 180.42 and 181.26. Sub. (6) would alter this rule for insurance corporations in rehabilitation or liquidation. In such cases no claim would be allowed for damages based on future, unperformed services under the contract. For completed services the executive has a claim with a relatively low priority under s. 645.68 (2) and (5).

Apart from delinquency proceedings, full recognition would be given to such contracts. The reason for changing the general rule as to executives of insurers in financial difficulty is that insurance corporations are public financial institutions in which the interests of the public as insureds and claimants deserve first priority. It is intolerable to have the difficulty of rehabilitation increased, or distributions in liquidation reduced, because of salary claims arising from unexpired employment contracts with officers who may be partly responsible for the demise of the corporation.

Such claims by officers of national banks are disallowed even in the absence of insolvency. The courts have held that an employment contract for a national bank officer is "illegal and void as it might result in detriment to the interests of the bank". Van Slyke v. Andrews, 146 Minn. 316, 318, 178 N.W. 959 (1920) (no action against the directors); Van Slyke v. Metropolitan Nat. Bank, 155 Minn. 319, 193 N.W. 470 (1923) (no action against the

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bank). This result was reached under a statute which merely provided for appointment of directors and officers to serve "at pleasure" of the board of directors. 12 U.S.C.A. S. 24, par. 5 (1945). The different treatment of employment contracts in regulated financial institutions as distinguished from industrial corporations appears clearly in In re Paramount Publix Corp., 90 F. 2d 441 (2nd Cir. 1937), where an almost indentical statute was held not to prevent an ordinary stock corporation from entering into a binding employment contract. The intermediate position proposed here seems best.

611.66 EXCLUSIVE AGENCY CONTRACTS. (1) GENERAL. Except under sub. (2), no corporation may enter into any contract whereby any person is granted or obtains directly or indirectly the exclusive right or privilege of soliciting, producing or receiving a fee or commission on all or substantially all of the insurance business of the corporation or on all or substantially all of the insurance business of the corporation in this state.

(2) SUBSIDIARIES. Sub. (1) does not apply to contracts in which a corporation is the exclusive agent of its insurance subsidiary authorized under s. 611.26 (1) or in which the subsidiary is the exclusive agent of the corporation.

NOTE: Exclusive agency contracts for the insurer's entire business are in all ordinary cases objectionable per se, irrespective of their terms, because they prevent the insurance corporation from developing. In effect, the corporation remains vestigial - a mere name - and the exclusive agent is the corporation for practical purposes. For this reason, whatever is done with management contracts, exclusive agency contracts for the entire business should be completely outlawed. With little less reason, this is also true for exclusive agency contracts applicable only to the domiciliary state. In its own state the company should begin at once to develop muscle and a separate identity, even if exclusive state agencies are permitted for a time in other states. The fear that this will weaken a corporation's bargaining position, vis-a-vis potential agents, is an exaggerated one. The agent could not bargain for an illegal arrangement.

This section applies directly only to domestic corporations. A less stringent version in s. 618.22 applies to licensed nondomestic insurers, giving appropriate but not unqualified recognition to the expressed public policy of other states.

The exception in sub. (2) is designed to permit parent-subsidiary exclusive agency contracts. Such arrangements have served useful business purposes without generating the abuses associated with other kinds of exclusive agency contracts.

611.67 MANAGEMENT CONTRACTS. No corporation may be a party to any contract the effect of which is to grant or delegate to any person, to the substantial exclusion of the board, management control of the corporation or of its underwriting, loss adjustment, investment, general servicing or production functions, or other major functions.

NOTE: This section implements s. 611.51 (5) and makes it more explicit with respect to management contracts.

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This section's outright prohibition of management controls is based on the following reasons: There now are probably no management contracts in effect in this state. It is a simple matter, therefore, to forbid their use for domestic corporations. No grandfather clauses have to be considered; no disruption attendant upon the termination of such agreements will ensue. Thus, the abuses that are possible in connection with management contracts and which have indeed been rampant in times past, as demonstrated by Gordon Sinykin and Shirley S. Abrahamson, Report on Study of Management Contracts of Wisconsin Insurance Companies (1965), can easily be avoided for the future by outright prohibition.

An insurance code might well permit such contracts subject to careful controls, but outright prohibition of management contracts for domestic corporations can cause no harm to the domestic market, and such prohibition can be supported by logic and experience.

611.69 DIVIDENDS AND OTHER DISTRIBUTIONS. (1) DISTRIBUTIONS. Subject to the requirements of s. 617.22, a stock corporation may make distributions under s. 180.38 or 180.39.

(2) UNCLAIMED DIVIDENDS AND DISTRIBUTIONS. Chapter 177 applies to stock corporations.

NOTE: This section replaces ss. 204.24 and 204.25, which were ill-conceived and ill-constructed. The basic requirements governing distributions are in s. 617.22.

Section 201.29 is also repealed by this bill. It permitted the payment of stock dividends from surplus, provided that after payment of the dividend the remaining surplus was at least 30% of the unearned premium liability. There seems no point in the restriction. As a general proposition, the capitalization of surplus commits funds more firmly to the insurance operation and thus strengthens it. There is a built-in indirect control over excessive capitalization of surplus in the provision of s. 645.03 (14), which defines insolvency in terms of authorized and issued capital stock, and thus makes it imperative that surplus always continue to exist in some amount.

SUBCHAPTER V.
CORPORATE REORGANIZATION.

611.71 ACQUISITION OF ALL OF THE SHARES OR OF A CLASS OF SHARES OF AN INSURANCE CORPORATION. (1) EXCHANGE OF SHARES PERMITTED. A domestic stock insurance corporation may acquire, in the manner provided by this section, in exchange for its shares, all the shares, or all the shares of any class, of any other domestic stock insurance corporation, provided no law is violated by the acquisition.

(2) OFFER. The acquiring corporation shall submit by 1st class mail to all holders of the shares to be acquired a written offer which shall:

(a) Specify the shares to which the offer relates;

(b) Prescribe the terms and conditions of the proposed exchange, including the method of acceptance and the manner of exchanging the shares;

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(c) Provide such information respecting both corporations as the commissioner prescribes by rule;

(d) Contain a statement summarizing the rights of the shareholders under sub. (5) (b); and

(e) Provide for the payment of cash or scrip in lieu of the issuance of fractional shares of the acquiring corporation.

(3) COPY OF OFFER. One copy of the offer shall be filed with the commissioner immediately.

(4) ACCEPTANCE. The exchange shall be consummated if, within 120 days after the date of the mailing, the offer is accepted by the holders of not less than 90% of the shares of each class to which it relates. In ascertaining what percentage have accepted, shares may not be counted if at the date of mailing of the offer they were already held by, or by a nominee for, the acquiring corporation or any affiliate.

(5) IMPLEMENTATION. If there is acceptance satisfying sub. (4), the acquiring corporation shall, within 60 days:

(a) Execute and file with the commissioner a certificate setting forth the acceptances; and

(b) Give written notice of the satisfaction of the requirement, by registered or certified mail return receipt requested, to each holder of shares to which the offer relates who has not yet accepted the offer. The notice, the form of which must be approved by the commissioner, shall include, or be accompanied by, a statement that such shareholders may dissent from the offer by notification to the offeror within 120 days after the date of the mailing and be paid the fair value of their shares as determined under s. 180.69, and that failure so to notify the offeror shall be deemed acceptance of the offer.

(6) ISSUANCE OF CERTIFICATES. Upon the filing of the certificate under sub. (5) (a):

(a) All shares in exchange for which shares of the acquiring corporation are issued shall become the property of the acquiring corporation, whether or not the certificates for the shares have been surrendered for exchange, and the acquiring corporation shall be entitled to have new certificates registered in its name as the holder;

(b) The acquiring corporation shall cause certificates for its shares to be issued and delivered to the holders of shares who have already accepted, and thereafter immediately after acceptance to those who accept or are deemed to have accepted, and shall promptly make the cash payments provided in sub. (2) (e) or (5) (b); and

(c) The acquiring corporation or a corporate fiduciary designated by it and acceptable to the commissioner, shall hold in trust, for delivery or payment to the persons entitled thereto but not at once located, certificates for its shares and cash payable under sub. (2) (e) or (5) (b).

(7) OTHER EXCHANGE OFFERS. This section does not prevent a person from making an offer to purchase the shares of an insurance corporation conditioned upon acceptance by holders of less than 90% of the shares to which the offer relates. Such an offer may be joined as an alternate offer with an offer made under this section; but the acquiring corporation shall have the right to avail itself

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of this section only if the requirements of subs. (1) to (6) are satisfied.

(8) ACQUISITION OF A SMALL MINORITY OF SHARES. If at least 95% of any class of shares of any domestic stock insurance corporation are held by any other domestic insurance corporation or its nominee, the owning corporation may proceed under subs. (2) and (5), even if the offer is accepted by less than the required number of shareholders.

NOTE: This section facilitates the exclusion of small minority stock interests in a subsidiary, under the limited class of cases comprehended within the section (both corporations being domestic). The proviso at the end of sub. (1) makes it clear that no antitrust law that is now or subsequently in effect will be inferentially repealed or qualified by this section. No commissioner approval is provided for, but notice to him under sub. (3) will give him or the attorney general an opportunity to consider the anti-competitive effects of the acquisition.

In substance, the proposed section largely confirms what is already within the power both of insurance corporations and of persons generally; namely, the acquisition by purchase of the shares of another corporation. The main difference is that under this section a relatively small minority interest can be involuntarily excluded: if 90% of the independently owned shares are voluntarily offered to the acquiring corporation, the remaining shareholders are required either to accept the offer, or be paid the value of their shares in cash. In addition, once an acquiring corporation acquires 95% of all the shares of a class, it may involuntarily acquire the remainder. Under general corporation law the nonacquired shares continue outstanding, so that the acquired corporation is a partially owned subsidiary. If an insurer is the parent it is desirable to simplify the relationship and eliminate potential conflict of interest situations by facilitating the buying out of remaining minority shareholders at a fair price.

Other considerations become important if the acquired person is not a domestic insurer; for that reason this liberalizing statute is limited.

There are few statutory precedents for regulating exchanges of stock. Illinois adopted a provision in 1967, limited to insurance companies only, which in effect makes exchanges of stock another form of merger. 73 Ill. Stat. Ann. s. 768.1 et seq. (Supp. 1967). Indiana has a similar provision. Ind. Ins. Laws s. 39-3904.

A provision of the New Jersey Business Corporation Act is applicable to all corporations organized in that state. S. 14A:10-9 (P.L. 1967, ch. 116). That provision is in turn drawn from British and Canadian corporation statutes. See, e.g. Can. Rev. Stat. ch. 53 s. 128 (1952).

It should be noted that the subsection does not alter the law with respect to fights for corporate control and tender offers. For example, if the proposed acquisition is opposed by the management of the company whose shares are being acquired, that opposition will terminate once the purchaser acquires control; if the purchaser cannot

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acquire enough shares to control the board, it plainly cannot get the 90% required to qualify under this provision.

Sub. (8) is consistent with s. 180.685 which permits merger without the consent of the merged corporation's shareholders if the merging corporation owns 95% of the shares.

611.72 MERGER AND CONSOLIDATION OF STOCK INSURANCE CORPORATIONS. (1) GENERAL. Subject to this section, ss. 180.62 to 180.69 apply to stock insurance corporations.

(2) APPROVAL REQUIRED. No proposed merger or consolidation plan under ss. 180.62 to 180.69 may be submitted to the shareholders of any domestic stock insurance corporation participating in the transaction unless it has been approved by the commissioner.

(3) GROUNDS FOR DISAPPROVAL. The commissioner shall approve the plan unless he finds, after a hearing, that it would violate the law or be contrary to the interests of the insureds of any participating domestic corporation or of the Wisconsin insureds of any participating nondomestic corporation.

(4) PLANS OF EXCHANGE. Any domestic stock insurance corporation may adopt a plan of exchange of all the outstanding shares of its shareholders under which another stock insurance corporation, which acquires the shares, shall as consideration transfer its own shares or other securities issued by it or pay cash or other consideration, or pay or provide any combination of the foregoing types of consideration. The procedure for the adoption and approval of a plan of exchange and the rights of shareholders of the participating corporations shall be the same as for a merger under subs. (2) and (3).

NOTE: The general corporate procedure for mergers and consolidations is prescribed by ss. 180.62 to 180.69. This includes the protection of dissenting shareholders (s. 180.69) and the effect of the merger or consolidation on existing rights (s. 180.67). There is little reason why domestic insurance corporations should be treated much differently.

The commissioner in reviewing the proposal will ascertain that the surviving or resulting insurer will meet all the applicable requirements of law upon consummation of the merger or consolidation. These will include all antitrust provisions in the law, as discussed in the comment on s. 611.57.

A merger is so important and potentially dangerous that affirmative prior approval by the commissioner, without time pressure, is necessary. Even under a deemer provision it is unlikely that management would call a shareholders' meeting without first obtaining certain knowledge of the department's position. This version is more realistic than a deemer provision would be.

Where the resulting corporation will be domestic, the commissioner's authority is relatively limited. If applicable and adequate financial requirements are complied with, and policyholders' interests are not threatened, the fact that the surplus allocable to (a particular class of) policyholders is reduced, or that the cushion available to protect a certain class of creditors is diminished, is of no concern to them. Except to some extent for stock life companies issuing partic-

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ipating policies, policyholders in a stock insurance corporation have no equity in its assets beyond those which it is required to maintain for their protection. Such "surplus surplus" belongs to the owners, whose business judgment respecting excess assets should not be overturned by regulatory review. In general, if such management decisions threaten the protection of the insureds, it is because the applicable financial requirements are inadequate and they should be strengthened.

A possible problem stems from the fact that failure to give the commissioner discretion to disapprove mergers or consolidations for lack of fairness to shareholders disqualifies the securities issued thereunder from exemption from the Securities Act of 1933. That statute provides that securities issued in exchange for outstanding securities and other assets of corporations being merged or consolidated are exempt from registration under the act if the insurance commissioner, after a hearing, approves the terms and conditions of the exchange as fair. The commissioner's authority must be given expressly by law. The relevant text of 15 U.S.C. s. 77c (10) is as follows:

"...the provisions of this subchapter shall not apply to any of the following classes of security;

"Any security which is issued in exchange for one or more bona fide outstanding securities, claims or property interests, or partly in such exchange and partly for cash, where the terms and conditions of such issuance and exchanges are approved, after a hearing upon the fairness of such terms and conditions at which all persons to whom it is proposed to issue securities in such exchange shall have the right to appear, by any court, or by any official or agency of the United States, or by any State or Territorial banking or insurance commission or other governmental authority expressly authorized by law to grant such approval..."

Under the quoted section the price of the exemption from registration of the securities is that the commissioner be empowered to pass on the fairness of the terms of the merger or consolidation. The position of this section is that as far as possible, the business judgment of the owners of insurance corporations should not be reviewable by the commissioner, so far as that relates only to shareholder interests.

A practical consideration makes the price a modest one. The Act is not applicable to the issuance of securities in a merger or consolidation transaction, under Rule 133 of the rules issued by the SEC under the Securities Act of 1933. This is the "No Sale" rule which provides inter alia that securities issued as a result of a merger or consolidation which has been approved by the recipients of the new shares, and which are issued in exchange for securities previously held by them, are not "sold" within the meaning of the Act. 17 C.F.R. s. 230.133 (a). See Subcommittee of the Public Regulation of the Business of Insurance Committee of the Section of Insurance, Negligence and Compensation Law of the American Bar Association, Merger of Insurance Companies pp. 54-58 (1966). Hence registration is not required, subject to certain qualifications.

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The general availability of this exemption makes it unnecessary to give the commissioner the power to pass upon the fairness of a transaction, and this section does not grant the commissioner such power.

The regulatory scheme for domestic insurers places substantial emphasis on the control over domestic companies by the Wisconsin commissioner. Many Wisconsin residents, having confidence in Wisconsin companies and in the quality of insurance regulation in this state, may select domestic companies for the purchase of insurance. While foreign companies are licensed here, it is the domiciliary state which bears the principal regulatory burden. The Wisconsin commissioner, because of staff limitations and for other reasons, cannot be as thorough in his investigations of foreign companies as he is in the case of domestics.

It is inconsistent with this conception of the responsibilities of the Wisconsin insurance industry to its public to permit domestic insurance corporations to be merged or consolidated into foreign corporations unless the Wisconsin commissioner is satisfied that the interests of the Wisconsin policyholders of all the companies are fully protected.

Sub. (4) is new, and is patterned after Ill. s. 768.1 (Supp. 1967), adapted to the existing merger and consolidation procedure. Unlike the model it does not require the acquiring corporation to be doing business in the state. The possibility of disapproval by the commissioner renders that limitation unnecessary. However, the provision does require both corporations to be stock insurers. It is designed to permit a corporate combination in which, unlike a merger or consolidation, both corporations continue as separate legal entities after the transaction is completed, one corporation becoming the wholly owned subsidiary of the other. It differs from the plan of exchange under s. 611.71, which does not contemplate corporate action by the acquired corporation. The end product may be the same.

A transaction of this type is peculiarly useful in the insurance industry, where both participating corporations may have names which are widely known and have substantial commercial value. Also, each corporation will usually have a large number of policies in force, so that a name change would produce inconvenience. The preservation of separate identities avoids these difficulties.

611.73 MERGER AND CONSOLIDATION OF MUTUALS. (1) AUTHORIZATION, DOMESTIC CORPORATIONS. Any 2 or more domestic mutuals may merge or consolidate under the procedures of ss. 181.42 to 181.47.

(2) AUTHORIZATION, DOMESTIC AND FOREIGN CORPORATIONS. Any 2 or more domestic and foreign mutuals may merge or consolidate under s. 181.48.

(3) APPROVAL BY THE COMMISSIONER. The plan of merger or consolidation shall be submitted to the commissioner for his approval after any necessary action by the boards and before any necessary action by the policyholders. The commissioner shall approve the plan unless he finds, after a hearing, that the proposed merger or consolidation would be contrary to the law or to the interests of the insureds of any participating domestic corporation

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or the Wisconsin insureds of any participating nondomestic corporation.

(4) VOTING BY POLICYHOLDERS. The commissioner may order that the plan submitted to him under sub. (3) be amended to provide for voting by policyholders of any mutual involved.

NOTE: This section follows ch. 181 rather than continuing s. 201.03 (8), because there seem to be few special insurance considerations relevant to merger or consolidation. The special provisions for mutual insurance companies are the same as for stock companies.

Sub. (4) makes it possible for the commissioner to require the consent of policyholders but also permits omission of voting where the commissioner is pressing for merger as a way to rehabilitate one of the insurers.

611.74 VOLUNTARY DISSOLUTION OF DOMESTIC INSURANCE CORPORATIONS. (1) PLAN OF DISSOLUTION. At least 60 days prior to the submission to shareholders or policyholders of any proposed voluntary dissolution of an insurance corporation under s. 180.753 or 181.50 the plan shall be filed with the commissioner. The commissioner may require the submission of such additional information as will establish the financial condition of the corporation or other facts relevant to the proposed dissolution. If the shareholders or policyholders adopt the resolution to dissolve, the commissioner shall, within 30 days after the adoption of the resolution, begin to examine the corporation. He shall approve the dissolution unless he finds, after a hearing, that it is insolvent or may become insolvent in the process of dissolution. Upon approval, the corporation may dissolve under ss. 180.753 to 180.768, or ss. 181.51 to 181.555, except that s. 180.757 (2) and the last sentence of s. 181.555 shall not apply. Upon disapproval, the commissioner shall petition the court for liquidation or for rehabilitation under ch. 645.

(2) CONVERSION TO INVOLUNTARY LIQUIDATION. The corporation may at any time during the liquidation under ss. 180.753 to 180.768 or ss. 181.51 to 181.555 apply to the commissioner to have the liquidation continued under his supervision; thereupon the commissioner shall apply to the court for liquidation under s. 645.41 (10).

(3) REVOCATION OF VOLUNTARY DISSOLUTION. If the corporation revokes the voluntary dissolution proceedings under s. 180.761 or 181.53 a copy of the revocation of voluntary dissolution proceedings shall be filed with the commissioner.

(4) DISTRIBUTION OF ASSETS OF A MUTUAL. No distribution may be made to policyholders in excess of the amounts to which they are entitled under s. 645.72 (2). Any excess over such amounts shall be paid into the state treasury to the credit of the common school fund.

NOTE: Ch. 180 provides for voluntary dissolution if the holders of two-thirds of the shares of a stock corporation vote for it. Stock insurers should also be able to dissolve, either under the voluntary procedures of ch. 180 or the involuntary ones of ch. 645.

S. 180.757 (2) ordinarily permits a dissolving corporation to apply for judicial supervision of the liquidation. In the case of an insurer, a supervised liquidation should be under ch. 645, and sub. (2) replaces s. 180.757 (2).

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If the proceedings are revoked, the commissioner must be informed under sub. (3) in order to decide whether the corporation can safely resume its insurance business.

The nature of the insurance business requires that the commissioner and the court play a larger role in insurance liquidations, and the direction to be taken should depend solely on the degree of solvency of the insurer. Only a solvent and nondelinquent stock insurer should have the option which is given by s. 180.757 (1) to liquidate without any supervision by the commissioner and the court. If it is solvent, the informal voluntary procedure is to be preferred as less expensive; if there is doubt about solvency, the liquidation should follow the procedures carefully worked out for insolvent insurers. It would be possible to have the commissioner hold the hearing on solvency before the shareholders' vote, but there is no point in it. If the proposal alerts the commissioner to a dangerous situation, he can institute proceedings under ch. 645 without waiting for the shareholders' vote; if no danger signs appear, he can wait until the shareholders' vote to see whether they want dissolution before he determines which route to take. Normally he should hold his hearing almost immediately after the vote; the 30 days is merely a maximum. Pending the shareholders' vote, the powers and procedures of ch. 645 are available for use in case of need; the commissioner should be engaged in careful and constant surveillance while he waits.

A convenient procedure is also needed for winding up solvent mutual insurers. Such liquidations rarely occur, and there is no reason to expect an increase in the future. Since policyholders of a solvent insurer have received all they were entitled to get under their policies, a dissolution cannot normally be a vehicle for oppression or unfairness. Sub. (4) prevents the management or the remaining policyholders from appropriating any surplus that remains after all amounts owing to creditors and policyholders have been paid. As under former s. 201.13, the residue goes to the school fund. The provision is of importance only in the event of a systematic freeze-out of policyholders, leaving only a handful to share the loot. Under this provision the loot disappears when the raiders are ready to grasp it. This should deter prospective raiders.

611.75 CONVERSION OF A DOMESTIC STOCK CORPORATION INTO A MUTUAL. A domestic stock corporation may be converted into a domestic mutual as follows:

(1) ACTION BY BOARD. The board shall adopt a plan of conversion. Thereafter no additional shares of capital stock shall be issued except that stock options to purchase capital stock may continue to be issued under existing contracts and outstanding options may continue to be exercised until the conversion is executed under sub. (6).

(2) PLAN OF CONVERSION. (a) The plan of conversion shall provide for the purchase by the corporation of all of its outstanding capital stock, at a price either specified in the plan or to be determined under a formula specified in the plan, for cash, specified debt securities to be issued by the corporation, or both. All holders of capital stock of the same class shall have the same rights under the plan. Shareholders may be given an election to take all or a portion of the price in the specified debt securities.

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Debt securities may be of any class authorized for mutual corporations under s. 611.33 (2).

(b) The plan shall provide a fair procedure subject to the commissioner's supervision to value contractual obligations of the corporation, such as those relating to stock options, that must be terminated on the date of conversion and are compensable under sub. (6) (b).

(3) APPROVAL REQUIREMENT. No conversion may be effected unless the plan of conversion is approved by the commissioner. The corporation shall file with the plan so much of the information under s. 611.13 (2) for the new mutual as the commissioner reasonably requires.

(4) CONDITION FOR APPROVAL. The commissioner shall approve the conversion unless he finds, after a hearing, that:

(a) The conversion would violate the law; or

(b) Its terms are not fair to the shareholders or the policyholders; or

(c) The resulting mutual would not meet the requirements for a certificate of authority under s. 611.20.

(5) APPROVAL BY SHAREHOLDERS. After the commissioner approves the plan of conversion, it shall be submitted to the shareholders for approval by the affirmative vote of a majority of each class of shares entitled to vote. Only shareholders of record on the date of the adoption under sub. (1) may vote.

(6) CONVERSION. (a) Continuation of corporation. If the shareholders approve the plan of conversion under sub. (5), the commissioner shall issue a new certificate of authority. The issuance of the certificate is the act of conversion, the corporation at once becomes a mutual and is no longer a stock corporation. The mutual shall be deemed to have been organized at the time the converted stock corporation was organized. The board shall thereupon implement the plan of conversion.

(b) Termination of contract rights. Any contractual obligation inconsistent with the nature of a mutual, including any obligation to issue or to redeem stock options, shall terminate upon the act of conversion under par. (a), without compensation unless the obligation was legally binding before the effective date of this chapter (1971).

(7) EXPENSES. The corporation may not pay compensation of any kind to any person other than regular salaries to existing personnel, in connection with the proposed conversion, other than for clerical and mailing expenses, except that with the commissioner's approval payment may be made at reasonable rates for printing costs and for legal and other professional fees for services actually rendered. All expenses of the conversion, including the expenses incurred by the commissioner and the prorated salaries of any insurance office staff members involved, shall be borne by the corporation being converted.

NOTE: This section replaces s. 201.301, and changes the conversion procedure in some major respects.

Mutualization of a stock insurer is a unique transaction by which a business enterprise is emancipated from its owners and becomes independent. All the equity or ownership interests of the shareholders are redeemed and are replaced by debt securities which in due course are

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repaid if the enterprise continues to operate profitably. Unlike the conversion of a mutual into a stock corporation, which only converts surplus into capital without changing the balance of the factors on the balance sheet, mutualization can seriously affect the solidity of the corporation. If the capital is transformed into liabilities, it can no longer perform its guaranty function and must immediately be replaced by surplus in an amount sufficient to support the operations of a mutual. That can be done either by providing surplus from a new source, or by subordinating the debt with which the capital is transformed so that it continues to perform its guarantee function until it is replaced by accumulating surplus.

While there is no doubt that shareholders should be permitted to do as they see fit with their ownership rights, including an exchange for a fixed, though subordinated, debt claim, it is less easy to understand why they should decide to do so. The usual way for a shareholder to withdraw his investment from a stock corporation in order to reinvest it elsewhere is to sell his stock in the market. If for some reason the market price does not adequately reflect the value of the corporation's assets, the investments can be recouped by liquidating the corporation. If the corporation has potential for further growth, debt securities present a less desirable investment than stock. For these practical reasons, mutualization will seldom occur. Yet it should be possible.

Most mutualizations have been motivated by considerations not exclusively economic. Motivation was supplied by the public indignation generated by the Armstrong investigation of 1905 in New York, which disclosed, among other things, efforts by controlling stockholders of large life insurance corporations to use the investment policy of their companies to establish huge financial empires for their own benefit. In the wake of the Armstrong investigation, several of the largest stock life insurers were converted into mutuals in order to reduce the danger of such abuses. Whether or not these were desirable from a strictly economic point of view or were in the interest of shareholders was not in issue. They were thought to be necessary because of the unscrupulous use of strategic positions of power in the economy.

Sub. (1) provides for the initial step in the conversion. If the conversion is accomplished, all outstanding shares will be purchased by the corporation under the plan. Hence, sub. (1) prevents the issuance of any additional shares except on stock options. Under sub. (5), such shares do not have the right to vote on the conversion.

If conversion is approved by the commissioner and the requisite vote of shareholders, sub. (2) (a) provides for the redemption of all shares at the plan price. This is a departure from former law which gave the dissenters special appraisal rights. S. 201.301 (4). Fairness to the dissenters does not require that they be granted the privilege of appraisal. The commissioner is required to find that the terms are fair in giving his approval. His order is subject to court review.

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Sub. (6) (a) makes clear that the new mutual is in all respects the successor to the stock corporation. The corporation continues without interruption, making it unnecessary to recite the assumption of the stock corporation's liabilities by the mutual.

The main innovation is the denial of any vote to the policyholders on the conversion of the corporation into a mutual. Stock policyholders "own" nothing but their contract rights. So long as the new company is solvent, and fully meets the financial requirements of the law, the policyholders have no more interest in the investment that the shareholders have made than do the creditors of any other solvent corporation. They are much less able to judge that question than is the commissioner who must give his approval.

The policyholders have no right to prevent the withdrawal by the shareholders of their ownership rights in excess of legal requirements, nor to prevent dissolution under s. 611.74. The only way in which a conversion differs from a payment of dividends or a partial liquidation, is that _all_ of the shareholders' ownership rights are withdrawn or transformed into debt. However, the process is subject to controls that prevent the interests of the policyholders from being compromised. This is because the resulting mutual must meet all the legal requirements for a mutual having the commitments of the stock company. Sub. (4) (c). The assets against which policyholder rights may be enforced are required by law to be sufficient for the purpose. There is therefore no issue on which the insureds need to vote to protect themselves. They do not even have to worry about assessments - a conversion plan could not transform nonassessable policies into assessable ones.

A special word should be said about the policyholders of life companies, who, unlike property-liability policyholders, are locked into the company, and cannot effectively "contract out" if they do not like the new situation. However, the record for solvency and stability of the life insurance industry suggests that the conversion from a stock to a mutual holds few risks for life policyholders. Moreover, they stand to gain. The inconvenience and expense involved in seeking a policyholder consensus on this question seems not to be justified. The policyholders' consensus could be made meaningful only by very expensive efforts to inform them.

PREFATORY NOTE to s. 611.76: The suspicion of chicanery often expressed about conversion of mutuals is not without factual historical basis. Although a conversion might sometimes arise from a legitimate effort to put a shaky company on a sound basis, it has often signalled a scheme by a controlling group to raid the surplus of a prosperous mutual for personal benefit. In the old days this could be done by dissolving the mutual and distributing its surplus or by simply appropriating the increased value of the stock resulting from the existence of the surplus. The primitive method no longer is of interest because of the limit imposed by s. 645.72 (2) and its predecessor sections.

The classic example was the well-known Madison Mutual case in the 1870's, of special interest because of the historical prominence of some of its _dramatis personae_. The celebrated decision in _Huber v. Martin_, (1906) 127

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Wis. 412, struck down a later conversion plan, by declaring unconstitutional a 1903 act providing for conversion with safeguards that were being evaded by an unfair preemptive formula. The mutual conversion process was thoroughly discredited, and was forbidden outright by legislation in 1911. See Kimball, Insurance and Public Policy (1960), pp. 84-91.

Not until 1963 was mutual conversion again permitted in Wisconsin. Ch. 282, Laws of 1963 permitted the conversion with what were thought to be appropriate safeguards. Some other states, on the other hand, still expressly prohibit mutual to stock conversion. Alaska, s. 21.69.580; Hawaii, ch. 181, s. 199; Idaho, s. 41-2855; Indiana, s. 39-4101; Kentucky, s. 304.192; New York, s. 54; South Dakota, ch. 16 s. 4; Virginia, s. 38.1-79 and Washington, s. 48.09.350. Most other states inferentially prohibit such conversions by not authorizing them. Although it is quite common to permit a stock corporation to mutualize the converse is less often authorized. Only 18 states (including Wisconsin) expressly permit mutuals to convert into stock corporations.

The widespread prohibition of conversions in other states indicates that abuses of the procedure have not been limited to Wisconsin. Indeed, recent experience keeps the issue alive. See e.g. Allyn v. Hull, 140 Conn. 222, 99A. 2d 128 (1953); Slavin v. Germantown Fire Ins. Co., 174 F. 2d 799 (1949). Several cases of fraudulent conversion schemes are described in detail in Gesell & Howe, Study of Legal Reserve Life Insurance Companies (TNEC Monograph No. 28) 65-88 (1941).

While mutual to stock conversions have often been exploited by managements, they also in a sense "benefit" policyholders, by unlocking the policyholders' shares of surplus which in a mutual have value to the individual policyholders only upon dissolution, while if conversion occurs they become saleable assets. For this reason it is easy to show a benefit to policyholders from conversion, in making marketable what in theory they have "owned" all the time. This tends to conceal the fact that conversions are almost invariably arranged so that insiders profit greatly from the process. No objection can exist to a conversion that protects the policyholders' rights to all the surplus and does not permit management insiders to exploit the process to appropriate part of the surplus for themselves beyond what they are entitled to as policyholders.

The reason most often advanced to justify a conversion is a need for additional capital which, it is said, can only be obtained through the sale of stock. The capital is needed, allegedly, for financing growth and expansion. This line of reasoning is suspect.

First, growth and expansion of an insurance enterprise do not necessarily benefit policyholders. It is not clear that policyholders in a big company necessarily get lower premiums or other advantages compared to small ones. The existence and success under competitive market conditions of hundreds of small insurance companies furnishes strong evidence to the contrary. An undue emphasis on growth and expansion is more likely to increase the cost of insurance than to lower it. The history of the insurance business abounds with examples

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of reckless drives for expansion accompanied by excessive commissions and other marketing expenses and considerable waste.

Second, outside capital is not always needed for rapid and even for dramatic growth. For example, State Farm Mutual Automobile Insurance Company became the nation's largest automobile insurer within 20 years after it was organized. In the insurance business initial capital needs are modest. The largest expense factor is commissions, payable only out of income. Rather than requiring heavy capital investment the insurance industry has, when successful, been an important generator of capital.

Need for capital may in some cases only be a pretense for justifying conversion. This conclusion is confirmed by a look at the real reasons for conversion as conceded in internal industry discussions. It is clear that the renewed interest in conversion is often either related to the insider desire to make a "killing", or to the holding company movement which has been mesmerizing the insurance industry for several years. In the latter case it reflects a strong desire to invest surplus, and sometimes even more, in speculative and perhaps more rewarding investments than the traditional insurance investment law permitted, and simultaneously to disinvest in the insurance business itself.

This can be done with little difficulty if the insurer is a stock corporation. It is easy to rearrange the financial structure so that the stock insurer becomes a wholly owned subsidiary of a holding company. Then as much of its surplus as is desired can be turned over to the parent holding company for diversified investment.

In the case of a mutual, the corporation cannot be owned by a parent holding company. Its "owners" are its policyholders. Its surplus belongs to them. If a mutual is to be made part of a holding company empire it must first be converted into a stock corporation. The policyholders of the mutual continue to be policyholders with unaffected contractual rights, and at the same time they first become shareholders in an insurance corporation and then in a general business corporation of which the insurance company is a subsidiary.

The principal objection to such a transaction results from the mutual concept. A mutual is supposed to operate without "profit" for anyone. It should accumulate only such surpluses as are necessary to cover reasonable contingencies, or at most for enough growth to be viable as an organization. To the extent that funds are needed for the protection of policyholders, they should be invested only in reasonably secure assets prescribed in the investment laws, and not put in jeopardy in more risky ventures. Assets need not and should not be accumulated for the sake of accumulation. The only even arguable exception is for sound growth of the insurance business. If a higher surplus is produced, the mutual idea requires that either premium rates be reduced or the excess be returned to policyholders in the form of dividends. The existence of uncommitted, disposable surplus in a mutual is evidence that the principle of mutuality has been disregarded by the management. Rather than allow the diversion of such excess funds into unrelated activities the law should require that

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they be used for the immediate benefit of policyholders. Probably policyholders of a mutual are more interested in paying less for their insurance or getting higher benefits from their premium dollars than in ultimately becoming shareholders in a diversified company. At any rate, investment decisions concerning the money they have put in specifically for insurance purposes should be theirs and should not be made for them by management. If conversion is a sound concept, then the mutual may be said to be anachronistic - the two notions are hard to reconcile.

If conversion does take place, of course no policyholder is forced to keep any of his stock; if he does not want it, he will usually be able to sell it and is then in the same position as if he had received a cash dividend. Actually, many policyholders will not receive shares at all but only a cash payment. This result will be fostered by the management, which has an understandable desire to remain in control of the corporation. If every policyholder's share in the surplus were converted, dollar for dollar, into voting stock, the stock of the new stock corporation would be immediately widely scattered. Management often fears that interested outsiders might then quickly buy up a controlling interest and take over control of the company. The most effective way for management to keep control is to authorize and issue stock at a high price so that most policyholders are entitled only to a fractional share and accept a cash payment rather than pay the difference to receive a full share. This retention of control by management can be facilitated by issuing non-voting preferred shares for a large portion of the surplus. Then management may get absolute voting control for a relatively modest investment.

There are other reasons why management may wish to convert a mutual into a stock corporation. In some cases it is an act of exchanging reality for fiction. In the past, the comparatively low financial requirements for organizing a mutual made this particular form of enterprise a vehicle for a small scale proprietary-type operation for the benefit of an individual or a small group of entrepreneurs. Whoever could not raise the capital for a stock corporation, or was unwilling to share control with a financier might be able, with minimum capital outlay, to organize a mutual. The "profits" of the operation could be siphoned off through the use of management or exclusive agency contracts without responsibility for losses. For a detailed description of this practice, see Gordon Sinykin and Shirley S. Abrahamson, Report on Study of Management Contracts of Wisconsin Insurance Companies (1965). The elimination of management contracts took away much of the attractiveness of these schemes. Under the proposed new corporation law with increased capital requirements for mutuals there will be less incentive to use the mutual form as a mere shell for a proprietary business. Under present circumstances, conversion into a stock corporation is the only way for mutuals operated under a proprietary concept to adjust to the change in the law and in regulatory attitude. The mutual form can be justified as a special form of enterprise only if it is not operated for profit, in practice as well as in theory. Every manager of a mutual who in fact has and wishes to retain "prerogatives" which can be attributed only to genuine ownership, rather than subscribe to the ideas of a non-

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profit operation, should adjust the form of the enterprise to his ideas.

Thus, although a conversion can sometimes be "in the interest of policyholders", it is also susceptible to serious abuse. From management's point of view, it can be desirable, and is not harmful if it is controlled so that the policyholders are protected against financial loss. The proposed s. 611.76 includes the necessary protective provisions.

611.76 CONVERSION OF A DOMESTIC MUTUAL INTO A STOCK CORPORATION. (1) CONVERSION PERMITTED. (a) General. Except under par. (b), a domestic mutual may be converted into a domestic stock corporation under subs. (2) to (11).

(b) Conversion of related insurers. No domestic mutual that is affiliated with other mutuals may be converted into a stock corporation, unless all such affiliated mutuals are also converted at the same time, or the commissioner finds that the interests of the policyholders of the remaining mutuals can be permanently protected by limitations on the corporate powers of the new stock corporation or on its authority to do business, or otherwise.

(2) RESOLUTION BY THE BOARD. The board shall pass a resolution to the effect that such conversion is in the best interests of the policyholders. The resolution shall specify the reasons for and the purposes of the proposed conversion, and the manner in which the conversion is expected to benefit policyholders.

(3) INVESTIGATION BY COMMISSIONER. (a) Application. The board shall file with the commissioner the resolution and any additional documents and information he reasonably requires, whereupon the commissioner shall order examination and appraisal of the corporation, unless he finds that:

1. The resolution is defective upon its face; or

2. The reason for or the purposes of the proposed conversion are contrary to law or to the interests of the policyholders or the public.

(b) Examination. The commissioner shall cause to be made an examination of the company and all its controlled affiliates under s. 601.43 to determine their financial condition and whether it is operated in accordance with the law.

(c) Appraisal. The commissioner shall appoint an appraisal committee, consisting of at least 3 qualified and disinterested persons with differing kinds of training, to determine the value of the corporation as of the date of the resolution in sub. (2). Members of the committee shall receive reasonable compensation and shall be reimbursed for reasonable expenses in discharging their duties. They may, as reasonably necessary, employ consultants to advise them on technical problems of the appraisal. The appraisal committee shall consider the assets and liabilities of the corporation, adjusting liabilities to take account of the amounts of any reserves in excess of or below realistic estimates, the value of the marketing organization, the value of goodwill, the going-concern value and any other factor having an influence on the value of the corporation.

(4) PLAN OF CONVERSION. When the examination and appraisal reports have been made to the commissioner, he shall make copies available to the board, which shall thereupon prepare and adopt by resolution a plan of conversion, which shall specify:

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(a) The number of shares proposed to be authorized for the new stock corporation, their par value and the price at which they will be offered to policyholders, which price may not exceed one-half of the median equitable share of all policyholders under par. (b);

(b) That each person who has been a policyholder and has paid premiums within 5 years prior to the resolution under sub. (2) shall be entitled without additional payment to so much common stock of the new stock corporation as his equitable share of the value of the converting corporation will purchase; that the equitable share shall be determined by the ratio which the net premium (gross premium less return premium and dividends paid) he has paid to the corporation during the 5 years immediately preceding the resolution under sub. (2) bears to the total net premiums received by the corporation during the same period; and that, if the equitable share is sufficient only for the purchase of a fraction of a share of stock, the policyholder shall have the option either to receive the value of the fractional share in cash or to purchase a full share by paying the balance in cash;

(c) The procedure for stock subscriptions which shall include a written offer to each such policyholder indicating his individual equitable share and the terms of subscription;

(d) That no common shares shall be subscribed by or issued to other persons than such policyholders until all subscriptions by the policyholders have been filled, and that thereafter any new issue of stock for 5 years after the conversion shall first be offered to the persons who have become shareholders under par. (b) in proportion to their interests under par. (b); and

(e) That no policyholder may receive a distribution of shares valued in excess of the amount to which he is entitled under s. 645.72 (2). Any excess over that amount shall be distributed in shares to the state treasury for the benefit of the common school fund. After 5 years the shares may be sold by the treasurer at his discretion and the proceeds credited to the common school fund.

(5) APPLICATION FOR APPROVAL. The plan of conversion shall be submitted to the commissioner for approval, together with:

(a) The proposed articles and bylaws of the new stock corporation which shall comply with s. 611.12;

(b) So much of the information specified in s. 611.13 (2) as the commissioner reasonably requires;

(c) A projection of the planned or anticipated financial situation of the new corporation for 5 years after the conversion.

(6) HEARING. The commissioner shall thereupon hold a hearing, notice of which shall be mailed to each person who was a policyholder of the corporation on the date of the resolution under sub. (2), together with a copy of the plan of conversion and any comment the commissioner considers necessary for the adequate information of policyholders.

(7) APPROVAL BY COMMISSIONER. The commissioner shall approve the plan of conversion unless he finds that the plan violates the law or is contrary to the interests of policyholders or the public.

(8) APPROVAL BY POLICYHOLDERS. After approval under sub. (7), the conversion plan shall be submitted to a vote of the persons who were policyholders of the mutual on the date of the resolution under sub. (2).

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(9) CONVERSION. (a) Continuation of corporation. If the policyholders approve the conversion under sub. (8), the commissioner shall issue a new certificate of authority. The issuance of the certificate is the act of conversion, the mutual at once becomes a stock corporation and is no longer a mutual. The stock corporation shall be deemed to have been organized at the time the converted mutual was organized. The directors, officers, agents and employes of the mutual shall continue in like capacity with the stock corporation.

(10) EXPENSES. The corporation may not pay compensation of any kind to any person other than regular salaries to existing personnel, in connection with the proposed conversion, other than for clerical and mailing expenses, except that with the commissioner's approval payment may be made at reasonable rates for printing costs and for legal and other professional fees for services actually rendered. All expenses of the conversion, including the expenses incurred by the commissioner and the prorated salaries of any insurance office staff members involved, shall be borne by the corporation being converted.

(11) SECURITY REGULATION. The filing with the department of securities of a certified copy of the plan of conversion as approved by the commissioner constitutes registration under s. 551.27 of the securities authorized to be issued thereunder.

NOTE: This section continues the substance of s. 201.14, with some important changes as well as technical adjustments to the new corporation law in this chapter.

One of the major innovations is a change in the order of the various steps. Another is found in sub. (4) (a) which requires the price of shares to bear a reasonable relation to what the smaller policyholders can purchase with their portions of the mutual's value. The reason for this requirement is clear from the preliminary comment.

Policyholders only have a right to vote on the conversion issue if they were policyholders of record on the date of the resolution under sub. (2), but anyone paying premiums within the previous 5 years is entitled to share in the stock that is issued. No reason has been suggested why the accident of termination of coverage shortly before the crucial date by a mutual policyholder of long standing should result in a forfeiture of his equitable share of the surplus, although he should, of course, no longer have a voice on the question whether to convert. Ideally and theoretically, the surplus should be allocated to all persons who have contributed to build it. The 5-year limitation is a reasonable and practicable compromise with principle.

The setting of the maximum value of shares will work as follows: Suppose a value of the corporation of $100,000,000, and one million policyholders. The average share of surplus is $100. If there are no or very few large policyholders, the average share would be about the same as the median, and the maximum value of a share would be about $50. But the median rather than the average is chosen because of quite a different situation. Suppose 100 large policyholders had $90,000,000 of the equitable share of the surplus and the remaining 999,900 policyholders had the remaining $10,000,000 of surplus. Then the average would still be $100 but the median would be closer to $10. In that

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case the maximum value of a share, if it were half of the average, would be too large for most policyholders to buy. If it is half of the median, the maximum would be $5. The purpose of the rule is to ensure that fractional shares will be relatively few and that the policyholders who "own" the corporation will have a reasonable chance to continue "owning" it after conversion. Policyholders having a $5 or $10 equitable share in surplus are unlikely to put up $40 or $45 cash to get a whole share, and much less will they put up $90 or $95. The desire to freeze out most policyholders as shareholders is the frankly conceded reason for the way share prices have been set by management in conversion plans. The device is transparent; indeed no effort is made to disguise its purpose. It should not be allowed to succeed.

611.77 CONVERSION OF ASSESSABLE TO NONASSESSABLE AND NONASSESSABLE TO ASSESSABLE MUTUALS. (1) ASSESSABLE TO NONASSESSABLE. Whenever an assessable mutual accumulates enough surplus to satisfy the financial requirements for the operation of a nonassessable mutual under like conditions, it may apply for a certificate of authority authorizing it to sell nonassessable policies. The commissioner shall issue a certificate of authority designating it a nonassessable mutual if he finds that the applicant satisfies the requirements of the law and that the issuance of nonassessable policies will not endanger the interests of its insureds or the public. Policies issued thereafter shall be nonassessable; existing policies shall continue in effect and shall also become nonassessable.

(2) NONASSESSABLE TO ASSESSABLE. A nonassessable mutual may apply to the commissioner for a certificate of authority designating it an assessable mutual. The commissioner shall issue the certificate if the law permits such a corporation to issue assessable policies and if he finds that the conversion will not endanger the interests of present or future insureds or of the public. All policies issued after conversion shall be assessable, and all policies in effect on the date of conversion shall be assessable except to the extent that there is a contract right then existing not to be assessed.

NOTE: S. 201.07 contemplated that an insurer may move rather freely up and down across the line dividing assessable from nonassessable mutuals. The change in financial standards and mode of operation is significant enough, however, that the change should be a formal one, reflected in the terms of the certificate of authority, and the commissioner should have supervision over the change.

Movement up to nonassessability may be a normal process in the growth of a corporation. The reverse transition is not, however. If a corporation needs to move "downward", action under ch. 645 may be justified. Of course this is not invariably true; the circumstances of the insurer may simply be such as to make an assessable operation the more appropriate form for it.

611.78 TRANSFER OF BUSINESS OR ASSETS. (1) SALE, LEASE, EXCHANGE OR MORTGAGE OF ASSETS WITH OR WITHOUT SHAREHOLDER ACTION, AND RIGHTS OF DISSENTING SHAREHOLDERS THEREON. Sections 180.70, 180.71 and 180.72 apply to stock corporations.

(2) REPORT TO COMMISSIONER. Any action by which an insurance corporation proposes to transfer to another person or to

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reinsure any part of its insurance business, other than in the normal and usual course of business, or to sell, lease, exchange, mortgage, pledge or otherwise dispose of or encumber more than one-fourth of its assets, shall be reported to the commissioner not less than 30 days in advance of the proposed effective date. The commissioner may defer the effective date for an additional period not exceeding 30 days by written notice to the corporation before expiration of the initial 30-day period.

(3) DISAPPROVAL. The commissioner may, within the 30-day period or its extension, prohibit the proposed action if it is contrary to law or to the interests of insureds or the public or if it will make possible the circumvention of any of the requirements of ss. 611.71 to 611.77.

NOTE: The transfer, or "bulk reinsurance", of the entire business of an insurer has often been used to achieve the same effect as a merger or a conversion. It should therefore be subject to the same degree of control. Such control is already presupposed in s. 645.31 (8) which makes any such transfer or attempted transfer a ground for rehabilitation unless the commissioner's written consent is first obtained. While normal reinsurance arrangements with relation to a portion of the risk carried by the insurer are indispensable for the successful operation of an insurance business, and even 100% reinsurance of individual risks may be a sound action to take in the ordinary course of business, bulk reinsurance of the entire business or of all the business in a particular line or territory is a serious matter affecting the overall financial situation of the insurer. It also can be exploited for all kinds of manipulations to the detriment of policyholders, as has been demonstrated in many cases. This is sufficient reason to submit such transactions to the scrutiny of the commissioner before they are consummated. The prior approval contemplated in s. 645.31 (8), though, is not consistent with the more liberal approach taken throughout this chapter, as, e.g., in s. 611.28. Consequently, this section requires only that transactions of this kind be filed with the commissioner and be subject to disapproval by him. Under s. 601.63 (5) the action could be made effective immediately by the commissioner's affirmative approval. S. 645.31 (8) is appropriately liberalized elsewhere in this bill.

Provisions restricting transfer of business or bulk insurance occur frequently in the insurance codes of other states; they usually require affirmative approval by the commissioner. See, e.g.: Illinois, ch. 73, s. 786; Indiana, s. 39-3907; Kentucky, s. 304.192 (2); New York, s. 77 (4), (5); South Carolina, s. 37-355 (1); Virginia, s. 38.1-38; Washington, s. 48.09.350. The remedies provided by s. 206.02 (7) seem inadequate.

The same control as for transfers of business is required for transactions involving substantial portions of the assets of an insurer. Again, the ordinary operation of the insurance business, especially with respect to the shifting of investments, should be left undisturbed, but control should be focused on those transactions which are particularly vulnerable to abuse. This section tries to make that distinction. The section could appropriately be more stringent if a sufficiently definite criterion were available for the portion of assets to which it was applicable.

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SECTION 73. 617.02 of the statutes is repealed.

NOTE: These definitions are moved to s. 600.03, since they have general application in the insurance code.

SECTION 74. Chapter 618 of the statutes is created to read:

CHAPTER 618.
NONDOMESTIC INSURERS.

PREFATORY NOTE: This chapter governs the relationships of alien and foreign insurers to this state's insurance law. Alien insurers are those domiciled outside of the U.S. while foreign insurers are U.S. companies not domiciled in this state. These 2 kinds of insurers are here both included in a single term - "Nondomestic insurers". The chapter provides a procedural framework and substantive requirements for authorization of nondomestic insurers, and regulatory controls on their subsequent operation. It also specifies the terms under which an insurance business may be done in this state by nondomestic insurers without having a certificate of authority.

Subchapter I contains some general provisions, subchapter II deals with the authorization of nondomestic insurers, while subchapter III deals with permitted insurance by unauthorized insurers.

Subchapter I: General Provisions

This subchapter provides the purposes and definitions that need to be stated.

Subchapter II: Authorization of Nondomestic Insurers

This subchapter uses the following principles in applying the law for domestic insurers to nondomestic ones.

1. Controls over the process of organization of domestic Wisconsin companies do not apply at all to companies organized elsewhere and authorized in this state after organization is complete, unless this state's law has been violated in the process, as it would be by the unauthorized sale of securities in this state.

2. Controls over the organizational framework and management practices of nondomestic insurers are imposed to a very limited extent - only where the public policy reflected by the rule is one of such overriding importance that it must be a prerequisite to admission, whatever the domiciliary law may be. Generally, the management framework of a nondomestic corporation is not a matter of overriding concern to this state, which can afford to let the domiciliary public policy be decisive.

3. Substantive controls over the insurance operation, and particularly of the financial aspects of the company's life, are a different matter. Many of them will be fully applicable. Others will not. Sometimes they are so important that they should be applicable to the insurer's operations everywhere. More often it is enough that the insurer conform only in Wisconsin. Substantive rules fall into three categories:

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(a) Rules that are only applicable to domestic insurers;

(b) Rules that apply to nondomestic insurers in substance, while allowing reasonable leeway on details, so that this state's public policy does not present a responsible nondomestic insurer with a requirement that it cannot satisfy in detail and that would be unreasonable when strictly applied to it;

(c) Rules, particularly financial requirements for solidity, that must be satisfied strictly. In particular, the Wisconsin requirements for reserving, for valuation of liabilities and assets, and for required capital and surplus, should be strictly adhered to. Differences between the law of this state and other laws place no insuperable burden on insurers when they are required to meet the standards of this state. All they have to do, as a practical matter, is to conform to the most rigorous standards to which any law subjects them. If they can meet those, they will automatically meet the less stringent ones. Direct conflict among such rules is uncommon - most often the more stringent rules simply include the less stringent. But where this is not the case, the problem will have to be dealt with specifically to resolve the conflict.

Alien insurers present special problems. Assets of alien insurers may sometimes be reached by creditors in ways that would render such companies unable to perform their obligations in the United States. Also they may sometimes be exploited by an irresponsible government. Some devices exist for avoiding the difficulties arising from international operations. The first is to require an alien insurer to enter the United States by the creation of an incorporated subsidiary here. This is a method by which many insurers do enter the American market. If the insurer chooses not to form an American subsidiary, at least two other alternatives exist. It may deposit funds in trust in sufficient amount to guarantee American obligations, as it does in the creation of a United States branch, or it may supply a bond conditioned on performance of American obligations.

The method of entry selected by an insurer will depend upon many factors, such as the size of the projected American operation and the law of its domicile. If only a small operation is intended in this country, it will be easy to satisfy the bond requirement. If the insurer intends a major American operation, it will likely choose to organize a subsidiary in some American state and enter that corporation elsewhere in the country, or make arrangements to put assets in trust and form a United States branch. The last 2 avenues are preferable when a major operation is intended. But a bond properly conditioned is functionally equivalent to the other 2 methods and should be permitted whenever appropriate.

Alien insurers sometimes keep records and accounts on a different basis than do American insurers. Underwriters at Lloyd's, London, (also called Lloyd's of London), for example, use different techniques. The Lloyd's-type accounting and records are equally rigorous and sound and should be acceptable. To avoid the constitutional problem of special legislation, the provisions in this chapter have been formulated in general terms. However, practically speaking, we propose herein that Underwrit-

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ers at Lloyd's London, be permitted to enter the state if they comply with English rules. Similar organizations based elsewhere would have to demonstrate to the commissioner's satisfaction that they meet standards equivalent to those imposed by Wisconsin law applicable to other forms of insurer or else to other standards deemed adequate. One example would be those imposed by law and by Lloyd's Corporation upon Underwriters at Lloyd's, London. Parenthetically it should be mentioned that Underwriters at Lloyd's, London, already satisfy the trust requirement mentioned above, substantially if not literally, through the Lloyd's American Trust Fund.

Subchapter III: Permitted Insurance Activities of Unauthorized Insurers.

Subchapter III deals with unauthorized insurance, which presents a variety of problems owing their existence largely to the fact that the insurance business, though national or even international in scope, is regulated independently by each of the states and by foreign countries. Under the system of state regulation, each state decides which insurers are permitted to operate in its territory. Certificates of authority are issued to insurers after they have satisfied the states' statutory requirements and have been found by the regulators to be acceptable. Conversely, any operation in a state by an insurer not so authorized is prohibited. However, this seemingly simple principle has not worked in practice without some important exceptions. Essentially, the exceptions are the following:

(1) Move-in business consists of contracts made legitimately in a state where the insurer was authorized to do business, with a policyholder who subsequently has moved into a state where the insurer is not authorized. If the policy is one of life or disability insurance, the policyholder usually has no reason to want to change to another insurer, nor is there any reason to force him to do so. Consequently, the insurer should be permitted to service such an "orphan" contract, perhaps even to renew it, to collect the premiums and to adjust losses, without being in violation of the law.

(2) Directly placed business includes contracts made directly by the policyholder with an unauthorized insurer outside the state, with no resident agent involved and no other significant act incidental to the making of the contract taking place within the state. In these cases, although the insured property is located within the state and/or the policyholder is a resident of the state, the policyholder, by leaving the state in his search for coverage, gives up the special protection of his state's laws. It should be beyond the state's concern to prohibit such transactions if they do not affect others than the policyholder in Wisconsin. However, a state may wish to subject such contracts to taxation if similar business done by authorized insurers is taxed, because otherwise policyholders could procure insurance outside the state solely for tax-saving purposes. Then the state's revenues would suffer and the state's authorized insurers, domestic or nondomestic, would be subjected to an unfair competitive disadvantage.

(3) Reinsurance is virtually unregulated by the states. No tax considerations are involved, because the insur-

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ance business is taxed at the direct insurance stage and need not be taxed again. In this revision, reinsurance is exempted from the general licensing requirement and is not "unauthorized insurance". Needed controls can be imposed on the authorized direct insurer.

(4) Surplus lines insurance is insurance placed with an unauthorized insurer because it is not available in the market formed by the insurers authorized in a given state, either because the amount for which coverage is sought is too great, because the risk is not acceptable to authorized insurers or because a special "tailor-made" policy with unusual terms is desired. A common example is a policy for a large industrial or commercial complex with plants located in many states. The difficulty of preparing a policy that would meet all the requirements of the various states involved is one of the problems that has resulted in policyholders seeking coverage in out-of-state markets. The states' concern in these instances is not limited to taxation but also includes protection of insureds. Former s. 201.63 (6) (a) required an affidavit that coverage was not available in the authorized market. New s. 618.41 is more liberal, and seeks to create self-executing controls over outside placements without a direct prohibition.

(5) Mail-order insurance has long plagued regulators. Insurers operating exclusively through the mails, without employing agents or maintaining regional offices, have managed to escape regulation for several reasons: first, because business transacted through the mails was not considered to be business done within the state where the policyholders resided, and second, because it was difficult for state courts and administrative agencies to establish jurisdiction over unauthorized mail-order companies domiciled in other states. Wisconsin pioneered in solving the problem by enacting s. 201.42 in 1961, which gave Wisconsin ample authority over mail-order insurance. Haase, Control of Unauthorized Insurance: The Ministers Life Case in Historical and Legislative Perspective, in Insurance, Government and Social Policy (Kimball and Denenberg ed.) 311-362 (1969), gives a detailed account of the development of the Wisconsin legislation.

The disposition of the unauthorized insurance law contained in ss. 201.42 and 201.63 is as follows: the general prohibition of unauthorized insurance is in s. 610.11, but does not apply to reinsurance. Section 610.11 (2) refers to ch. 618 for the definition of the business that may be done by unauthorized insurers. Section 618.41 deals with surplus lines and s. 618.42 with direct placement business. Section 618.43 provides for taxation of such business. Procedural matters have already been disposed of in ss. 601.72 and 601.73.

618.01 PURPOSES. The purposes of this chapter are:

(1) To protect insureds, creditors and the public in this state by providing adequate standards and an orderly procedure for the authorization of nondomestic insurers;

(2) To prevent evasion by unauthorized insurers of the regulatory and tax laws of this state and to protect this state and its residents against loss from such action;

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(3) To subject unauthorized insurers and other persons doing an insurance business in this state to the jurisdiction of the commissioner and the courts of this state;

(4) To protect authorized insurers from unfair competition by unauthorized insurers; and

(5) To provide an orderly method, under reasonable and practical safeguards, for procuring insurance from unauthorized insurers.

NOTE: This section gathers the purpose provisions formerly stated in s. 201.42, dealing with unauthorized insurance, and s. 201.63, dealing with surplus lines insurance. There has been substantial reorganization of the provisions of s. 201.42, however.

The motives of the legislature in passing ss. 201.42 and 201.63 are still relevant to this section, since the substance is retained and only the form of those sections is changed. Following is the statement of purpose in s. 201.42, which is still applicable to ch. 618.

"The purpose of this section is to subject certain persons and insurers to the jurisdiction of the commissioner, of proceedings before the commissioner, and of the courts of this state in suits by or on behalf of the state and insureds or beneficiaries under insurance contracts. The legislature declares that it is a subject of concern that many residents of this state hold policies of insurance issued by persons and insurers not authorized to do insurance business in this state, thus presenting to such residents the often insuperable obstacle of asserting their legal rights under such policies in forums foreign to them under laws and rules of practice with which they are not familiar. The legislature declares that it is also concerned with the protection of residents of this state against acts by persons and insurers not authorized to do an insurance business in this state by the maintenance of fair and honest insurance markets, by protecting the premium tax revenues of this state, by protecting authorized persons and insurers, which are subject to strict regulation, from unfair competition by unauthorized persons and insurers and by protecting against the evasion of the insurance regulatory laws of this state. In furtherance of such state interest, the legislature herein provides methods for substituted service of process upon such persons or insurers in any proceeding, suit or action in any court and substitute service of any notice, order, pleading or process upon such persons or insurers in any proceeding before the commissioner to enforce or effect full compliance with the insurance and tax statutes of this state, and declares in so doing it exercises its power to protect residents of this state and to define what constitutes doing an insurance business in this state, and also exercises powers and privileges available to this state by virtue of P.L. 79-15 (1945), (Chapter 20, 1st Sess., S. 340), 59 Stat. 33, as amended, which declares that the business of insurance and every person engaged therein shall be subject to the laws of the several states."

The purpose stated in the first sentence of the quoted language is partly achieved by s. 262.05 (10), and partly by ss. 601.71 to 601.73. The former is a pioneering general long-arm statute that was developed

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contemporaneously in Wisconsin with s. 201.42, which was a pioneering long-arm statute for insurance. Wisconsin was a leader in both, though they were developed independently. The latter (ss. 601.71 to 601.73) is a part of this revision, enacted in Laws of 1969, ch. 337. The second sentence is partly repetitive of the first, and is fully covered in s. 262.05 (10). The third sentence is concerned with jurisdiction and substantive regulation of unauthorized insurance, and is continued in the purposes stated in subs. (2), (3) and (4). Thus the purposes of s. 201.42 are fully retained in the present law. The last sentence of the quoted passage is a sound declaration of the operative portions of s. 201.42 and of the power to enact it. It is correct and unobjectionable, but not necessary.

The purpose clause of s. 201.63, fully applicable to ch. 618, reads as follows:

"Insurance transactions which are entered into by citizens of this state with unauthorized insurers through a surplus lines agent as a result of difficulty in obtaining coverage from licensed insurers are a matter of public interest. The legislature declares that such transaction of surplus lines insurance is a subject of concern and that it is necessary to provide for the regulation, taxation, supervision and control of such transactions and the practices and matters related thereto by requiring appropriate standards and reports concerning the placement of such insurance; by imposing requirements necessary to make such regulation and control reasonably complete and effective; by providing orderly access to insurers that are not authorized to transact the business of insurance in this state; by insuring the maintenance of fair and honest markets; by protecting the revenues of this state; and by protecting authorized insurers, which under the laws of this state must meet strict standards as to the regulation of the business of insurance and the taxation thereof, from unfair competition by unauthorized insurers. In order to properly regulate and tax such unauthorized insurance within the meaning and intent of P.L. 79-15 (1945), (Chap. 20, 1st Sess., S. 340), 59 Stat. 33, the legislature herein provides an orderly method for the insuring public of this state to effect insurance with unauthorized insurers through qualified, licensed and supervised surplus line agents in this state and under reasonable and practical safeguards so that such insurance coverage may be obtained by residents of this state to the extent that the coverage is not procurable from duly licensed, regulated insurers conducting business in this state."

In a simplified form, the surplus lines law is continued in full in this section. Much of the comment above on s. 201.42 (1) is also applicable to this passage. Its principal purpose is now found in sub. (5). Thus the purposes of these two important statutes are fully retained in this section, which is not intended to abandon any jurisdictional basis existing in present law.

618.02 DEFINITIONS. For the purposes of this chapter, unless the context indicates otherwise:

(1) "Independently procured insurance" means insurance procured under s. 618.42.

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(2) "Doing an insurance business" includes:

(a) Soliciting, making, or proposing to make an insurance contract;

(b) Taking or receiving an application for insurance;

(c) Collecting or receiving, in full or in part, an insurance premium;

(d) Issuing or delivering an insurance policy except as a messenger not employed by the insurer or by an insurance agent or broker;

(e) Inspecting risks, setting rates, disseminating information or advising on risk management in connection with the solicitation, negotiating, procuring or effectuation of insurance coverage;

(f) Investigating, settling, adjusting or litigating claims;

(g) In any way representing or assisting any person to do an insurance business or to procure insurance; and

(h) Any other act generally regarded as doing an insurance business.

(3) "Doing an insurance business" does not include:

(a) Acting as an attorney for a client; and

(b) Acting as a full-time salaried employe of an insured in the capacity of an insurance buyer or manager.

NOTE: Subs. (2) and (3) continue in substance the definitions of s. 201.42 (2).

SUBCHAPTER II.
AUTHORIZATION OF NONDOMESTIC INSURERS.

618.11 APPLICATION. Any person, including the United States branch of an alien insurer, authorized to transact the business of insurance as an insurer in another jurisdiction may apply for a certificate of authority to do an insurance business in this state, using the forms prescribed by the commissioner. The applicant shall include the information and documents the commissioner requests, including the following unless the commissioner excludes any of them:

(1) A copy of the insurer's articles and bylaws;

(2) Financial statements for the most recent completed fiscal year, with an explanation of the bases of all valuations and computations, in such detail as the commissioner reasonably requires;

(3) A summary, as detailed as the commissioner reasonably requires, of the insurer's financial history for the preceding 10 years;

(4) The names of its directors and principal officers and all their addresses and occupations for the preceding 10 years;

(5) In the case of an alien insurer, the name of its United States manager and for the preceding 10 years all the manager's addresses and occupations; and if the manager is corporate the

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names, addresses and occupations of the manager's directors and principal officers and detailed financial statements of the manager;

(6) A schedule listing:

(a) All jurisdictions in which it has done or been authorized to do an insurance business during the preceding 10 years;

(b) All jurisdictions to which it has applied for authorization to do an insurance business during the preceding 10 years, and the dates and results of such applications;

(c) All jurisdictions from which it has withdrawn during the preceding 10 years, and the reasons for its withdrawals;

(d) All administrative or criminal actions, orders or proceedings to which it or any of its directors or principal officers have been subjected on account of an alleged violation of any law governing insurance operations in any jurisdiction during the preceding 10 years, or not involving insurance operations if it is a felony;

(7) A description of its present business operations, including the coverages written and the territories in which it does business;

(8) A list of any significant statements, reports or other documents that have been prepared during the preceding 10 years for any insurance regulatory authority or for general distribution among creditors, shareholders, members, subscribers or policyholders;

(9) If it has actually transacted an insurance business for less than 5 years, a detailed history of the past and projection of the anticipated operating results at the end of each of the first 5 years of operation, based where known on actual data and otherwise on reasonable assumptions of loss experience, premium and other income, operating expenses and acquisition costs;

(10) A statement showing to what extent organizational and promotional expenses have been paid, and to what extent organizational procedures are incomplete;

(11) A certificate from the domiciliary regulatory authority and the state of entry into the United States, if any, that so far as known the applicant is sound and that there are no legitimate objections to its proposed operations in this state;

(12) The plan for conducting an insurance business in this state, including:

(a) The geographical area in which business is intended to be done;

(b) The types of insurance intended to be written;

(c) The proposed marketing methods;

(d) The proposed method for the establishment of premium rates; and

(e) Copies of the policy and application forms intended to be used in this state;

(13) Any other information the commissioner reasonably requires; and

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(14) Authorization to the commissioner to make inquiry of any person about the applicant, its manager under a management contract, its attorney in fact, its general agents, and any of the officers, directors or shareholders of any of them designated by the commissioner, and agreement by the applicant and any other persons so designated that in the absence of actual malice, no communication made in response to any such inquiry will subject the persons making it to an action for damages for defamation brought by the applicant or the designated person or a legal representative of either. No such action shall lie whether such agreement is made or not.

NOTE: The purpose of this section is to provide the commissioner with the information he needs to decide whether the applicant is qualified for admission to this state, although the commissioner would be able to ask for the prescribed information under his ch. 601 powers. But clarity suggests the enumeration. The information requested is like that required when a new insurer is organized in this state, with omissions where the information would be irrelevant, and an addition so the commissioner can evaluate the performance of the insurer in other states. It is desirable not to burden the insurance office with unnecessary paper. A schedule of available statements and reports under sub. (8) is better than a truck full of such statements and reports sent to the insurance office. Most of the available material will be of no interest to him, but he should know of its existence and be able to get it if he wants it. The provision applies only to significant documents which the commissioner can define by rule to get him neither more nor less information than he wants. He can also inform the applicant of kinds of documents he would rather not have, and extra information he desires.

Sub. (2) should normally be satisfied by the most recent annual statement of the insurer, with such supplements as the commissioner reasonably requires.

The statement required under sub. (10) is intended to make it clear that the applicant is past the organizational phase. If it is not, that would not preclude consideration of its application, but special caution would be justified.

The agreements in sub. (14) will protect against actions for defamation outside the state. The last sentence will prevent such actions in this state, even if the agreements should not be supplied.

This section and s. 618.12 cover nondomestic fraternals, eliminating any necessity for a separate section.

618.12 CERTIFICATE OF AUTHORITY. (1) ISSUANCE. The commissioner shall either issue a certificate of authority to an applicant under s. 618.11 or issue an order refusing the certificate which finds:

(a) That not all requirements of the law have been met; or

(b) That the applicant is either not sound, not reliable, not entitled to public confidence or cannot reasonably be expected to perform its obligations continuously in the future; or

(c) That the applicant's directors and officers or, in the case of an alien insurer, its United States manager, are not sufficiently trustworthy, competent, experienced and free from conflict

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of interest to engage in the proposed business in this state and to comply continuously with the laws of this state; or

(d) That the methods and practices to be used in doing business are not consistent with the interests of the applicant's insureds, creditors or the public in this state.

(2) SUBSTITUTES FOR LEGAL REQUIREMENTS. If the commissioner finds that the applicant does not comply with all requirements of the law, he may after a hearing under s. 618.28 issue a certificate of authority if the purposes of each such requirement and the protection of insureds, creditors and the public in this state are otherwise achieved by:

(a) A deposit in trust to be established and maintained under s. 601.13; or

(b) A bond conditioned on the satisfaction of the purposes of the requirement and acceptable to the commissioner; or

(c) Special limits on the applicant's business or methods of operation in this state or elsewhere; or

(d) Additional or alternative protective devices that the commissioner considers satisfactory.

(3) LIMITS. The certificate of authority shall specify the terms of any deposit or bond required as a condition for authorization, any special limits placed on the insurer's business or methods of operation in this state, and any other restrictive terms imposed under sub. (2).

(4) ALTERATION OF CERTIFICATE. An insurer may at any time apply to the commissioner for a new certificate of authority, removing, altering or adding limits on its business or methods of operation. The application shall be accompanied by so much of the information under s. 618.11 as the commissioner reasonably requires. The commissioner shall issue the new certificate as requested if he would do so if an initial application were being made.

NOTE: Sub. (1) defines the commissioner's discretion in deciding whether to issue a certificate of authority, establishes some criteria for decision, and makes refusal to issue a certificate an order to lay a foundation for review of an adverse decision by the commissioner.

Sub. (2) is not likely to be used very frequently, but is desirable to make it possible to forego a technical requirement, if the ready availability of money or a bond, or limits on the insurer's operation makes compliance unimportant.

Sub. (3) follows s. 611.20 (2) (b); it is not intended to provide any independent basis for limitations by the commissioner, but merely to provide for inclusion in the certificate of limitations either imposed by law or by the commissioner under powers given elsewhere in the law.

The section does not contemplate annual renewal of the certificate, thus reflecting a policy of minimizing paperwork and eliminating unnecessary activity. There is no good reason for annual renewal. It tends to mislead a department into sloppy enforcement activity, by excessive reliance upon the opportunity to withhold a certificate at the annual renewal date rather than

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taking action to revoke a certificate when action should be taken. Considerations of "fairness" favor doing away with annual renewal. There is no justification for a commissioner's refusal to renew a certificate of authority on any other ground than one he could use to revoke a certificate. Equally, a hearing should either be held or be available to the insurer on request in either case. There seems to be no proper advantage the commissioner can have from a system that declines to make the certificate of authority permanent, subject to later revocation, suspension, or limitation. It has been traditional, though unfair, to give the commissioner greater discretion to nonrenew than to revoke. Revocation is provided for in s. 618.37.

618.21 CORPORATION LAW REQUIREMENTS FROM CHAPTERS 610, 611 AND 623 APPLICABLE TO NONDOMESTIC CORPORATIONS. (1) STRICT COMPLIANCE. No nondomestic corporation may be authorized to do business in this state unless it complies strictly with the following requirements:

(a) Financial requirements. The financial requirements of ss. 611.19 and 611.35 whenever capital is reduced under the law of the domicile, and s. 623.11;

(b) Other requirements. The requirements of s. 611.41 (1) as modified by s. 611.41 (3); s. 611.54 (1) (a); the reporting requirement of s. 611.54 (2) whenever removal is made involuntarily under the law of the domicile; and s. 611.57; and

(c) Requirements applicable to new corporations. For 5 years after the initial issuance of a certificate of authority in its domiciliary jurisdiction, the requirements of s. 611.29 (2); and if the corporation has transacted an insurance business for less than 5 years or has not paid in full all organizational and promotional expenses, it must still have initial expendable surplus considered by the commissioner to be adequate, subject to the limits of s. 611.19.

(2) SUBSTANTIAL COMPLIANCE. (a) General. No nondomestic insurance corporation may be authorized to do business in this state unless it everywhere complies substantially with ss. 611.12 (2) (d), 611.24 and 611.25 except that the approval requirement of s. 611.25 (1) does not apply, and s. 611.26.

(b) Corporate reorganization or transformation. When any corporate reorganization, transformation or liquidation of a nondomestic insurer is proposed by it or approved by the domiciliary commissioner or by another official act, notice shall be given to the commissioner promptly.

(3) ORDERS IMPOSING AND ELIMINATING RESTRICTIONS. The commissioner may issue orders under s. 611.03 that are applicable to nondomestic corporations.

(4) OTHER REQUIREMENTS. After a hearing, the commissioner may by order apply any provision of ch. 611 to a nondomestic corporation if he finds that it is necessary for the protection of the interests of its insureds, creditors or the public in this state.

NOTE: In general the standards required of nondomestic insurers conform to those proposed for domestic insurers. A policyholder needs the same kind of protection whether his company is domiciled in Wisconsin or elsewhere. Moreover, it is competitively unfair to expect domestic companies to operate on more rigid requirements than those expected of insurers who have a non-Wisconsin

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domicile. On the other hand, balance must be maintained. States have widely differing requirements. It would be difficult, perhaps impossible, for some perfectly reliable insurers to comply strictly with Wisconsin's standards. Accordingly, in each instance, the requirements set for Wisconsin insurers have been analyzed and subjected to these questions:

First, is this requirement essential for the safety of Wisconsin insureds? If so, it must be followed strictly.

Secondly, is the requirement desirable although not absolutely essential? If so, it must be substantially complied with.

If the answer to both questions is no, then the nondomestic insurer is left free if it follows the law of its domicile. An insurer that does not do the latter should be considered ineligible for admission in this state.

1. Strict compliance. In general, financial requirements should be followed strictly. This includes the initial capital and surplus requirements, restrictions on the reduction of capital, and the compulsory surplus requirement. A few nonfinancial requirements are equally important, such as the requirement that communications to policyholders and shareholders be sent to the commissioner under s. 611.41 (1), except as modified by s. 611.41 (3), the report to the commissioner of new directors and principal officers, the report to the commissioner of involuntary removal of directors and principal officers, and the prohibition of interlocking directorates. Certain requirements applicable to new corporations are also strictly imposed.

2. Substantial compliance. Assessable mutuals must contain information about assessments in their articles, and for all companies there must be substantial compliance with the rules respecting separate or segregated accounts and subsidiaries. Since all these latter are basically permissive, substantial compliance is no hardship. The commissioner must be notified of major corporate changes, too.

3. Discretionary application of rules. The commissioner may extend for nondomestic insurers, as well as for domestics, certain rules applicable to new corporations. He may also make a special finding of necessity for the application of other rules to nondomestics. Thus the rules to be applied to nondomestics are generally few, but may be expanded on a finding that Wisconsin interests require it. A hearing and judicial review would be applicable to the latter cases.

618.22 EXCLUSIVE AGENCY AND MANAGEMENT CONTRACTS OF NONDOMESTIC CORPORATIONS. (1) FILING OF CONTRACT. No nondomestic insurer may be a party to any exclusive agency contract or management contract as defined in ss. 611.66 and 611.67 respectively, unless the contract is filed with the commissioner and not disapproved under this section within 30 days after filing, or such reasonable extended period as the commissioner may specify by notice given within the 30 days.

(2) DISAPPROVAL. The commissioner shall disapprove a contract under sub. (1) if he finds that:

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(a) It subjects the insurer to excessive charges; or

(b) The contract extends for an unreasonable period of time; or

(c) The contract does not contain fair and adequate standards of performance; or

(d) The persons empowered under the contract to manage the company are not sufficiently trustworthy, competent, experienced and free from conflict of interest to manage the company with due regard for the interests of its insureds, creditors or the public; or

(e) The contract contains provisions which impair the interests of its insureds, creditors or the public in this state.

NOTE: Ch. 611 forbids domestic insurers from entering into exclusive agency contracts and management contracts in all cases. This section takes a different approach for nondomestic insurers, in recognition of the realities of today's insurance marketplace. There is a shortage of insurance capacity. There are important nondomestic insurance companies, of unquestioned solidity, now operating in Wisconsin, which would be driven from the marketplace if required to comply with the ch. 611 provisions forbidding exclusive agency contracts and management contracts. Hence, this section will permit such nondomestic insurers to continue to operate in Wisconsin, provided they conform to the safeguards of sub. (2). This compromise may not be ideal, but it will preserve needed insurance capacity in this state, and at the same time give the commissioner power to prevent abuses arising from nondomestic companies which utilize exclusive agency or management contracts. The commissioner will be able to bar a company from the state altogether if he finds that these contractual arrangements imperil Wisconsin interests.

618.23 REQUIREMENTS FOR NONDOMESTIC RECIPROCALS. (1) CONDITIONS OF AUTHORIZATION. No nondomestic reciprocal may be authorized to do business in this state unless under the laws of its domicile or the provisions of its power of attorney or otherwise it can sue and be sued in its own name, and the assets resulting from the exchange of insurance contracts can be reached by its creditors; and either:

(a) Nonassessable reciprocals. If it issues only nonassessable policies, it meets all the financial requirements for a mutual corporation in like circumstances including surplus, whether unallocated or in subscribers' accounts, that is at least as great as the level specified by s. 623.11; or

(b) Assessable reciprocals. If it issues any assessable policies, it meets all the requirements for a mutual corporation issuing assessable policies in like circumstances and its subscribers are liable to the exchange to the limit of their assessability without regard to the validity or collectibility of any assessment levied against other subscribers.

(2) SUBSTITUTE FOR THE LIABILITY UNDER SUB. (1) (b). Where the liability of subscribers does not satisfy sub. (1) (b), the commissioner may nevertheless authorize an assessable reciprocal if he is satisfied that practices are actually followed by the attorney in fact which ensure the capacity and willingness of all subscribers to pay assessments if called upon to do so, or which otherwise ensure the solidity of the operation.

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(3) CORPORATION PROVISIONS APPLICABLE. To the extent consistent with the nature of a reciprocal, the provisions of ch. 611 that are made applicable to nondomestic mutual corporations by s. 618.21 apply to nondomestic reciprocals and the provisions and requirements applicable to principal officers of corporations apply to the attorneys in fact of reciprocal insurers.

NOTE: As in the case of alien corporations, Wisconsin access to the assets is a problem of concern in connection with reciprocals. Sub. (1) is intended to ensure that before a reciprocal is admitted to this jurisdiction it can be treated as an entity for the purposes of getting jurisdiction over it and of getting at its assets.

Another inherent concern with the reciprocal as a form for use in large commercial insurance operations is the limitation of liability of the subscribers to several liability. This concern lessens once nonassessable policies can be issued, because of the requirement that the exchange have, prior thereto, an accumulation of surplus equivalent to that required of mutual corporations, subject to withdrawal without subjection to corrective action only if the surplus is not thereby made inadequate. Under those circumstances there is every reason to permit the admission to the state of a soundly and fairly operated reciprocal.

If an assessable operation is permitted, liability limited only by the limit of assessability should be insisted upon except for those small and specialized reciprocals where it is in fact possible to be sure that all subscribers can and will pay assessments on demand.

In treating the nondomestic reciprocal in this way, the law is, for practical purposes, treating it as if it were in fact a corporation. This analysis underlies the recommendation that the insurance law should not allow the organization of new domestic reciprocals. A reciprocal, in order to be a completely sound insurer which does not endanger the interests of insureds or the public, needs to be treated essentially in the same way it would be treated if it were a mutual corporation. If that is so, then preferably it should be organized as a mutual corporation rather than in the "reciprocal" form.

The appropriate place for a reciprocal, in its original conception as a multilateral exchange of individual contracts among subscribers through an attorney in fact, each being severally and not jointly liable, was in a limited operation involving relatively few people, knowing each other well, with all of them solvent and even possessing substantial assets. The owners of large department stores, for example, formed the first reciprocal. Once the reciprocal outgrows that limited cooperative notion and becomes a commercial enterprise with large numbers of subscribers, a basic reason it has for operating as an unincorporated association or as a complex of multilateral contracts no longer exists. It is the desirability of admitting any well-managed and sound established insurer to help solve the market problems of the state that justifies the liberality of this section.

Allocation of surplus to subscribers' accounts is desirable and should be encouraged. It also tends to dis-

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appear in reciprocals that become large and impersonal enterprises. Moreover, there is no barrier to its use by mutual corporations.

618.24 REQUIREMENTS FOR INCORPORATED ALIEN INSURERS. (1) CONDITIONS FOR AUTHORIZATION. No incorporated alien insurer may be authorized to do business in this state unless:

(a) It has operated for 5 years in its domicile or the commissioner finds other grounds for being confident that it will be solid during its formative period;

(b) It supplies and commits itself to maintain in the United States a deposit or bond in an amount the commissioner deems sufficient to protect the interests of insureds, creditors and the public in this state; and

(c) It files with the commissioner such agreement as he requires with respect to records, reports and submission to examinations, including an undertaking to keep its records, reports and other documents constantly available in full in the English language so far as they are relevant to its United States business, and an undertaking to keep records and make reports on United States business in a form satisfactory to the commissioner.

(2) DEPOSITS. A deposit under sub. (1) (b) may be made as specified in s. 601.13 or with another trustee in this or another state approved by the commissioner. The deposit shall be in trust for such persons as the commissioner deems appropriate to achieve the purposes of sub. (1) (b). The trustees shall supply a certificate of the deposit in whatever form and at whatever intervals the commissioner reasonably requires.

(3) BONDS. A bond satisfies sub. (1) (b) if it is issued by an insurer authorized to do a surety business in this state and is conditioned on nonperformance of any obligation to such persons as the commissioner considers appropriate to achieve the purposes of sub. (1) (b). Each such bond shall cover any claims that arise out of occurrences prior to termination of the bond, and shall not be terminable on any ground without at least 30 days' notice to the commissioner. Each such bond shall be in such form and be renewed at such intervals as the commissioner reasonably requires.

618.25 REQUIREMENTS FOR UNINCORPORATED NONDOMESTIC INSURERS. No nondomestic individual underwirter or syndicate may be authorized to do business in this state unless:

(1) It complies with such requirements stated in s. 618.24 as are applicable to an unincorporated insurer;

(2) It files undertakings with the commissioner to comply with legal controls and institutional practices for securing the performance of obligations that are functionally equivalent to those imposed on nondomestic insurance corporations, even if in detail the controls and practices are dissimilar; and

(3) The commissioner is satisfied that it keeps records and can supply information that will enable him to protect fully the interests of insureds, creditors and the public in this state.

NOTE: This section will have primary application to Lloyd's type underwriters. There is no reason, however, for not also authorizing other unincorporated insurers that may at some future time seek admission to Wisconsin, so long as they meet the standards herein specified. It is not contemplated that many Lloyd's type underwriters organized in other American states will

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either seek a certificate of authority or be qualified to receive one under this section. The Lloyd's form is, despite the success of Lloyd's of London, anachronistic and should not be encouraged. On the other hand, the needs of the market urge admission of all major existing insurance organizations, if their solidity can be assured, in order to help solve capacity problems. The desirability of preserving generality in the law makes it best to authorize admission broadly so that any sound foreign Lloyd's associations that develop might seek admission. Despite any reservations the state of Wisconsin should feel about permitting new insurers to be organized here in certain forms, once an insurer is in fact organized, gains experience in the business, and demonstrates that it can conduct a successful and reputable operation that does not endanger the interests of insureds, creditors or the public in this state, there is merit in permitting it to enter this state. The market demand for insurance in the United States seems insatiable, the supply is currently inadequate and despite the presence of an extremely large number of insurers in the market, and perhaps theoretically even enough capital for excess capacity, actually available market capacity may not be adequate to the needs of the economy over the next few decades. There is clearly an inadequate insurance market at the present time. This suggests the desirability of encouraging both the formation of sound new domestic insurance corporations and of permitting any sound foreign insurer in any organizational form to enter the state even though the particular form is one that would not be permitted to be organized in this state.

Underwriters at Lloyd's, London, certainly presents a case where admission on appropriate terms is desirable. Any close analysis of the safeguards that the law and Lloyd's Corporation impose on the operation of Underwriters at Lloyd's, London, should make it clear that the operation is a sound one that gives good protection to insureds and the public, even though its methods differ substantially from those used in the United States. In particular, the methods of accounting are altogether different, and could not be adjusted to the American form without a major change that can hardly be required. Because Lloyd's are unwilling to make significant changes in record keeping methods and reporting practices, and, indeed, could not do so under British law, Underwriters at Lloyd's have sought admission to the United States only in a few situations in a very small number of jurisdictions. This is unfortunate. Despite its nonadmission, Lloyd's is a major factor in the insurance business in the United States. Because it is not admitted, it creates special problems of control in the surplus lines and nonadmitted market that could be reduced if Lloyd's were admitted in most of the states. The latter is possible only if special provisions are worked out that recognize the differences in technique between Lloyd's of London and American insurance corporations.

This section thus recommends that Underwriters at Lloyd's, London, be admitted in Wisconsin on terms they can comply with. Lloyd's is one of the great insurance enterprises of the world, and in days when a shortage of insurance capacity is creating a serious problem, it is desirable to make it possible for Lloyd's to enter on terms that can be met.

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This is not to say that Lloyd's does not need regulation. But it does not necessarily need conventional American-style regulation. We in this country cannot claim a monopoly on wisdom in the preservation of the solidity of enterprises, whether as management or as regulators. Consequently, what is proposed here is a relatively simple solution to a very important problem. Essentially it simply accepts the British control over Lloyd's as quite suitable for the special nature of Lloyd's. This proposed solution is basically sound. No such concession is made to the British control over insurance corporations, which is quite different and less adequate.

618.28 EXEMPTIONS FROM WISCONSIN LAW. (1) EXEMPTIONS. Any nondomestic insurer authorized to do business in this state may apply for and the commissioner may make an order exempting it from any requirement otherwise applicable to it, if he finds after a hearing:

(a) That in the absence of the statutory requirement in this state the requirement would not be imposed on the insurer or on a similar Wisconsin insurer by the law of the insurer's domicile;

(b) That exemption from the requirement will not endanger the interests of insureds, creditors or the public in this state; and

(c) That the exemption will not give the insurer an unfair competitive advantage over domestic insurers.

(2) NOTICE AND HEARING. The hearing may not be held until at least 30 days after notice has been given to competing insurers authorized to do business in this state by publication in the administrative register or otherwise in a manner considered adequate by the commissioner. Any such insurer may appear in the hearing and state its position on sub. (1) (c).

NOTE: There may be occasions, not easily anticipated in advance, where special considerations make it fair not to impose a specific requirement on a nondomestic insurer. This section provides a method for granting an exemption in a meritorious case, without making the exemption so easy to get that it can do harm to the public or provide unfair competition to domestic insurers. Full consideration of the proposal is necessary first, and any competing insurer may intervene on the question of competitive advantage.

618.31 CHANGES IN BUSINESS PLAN. (1) NOTIFICATION. Within 5 years after the initial issuance of a certificate of authority to a nondomestic insurer by its domiciliary jurisdiction no substantial change may be made in the business plan and the insurer may not substantially deviate from it unless notice of the proposed action is filed with the commissioner 30 days in advance of the proposed effective date. The commissioner at least 5 days before the proposed effective date may request that the effective date be deferred for an additional period not exceeding 30 days.

(2) DISAPPROVAL. (a) Applicability in this state. If the commissioner finds that effectiveness of the proposed change within this state would be contrary to the laws of this state or to the interests of insureds, creditors or the public in this state, he may prohibit the application of the change to this state.

(b) Changes outside state. If the commissioner finds after a hearing that the application of the change outside of this state would endanger the interests of insureds, creditors or the public in

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this state, he may revoke the insurer's certificate of authority unless it agrees not to make such a change.

NOTE: This is parallel to s. 611.28. Control over changes is limited mainly to young companies. After 5 years, there is freedom to change without notice, subject to any other special provisions of the law. General powers under chs. 601 and 645 must then be relied on to provide information and a basis for corrective action.

618.32 TRANSFER OF BUSINESS. (1) REPORT TO COMMISSIONER. Any action by which a nondomestic insurer proposes to transfer to another person or to reinsure any part of its insurance business in this state, other than in the normal and usual course of business, shall be reported to the commissioner not less than 30 days in advance of the proposed effective date. The commissioner may defer the effective date for an additional period not exceeding 30 days by written notice to the insurer before expiration of the initial 30-day period.

(2) DISAPPROVAL. The commissioner may, within the 30-day period or its extension, prohibit the proposed action if it would be contrary to the law or to the interests of insureds, creditors or the public in this state.

NOTE: This is patterned after s. 611.78, except that it subjects only transfer and bulk reinsurance of Wisconsin business to control. Such transactions by their nature affect Wisconsin insureds immediately. No attempt is made in this chapter to control other transactions affecting the corporate or financial structure of a nondomestic insurer, like mergers, consolidations, conversions, or transfer of assets. Such actions can of course have a profound effect on the insurer's solidity and could trigger delinquency proceedings under ch. 645. But it seems neither necessary nor justified to subject them to approval or disapproval by the commissioner. Under ch. 601 the commissioner has the power to obtain all the necessary information about transactions of this sort. He can also approve affirmatively, rather than failing to act for 30 days, if there is some urgency about the transaction, which could thereupon be effectuated immediately.

618.34 ASSESSMENT BY NONDOMESTIC COMPANY. Every nondomestic mutual insurer authorized in this state shall, immediately after making an assessment upon any of its members in this state, notify the commissioner thereof with a statement of the condition of the insurer, setting forth the facts showing the necessity for the assessment. No such insurer may make or increase any assessment because of its inability to collect assessments from its members in other states in which its policies were written in violation of law.

NOTE: This section continues s. 203.31, considerably edited. It is expanded from fire insurance companies to any kind of insurer, and the exemption for church mutuals is deleted, since no justification for the exemption appears.

618.36 RELEASE FROM REGULATION. (1) CONTINUANCE OF REGULATION. A nondomestic insurer authorized under this chapter is subject to regulation under the applicable provisions of chs. 200 to 212 and 600 to 649 until released from regulation under this section.

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(2) APPLICATION FOR RELEASE. A nondomestic insurer may apply for release from regulation by filing with the commissioner:

(a) Its certificate of authority;

(b) A schedule of its outstanding liabilities from policies issued in this state, to residents of this state, or on risks located in this state and from other business transactions in this state;

(c) A plan for securing the discharge of such liabilities; and

(d) Such other information as the commissioner reasonably requires.

(3) RELEASE ORDER. The commissioner shall release the insurer from regulation if he finds:

(a) That the insurer has ceased to do any new business in this state;

(b) That the discharge of existing liabilities to creditors in this state is sufficiently secured; and

(c) That the release would not otherwise be prejudicial to the interests of insureds, creditors or the public in this state, or of all insureds, creditors and the public in the United States if this state is the state of entry of the insurer into the United States.

(4) NOTIFICATION OR PUBLICATION. The commissioner may, before deciding on the release, require the insurer to notify all agents or other classes of potentially interested persons in a manner he prescribes, or in a manner he prescribes to publish at its own expense its intention to withdraw. The notice shall advise affected persons to communicate to the commissioner any objections they may have to the withdrawal.

(5) DEPOSITS AND SUBJECTION TO JURISDICTION. The commissioner may, as a prerequisite for releasing the insurer, require a deposit under s. 601.13, a bond issued by a surety authorized in this state, or other appropriate security or reinsurance in an amount sufficient to secure the proper discharge of the insurer's liabilities in this state. He may also require an agreement to remain subject to the jurisdiction of the commissioner and the courts of this state with respect to any matter arising out of business done in this state prior to the release.

NOTE: This section is new. It provides an orderly procedure for terminating supervision by the authorities of this state if a nondomestic insurer voluntarily ceases to do business here. Some other states have much more elaborate provisions. See, e.g., California ss. 1070-1075.

Traditional regulation has focused on the certificate of authority. The ultimate threat to revoke that certificate provides much of the motivation for insurers to comply with the law. However, the need for regulation does not stop immediately when the insurer is prohibited from writing or renewing policies or when an insurer voluntarily stops writing new business. Insureds under existing policies must be protected against being left stranded and without any guaranty that their potential claims will be honored.

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This section seeks to achieve this protection as follows: if a nondomestic insurer is forced by the commissioner to discontinue business operations in this state, s. 645.21 gives the commissioner the power to issue all orders necessary for winding up the existing business.

If an insurer stops writing new business voluntarily, sub. (1) ensures that it continues to be subject to full regulation, especially to the reporting requirements and to examination under ch. 601, and to ch. 645. The insurer can put an end to this continuing surveillance only by satisfying the commissioner that Wisconsin insureds and other creditors are sufficiently secured. Often this will be done by transferring or reinsuring the entire Wisconsin business under s. 618.32; in that event there would be no insureds or creditors left to be concerned about.

618.37 REVOCATION OF CERTIFICATE OF AUTHORITY. Whenever there are grounds for delinquency proceedings against a nondomestic insurer under ch. 645, the commissioner may, after a hearing, revoke, suspend or limit its certificate of authority. No such action shall affect insurance already issued and the insurer shall remain subject to regulation until released under s. 618.36.

NOTE: This section transfers s. 601.64 (5) to this chapter, so far as it applies to nondomestic insurers.

SUBCHAPTER III.
PERMISSIBLE BUSINESS BY UNAUTHORIZED INSURERS.

618.39 ASSISTING UNAUTHORIZED INSURERS. No person may do an insurance business in this state if he knows or should know that the result is or might be the illegal placement of insurance with an unauthorized insurer or the subsequent servicing of an insurance policy illegally placed with an unauthorized insurer.

NOTE: In order to control adequately the issuance of insurance by unauthorized insurers, it was necessary to define "doing an insurance business" very broadly in s. 618.02 (2). This section makes the doing of such acts illegal when performed by any person in such a way as to assist in illegal placement of insurance with an unauthorized insurer. If the insurer is authorized, many of the acts defined as doing an insurance business may be done legally by anyone. Other provisions of this code will forbid certain acts to be done by persons not specifically authorized or licensed, even if done in a transaction with an authorized insurer.

618.41 SURPLUS LINES INSURANCE. (1) GENERAL PERMISSION. A nondomestic insurer which has not obtained a certificate of authority to do business in this state under s. 618.12 may negotiate for and make insurance contracts with persons in this state and on risks located in this state, subject to the limitations and requirements specified in this section.

(2) INCIDENTAL ACTS PERMITTED. With respect to contracts made under this section, the insurer may in this state also inspect risks to be insured, collect premiums and adjust losses, and do all other acts reasonably incidental to the contract.

(3) SOLICITATION PROHIBITED. Nothing in subs. (1) and (2) permits the solicitation of business in this state by or on behalf of an insurer without a certificate of authority. The commissioner may by rule prescribe the manner in which insurance agents or brokers may advertise the availability of their services in procuring,

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on behalf of persons seeking insurance, contracts with insurers without a certificate of authority.

(4) INFORMATION TO POLICYHOLDER. The insurer and any agent or broker are obligated promptly to furnish the policyholder a statement in a form prescribed or approved by the commissioner, informing him that the insurer has not obtained a certificate of authority to do business in this state and is not regulated in this state except as provided in this section.

(5) TRADE PRACTICES. With respect to contracts made under this section, nondomestic insurers are subject to ch. 207 and rules promulgated thereunder.

(6) PROHIBITED AND RESTRICTED SURPLUS LINES BUSINESS. (a) Prohibited classes. The commissioner may by rule prohibit the making of contracts under sub. (1) in a specified class of insurance if authorized insurers provide an established market for the class in this state which is adequate and reasonably competitive with reputable unauthorized insurers.

(b) Restricted classes. The commissioner may by rule place restrictions and limitations on and create special procedures for the making of contracts under sub. (1) for a specified class of insurance if there have been abuses of placements in the class or if the policyholders in the class, because of limited financial resources, business experience or knowledge, cannot be expected to protect their own interests adequately.

(c) Exclusion of individual insurers. The commissioner may prohibit an individual insurer from making any contracts under sub. (1) and all insurance agents and brokers from dealing with the insurer, if:

1. It has wilfully violated this section, ch. 207, s. 610.11 (1), or any rule promulgated under any of them; or

2. It has failed to pay the fees and taxes specified in s. 618.43; or

3. The commissioner has reason to believe that the insurer is in an unsound condition or is operated in a fraudulent, dishonest or incompetent manner or in violation of the law of its domicile.

(d) Evaluations. The commissioner may issue lists of unauthorized nondomestic insurers whose solidity he believes to be doubtful or whose practices he believes to be objectionable. He may issue lists of unauthorized nondomestic insurers he believes to be reliable and solid. He may also issue other relevant evaluations of unauthorized insurers. No action shall lie against the commissioner or any employe of the office for anything said in the issuance of such lists and evaluations.

(7) SURPLUS LINES AGENT'S LICENSE. (a) The commissioner may issue to any authorized agent a surplus lines license granting the agent authority to procure insurance under this section. Every such license shall be for a term expiring on the last day of February following the issuance of the license and may be renewed for ensuing periods of 12 months. Before any such license may be issued and before each renewal thereof a written application shall be filed by the applicant in such form as the commissioner prescribes and the fee provided therefor by this section shall be paid.

(b) The fee for issuance of a surplus lines license is the fee required by s. 601.31 (15) (c).

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(8) SURPLUS LINES AGENTS AND BROKERS; RESPONSIBILITY. No agent or broker shall, either knowingly or without adequate investigation of the financial condition and general reputation of the insurer, place insurance under this section with financially unsound insurers or with insurers engaging in unfair practices, or with otherwise substandard insurers, without giving the applicant notice in writing of the deficiencies of the insurer. Copies of such notices shall be kept in the office of the agent or broker for at least 5 years. To be financially sound, an insurer must be able to satisfy standards comparable to those applied under the laws of this state to authorized insurers.

(9) REQUIREMENTS FOR SURPLUS LINES POLICIES. (a) Required information. Every new or renewal insurance policy procured and delivered under this section shall bear the name and address of the insurance agent or broker who procured it and, except for ocean marine insurance, shall have stamped or affixed upon it the following: "This insurance contract is with an insurer which has not obtained a certificate of authority to transact a regular insurance business in the state of Wisconsin, and is issued and delivered as a surplus line coverage pursuant to s. 618.41 of the Wisconsin Statutes. Section 618.43 (1), Wisconsin Statutes, requires payment by the policyholder of 3% tax on gross premium". Every ocean marine insurance policy shall have stamped or affixed upon it the above statement except that the tax shall be one-half of one per cent on gross premium.

(b) Additional required information. The policy shall include a description of the subject of the insurance, and indicate the coverage, conditions and term of the insurance, the premium charged and premium taxes to be collected from the policyholder, and the name and address of the policyholder and insurer. If the direct risk is assumed by more than one insurer, the policy shall state the names and addresses of all insurers and the portion of the entire direct risk each has assumed.

(10) ISSUANCE OF EVIDENCE OF INSURANCE. Upon placing a new or renewal coverage under this section, the agent or broker shall promptly deliver to the policyholder or his agent evidence of the insurance consisting either of the policy as issued by the insurer or, if the policy is not then available, a certificate, cover note or other confirmation of insurance.

(11) FORM REGULATION. The commissioner may by rule subject policies written under this section to as much of the regulation provided by this code for comparable policies written by authorized insurers as he finds to be necessary to protect the interests of insureds and the public in this state.

NOTE: This section abandons the requirement of s. 201.63 (5) of the unavailability of insurance within the state as a condition of surplus lines placement and seeks to achieve the same result by an economic incentive. The affidavit of unavailability is a much-abused and thoroughly unsatisfactory control device. Surplus lines placement is to be taxed at a higher rate than business in a licensed insurer. There is justification for this extra charge in the special costs of surveillance of surplus lines insurance and in the freedom of the insurer from the costs of regulation in this state. The price differential alone should induce those surplus lines insurers to come into the state whose business is extensive enough to matter. In addition, under s. 618.41 (6) (b) the commissioner may impose closer regulation of surplus lines if abuses appear. He may, for example, impose a requirement of an affidavit of unavailability before insurance can be placed; or

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require more rigorous disclosure requirements by the surplus lines intermediary of the financial condition of his insurers, or take other appropriate steps. Under s. 618.41 (6) (a) he may prohibit specified surplus lines placements altogether.

Sub. (8) puts a burden on the surplus lines intermediary that is essentially the same as he now bears.

Sub. (10) was s. 201.63 (6) (b), and incorporates by necessary implication the important parts of s. 201.63 (6) (d).

Sub. (11) should not be much used, but some protection of Wisconsin insureds and public may be needed for surplus lines policies.

618.42 DIRECT PLACEMENT OF INSURANCE. (1) PERMITTED DIRECT PLACEMENT. Subject to the restrictions of this section, any person seeking insurance may obtain it if no agent or broker resident or doing business in this state is involved and if negotiations occur primarily outside this state. Negotiations by mail occur within this state if a letter is sent from or to an address in this state.

(2) REPORTS AND TAXATION. Every policyholder who procures or renews insurance otherwise subject to this code from any insurer not authorized to do business in this state, other than insurance procured under s. 618.41 and the renewal of guaranteed renewable insurance lawfully issued outside this state, shall within 60 days after the insurance procured or renewed report to the commissioner in such form as he requires and pay the taxes specified by s. 618.43.

(3) PROHIBITED PLACEMENT WITH UNAUTHORIZED INSURERS. (a) Sales of personal property. Any insurance on personal property sold on the instalment plan or under a conditional sales contract or equivalent security agreement under the commercial code for which a charge is made to the buyer as a part of the consideration in the agreement of sale shall be placed with an insurer authorized to do business in this state.

(c) Compulsory insurance. Whenever the law of this state requires a person to purchase insurance on risks in this state, he shall obtain it from an insurer authorized to do business in this state, or under s. 618.41.

NOTE: Subs. (1) and (2) continue s. 201.42 (2) (b) 4 and (12). The section continues to assume that direct procurement of noncompulsory insurance in another state by a Wisconsin policyholder is permissible without restriction so long as the policyholder reports the purchase and pays taxes on it. However, by such placement the policyholder forfeits the protection of this state's regulatory apparatus and there is reason to question whether it should be permitted when the interests of third persons are involved, even if the insurance is voluntary. This section does not change the law.

Sub. (3) continues s. 201.37, which reflects the policy suggested in the previous paragraph, for a limited class of cases. The need for countersignature is dropped from s. 201.37. It is an anachronism.

618.43 TAXATION OF INSURANCE WRITTEN BY UNAUTHORIZED INSURERS. (1) BUSINESS SUBJECT TO TAXATION. The insurance business transacted under ss. 618.41 (1) and 618.42 is

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subject to a premium tax of 3% of gross premiums charged for such insurance, excluding annuities, if it is other than ocean marine insurance and one-half of one per cent if it is ocean marine insurance. Any insurance business transacted in violation of the law is subject to a premium tax of 5% of gross premiums charged for such insurance if it is other than ocean marine insurance and 2% if it is ocean marine insurance. If the tax is not paid within the time prescribed under sub. (3), a penalty shall be imposed of 25%, plus one per cent per month from default until payment.

(2) PAYMENT OF TAX. The insurance agent or broker and the policyholder are jointly and severally liable for the payment of the tax required under sub. (1) on business written under s. 618.41 (1), and the insurer, insurance agent or broker and policyholder are jointly and severally liable for the payment of the tax required under sub. (1) on business written illegally. The tax shall ultimately be paid by the policyholder. Absorption of the tax by either the agent or broker or the insurer is an unfair method of competition under s. 207.04.

(3) ACCOUNTING AND REPORTING. The commissioner shall by rule prescribe accounting and reporting forms and procedures for insurers, agents or brokers and policyholders for the purpose of determining the amount of the taxes owed, and the manner and time of payment.

(4) APPLICABILITY OF TAX LAW. Section 76.37 is applicable to any tax payable under this section.

(5) EXCLUSIVE NATURE. The tax under this section is in lieu of all other taxes on insurance business and of fire department dues.

(6) ALLOCATION OF TAX. If a policy covers risks that are only partially located in this state, the premium shall be reasonably allocated among the states on the basis of risk locations in computing the tax, except that all premiums received in this state or charged on policies written or negotiated in this state shall be taxable in full under this section, with a credit for any tax actually paid in another state to the extent of a reasonable allocation on the basis of risk locations.

(7) TAXES AS TRUST FUNDS. All premium taxes collected under this section by an agent or broker or by an insurer are the property of this state. They shall be kept in a separate account and may not be commingled with funds belonging to anyone else.

(8) TAXES AS PREFERRED CLAIMS. If the property of any agent or broker is seized upon any process in any court in this state, or when his business is suspended by the action of creditors or put into the hands of any assignee, receiver or trustee, all taxes and penalties due the state from him under this section are preferred claims and the state is to that extent a preferred creditor.

NOTE: Sub. (1) continues the taxes imposed by ss. 201.42 (11) (a) and 201.63 (12), but with an additional provision for illegal business. Serious consideration should be given to increasing the rates because of the change in emphasis in enforcement from administrative machinery and criminal action to economic incentive. High rates are justified because of the insurer's freedom from the expenses of conforming to the state's regulation, and the greater cost to the state of surveillance of surplus lines business and directly placed business, and the still greater cost of watching illegally placed business. The tax can also help restore

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competitive balance between authorized and unauthorized insurers. The rates to be imposed deserve closer scrutiny.

Sub. (2) is a statement, in much simpler form, fo what the law now is in practice. It should be the responsibility of the parties to the surplus lines insurance or the unauthorized or directly placed insurance to worry about which should pay the tax initially.

The commissioner, through rules under sub. (3), can place the duty of reporting on the person most likely to be the easiest from whom to collect the tax. It is an unfair trade practice, however, for the policyholder not to be the ultimate payor.

Sub. (4) makes the procedure of tax law applicable. If there is a dispute over liability, the taxpayer should pay first and sue the state to recover. The taxpayer's failure to pay will subject him to the risk of all the enforcement procedures of ch. 601, as well as those of the tax law.

Sub. (5) continues a provision of both ss. 201.42 (11) (a) and 201.63 (12) (a).

The allocation of the tax under sub. (6) seems fair. The entire premium should be taxed here except to the extent that it is legitimately taxed elsewhere, in the case where the insurance has its closest connection with this state.

Subs. (7) and (8) are useful protective devices. Sub. (7) continues s. 201.63 (12) (b). Sub. (8) continues s. 201.63 (12) (c) with editorial changes.

The tax liability on independently procured insurance is broadened over present law to include individual life and individual disability insurance. There is no reason such insurance should not be taxable on the same basis as other insurance placed with unauthorized insurers. It may be hard to collect and not worth much enforcement effort, but when it is worth the trouble it should be collectible. The tax liability also includes insurance heretofore excluded under s. 201.42 (15). Such companies should be treated for taxation and general regulation like other insurers. An exemption for form regulation is provided by s. 631.01, which is justified so long as the commissioner may impose form regulation after making appropriate findings. See s. 631.01 and comment thereon.

618.44 EFFECT OF ILLEGAL CONTRACTS. An insurance contract entered into in violation of this chapter is unenforceable by, but enforceable against, the insurer. The terms of the contract are governed by this code and rules promulgated thereunder. If the insurer does not pay a claim or loss payable under the contract, any person who assisted in the procurement of the contract is liable to the insured for the full amount of the claim or loss, if he knew or should have known the contract was illegal.

NOTE: This section essentially continues s. 201.42 (8). It is slightly less stringent since it requires that the assistance in the procurement of the contract be with knowledge, actual or constructive. Knowledge will be relatively easy to establish in the case of a professional, and difficult to show in the case of a casual

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participant. That is as it should be.

618.45 SERVICING OF CONTRACTS MADE OUT OF STATE. (1) SERVICING PERMITTED. A nondomestic insurer which does not have a certificate of authority to do business in this state under s. 618.12 may in this state collect premiums and adjust losses and do all other acts reasonably incidental thereto, with respect to contracts lawfully made outside this state.

(2) CONTRACT CHANGES PROHIBITED. Nothing in sub. (1) shall be interpreted to permit any renewal, extension, increase or other substantial change in the terms of any contract under sub. (1) unless:

(a) It is permitted by s. 618.41; or

(b) The contract is for life or disability insurance; or

(c) It is permitted by a rule promulgated by the commissioner, under circumstances in which the interests of the policyholder and the public appear to be sufficiently protected.

NOTE: This section protects the right of an unauthorized insurer to continue to service "orphan" or move-in business.

618.47 DEFENSE OF ACTION BY UNAUTHORIZED PERSON. (1) CONDITIONS FOR FILING. No pleading, notice, order or process in any court action or in any administrative proceeding before the commissioner instituted against an unauthorized person under ss. 601.72 or 601.73 may be filed by or on behalf of the unauthorized person unless he either:

(a) Deposits with the clerk of the court in which the action or proceeding is pending, or with the commissioner in administrative proceedings before him, bond with sureties in an amount fixed by the court or the commissioner, sufficient to secure the payment of any probable final judgment or order. The court, or the commissioner in administrative proceedings before him, may make an order dispensing with a deposit or bond where the person makes a satisfactory showing that in a state of the United States he maintains funds or securities, in trust or otherwise, sufficient and available to satisfy any probable final judgment or order; or

(b) Procures proper authorization to do an insurance business in this state.

(2) POSTPONEMENT. The court in any such action or proceeding, or the commissioner in any administrative proceeding before him, may order such postponement as may be necessary to afford the unauthorized person reasonable opportunity to comply with sub. (1).

(3) EXCEPTION. Sub. (1) does not prevent an unauthorized person from filing a motion to quash a writ or to set aside service on the ground that he has not done an insurance business in this state.

NOTE: This is adapted from s. 201.42 (6).

618.48 ATTORNEY FEES. In an action against an unauthorized person upon a contract of insurance issued in violation of this chapter, if the unauthorized person fails to make payment in accordance with the contract for 30 days after the payment is due and demand is made, and it appears to the court that the refusal was without reasonable cause, the court may allow the plaintiff a reasonable attorney fee and include the fee in any judgment that may be rendered in the action. Failure of the unauthorized person to

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defend any such action is prima facie evidence that the failure to pay was without reasonable cause. If the unauthorized person knew or should have known that the contract was in violation of this chapter, the court may also award punitive damages.

NOTE: This is adapted from s. 201.42 (7). It provides the policyholder with a measure of protection against unjustified failure of an unauthorized insurer to settle a claim. It goes farther than s. 201.42 (7) in providing for punitive damages, but only for knowing violation and only in the court's discretion.

618.49 INVESTIGATION, DISCLOSURE AND TAXATION OF INSURANCE CONTRACTS. (1) REPORT ON INSURANCE. Whenever the commissioner has reason to believe that insurance has been effectuated by or for any person in this state with an unauthorized insurer, the commissioner may in writing order the person to produce for examination all insurance contracts and other documents evidencing insurance contracts and other documents evidencing insurance with both authorized and unauthorized insurers and to disclose to the commissioner the amount of insurance, name and address of each insurer, gross amount of premium and the name and address of any person who has assisted in the effectuation of the insurance.

(2) UNINSURED PROPERTY. The commissioner may order any owner of property situated in this state, other than property owned by a unit of government that maintains a public fire department and furnishes full fire protection for the property, to furnish in addition to the information furnished under sub. (1) information about amounts paid to or credited to any insurance fund or other reserve against loss or damage by fire. If the owner of the property has not insured it, he shall pay under s. 201.59 an amount equal to 2% of the annual premium that would have been charged for insuring such property by authorized insurers using the rates promulgated by the rate service organization of which the state insurance fund is a member or subscriber under s. 210.02, or which is designated for that purpose by the commissioner.

NOTE: Enforcement of the unauthorized insurance laws requires information, some of which is made more accessible by this section. Sub. (1) is adapted from s. 201.42 (9) (a). Sub. (2) is adapted from s. 201.62.

618.50 REPORTING OF ILLEGAL INSURANCE. (1) ADJUSTERS' DUTY TO REPORT. Every person investigating or adjusting any loss or claim on a subject of insurance in this state shall promptly report to the commissioner every insurance policy or contract connected with his investigation or settlement, of which he knows, which has been entered into illegally by any insurer not authorized to transact business in this state.

(2) CONSULTANT'S DUTY TO REPORT. Every person acting in the capacity of insurance consultant shall report immediately to the commissioner every insurance policy or contract effected with his assistance or otherwise known to him covering a subject of insurance in this state, which has been entered into legally by an insurer not authorized to transact such insurance in this state.

(3) EXCEPTIONS. This section does not apply to transactions in this state involving a policy lawfully solicited, written, and delivered outside of this state covering only subjects of insurance not resident, located or expressly to be performed in this state at the time of issuance.

NOTE: Enforcement of the unauthorized insurance laws requires information, some of which is made more accessible by this section. It is adapted from s. 201.42

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(10).

618.61 RECIPROCAL ENFORCEMENT OF FOREIGN DECREES. (1) DEFINITIONS. In this section:

(a) "Reciprocal state" means any state the laws of which contain procedures substantially similar to those specified in this section for the enforcement of decrees or orders issued by courts located in other states against any insurer authorized to do business in the reciprocal state, and which in turn recognizes this state as a reciprocal state under its law.

(b) "Foreign decree" means any decree or order of a court located in a reciprocal state, including a court of the United States located therein, against any insurer authorized to do business in this state.

(2) LIST OF RECIPROCAL STATES. The commissioner shall determine which states qualify as reciprocal states and shall maintain a list of them.

(3) ENFORCEMENT OF WISCONSIN DECREES OR ORDERS. The attorney general upon request of the commissioner may proceed in the courts of this state or any other state to enforce an order or decision issued in this state in any court proceeding or in any administrative proceeding before the insurance commissioner.

(4) ENFORCEMENT OF FOREIGN DECREES OR ORDERS. (a) Filing. A copy of any foreign decree authenticated in accordance with the statutes of this state may be filed in the office of the clerk of the circuit court for Dane county. The clerk, upon verifying with the commissioner that the decree or order qualifies as a "foreign decree", shall treat it in the same manner and it shall have the same effect as a decree of a county or circuit court of this state. It is subject to the same procedures, defenses and proceedings for reopening, vacating, or staying as a decree of a county or circuit court of this state and may be enforced or satisfied in like manner.

(b) Notice of filing. 1. At the time of the filing of the foreign decree, the filer shall deposit with the clerk of the court an affidavit setting forth the name and last-known post-office address of the defendant in this state.

2. Promptly upon the filing of the foreign decree and the affidavit, the clerk shall mail notice of the filing of the foreign decree to the defendant at the address given and to the commissioner and shall note the mailing in the docket. In addition, the attorney general may mail a notice of the filing of the foreign decree to the defendant and to the commissioner or the commissioner may mail such a notice to the defendant, and either may file proof of mailing with the clerk. Failure of the clerk to mail notice of filing shall not affect the enforcement proceedings if the attorney general or commissioner has filed proof of mailing.

3. No execution or other process for enforcement of a foreign decree shall issue until 30 days after the decree is filed.

(c) Stay. 1. If the defendant shows the court that an appeal from the foreign decree is pending or will be taken, or that a stay of execution has been granted, the court shall stay enforcement of the foreign decree until the appeal is concluded, the time for appeal expires, or the stay of execution expires or is vacated, upon proof that the defendant has furnished the security for the satisfaction of the decree required by the state in which it was rendered.

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2. If the defendant shows the court any ground upon which enforcement of a decree of any county or circuit court of this state would be stayed, the court shall stay enforcement of the foreign decree for an appropriate period, upon requiring the same security for satisfaction of the decree as is required in this state.

(d) Fees. Any person filing a foreign decree shall pay to the clerk of court the same fees for any enforcement proceeding as are provided for decrees of the circuit courts.

NOTE: This section is s. 6 of the proposed "Uniform Unauthorized Insurers Act", slightly rearranged and otherwise modified. That bill was recommended by an Industry Advisory committee to, and was adopted by Subcommittee D3 of the National Association of Insurance Commissioners on December 2, 1968. It enables states expeditiously to enforce decrees obtained in their own courts which must, as a practical matter, be enforced in other states. This kind of cooperation is a valuable support for state regulation of insurance, helping each state to enforce its unauthorized insurance laws without recourse to federal machinery.

Although the organization is different this state follows rather closely the provisions of the Uniform Act, which is based, in its original conception, on Wis. Stats. s. 201.42. The provision for reciprocal enforcement is new in the Uniform Act, however. It is not found in s. 201.42.

It should be noted that the provision for Wisconsin enforcement of foreign decrees under sub. (4) applies only to court orders, while the attorney general may, if the other state permits it, also seek foreign enforcement of Wisconsin administrative orders. This is provided by s. 6 of the Uniform Act. Though the provision is thus asymetrical, there is no reason not to take advantage of any foreign provision that may be more generous than the Wisconsin reciprocal enforcement provision. Of course there are not likely to be any such cases but they should be used if they exist.

SECTION 75. Chapter 620 of the statutes is created to read:

CHAPTER 620.
THE REGULATION OF INVESTMENTS.

PREFATORY NOTE: (The chart at the end of this note will help make clear some of the terminology used in the prefatory note and in the law.) This chapter has been titled "The regulation of investments", which is only partially descriptive. It does in fact contain provisions that do regulate investments. But that is only one of the aspects of the chapter. In a sense, it does not regulate investments significantly, except in those instances where the commissioner intervenes in insurance management under s. 620.03.

In normal cases, however, the chapter has a different principal aspect: it provides certain criteria for determining the solidity of an insurer. It says little more than that investments falling outside certain very broad categories, as defined in s. 620.22, or exceeding certain generous limitations specified in s. 620.23, shall not be counted in determining whether an insurer meets Wisconsin's tests of solidity, as prescribed in ss. 623.11 and 623.12. No investments are prohibited

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except those illegal under other statutes or under general law. This chapter contains no prohibition of an investment that gives control of other enterprises. The latter is unnecessary in those cases where it can be effective.

This liberality in investment law is only tenable if:

(1) The provision of s. 620.03 permitting the commissioner to intervene when necessary is preserved intact, and

(2) The provisions of ss. 623.11 and 623.12 are simultaneously enacted so that the commissioner has a clear statutory basis for his intervention on financial grounds under s. 620.03.

When it is seen in this light, a strict compliance rule for nondomestic insurers is fully justified. No longer does the law say what investments nondomestics may have, either strictly or substantially. All it says is that the same test of solidity will be applied to nondomestics as to domestic insurers. Control over investments is only indirect. If the test is met, the insurer's investments are thereafter its own concern. Any more liberality than this would be a betrayal of the interests of Wisconsin insureds.

As thus seen, this chapter is a new approach to insurance investments. This approach in the hands of even reasonably competent regulators will produce better results than the traditional one. It eliminates artificial intermediate criteria for solidity and goes directly to the basic question. It gives management maximum freedom, and it induces commissioners to ask the right questions.

Regulating the investment of assets has been an important part of the regulation of the insurance enterprise. The assets are the security of the insured that his claims will be paid and his interests protected. Unless they are safeguarded against dissipation and are available if needed, the insurance policy does not insure. The law has adequate justification for intervention, therefore, to the extent that sound judgment sees dangers to the insured and the public from assets dissipated through misinvestment. Although insurers are in general sophisticated investors, not all of them are equally wise, skilled or responsible.

In all branches of insurance, but especially in life insurance, investment income is an important part of the economics of the enterprise. In life insurance, the level-premium mode of operation puts large sums into the insurer's hands to be held for the insureds and the long-range character of the obligations gives compound interest an opportunity to work its wonders. Investment income is a major factor in determining the level of premiums to be charged. In computing premiums, a rate of return is assumed and guaranteed. The long-run solidity of the life insurer depends on its actually earning a rate at least as large as that assumed; if it earns more, dividends can be paid from the excess either to participating policyholders or to shareholders, or kept as surplus for expansion. If it earns less, surplus must be available to meet the resulting deficit.

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On the property-liability side, investment income has kept many an insurer afloat during recent years in the face of underwriting losses. The different nature of the insurance operation results in smaller reserves, and investment income is less in comparison with premium income and not so large a factor in the level of premium rates as in life insurance. But it is still important in the earnings picture and in pricing decisions. It is a principal source of policyholder or shareholder dividends and of internally generated capital for expansion. Moreover, and perhaps most important, it is a fruitful source of misunderstanding, disagreement and controversy in the area of rate regulation. In some states it has been expressly treated as a factor in the rate-making process; in others it is a tacit though real factor.

General Objectives

The law of insurance investments has a number of objectives, some of which are not expressly articulated in existing insurance codes. First, it seeks to prevent management from making speculative or otherwise unsuitable investments that endanger policyholder interests. To achieve this purpose, the laws historically prescribe minimum standards of quality and exclude as improper classes of investments thought to be unduly risky.

Second, they seek to stabilize the financial position of insurers, to prevent them from being vulnerable to shifts in economic circumstances. This goal is sought by requiring diversification of the portfolio, both among broad classes of investment and among individual investments, and by limiting investments to a minimum level of quality.

Third, laws concerning investments may sometimes have objectives concerned with concentration of economic power and not directly related to ordinary insurance regulatory purposes. The laws may, for example, prohibit an insurer from purchasing a bloc of stock in another corporation large enough to permit the insurer to establish control.

Fourth, the investment laws may have specific "social" objectives. For example, in authorizing investments in housing, s. 84 of the New York Insurance Law states: "To promote and supplement public and private efforts to provide an adequate supply of decent, safe and sanitary dwelling accommodations for persons of low and moderate income and to assist in relieving the housing situation any domestic life insurance company may, wherever it is actively doing the business of life insurance, acquire or construct housing projects...."

Social objectives like the foregoing are more numerous than they once were - sometimes they are explicitly mentioned by the statutes, sometimes a diffuse social "pressure" compels them. In any event, it is no longer possible, if it ever was, for the insurance industry to regard the great needs of our society as irrelevant to the insurance business, nor does responsible leadership in the insurance community wish to do so. The recent investment program of the life insurance industry in the urban core indicates that social purpose is a real objective in practice as well as in theory. That was a response to real if unfocused demands of others as well as an expression of conviction within the business.

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Sometimes, in its pursuit of legitimate objectives, the law has erred and has unduly restricted management initiative and judgment. It may, in the process, have interfered with management's attempt to achieve maximum return consistent with safety, thus raising the price of insurance and sometimes restricting its supply.

Sometimes the objectives of investment regulation are inconsistent. An effort to contribute to the solution of social problems may reduce yield and security; if they are reduced, it is doubtful whether the law has put the burden on the right shoulders. If social purposes are in conflict with objectives relating to solidity, the special social purpose should give way, since the paramount and overriding purpose of insurance is to provide security, which is only possible if insurers have assets soundly invested. Insolvent insurers create rather than solve social problems. On the other hand, our total security in the most fundamental sense depends on assuring a society just enough to be viable and orderly. The problem of interrelating and balancing the goals is complex and not easily solved.

Former Wisconsin law

The last century has witnessed a continous liberalization of the investment laws of Wisconsin. Two highly restrictive laws of 1870, controlling separately life and nonlife insurers, established strict standards of control over insurer investments. Thereafter, a steady process of amendment expanded the list of permitted investments and liberalized their terms.

This process of widening the investment discretion of management was not even interrupted by the investigations of the insurance industry in the early part of this century. Widespread abuses uncovered in large eastern companies resulted in restrictive legislation in New York as well as other states, especially for life insurance. But no serious abuses were discovered in Wisconsin, and in addition the existing laws were already stricter than elsewhere. Hence there was no resulting legislative action in Wisconsin.

While the amendment process continuously liberalized the Wisconsin investment law, it failed to systematize it or restructure it, since the detailed enactments were each in response to a separate need or problem. The law was too complex, too detailed, too unsystematic and too restrictive for the rapidly unfolding investment environment. The details were found in ss. 201.25 and 206.34, both of which are repealed by this law. The provisions were summarized in successive drafts of this chapter but that summary is omitted here.

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Changes Made by this Chapter

This chapter makes fundamental changes in the pattern of investment regulation. For the most part, they are liberalizing changes, based on the assumption that most insurance managements are both able and willing to pursue a sound investment policy, and that present investment laws may sometimes hinder more than help in achieving that goal. Only for new, small or marginal insurers is there need to provide the detailed rules that formerly characterized investment regulation. In a few respects the changes are toward more stringent control, but the overall effect of the law is to give solid insurers much more freedom, and to give the commissioner power to concentrate on the areas of real concern.

Changes in Method of Control

The main change is not substantive, but procedural. The chapter enlarges greatly the rule-making responsibility of the commissioner and reduces the amount of detail contained in the statute. This change is closely related to and makes possible a classification of insurers, freeing most of them from detailed control over investments, but intensifying control where such intensification is necessary. See s. 620.03, which has its counterpart in the corporation chapter. S. 611.03.

The statutes relating to investments have required a continuous stream of statutory amendments to keep pace with economic developments, legal changes and evolving investment philosophies. To ensure that investment laws permit application of sound but recent views and that new investment insights can be promptly utilized, this chapter is content to outline investment principles and objectives, leaving it to rules of the commissioner to spell out the details and to implement needed changes more expeditiously. In particular the authorized list is retained in form but the list is stated with great generality and the commissioner has wide discretion to add to it. While change in investment regulation should not be lightly undertaken, sound investment opportunities should not have to be foregone simply because the legislative process is inherently and properly slow in adapting to change. The authority to make such needed changes expeditiously can be safely entrusted to the commissioner, if he is properly guided by general statutory standards. In exercising his discretion, the commissioner should make extensive use of advisory groups from the industry, as he is authorized to do by s. 601.20. The changes required from time to time are only in detail and not in principles. Moreover, the legislature can always deal explicitly with any matter that it considers important enough to deserve embedding in a statute. The real danger is the converse one, for the temptation is constantly present for the legislature to deal explicitly with details that do not deserve legislative attention. Even the commissioner should not deal extensively with details, except under ss. 620.03 and 620.04.

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Liberalization of Controls on the Majority of Insurers and Imposition of Special Restrictions on Certain Insurers

The insurance commissioner and the legislature, in dealing with investment regulation, have long faced the horns of a dilemma. Either legislation and regulation must be so detailed and strict as to put handcuffs on the competent investment managers of strong and well-run insurers, or so general and lacking in detail as to make it possible for inexperienced investment personnel to endanger seriously the interests of insureds and the public. This law attempts to go in between the horns, by imposing special restrictions on certain insurance corporations, leaving others relatively free. All new insurers for their first 5 years, and older insurers on order of the commissioner, are subject to more restrictive investment regulation than is applicable to other insurers - to most insurers. Certain types of insurers of limited size and restricted markets may need to be permanently restricted. The commissioner may reclassify an insurer in either direction by an order, which would be subject to judicial review. For most insurers, only the statutory provisions and a few simple implementing rules will apply; they provide much greater freedom and flexibility than the current law. For insurers subject to special restrictions, something comparable to the present law will ordinarily be applicable through more explicit and detailed rules, but there will also exist the possibility of more direct supervision by the insurance commissioner, as well as the greater flexibility that results from the more extensive use of rules.

This law assumes that the commissioner and his staff should not replace nor interfere with experienced and skilled investment management of strong and mature insurers; as to most insurers it contemplates virtually no interference. It does assume, however, that when management is demonstrably lacking in competence or reliability, or the financial condition of an insurer demands special watchfulness, the commissioner should be empowered to protect insureds and the public. In such cases, stringent rules and close control are needed. This is the underlying principle that the former law already expressed; this law tries to make it more workable and to focus the commissioner's attention where it belongs, almost exclusively on weak insurers, new insurers and those in special situations. At the same time, sound insurers are freed from the undue strictness and detail of present control. When the commissioner does undertake close surveillance of an insurer's investments, he perhaps should, and is empowered under s. 601.20 to, create an advisory committee or group of investment men from sound insurers to help him. Or he can get sound advice in other ways.

It goes without saying that special restrictions on investment do not alone indicate that an insurer is second class. An insurer thus restricted, whether new or old, may be potentially excellent; its temporary financial condition or other conditions, however, may make closer control over investments important for the time being. An insurer should be rehabilitated or liquidated, not merely restricted in its investments, if its situation is such as to endanger the interests of insureds or the public.

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Unification of Life and Nonlife Requirements.

There are some significant differences between the investment needs of nonlife and life insurers. The nonlife insurer must place greater emphasis on liquidity, faces a much more substantial risk of catastrophic loss, and deals in shorter-term commitments. The life insurer, mainly dealing in longer-term fixed-dollar commitments and operating on the basis of premiums that assume that a specified rate of interest will be earned, must select its investments accordingly.

Despite these operational differences, however, the types of eligible investments for both life and nonlife insurers were basically the same, even under former law. The differences are mainly in portfolio distribution rather than in eligibility of assets.

In this chapter, an attempt has been made, wherever possible, to unify life and nonlife prescriptions. Differences should exist only for good reasons related to operational differences.

Liberalization of Investment of Surplus in Excess of Security Surplus

Some specific ways in which the laws are liberalized are detailed below. But both for domestic and foreign insurers, the specific liberalization is less important than a more general liberalizing notion. The present law applies to all assets. This chapter applies to less — to the assets equal to liabilities plus "security surplus", as defined in the next paragraph. There would be virtually complete investment freedom for surplus in excess of the security surplus. Any insurer that has surplus beyond what it needs to support its insurance operation with safety can invest the excess without any restraints other than those derived from overriding public policy.

It is well established in regulatory practice in insurance departments that some limits will be placed on the amount of business that can be written on the basis of a given amount of capital and surplus. The amount of capital and surplus required for clearly sound operation by a specific insurer is its "security surplus". The term is new but the concept is not. It is not required for solvency, and failure to maintain it is not alone ground for drastic action like rehabilitation. Nor is it a maximum - it is the amount of surplus the insurer should have to be regarded as solid, but sound policy is not currently thought to prohibit having even more. Failure to maintain the security surplus appropriately subjects the insurer to administrative surveillance - with respect to dividends and other distributions, for example. In a variety of ways, the existing regulatory patterns in the more sophisticated states already recognize a point beyond which an insurer has funds not deemed essential for the insurance operation. Thus in applying a "substantial compliance" concept to a foreign insurer, the commissioner may ignore improper investments if the insurer does not need them to satisfy him as to solidity. For explicit statutory enactment of this application, see N.Y. s. 90 (1). Likewise, when a holding company is formed for the purpose of freeing some surplus for other activity, the commissioner must decide how much surplus needs to remain to support the

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insurance operation. Again, the commissioner might begin to put pressure on a property-liability insurer to do various things when its surplus drops below a certain ratio to its premium writings, perhaps plus investments in equities. The Kenney rules are well known, and are sometimes used, with or without modification. Some states have refined and somewhat liberalized them. But whatever the appropriate amount, if surplus declines below it, the insurer does not have the security surplus. It may still be far from insolvent, however. When an insurer has surplus in excess of that amount it should be almost completely free to deal with the excess as it likes. For more extensive discussion, see Report of the Special Committee on Insurance Holding Companies to the Superintendent of Insurance of the State of New York 43-47 (1968).

For life insurers, the concept would have less important application. The valuation of life insurance liabilities is done on such a conservative basis, in general, that to be soundly operated a mature insurer does not really need much surplus beyond its reserves, to deal with unpredictable liabilities. It will need surplus or a special reserve to cover asset value fluctuation, of course, to the same extent as a property-liability company. See ss. 620.01 (1) (b) and 620.32. That need has been lessened however, by other devices in life insurance. Amortization of bonds and the mandatory securities valuation reserve are examples.

Any surplus above security surplus would be free, so far as the investment laws are concerned. Thus, for an insurer that has a very large surplus, this chapter is much more liberal than the former law. For insurers with little or no surplus, the chapter is no less liberal than former law, with a few specific exceptions which seem fully justified. Many property-liability insurers have had substantial excess surplus. Of course, if they form holding companies, as many have done, and "dividend up" or "milk out" the excess surplus into the holding companies, the amounts paid out are no longer subject to this chapter and also cease to be counted in determining the insurer's solidity.

An important corollary of this view of surplus is a new approach to sanctions against violations of the limitations on investment. Traditionally, divestment is required by the insurance law. The law governs _all_ investments and forbids many. This chapter permits instead the treatment of investment in excess of statutory or administrative prescription first as leeway and thereafter simply declines to count it toward satisfaction of either the compulsory surplus requirement or the security surplus standard. As long as remaining surplus is adequate - in excess of security surplus - the insurer can continue to hold assets irrespective of any limitations except those imposed by overriding public policy in other chapters.

The effect of this innovation will be rather limited for some time to come, since statutory investment standards are not the only factor to which investment managers have to respond. As a matter of fact, the investment laws of most states have had only a modest impact as compared to the dominant role played by the rules for the preparation of annual statements promulgated by the NAIC. A special committee of the NAIC, the Committee on

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Valuation of Securities, decides what assets are "admitted" for purposes of the annual statements, and how they are to be valued. As long as the present system of uniform annual statements prevails in its traditional rigidity, which in turn is a natural result of the difficulties of reaching an agreement among 50 regulatory authorities, interstate insurers cannot make full use of all the investment opportunities offered by this chapter. Even if an insurer could use a specific investment to satisfy Wisconsin standards for compulsory and security surplus, it would be of little use unless it was also an "admitted asset" for annual statement purposes. This limitation is not a reason to delay forever any improvement of investment regulation. A start must be made sometime and somewhere.

Liberalization of Common Stock Investments for Life Insurers

The Wisconsin law formerly limited the common and preferred stock investments of a life insurer to 15% of its admitted assets. This figure was recently raised from 5% for each. Laws of 1965, ch. 392, s. 1, amending s. 206.34 (1) (eg) and (es). This provision was more permissive than New York's comparable requirement which until 1969 limited investment in common stocks to 5% of admitted assets or one-half of surplus, whichever was less; now the limit is 10% of admitted assets or surplus to policyholders, whichever is less. New York Insurance Laws s. 81 (13) (c) as amended by ch. 190, laws of 1969.

A relatively recent authoritative study of the life insurance investment process concluded that "the capacity of life companies for risk taking is appreciably greater than the degree of risk taking reflected in their investment portfolios". Walter, The Investment Process (Boston: Harvard University Graduate School of Business Administration, 1962), p. 62. Further liberalization of common stock investments for life insurers would help in achieving several goals. It would help make life insurance a more attractive savings medium by providing greater opportunities for growth and yield. It would provide greater protection against the effects of inflation for policyholders as well as insurers. It would provide more satisfactory alternative investment outlets for insurers when the yield on fixed-dollar investments dips very low, as it did in the late 1940's. It would help increase the supply of equity capital, thus contributing to the growth of the economy and enlarging the options of small and medium-sized as well as larger insurers. It would, in a word, encourage the allocation of investable resources that would be of optimum value to our society.

This chapter permits a life insurer to invest up to 20% of its assets in common stocks, an increase of 5% over the present authorization. In addition preferred stock becomes unrestricted. Before ascertaining what percentage the insurer has, the common stock component of the mandatory securities valuation reserve may be deducted. Moreover, excess investment beyond those limits is not prohibited; but it is not counted in determining compliance with the security surplus standard and compulsory surplus requirement. This liberalization is qualified, however, by a change, for purposes of the limitation, to valuation at market. Under some circumstances this may be more stringent than the present law. Twenty percent

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of assets measured by original cost can be very dangerous if by reason of a considerable increase in value and other changes in circumstances the equity investment in shares actually represents a much larger share of the total asset value of a company operating with a small surplus.

Such an extensive commitment as 20% would not be appropriate for every life insurer; each must decide for itself whether to commit so much of its assets to common stocks. But strong insurers should not be needlessly strait-jacketed by unnecessary restraints devised for weaker ones. One way to provide some specific statutory control over individual insurers whose financial position is weaker than the normal is to establish a limit on common stock (and other equity) investments that relates these more volatile categories to surplus. This recognizes that one function of surplus is to cover short-term fluctuations of value of the portfolio of invested assets. The function of such a limitation is to ensure that the most extreme fluctuation of the stock market that one can reasonably anticipate will not wipe out surplus as a result of a decline in the market value of shares held. This chapter takes the logical next step. The relationship to surplus is not directly imposed as a fixed percentage of surplus, but is with other relevant variables built into the calculation of compulsory and security surplus.

One important limitation on common stock investments that is continued is the prohibition of controlling interests in unrelated enterprises. This is based on the general rule that insurers should not do any other business, and that they should not be allowed to do indirectly, through acquisition of a controlling portion of the stock in a noninsurance corporation, what they could not do directly. This limitation is not applied to the leeway clause, however, which is given its full and natural meaning.

The basic purpose of the restrictions of ch. 620 is the financial soundness of the insurance enterprise and its protection, in the interest of the insureds, against insolvency. It has been a rule for many years that an insurer may not transact any noninsurance business, lest its solidity with respect to its insurance obligations suffer from more risky ventures in other fields. Financial breakdown and bankruptcy, the traditionally accepted regulating forces of the free marketplace, cannot be permitted to operate with full force in the field of insurance, where they would destroy the very foundation of the insurance business - security. Therefore, the insurance business must in general be kept separated from other enterprises. See former s. 201.24 (1) and s. 610.21. Even within the insurance business, it has traditionally been required that the more hazardous kinds of insurance be separated from the more secure kinds. This law permits domestic insurers to write all kinds within the same corporate entity. But it continues some elements of the traditional cautious approach. Assets employed in life insurance or mortgage guaranty insurance must be segregated from those in other lines. S. 611.24.

Another reason for prohibiting insurers from venturing into unrelated businesses is that the business of providing security affects such vital interests of cus-

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tomers that it requires the full and undivided attention of management. This precludes preoccupation with other unrelated and especially with more hazardous ventures, even if the insurer's guaranty funds are not immediately endangered. A modest concession is made with the leeway clause. In very limited amounts, investment can be unrestricted. Nothing in modern economic developments justifies a departure from these basic principles. Nor would it be justified to permit insurers to do through subsidiaries what they are not allowed to do directly.

Investments in Real Property

The authorization to invest in real property is liberalized in several ways. First, the limitation on real property for the convenient transaction of business to 20% of admitted assets is made inapplicable to the extent that the insurer is able to treat any excess over 20% as assets it does not need to meet the test of security surplus. Second, real property (like any other asset) acquired in the bona fide enforcement of creditors' rights may be held indefinitely if not needed for those purposes and may be held for a reasonable period of time even if so required. Third, an insurer may commit a larger portion of its portfolio to income-producing real property. The former limit of 5%, applicable to life and nonlife insurers, is raised to 20% of all assets for a life insurer and to 10% of all assets for a nonlife insurer. S. 620.23 (1) (c). The limit was higher under former law for life insurers if certain narrow categories of real property investment are considered. Finally, and applying not only to this category but to others as well, the limitation is couched in terms of gross assets rather than admitted assets. This last change is a minor liberalization - the difference will ordinarily be small.

Nondomestic insurers

Former Wisconsin law, like the law of most states, did not attempt to regulate the investments of nondomestic insurers, except for the deposits of alien companies, regulated by s. 201.32 (6). As a rule, each state relies on the control exercised by the domiciliary state of an insurer. Such abstinence is hard to understand, in view of the degree to which local control is imposed on nondomestics on other matters, such as forms and rates. Nothing so affects the solidity of an insurer as its investment policy. The power to intervene, and decisively, is important, though it should be exercised with restraint.

Under the liberalized investment regime of this chapter, even literal compliance for nondomestics is not unduly stringent. All that means is that if a nondomestic insurer's investment portfolio is valued as this statute provides, and meets the tests of ss. 623.11 and 623.12, it is solvent. Two different formulations of extraterritorial control less than strict compliance can be found in the statutes. One is expressed in a provision like Florida's s. 625.0139: "The investment portfolio of a foreign or alien insurer shall be as permitted by the laws of its domicile if of a quality as high as that required under this chapter for similar funds of like domestic insurers." Although under such a rule the commissioner could disapprove investments of a foreign insurer upon a finding that they did not conform to the

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standards set for domestic companies, since they could be said not to have comparable quality, intervention under such a statute would be unusual.

In a different formulation, New York's s. 90 (1) requires foreign insurers to "comply in substance" with the rules established for like domestic companies. Compliance in substance is defined as having, after disregarding any noncomplying investments, a surplus to policyholders in a reasonable amount in relation to liabilities and adequate to the insurer's financial needs, invested as required for like domestic companies.

Neither approach seems applicable without qualification to the system of investment regulation proposed in this chapter. "Substantial compliance" of the New York type would impose on nondomestic insurers requirements no different from the requirements for domestic insurers, since domestic insurers too are limited only to the extent of their security surplus.

The Florida formula is equally inappropriate. The reference to the "quality" of an investment portfolio places too much emphasis on the security of investments while neglecting the equally important requirement of diversification. In any event it is a very vague standard for deciding whether intervention is to be undertaken.

The nature of investment regulation under this chapter is such that strict compliance is no burden, because strict compliance is only required to the extent of the security surplus. That is no more stringent than New York's substantial compliance, and may be less stringent because of the greater liberality of the underlying investment requirements. Consequently, nondomestic insurers receive essentially the same treatment as domestic insurers. In the unusual event that this would subject an insurer to inconsistent requirements, rather than requirements merely differing in degree of stringency, a special exemption can be granted by the commissioner under the general rule of proposed s. 618.28.

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RELATIONSHIP OF VARIOUS CONCEPTS IN THE INSURANCE CODE

The annexed chart may be helpful in making clear the relationships among certain terms and requirements contemplated in this chapter and related laws.

ASSETS

Total Assets

Assets that need not satisfy investment rules.

Assets necessary to escape regulatory concern. They must satisfy s. 623.12, which defines "Security surplus", and must conform to ch. 620.

Assets necessary not to be in hazardous condition. They must satisfy s. 623.11, which defines "compulsory surplus" and must conform to ch. 620.

Assets necessary to avoid insolvency. They must meet the test of s. 645.03.

LIABILITIES

Excess or Surplus surplus

Security Margin

Margin of Solvency

Voluntary additional capital

Minimum capital or minimum permanent surplus

Liabilities (mostly) reserves

Compulsory Surplus s. 623.11

Security Surplus s. 623.12

Capital (stock companies)

Surplus (stock companies)

Surplus (mutual companies)

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620.01 PURPOSE AND SCOPE. (1) INVESTMENT OBJECTIVES. The purpose of this chapter is to protect and to further the interests of insureds, creditors and the public, by providing, with minimum interference with management initiative and judgment, standards for the development and administration of programs for the investment of the assets of insurers, which standards seek an optimal balance of the following objectives:

(a) Safety of principal, and to the extent consistent therewith, maximum yield and growth;

(b) Stability of value, except where higher risk and possible fluctuations of value are compensated by a commensurate increase in yield and growth possibilities, and either special reserves or surplus is available in sufficient amount to cover reasonably foreseeable fluctuations in value;

(c) Sufficient liquidity to avoid the necessity in reasonably expected circumstances for selling assets at undue sacrifice;

(d) Reasonable diversification with respect to geographical area, industry, maturity, types of investment, individual investments and other relevant variables; and

(e) Reasonable relationship between liabilities and assets as to term and nature.

(2) SCOPE. Except as otherwise provided, this chapter and the rules promulgated to interpret and implement it, apply to all insurers authorized to do business in this state.

NOTE: No legislature and no insurance department should interfere unduly with the freedom of the technically skilled, well-staffed and responsible management of financially solid insurers in the performance of a task in which normal management objectives are largely the same as those demanded by the interests of the insureds and the public which are stated in this section. Not every insurer is thus staffed and financially stable, however. Consequently, a balance has to be struck between the objective of making sure that investment control is not unduly restrictive on the one hand and on the other that the commissioner has the capacity to deal with potentially dangerous situations. The limits of this chapter will not fasten in chains the skilled investment departments of good insurers, but will help to prevent the occasional badly managed or temporarily weak insurer from making mistakes serious enough to endanger its insureds and the public.

Sub. (1) states the balancing problem the chapter has to solve, and expresses a fundamental position that management initiative and judgment are the principal insurance assets of our society, and should be given room to operate.

It then goes on to state the basic goals of insurer investment. Par. (a) expresses a point of view that has not always been accepted for insurance law. The basic investment laws of this country were written either in periods of depression or deflation, or at least when the prospects of deflation or depression seemed the greatest danger to an institution, like insurance, that seeks security. Now, however, we see a steady and seemingly inevitable inflation as the basic problem to be faced by the insurance institution. The danger is less the loss of assets than the diminution in the real value of

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assets. Heretofore, exclusive attention has sometimes been given in the statutes to safety of principal, with the result that the institution of life insurance is in danger in an inflationary period of losing some of its relevance because it has ceased to be as good a savings medium as it once was and as it could be again. Yield and capital appreciation, and the transmission of their benefits to the insureds, are very important if life insurance is to perform its historical role with maximum effectiveness, and they cannot be so completely subordinated to safety of principal as they have customarily been. See Report of the Special Committee on Insurance Holding Companies to the Superintendent of Insurance of the State of New York 11 (1968). The subordination has been partly a result of a very narrow conception of the life insurance product, which has not yet fully adapted to a change in the economic climate, but it is also related to investment statutes and traditions that for a continuously inflationary era overemphasize safety at the expense of yield and growth. These strictures should not be taken to mean that no progress has been made toward solving the problem. Wisconsin, in particular, has considerably liberalized investment laws at the suggestion of the industry. Moreover, the whole development of variable annuities is a response to the problem by the industry. Other responses could be reported, but all of the responses taken together have not completely solved the problem, which must still be kept very much in mind.

In another tradition, British life insurers are given much greater investment freedom, and some of them now invest extensively in common stocks. Percentages as high as 30 are not unknown; the average is well over 20%. Yield and growth should be among the primary considerations in insurance investment and its regulation. If the insurer writes participating contracts, policyholders have a direct stake in yield and growth. If there is no participation, the stake is indirect but better investment results still benefit the policyholders indirectly through price competition. Regardless of legal form, yield and growth are important goals that should be pursued as a hedge against inflation, and are sound economic objectives.

Moreover, even the goal of long-term safety of principal does not necessarily require avoidance of all high-risk situations, but rather a proper mix of low and high-risk investments, with appropriate attention to the better investment results that may come with the latter. The problem is one that can be solved with diversification and with due attention to surplus and other safety factors in the insurance operation.

Par. (b) recognizes that many investments, notably common stocks, may be high-yield investments and still not involve either instability or excessive risk, if the investor is in a position to ride out short-term declines in value and has a properly diversified portfolio. But for nonlife insurers, a caveat is often expressed by saying that investment exposure should take into account underwriting exposure. Heavy insurance commitments in relation to surplus necessitates a more cautious investment policy that avoids fluctuation in values.

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Par. (c) is a goal for all insurers but of special concern to nonlife insurers. Par. (d) speaks for itself.

Par. (e) recognizes as valid a consideration that has played an important - perhaps an excessively important - role in determining the nature of life insurance investments: the fact that security of performance is enhanced if long-term obligations are matched by long-term assets, and fixed-dollar obligations are matched by fixed-dollar assets. The principle is easy to pursue too far in life insurance, and management may properly have greater freedom to depart from it than in the past. But this chapter continues to recognize the relevance of the principle; it will not forbid, for those who favor it, a more conservative investment policy than it specifies as a limit for the more venturesome. Even if it is true that traditional life insurance investment law and practice have been too conservative and have risked making the life insurance contract irrelevant because of steady inflation, the point made by par. (e) is a valid one. Part of the solution may lie in the redefinition of a guarantees of the life insurance contract, and especially the reconsideration of nonforfeiture values, such as the cash surrender value. That is a matter to be pursued elsewhere, however.

There is another important application of the objective of par. (e). Alien insurers doing business in the United States should attempt, within reason, to cover their dollar liabilities with dollar investments. Otherwise they expose themselves to an unreasonable risk of currency fluctuations. The same precaution should be taken by American insurers doing business abroad.

This subsection is inserted to give general direction to the more specific standards and requirements stated elsewhere in this chapter, rather than to create specific duties for insurers. It follows the pattern already set in chs. 601 and 645 of the statutes.

Sub. (2) applies the chapter to all "insurers", except as special provisions for certain insurers are included in later sections. The new liberalized investment rules apply to domestic and foreign insurers alike. If an organization is an "insurer", i.e. if its operations have been brought under the rules of this code, then this chapter should ordinarily apply.

In those instances, if any, where a more stringent rule is imposed, a reasonable period of transition is provided in s. 620.12 (1), for accommodation to the new provisions.

620.02 SEGREGATED ACCOUNT INVESTMENTS. (1) GENERAL. Each segregated or separate account established under s. 611.24 or 611.25 shall be evaluated separately to determine compliance with this chapter.

(2) LIFE INSURANCE VARIABLE BENEFIT SEPARATE ACCOUNTS. (a) General. The amounts allocated to each account created under s. 611.25 and accumulations thereon may be invested and reinvested without regard to any requirements or limitations prescribed by this chapter.

(b) Guaranteed benefits. To the extent that the corporation's reserve liability, with regard to benefits guaranteed as to dollar amount and duration and funds guaranteed as to prin-

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cipal amount or stated rate of interest, is maintained in any separate account, a portion of the assets of the account at least equal to the reserve liability shall be invested in accordance with this chapter, or in accordance with such requirements as the commissioner prescribes by rule.

(3) VALUATION OF SEGREGATED ACCOUNT ASSETS. Assets allocated to a segregated account shall be valued at their market value on the date of valuation, or if there is no readily available market, then in accordance with the applicable contract; but a portion of the assets of the account at least equal to the corporation's reserve liability with regard to the guaranteed benefits and funds referred to in sub. (2), if any, shall be reported separately and valued in accordance with the rules otherwise applicable to the corporation's assets or in accordance with rules promulgated under sub. (2). No securities valuation reserve or other reserve for fluctuation in the value of securities need be maintained for assets that do not have to comply with this chapter.

NOTE: General provisions for segregated and separate accounts are to be found in ss. 611.24 and 611.25. They are accounts to which some identifiable portion of the assets of the corporation is attributed. Sub. (1) makes clear that each account is to be treated separately for investment purposes.

A segregated or separate account is needed in a number of situations, one of which is when variable value contracts are issued. The promised payment varies in such contracts in accordance with the performance of a portfolio of investments, usually principally common stocks. Such contracts give the insureds an opportunity to participate in the profits of a rising security market. They also subject insureds to the danger of loss in the event of a long-term reversal of market trends, or even of early termination of the contracts when the market is down. These contracts are quite unlike the traditional fixed-dollar insurance policy with which most insurance law has been concerned. The fact that the very purpose of such contracts is to provide for direct participation in the fortunes of the market justifies a greater freedom of investment. It does not justify violation of any specific prohibition that may exist in the law nor of the proscription of s. 610.21.

Perhaps the freedom given in sub. (2) (and in former s. 206.385 (2)) is too great. Some criteria should perhaps be imposed on such a portfolio to prevent speculative excesses as a result of overly vigorous competition, and to require appropriate diversification. But such rules have to develop gradually, out of experience. For the present what has been done is, essentially, to cast into a more generalized form the investment provisions of s. 206.385 (2).

Sub. (3) continues s. 206.385 (4), with slight changes.

620.03 SPECIAL INVESTMENT RESTRICTIONS. (1) SPECIAL RESTRICTIONS FOR NEW INSURERS. For the first 5 years after obtaining a certificate of authority in this state, an insurer shall be subject to the following restrictions:

(a) Procedural requirements. The commissioner may by rule prescribe for all or for certain classes of such insurers special procedural requirements including special reports, prior approval or subsequent disapproval of investments.

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(b) Substantive restrictions. The commissioner may by rule prescribe for all, or separately for different classes of, such insurers substantive restrictions on investments, including:

1. Specification of classes of assets that may not be counted toward satisfaction of the compulsory surplus requirement or the security surplus standard even though they may be counted for unrestricted corporations;

2. Specification of maximum amounts of assets that may be invested in any single investment, or any issue, class or group of classes of investments, expressed as percentages of total assets, capital, surplus, legal reserves or other variables;

3. Prescription of qualitative tests for investments and conditions under which investments may be made, including requirements of specified ratings from investment advisory services, listing on specified stock exchanges, collateral, marketability, the financial and legal status of the issuer and its earnings capacity, and currency matching.

(2) EXEMPTIONS. The commissioner may by order grant an insurer exemption from any restriction under sub. (1) to the extent that he is satisfied that the interests of insureds, creditors and the public of this state are sufficiently protected in other ways, such as by the investment regulation actually exercised in the domicile of a nondomestic insurer; or by other evicence of the solidity of the insurer and the competence of its management and its investment advisers.

(3) EXTENSIONS. The commissioner may by rule apply to a class of insurers any restriction of sub. (1), more than 5 years after issuance of a certificate of authority, if he finds that financial condition or management require additional investment regulation for the protection of the interests of insureds, creditors or the public in this state.

NOTE: This section seeks to solve the basic dilemma of investment regulation: (1) that the investment staffs of most insurers are better equipped than the insurance department or the legislature to make wise decisions about appropriate investment programs for themselves, and (2) that the same thing cannot be said about all insurers indiscriminately. Wisdom dictates that maximum freedom be given to insurers in general, but also that there be power to intervene decisively wherever and whenever necessary. This section attempts so to provide.

The form of control applied to most restricted corporations under this chapter (including the suggested rules) approximates former law; unrestricted corporations are much freer than before. Restriction of a corporation under this section does not indicate that it is insolvent or even close to insolvency. It means no more than sub. (3) says - that the corporation needs restriction with respect to its investments. The commissioner should feel freer to intervene in investment policy than to institute delinquency proceedings under ch. 645, but of course even intervention in investment policy should be unusual, except for new insurers and perhaps for very small local insurers which might properly remain restricted indefinitely.

The section is very flexible. Restrictions can vary all the way from complete supervision of every investment to a modest limitation on the classes of investments per-

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mitted, such as a temporary prohibition against acquiring common stock or income-producing real estate. As experience develops, the commissioner may develop classifications applicable to restricted insurers and develop differentiated controls for the various classes. This section would give him flexible power to do so under his rule-making authority. In giving the commissioner this power to modulate the law to match regulatory needs, the section implements a fundamental principle of this chapter that a separation should be made between the statement of general principle and the formulation of detailed application.

It is the legislature's role to concern itself with statements of principle and the establishment of general direction, not with detail. The circumstances of the securities markets of this country change so much over time that it would be unfortunate if even closely restricted insurers were locked into an investment framework without the possibility of quick changes in the details to meet new circumstances. The history of investment statutes is one of constant legislative amendment to keep pace with changing legal forms and investment opportunities. But the legislative process is too slow to keep up with the swift tides of legal and economic change, and legislatures lack the facilities for the continuity of study and decision-making essential to the regulatory process. This is true a fortiori in dealing with the troubles of restricted insurers.

Exercise by the commissioner of his rule-making power under s. 601.41 (3), within an overall legislative framework and subject to the controls of ch. 227, is a sounder way to deal with changing circumstances than is constant legislative concern with the changing details of the securities markets. The latter is a facade, anyway - the reality is that interested parties ask for what they want and in the absence of strenuous opposition from the commissioner, the legislature complies with the request. Only counter pressure would give it reason to do otherwise.

620.04 SPECIFIC ORDERS. (1) ADDITIONAL RESTRICTIONS. If the commissioner finds that by reason of investment conditions generally or of the financial condition or current investment practice of an individual insurer, the interests of insureds, creditors, or the public are or may be endangered, he may impose reasonable and temporary restrictions upon the investments of an individual insurer, including prohibition or divestment of a particular investment.

(2) CONSENT INVESTMENTS. The commissioner may count an asset toward satisfaction of the compulsory surplus requirement or the security surplus standard, or both, even it if does not conform to this chapter or rules promulgated thereunder, if he finds that counting it does not endanger the interests of insureds, creditors or the public.

(3) ALIEN INVESTMENTS. The commissioner may count toward satisfaction of the compulsory surplus requirement or the security surplus standard any assets in which an insurer must invest under the laws of a country other than the United States as a condition for doing business in that country if he finds that counting them does not endanger the interests of insureds, creditors or the public of this state.

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NOTE: Under certain circumstances, hard to imagine under the proposed liberal rules, the investment policy of an insurer may present special dangers, special opportunities or special needs that cannot be handled satisfactorily under applicable statutes and rules. The commissioner should then have power to intervene in an individual insurer's investment policy. Sub. (1) gives him the right to impose additional restrictions. It is adapted from N.J. s. 17:24-22.

Sub. (2) recognizes that investments not otherwise authorized may occasionally be satisfactory for a given company, and gives the commissioner power to authorize the investment. It is adapted from Washington, s. 48.13.250. However, the danger of abuse is great, and a wise commissioner will exercise such power sparingly to avoid the charge of unjustified discrimination and arbitrariness. In all but truly exceptional cases, the rules should apply evenly to all. Moreover, the new freedom accorded to unrestricted insurers should obviate the necessity for more than occasional approval of a consent investment.

Sub. (3) gives a power that is sometimes necessary to enable insurers to qualify to do business in foreign countries. It partly existed in s. 201.25 (1) (i).

The order-issuing power under subs. (2) and (3) is a special liberalizing provision to deal with particular problems that may arise beyond the scope of the rules as they exist at the crucial time. Generally this liberalization may and should be done in general terms by rule, as experience develops, but some order-making discretion will always be appropriate for unanticipated cases.

620.12 DISPOSAL OF PROHIBITED ASSETS. (1) INVESTMENTS BECOMING ILLEGAL. The commissioner shall allow a reasonable time not longer than 10 years for disposal of any investment legally held on the effective date of this chapter, or of any investment legal when made but subsequently becoming illegal.

(2) HARDSHIP CASES. A reasonable time shall be allowed for disposal of assets if the investment was made by mistake or if forced sale of the asset would be contrary to the interests of insureds, creditors or the public of this state.

NOTE: Assets held in violation of specific statutory restrictions found anywhere in the statutes constitute violation of the law; if an insurer wishes to avoid the consequences of s. 601.64 or ch. 645, it must dispose of such assets. By way of contrast, assets held contrary to investment rules devised only to protect the insurer's solidity need not be sold if other changes are made in the insurer's operation to render it unnecessary for the insurer to have the assets counted. S. 620.21. It will be a rare occurrence that an investment legal when made subsequently becomes illegal. A reasonable time should be allowed for divestment in such cases. This is especially true if forced sale would be clearly detrimental to insureds, whose protection is the raison d'etre of investment regulation. Any order of the commissioner ordering divestment would be judicially reviewable.

620.21 EFFECT OF INVESTMENT RESTRICTIONS. (1) GENERAL. Assets may be counted toward satisfaction of the compulsory

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surplus requirement or the security surplus standard only so far as they are invested in compliance with this chapter and applicable rules promulgated by the commissioner.

(2) EXEMPTION FROM LIMITATIONS FOR ASSETS ACQUIRED IN ENFORCING RIGHTS. Assets necessarily acquired in the bona fide enforcement of creditors' rights may be counted for the purposes of sub. (1) for 5 years after acquisition if real property and one year if not real property, even if they could not otherwise be counted under this chapter. The commissioner may allow reasonable extensions of such periods if replacement of the assets within the periods would not be possible without substantial loss.

NOTE: Apart from specific statutory restrictions, the only penalty for failure to comply with the investment laws is refusal to count the investments for the specified purposes. These investments are not rendered illegal.

The availability of sufficient assets to satisfy "solidity" requirements is the principal objective of the investment law; once those requirements are satisfied, additional assets are subject to far less regulatory concern. Consequently, this section will have a different impact on insurers depending on where they stand in the solidity scale. An insurer having far more than security surplus will rarely have to concern itself with legal limitations on its investments, other than statutory limitations making investments illegal. It may invest large sums outside the limits prescribed by the law without concern with the strictures of the law. But a marginal company will have to be much more careful in complying with the investment statutes.

This chapter does not decide which assets are to be "admitted" for purposes of the annual statement. The concept of "admitted assets" is really only one aspect of the valuation of assets and does not deserve special attention in the investment law.

Sub. (2) is adapted from s. 201.24 (2) and is intended to avoid the necessity for forced sale of assets acquired on foreclosure or otherwise in enforcement of rights, with consequent avoidable loss to the insurer, in those instances in which the insurer needs the asset to be counted in determining solidity and it does not otherwise qualify to be counted. No problem exists if the insurer has enough surplus not to need the asset to be counted, or if it can be charged against the leeway clause.

620.22 PERMITTED CLASSES OF INVESTMENTS. The following classes of investments may be counted for the purposes specified in s. 620.21, whether they are made alone or as a participant in a partnership or joint venture:

(1) Bonds or other evidences of indebtedness of governmental units in the United States or Canada, or the instrumentalities of such governmental units, or of private corporations domiciled therein;

(2) Loans secured by mortgages, trust deeds or other security interests in tangible property located in the United States or Canada or secured by insurance against default issued by a government insurance corporation of the United States or Canada or an insurer authorized to do business in this state;

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(3) Preferred or common stock of any United States or Canadian corporation;

(4) Property needed for the convenient transaction of the insurer's business;

(5) Real property, together with the fixtures, furniture, furnishings and equipment pertaining thereto in the United States or Canada, which produces or after suitable improvement can reasonably be expected to produce substantial income;

(6) Loans upon the security of the insurer's own policies in amounts that are adequately secured thereby and that in no case exceed the surrender values of the policies;

(7) Such other investments as the commissioner authorizes by rule; and

(8) Investments not otherwise permitted by this section, and not specifically prohibited by statute, to the extent of not more than 5% of the insurer's assets.

NOTE: These categories of permitted investments include the major headings in the present law. The miscellaneous permitted investments of sub. (7), which may be added by rule or order, should include the minor classes in the present law and new classes as they develop. The traditional quality restrictions are eliminated for unrestricted insurers.

Sub. (4) is adapted from s. 201.24 (2), but is broadened to include related personal property. It is supplemented by s. 620.23 (1) (b) and by rules.

Sub. (8) is essentially the same as the rule for life insurers under the former statute; it further restricts nonlife insurers which formerly had a leeway provision of 10%. It is not always a stricter rule, however, for as this chapter is drafted, the limitations on investment, other than any specific statutory prohibitions that may exist, apply only to the extent of the security surplus. See s. 620.21. Moreover, the increased freedom allowed under this chapter for unrestricted insurers should lessen the need for any "leeway". A leeway clause should not be a device to liberalize investment regulation - that should be done directly. But with a sufficiently modest limit the leeway provision is useful; it can be used to provide a small margin for investments of novel types pending their authorization by rule under sub. (7), to provide a reasonable safety margin for investments that are inadvertently made or that change status, and for investments that are slightly in excess of diversification or other limits of s. 620.23. The leeway provision gives the insurer opportunity to disagree with the commissioner's interpretation of the statute, without penalty, or time to apply to him for an enlargement of the permissible classes of investment (or for a special dispensation). Obviously this is not intended to apply to investments prohibited for public policy reasons. To allow as much as 10 or even 5% of assets to be invested in otherwise unqualified investments might be dangerous to some insurers, especially if the rules are otherwise as liberal as they ought to be. While well-staffed large insurers can usually be relied on not to misuse the larger leeway, as unrestricted insurers they are the least likely to need it, if the laws are sufficiently

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liberal. There is a case, therefore, for reducing the leeway clause to 2 or 3%, which would still be sufficient for the legitimate purposes of the clause. The chapter still specifies 5%. Within the limits of a modest leeway figure, investment in control situations can be tolerated, if no other law is thereby violated.

620.23 LIMITATIONS GENERALLY APPLICABLE. (1) CLASS LIMITATIONS. For the purposes of s. 620.21, the following limitations on classes of investments apply:

(a) Investments authorized by s. 620.22 (1) which are not amortizable under applicable valuation rules, 5% of assets;

(b) Investments authorized by s. 620.22 (4), 20% of assets in the case of nonassessable insurers, and 50% of the earned premium and assessments for the preceding calendar year in the case of assessable insurers;

(c) Investments authorized by s. 620.22 (5), 20% of assets in the case of life insurers, and 10% of assets in the case of nonlife insurers; and

(d) Investments by life insurers in common stock and in shares of mutual funds, 20% of assets, except that the total of investments in common stocks and under s. 620.22 (5) shall not exceed 30% of assets.

(2) INDIVIDUAL LIMITATIONS. For the purposes of s. 620.21, the following limits on investments apply:

(a) Common stock. Common stock of a single corporation and its affiliates, other than subsidiaries of the types authorized under s. 611.26 (1) to (3) or mutual funds, 3% of assets;

(b) Total investments. All securities of a single issuer and its affiliates, other than the government of the United States and subsidiaries of the types authorized under s. 611.26 (1) to (3), 10% of assets.

(3) INVESTMENT SUBSIDIARIES. For the purpose of determining compliance with the limitations of this chapter, the assets of subsidiaries under s. 611.26 (2) shall be deemed to be owned directly by the insurer and any other investors in proportion to the market value, or if there is no market, the reasonable value, of their interest in the subsidiaries.

(4) EFFECT OF QUANTITY LIMITATIONS. To the extent that investments exceed the limitations specified in subs. (1) and (2), the excess may be assigned to the investment class authorized in s. 620.22 (8), until that limit is exhausted.

(5) SPECIAL RULE FOR MUTUAL FUNDS AND OTHER INVESTMENT COMPANIES. If the commissioner considers it desirable in order to get a proper evaluation of the investment portfolio of an insurer, he may require that investments in mutual funds or other investment companies be treated for purposes of this chapter as if the investor owned directly its pro rata share of the assets owned by the mutual fund or investment company.

NOTE: The extent to which limitations need to be placed on categories of investments or individual investments is a troublesome problem. The limits suggested here are directed to reasonable diversification and to limiting the riskier classes of investment or individual investments to some reasonable relationship to the insurer's capacity to absorb investment losses without hardship or

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danger to insureds. These limits could be related to "admitted" assets. For diversification purposes "all" assets seems better. The rule is slightly more liberal and begins the departure from antiquated concepts. If an insurer has a large percentage of its assets "unadmitted" in the traditional sense of that term, it should certainly be placed under restriction under s. 620.03, which gives the commissioner adequate power to deal with any emerging problems. In the normal case the difference between admitted and gross assets will be inconsequential.

The wording of sub. (2) (a) and (b) would permit investment in shares of a single mutual fund up to 10% of assets, as an exception to the limit of 3% on investment in common stock of single corporation and its affiliates. This seems justified on the basis that mutual funds themselves provide a substantial measure of diversification. But they can be badly managed or wildly speculative; hence the 10% limitation. If they are subsidiaries under s. 611.26 (2), the 10% limitation does not apply. But they may not diversify properly, whether subsidiaries or not. Hence sub. (5) is included to take care of the possibility that investment limitations of ch. 620 may be circumvented by investing in an undiversified mutual fund.

The required consolidation under sub. (3) prevents otherwise impermissible assets from escaping proscription by being included in the value of the investment in a subsidiary.

620.31 VALUATION OF ASSETS. For the purposes of this chapter, except as otherwise provided by this code, all assets shall be valued as they are valued for purposes of the financial statements submitted under s. 601.42 (1) (a), less the amount of any investment fluctuation reserves explicitly attributable to them.

NOTE: Valuation rules and procedures will of necessity be closely tied to practices and standards developed in connection with financial statements, and in particular with the convention statement. See s. 601.42 (2). This section is tied to those more general provisions, subject to minor modifications.

One thing seems very clear in valuation for purposes of this chapter. The valuation method used to determine surplus and total assets should also be used to determine whether the limits on investments are exceeded. Ideally, valuation at market or its nearest equivalent for all purposes and for all assets would be most satisfactory. It provides the most accurate picture of the insurer's true current position. In this matter, however, a completely consistent rule would put this state at odds with national practice, and the compromise solution of this section - to follow the annual statement valuation - seems a reasonable one.

620.32 INVESTMENT VALUATION RESERVES. (1) GENERAL. The commissioner may by rule, applicable to all or specified classes of insurers, provide for the establishment in reasonable amounts of investment valuation reserves that are necessary and appropriate to lessen the impact on surplus of the fluctuation of the values of specific classes of assets.

(2) SPECIFIC. The commissioner may by order require an individual insurer to establish investment valuation reserves in addi-

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tion to those required for other insurers of the class to which the insurer belongs, to the extent that the financial condition of the insurer and the nature of its assets and liabilities or business require that such reserves be established for the adequate protection of its insureds.

(3) UNIFORMITY. So far as reasonably possible, reserves required under sub. (1) shall correspond with those generally required in other states.

NOTE: This section would not only give a legal basis for the commissioner to require the mandatory securities valuation reserve now applicable to life insurers, but it would also permit him to require other similar reserves, either generally for all insurers of specified classes, or specifically for individual insurers. By providing a way to dampen the effect of asset value fluctuations on insurers' solidity, such reserves would reduce the amount of the security surplus and compulsory surplus, as proposed ss. 623.11 and 623.12 show, thus constituting an alternative device for protecting insureds against depletion of surplus by reason of fluctuation in value.

There is no thought that the Wisconsin commissioner will go off on a tangent of his own in providing for such reserves beyond the life insurance field. Whatever he does should be done in parallel with other important insurance states and only after close consultation with the affected part of the industry. Fear of precipitate, arbitrary and unjustified commissioner action is unrealistic.

SECTION 76. Chapter 623 (title) of the statutes is created to read:

CHAPTER 623.
ACCOUNTING AND RESERVES.

SECTION 77. 623.11 and 623.12 of the statutes are created to read:

623.11 AMOUNT OF COMPULSORY SURPLUS. (1) DETERMINATION OF AMOUNT. The commissioner shall, when necessary, determine the amount of compulsory surplus that an insurer is required to have in order not to be financially hazardous under s. 645.41 (4), as an amount that will provide reasonable security against contingencies affecting the insurer's financial position that are not fully covered by reserves or by reinsurance.

(a) Types of contingencies. The commissioner shall consider the risks of:

1. Increases in the frequency or severity of losses beyond the levels contemplated by the rates charged;

2. Increases in expenses beyond those contemplated by the rates charged;

3. Decreases in the value of or the return on invested assets below those planned on;

4. Changes in economic conditions that would make liquidity more important than contemplated and would force untimely sale of assets or prevent timely investments;

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5. Currency devaluation to which the insurer may be subject; and

6. Any other contingencies the commissioner can identify which may affect the insurer's operations.

(b) Controlling factors. In his determination, the commissioner shall take into account the following factors:

1. The most reliable information available as to the magnitude of the various risks under par. (a);

2. The extent to which the risks in par. (a) are independent of each other or are related, and whether any dependency is direct or inverse;

3. The insurer's recent history of profits or losses;

4. The extent to which the insurer has provided protection against the contingencies in other ways than the establishment of surplus, including redundancy of premiums; adjustability of contracts under their terms; investment valuation reserves whether voluntary or mandatory; appropriate reinsurance; the use of conservative actuarial assumptions to provide a margin of security; reserve adjustments after rate increases for policies written at earlier and less adequate rates; contingency or catastrophe reserves; diversification of assets and underwriting risks;

5. Independent judgments of the soundness of the insurer's operations, as evidenced by the ratings of reliable professional financial reporting services; and

6. Any other relevant factors.

(2) RULES. The commissioner may, subject to adjustment to the circumstances of individual insurers in accordance with the factors in sub. (1) (b), establish by rule minimum ratios for the compulsory surplus in relation to any relevant variables, including the following:

(a) Amounts at risk;

(b) Premiums written or premiums earned;

(c) Liabilities;

(d) Equity investments of all or certain kinds in combination with any of the variables under pars. (a) to (c).

NOTE: The idea behind this statutory definition of variable or flexible surplus requirements has been explained in the introductory comment to ch. 620. The necessity of a variable surplus has long been recognized by the insurance industry and by regulators, and only the difficulty of measuring it has so far prevented the requirement from being formally recognized in the law.

It would be useful to develop a formula to permit determination of the proper amount of the surplus by a simple computation. Unfortunately, there is little basic research to rely on, nor many constructive suggestions from the industry except in very general terms. Consequently, the weight to be attributed to the various factors determining the solidity of an insurer, and the interrelations between factors, are difficult to evaluate quantitatively and too complex to be consolidated into a statutory formula applicable to all insurers, at

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this stage of our knowledge. There is no option except to repose fairly extensive discretion in the commissioner to decide each case individually - at least until further research provides the knowledge from which a more precise determination can be developed. This is, of course, the present de facto, if not de jure, situation, in insurance regulation.

There is general agreement about the factors that have a bearing on the solidity of an insurance company and therefore should be considered in determining the amount of surplus to be required. Some of them are:

(a) The size of the insurer as measured by its assets, capital and surplus, reserves, premium writings, insurance in force and other appropriate criteria.

(b) The extent to which the insurer's business is diversified among the several lines of insurance.

(c) The number and size of risks insured in each line of business.

(d) The extent of the geographical dispersion of the insurer's insured risks.

(e) The nature and extent of the insurer's reinsurance program.

(f) The quality, diversification, and liquidity of the insurer's investment portfolio.

(g) The recent past and projected future trend in the size of the insurer's surplus in relation to policy obligations.

(h) The surplus in relation to policy obligations maintained by other comparable insurers.

(i) The adequacy of the insurer's reserves.

(j) The possibility that surplus may be freely withdrawn by policyholders or subscribers and the probability that they will do so.

These factors are fairly obvious, and would have to considered by the commissioner whether or not they are specifically enumerated in the law. Their simple enumeration does not provide any real standards or guidelines to help the commissioner in evaluating the insurer's financial situation. This section tries to do something more by formulating some relationships, albeit crude ones, not quantitatively pinned down, for the evaluation of factors.

The interrelations among the various kinds of financial requirements proposed in ch. 611 and in this chapter, or otherwise possible, are the following. Five concepts may be suggested:

(1) The "proper surplus" for a particular company's operation. This is a level for the determination of management, subject to the limits imposed by the others.

(2) The "minimum capital" (for stock corporations) and "minimum permanent surplus" (for mutuals) are intended to provide solidity at the time a new corporation is

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launched, and for its formative period. The amount needed depends on what the new company intends to do, and it has to be fixed on the basis of the information given to the commissioner at the time of incorporation. It is specified under s. 611.19.

(3) Thereafter, the financial needs of the corporation will change, as it develops and expands its operations. The minimum capital or surplus fixed once and for all at the time of incorporation is too static to satisfy such developing needs. If it were to accommodate all possible or imaginable developments, it would have to be so large that it would prevent all new incorporations. The "compulsory surplus" is designed to accommodate the needs of the going concern; it expands as the financial needs of the corporation expand, but it also may contract with them. One of the consequences is that the minimum capital or permanent surplus can be fixed at a more modest level, because only the short-range financial needs of the beginning or small corporation must be taken into account at that point. If the proposed operations are not too ambitious at the time of incorporation, the amount required as minimum capital or minimum permanent surplus may justifiably be lower than under the inflexible standards of the present law. If the corporation continues its operations at the small scale envisioned at the beginning, it may never need more capital or surplus than the minimum. Only if its business becomes more extended or more risky or if its financial needs otherwise increase beyond the scope originally anticipated, would compulsory surplus beyond the minimum level be required to satisfy those additional needs.

Concern has been expressed by life insurers about the impact on them of the compulsory surplus requirement. Life insurance is a relatively stable business. For a life insurer using conservative actuarial tables and having a conservative investment policy coupled by the mandatory securities valuation reserve (if the latter approaches its maximum under the rules for building it up gradually), compulsory surplus should be extremely small, perhaps near zero in some instances. It is hard to see any difficulty in such cases without a gross abuse of discretion by the commissioner. But a company with a more aggressive and speculative investment policy, as authorized under ch. 620, an incompletely developed mandatory securities valuation reserve, and actuarial tables that are not conservative, might appropriately be expected to have a larger compulsory surplus. Even then it should be small compared with that required for property-liability business.

(4) The "security surplus" is a device to take account of the inherent uncertainty in the determination of compulsory surplus. If it were possible to determine with absolute precision or even with acceptable accuracy the amount of surplus necessary to keep an insurer's operation solid, then that amount could be the compulsory surplus and only one level would need to be defined. Since that degree of precision cannot be achieved, a two-level approach is suggested to provide more flexibility. Just as the existence of the compulsory surplus requirement permits the commissioner to be more liberal in fixing the minimum capital or permanent surplus, so does the existence of the security surplus standard give more freedom in the determination of the

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compulsory surplus. It permits the compulsory surplus to be fixed as the lowest permissible figure below which the insurer's operation is considered so hazardous as to require delinquency proceedings. The security surplus is the amount dictated by more conservative standards, and encouraged in various ways but not required for continued operation. It is a _quasi_-compulsory surplus - an augmented compulsory surplus with a better margin of safety. Security surplus is set under s. 623.12.

(5) Another statutory level can be conceived. It is possible that an insurer which has excessive surplus should disgorge some of it. New York s. 207 puts such a limit on surplus for life insurance companies. This limit might be called the "maximum surplus". This chapter does not establish any maximum for surplus.

This system of various levels of surplus, and especially the compulsory and security surpluses, one a requirement and the other a standard, allows room for differences of opinion and evaluation, without eliminating the commissioner's power to control insurers' solidity effectively. An insurer having less than the security surplus would still be considered sound but would be subject to special regulatory attention, particularly in relation to dividends and investments. Such regulatory concern would continually increase as the surplus of the insurer dropped toward the compulsory surplus level. In other words, the security surplus provides a cushion or margin of solidity. Therefore, it can be expressed for present purposes as a simple proportionate increase in the compulsory surplus.

In the absence of reliable and precise standards, verified by sophisticated research, there is bound to be disagreement between individual insurers and the commissioner if the latter finds the insurer's surplus less than either level. The commissioner should be cautious in seeking to impose his evaluation as a compulsory surplus requirement. But this does not mean that the attempt need not be made. Indeed, it is made now and must be made, however difficult it may be. In the course of time and as our knowledge of the risk factors in the insurance business gains precision it will be possible for the commissioner to be more precise in his rules. But for the present, the determination of appropriate surplus levels remains one of the most important unsolved problems of insurance.

The determination contemplated in this and the following section may be difficult. Thus it becomes important to appreciate that it will not often need to be made. If an insurer is obviously sound, and most are, no determination is called for unless the insurer is proposing to pay out an extraordinary dividend of the kind that must be reported to the commissioner under s. 617.22 or if it is the subsidiary of an insurer that wishes to count some of the investment for its own surplus under s. 611.26 (1). It is only for insurers about which the commissioner has doubts that the determination will normally need to be made. Then he should be making it and reexamining it frequently. It will enable him to give greater precision to his dealings with the insurer, for it will enable him to say with more authority and reliability than in the past just how the insurer's financial position needs to be improved to relieve the commissioner's mind of his concern.

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623.12 AMOUNT OF SECURITY SURPLUS. The security surplus shall be set by the commissioner between 110% and 140% of the compulsory surplus. In setting the figure the commissioner may consider such factors as the size of the insurer, its recent experience, the volatility of the lines of insurance in which it engages and any other relevant factors.

NOTE: The section should ultimately discriminate more explicitly among lines of insurance, and even among the kinds of risks that are components of the compulsory surplus determination. Until there is more research on the problem, there is no option but to leave wide discretion to the commissioner.

SECTION 78. 631.01 of the statutes is created to read:

631.01 EXEMPTION FROM FORM REGULATION. The requirements of this code relating to the terms of insurance contracts do not apply to group policies or annuities provided on a basis as uniform nationally as state statutes permit to educational, scientific research, religious or charitable institutions organized without profit to any person, for the benefit of employes of such institutions. The commissioner may by order subject such contracts issued by a particular insurer to this code if he finds, after a hearing, that the interests of insureds, creditors or the public of this state so require.

NOTE: This provision exempts certain contracts from form regulation. Essentially it replaces s. 201.42 (15), which exempts TIAA from the unauthorized insurers law. The latter exemption is too broad. Relief from detailed form regulation is justified but such insurers should operate on an admitted basis, subject to general regulatory controls and to whatever taxation the public policy of this state imposes.

SECTION 79. 645.03 (1), (5), (6), (14), (16) and (18) of the statutes are repealed.

NOTE: These definitions are applicable to the entire insurance code. Sub. (1) is transferred to s. 600.05. Subs. (5), (6), (14), (16) and (18) are transferred to s. 600.03.

SECTION 80. 645.21 (1) of the statutes is amended to read:

645.21 (1) Whenever the commissioner has reasonable cause to believe, and determines, after a hearing held as prescribed in s. 601.62, that any insurer has committed or engaged in, or is committing or engaging in or is about to commit or engage in any act, practice or transaction, or is in or is about to get into a situation that would subject it to formal delinquency proceedings under this chapter, he may make and serve upon the insurer and any other persons involved, such orders other than seizure orders under ss. 645.22 and 645.23 as are reasonably necessary to correct, eliminate or remedy such conduct, condition or ground. ~~If the order is for a restoration of or addition to capital, it shall be carried out as provided in s. 200.06.~~

NOTE: Section 200.06 is repealed by this bill and the deleted sentence is no longer necessary.

SECTION 81. 645.31 (8) of the statutes is amended to read:

645.31 (8) That ~~without first obtaining the written consent of the commissioner~~ less than 30 days after reporting the proposed

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action to the commissioner unless it is earlier approved, or after the action has been disapproved by the commissioner, the insurer has transferred, or attempted to transfer, substantially its entire property or business, or has entered into any transaction the effect of which is to merge, consolidate or reinsure substantially its entire property or business in or with the property or business of any other person;

NOTE: This liberalizes s. 645.31 (8) to conform to the principles of ch. 611, especially as reflected in s. 611.78.

SECTION 82. 645.54 (1) (c) of the statutes is created to read:

645.54 (1) (c) Indemnifications. Any payment to which s. 611.62 (2) applies is a preference and is voidable under par. (b) if made within the time period specified in par. (a). Payments made by insurers under s. 611.62 (3) are not preferences.

SECTION 83. 645.61 (1) of the statutes is amended to read:

645.61 (1) Proof of all claims must be filed with the court in the form required by s. 645.62 on or before the last day for filing specified in the notice required under s. 645.47, except that proof of ~~preferred ownership claims and proprietary~~ claims under s. 645.68 (9) ~~and (10)~~ to (11) need not be filed at all, and proof of claims for unearned premiums and claims for cash surrender values or other investment values in life insurance and annuities need not be filed unless the liquidator expressly so requires.

SECTION 84. 645.63 (6) of the statutes is created to read:

645.63 (6) CLAIMS UNDER EMPLOYMENT CONTRACTS WITH DIRECTORS AND OTHERS. Claims made under employment contracts by directors, principal officers or persons in fact performing similar functions or having similar powers are limited to payment for services rendered prior to the issuance of any order of rehabilitation or liquidation under s. 645.32 or 645.42.

NOTE: This subsection parallels the substantive provision of s. 611.63 (6).

SECTION 85. 645.68 (8) (e) and (f) of the statutes are amended to read:

645.68 (8) (e) Portions of claims subordinated under sub. (5); ~~and~~

(f) Claims or portions of claims payment of which is provided by other benefits or advantages recovered or recoverable by the claimant~~.~~; and

SECTION 86. 645.68 (8) (g) of the statutes is created to read:

645.68 (8) (g) Any indemnification recovered as a voidable preference under s. 645.54 (1) (c).

SECTION 87. 645.68 (9) and (10) of the statutes are repealed and recreated to read:

645.68 (9) MUTUAL BONDS. The claims of the holders of mutual bonds, including interest thereon;

(10) MUTUAL CONTRIBUTION NOTES. The claims of the holders of contribution notes, including interest thereon;

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SECTION 88. 645.68 (11) of the statutes is created to read:

645.68 (11) PROPRIETARY CLAIMS. The claims of shareholders or other owners, including policyholders of a mutual insurance corporation within the limits of s. 645.72 (2).

SECTION 89. 646.01 (title) of the statutes is amended to read:

646.01 (title) **SCOPE AND PURPOSE.**

SECTION 90. 646.01 (3) of the statutes is repealed.

NOTE: This provision is unnecessary in view of s. 600.12.

SECTION 91. PROGRAM RESPONSIBILITY CITATIONS. (1) In the list of program responsibility citations enumerated for the executive office under section 14.011 (intro.) of the statutes, reference to section "206.38 (5)" is deleted.

(2) In the list of program responsibility citations enumerated for the office of secretary of state under section 14.361 (intro.) of the statutes, reference to section "201.42 (5)" is deleted.

(3) In the list of program responsibility citations enumerated for the office of state treasurer under section 14.561 (intro.) of the statutes, reference to section "203.16" is deleted.

(4) In the list of program responsibility citations enumerated for the commissioner of insurance under section 15.731 (intro.) of the statutes, reference to section "102.31" is deleted.

SECTION 92. CROSS REFERENCE CHANGES. (1) Wherever the reference to section "201.05 (3)" appears in sections 201.04 (18) and 206.60 (6) of the statutes, the reference "201.05 (1)" is substituted.

(2) Wherever the reference to section "201.05 (7)" appears in section 201.25 (1) (m) of the statutes, the reference "201.05 (5)" is substituted.

(3) Wherever the reference to section "201.25" appears in sections 25.17 (3) (d), 198.18 (4), 210.04 (6) and 210.20 (3) of the statutes, the reference "201.25 of the 1969 statutes" is substituted.

(4) Wherever the reference to section "206.34" appears in sections 25.17 (3) (a), 42.243 (4) (e), 42.76 (4) (d), 66.82, 102.49 (8), 102.59 (4), 199.02 and 210.05 (2) of the statutes, the reference "206.34 of the 1969 statutes" is substituted.

(5) Wherever the reference to section "206.34 (1) (c)" appears in section 25.17 (10) of the statutes, the reference "206.34 (1) (c) of the 1969 statutes" is substituted.

(6) Wherever the reference to section "206.34 (1) (a), (b), (bm), (bn) and (j)" appears in section 601.13 (3) of the statutes, the reference "206.34 (1) (a), (b), (bm), (bn) and (j) of the 1969 statutes" is substituted.