

MIKE BEEBE
GOVERNOR

A. HEATH ABSHURE
COMMISSIONER



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201 EAST MARKHAM STREET
LITTLE ROCK, ARKANSAS 72201-1692
TELEPHONE: (501) 324-9260
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ARKANSAS SECURITIES DEPARTMENT

April 23, 2008

Thomas E. Tarpley
Williams & Anderson PLC
111 Center Street, Twenty-Second Floor
Little Rock, Arkansas 72201

RE: Arkansas Mutual Insurance Company Surplus Notes
No. 08-90000383-NA003

Dear Mr. Tarpley:

The Arkansas Securities Department is in receipt of your request, on behalf of Arkansas Mutual Insurance Company (the "Company"), a physician-owned mutual insurance company domiciled in Arkansas, that the Arkansas Securities Department ("Department") issue a no-action letter with regard to the Company's issuance of certain "Surplus Notes" to Arkansas residents. Your request includes representations concerning the ownership and operation of the Company, details concerning the proposed issuance of the Surplus Notes, and the unique characteristics of the Surplus Notes in support of your request for no-action relief. Additional documents you provided to the Staff of the Department on April 7 and April 9, including the form of the Surplus Notes, support representations made in your request. Copies of both your request letter and form of the Surplus Notes are attached.

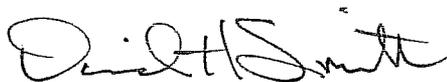
Based on the specific facts contained in your representation and the terms of the Surplus Notes, the Staff of the Department will recommend that the Arkansas Securities Commissioner take no enforcement action against Arkansas Mutual Insurance Company if the Surplus Notes are not registered or a proof of exemption is not filed with the Department prior to the issuance of the Surplus Notes.

Please note that the position of the Staff of the Department is based solely upon the representations made to us in your request and applies only to the facts set out therein. Different facts or circumstances might and often would require a different response. The

Mr. Tarpley
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position expressed deals only with anticipated enforcement action by the Department and does not purport to be a legal opinion.

Very truly yours,

A handwritten signature in black ink, appearing to read "David H. Smith". The signature is written in a cursive, flowing style with some capitalization.

David H. Smith
Chief Counsel

Attachments

WILLIAMS & ANDERSON PLC

TWENTY-SECOND FLOOR
111 CENTER STREET
LITTLE ROCK, ARKANSAS 72201

March 6, 2008

(501) 372-0800
TELECOPIER
(501) 372-6453

Arkansas Securities Department
Heritage West Building, Suite 300
201 East Markham Street
Little Rock, AR 72201

Via Hand Delivery

Dear Sir or Madam:

On behalf of Arkansas Mutual Insurance Company (the "Company"), we request that the Staff of the Arkansas Securities Department (the "Department") recommend that no enforcement action be taken with regard to the Company's issuance of certain "Surplus Notes" to Arkansas residents. Specifically, the Company requests that the Department conclude that the Surplus Notes do not constitute securities as defined by the Arkansas Securities Act (the "Act"). Alternatively, the Company requests that the Department find that registration is not necessary or appropriate in the public interest or for the protection of investors as allowed by Ark. Code Ann. § 23-42-503(a)(9).

A. Description of the Company

The Company will operate as a physician-owned mutual insurance company domiciled in Arkansas. As a mutual insurance company, the Company will be owned by its policyholders, rather than by stockholders or other outside owners. Therefore, the Company's goal is not to earn a profit for outside parties, but to serve the interests of its policyholders. One of the benefits of the mutual form is that any earnings in excess of expenses belong to the policyholders, rather than to stockholders. If, for example, a mutual company experiences favorable loss development (actual losses are less than expected when the Company collected premiums), the funds must be used to benefit the Company's policyholders. Excess earnings can be returned in the form of cash to policyholders (as a partial refund for premiums already paid) or as premium credits to policyholders.

The Company will be licensed as an admitted insurance company in the state of Arkansas and will be subject to all applicable state regulations and statutes. The Company will be domiciled in Arkansas for the benefit of Arkansas physicians only.

B. Description of the Surplus Notes

In order to be insured by a malpractice policy issued by the Company, potential insureds must first purchase a "Surplus Note" (referred to in Ark. Code Ann. § 23-69-132 as "Borrowed Surplus"). As provided in Ark. Code Ann. § 23-69-132, the Company may borrow money to defray the expenses of its organization and to provide it with surplus funds as long as there is a written

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agreement that the money is required to be repaid only out of the Company's surplus. The Surplus Notes will be non-interest bearing and therefore the reason for purchasing a Surplus Note will not be to receive a profit but instead to be covered by a policy issued by the Company. However, as allowed by Ark. Code Ann. § 23-69-130, the directors of the Company may from time to time pay or credit to its members dividends out of that part of its surplus funds which represents net realized savings and net realized earnings in excess of the surplus required by law to be maintained.

The proceeds received by the Company for the Surplus Note will be held for the benefit of the insured and will be returned to the insured if he or she decides to withdraw from the Company and no longer be covered by a policy issued by the Company or if the Company has excess funds as described above. The Surplus Notes are not transferrable other than by redemption by the Company.

As provided in Ark. Code Ann. § 23-69-118, each policyholder will be a member of the Company with all rights and obligations of membership. Therefore, although each policyholder will purchase a Surplus Note prior to becoming a policyholder, the voting rights and other membership benefits are acquired by virtue of the purchaser becoming a policyholder and not because of his or her purchase of a Surplus Note.

C. Applicable Law

The form of an instrument should be disregarded for economic reality when determining whether the instrument is a security. Simply because these instruments are referred to as "notes" should not definitively determine whether the Surplus Notes are securities as defined by Ark. Code Ann. § 23-42-102(A). The five significant factors for determining whether an instrument is a security under the Act are: (1) the investment of money or money's worth, (2) investment in a venture, (3) the expectation of some benefit to the investor as a result of the investment, (4) contribution towards the risk capital of the venture, and (5) the absence of direct control over the investment or policy decisions concerning the venture. *See Cook v. Wills*, 305 Ark. 442, 808 S.W.2d 758 (1991). Under this analysis, the Surplus Notes are not securities because (a) there is no real investment of money or money's worth (a policyholder can simply get his or her money back by withdrawing from the Company and cancelling his or her policy), and (b) there is no expectation of profit to the investor as a result of the investment. The absence of this factor is discussed in more detail below. We direct the Department to the following guidance issued by the Department in the past.

On June 29, 2004, the Department considered a no-action request regarding the issuance of stock by American Pharmacy Cooperative, Inc (the "Cooperative"). As stated in the Department's letter, the primary purpose of the Cooperative was to enable member pharmacists to aggregate their buying power and negotiate discounts on the purchase of pharmaceutical products from their manufacturers. To be a member of the Cooperative, each pharmacist had to purchase 100 shares of

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common stock and pay a membership fee. The stock was not transferable and could only be sold back to the Cooperative at the price the member originally paid for it. No dividends were to be paid on the stock and the only instance in which a member could receive more for the stock than the original purchase price was in the unlikely event of liquidation and a pro rata distribution to members according to the shares of stock issued.

When presented with these facts, the Department concluded that the shares of stock were not securities. The facts presented to the Department in that case are very similar to the facts surrounding the Company's issuance of Surplus Notes:

1. The only reason someone would purchase a Surplus Note from the Company is for the right to be a policyholder of the Company.
2. The Surplus Notes cannot be freely transferred other than by redemption by the Company.
3. The Surplus Notes can be sold back to the Company at the price the policyholder originally paid for it.
4. No interest is paid on the Surplus Notes. Any excess earnings can be returned in the form of cash to policyholders, but only as a partial refund for premiums already paid or as premium credits to policyholders. A member could receive more for the Surplus Notes than the original purchase price only in the unlikely event of liquidation and a pro rata distribution to policyholders.
5. The Surplus Notes will not increase in value.
6. A policyholder acquires voting rights in the Company through its policy and not through the purchase of a Surplus Note, as required by statute.

Based on these facts, the Department should conclude that the Surplus Notes are not securities required to be registered under the Act.

In an earlier no-action response regarding Professional Veterinary Products, Ltd., dated October 3, 1996, the Department found that the purchase of stock in another cooperative did not equate to an investment in a security. The Department concluded that:

[T]he price of a share is more akin to an initiation fee, and the expectations of members are not of profits, but of lower prices for the necessary supplies and equipment needed for the practice of veterinary medicine. What is shown is

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not a profitable business, but a cooperative association of professionals. Accordingly, the staff of the Department will recommend that the Arkansas Securities Commissioner take no enforcement action against PVP for not registering its stock or filing a proof of exemption for it if the facts remain as stated in your letter.”

With regard to the application of the securities laws, a cooperative scenario is very similar to a mutual insurance company. The purchase of a Surplus Note is nothing more than an initiation fee and the purchaser’s expectations will not be of profits, but of lower premium costs.

Other no-action responses issued by the Department have focused on the expectation of profits. On February 8, 2006, the Department analyzed the sale of units in a LLC formed for the purpose of owning and managing a hunting club. As was noted in the Department’s letter and as is the case here, although there is a potential for profit to the holders of the instruments, that potential is not the primary motivation for the purchase of said instrument. Instead, the primary reason a purchaser purchased units in the hunting club is for the use of the facility, and the primary reason a purchaser would purchase a non-interest bearing Surplus Note is to allow that person to be insured by a policy issued by the Company. Similarly, on February 21, 2006, the Department found that a contribution to a hunting club amounted to little more than an initiation fee where the expectations of members were not of profits but instead for the use of club facilities.

D. Regulation by the Arkansas Insurance Department

As described above, the issuance of the Surplus Notes is regulated by the Arkansas Insurance Department and is subject to the Arkansas Insurance Commissioner’s approval as provided in Ark. Code Ann. § 23-69-132(c). This statute provides that the Arkansas Insurance Commissioner shall disapprove any proposed loan or agreement if he or she finds the loan is unnecessary or excessive for the purpose intended or that the terms of the loan agreement are not fair and equitable to the parties or that the information so filed by the Company is inadequate. Additional regulation of the Surplus Notes, instruments issuable and regulated by statute, is unnecessary.

The Act and the rules promulgated thereunder expressly exempt or have special rules applying to securities issued by banks, public utility companies, farm cooperatives and other regulated entities. The Surplus Notes will be issued by a heavily regulated entity and are not the type of security to which the Act is intended to apply. The Company requests that even if the Department finds that the Surplus Notes are securities as defined by the Act, the Department should find that registration is not necessary or appropriate in the public interest or for the protection of investors as allowed by Ark. Code Ann. § 23-42-503(a)(9).

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E. Request Limited to the Surplus Notes

This request for no action is limited to the issuance of the Surplus Notes which will be purchased by each and every policyholder for the sole purpose of being covered by a policy issued by the Company. The Company may decide to raise additional funds by issuing other notes which would be interest-bearing and which would likely be sold to hospitals and clinics but not necessarily to policyholders. These notes, if issued, would also be regulated by the Arkansas Insurance Department and would be sold to a very limited number of persons. If the Company decides to issue other notes, it will either submit a separate no-action request for those notes or will file a proof of exemption with the Department pursuant to § 23-42-504(b). However, these notes, if issued, will be separate instruments with substantially different terms than the Surplus Notes (primarily interest bearing v. non-interest bearing) and should therefore not be integrated or considered in connection with this request.

On behalf of the Company, we respectfully request assurance that the Surplus Notes will not constitute securities as defined by Ark. Code Ann. § 23-42-102(15)(A). Alternatively, we request that even if the Department finds that the Surplus Notes are "securities," the Department find that neither registration nor the filing of a proof of exemption is required.

Thank you in advance for your consideration of this matter.

Cordially yours,

Williams & Anderson PLC

WILLIAMS & ANDERSON PLC

by David E. May

SURPLUS NOTE

Little Rock, Arkansas
_____, 20__

\$ _____, _____ .00

In consideration of a contribution of _____ (\$ _____) from _____ (the "Participant"), the receipt of which is hereby acknowledged, Arkansas Mutual Insurance Company (the "Company") will make its best efforts to repay to Participant, or his or her order, at _____, _____, Arkansas _____, or such other place as may be designated by him or her in writing, the principal sum of _____ Dollars (\$ _____). This contribution shall not form a part of the Company's legal liabilities, or be the basis of any set off, and repayment shall be subject to the approval of the Insurance Commissioner for the State of Arkansas (the "Commissioner"). Provided further, the contribution shall be subordinate to the rights of policyholders, claimants and beneficiaries under policies issued by the Company, holders of interest bearing Surplus Notes and all other classes of creditors other than holders of non-interest bearing surplus notes issued subsequent to the date of this note. The purpose of this contribution is to provide the Company with additional surplus to assure the continued financial well being and solvency of the Company. This note is subject to the approval of the Commissioner.

Upon written notice from Participant, and after approval by the Commissioner, the Company shall promptly pay to Participant any or all of the balance of this note demanded by him or her. The Commissioner shall consider the financial condition of the Company in reviewing a request for approval of any such request for payment. The Commissioner's decision regarding the approval or disapproval of a request for payment shall be binding upon the Company.

This note is made and delivered in _____, Arkansas, effective the _____ day of _____, 2008.

By: _____