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Demutualization is a bad deal for policyholders.

The ultimate outcome of redomesticating to Iowa and merging the two CUNA mutual insurance companies will be an attempt to demutualize.

And demutualization is a bad deal. But don't take our word for it – take CUNA's. Not CUNA Mutual, but CUNA the Credit Union National Association. CUNA Director Tom R. Dorety, President & CEO of Suncoast Schools Federal Credit Union, testified before a Congressional committee in May 2006 against credit union conversions. In his testimony, Dorety cited a major problem with British insurance company demutualizations:

A government report on conversions of British non-profit mutual building societies and life assurance companies to stock companies between 1995 and 2000 found that the remaining mutuals outperformed their converted rivals in a variety of financial performance indicators and passed along these cost advantages to consumers in terms of better rates. The study also found "**there had been substantial increases in remuneration enjoyed by directors of those institutions which had demutualized. . .but no corresponding improvement in performance.**"

Mr. Dorety's full testimony is available here:
<http://financialservices.house.gov/media/pdf/051106td.pdf>

Another expert, insurance consultant Glenn Daily, cites many potential problems with demutualization on his website www.glenndaily.com:

1. Mutual company executives may want to receive higher compensation, particularly in the form of stock and stock options. The top executives at mutual companies are generally not as highly paid as their counterparts at stock companies. The deal-making that follows reorganizations also provides an opportunity to get greater power and prestige by managing a larger organization.
2. Reorganizations also benefit the investment bankers, attorneys, accountants, and consulting actuaries whose professional services are required to prepare and implement a reorganization plan.
3. Demutualization is expensive. A large company can easily spend tens (or even hundreds) of millions of dollars on the professional services needed to go through the

process. One costly task is figuring out how to allocate the company's surplus among the individual policyholders.

4. It is time consuming. It can take 18 to 24 months from start to finish. During this time, management's attention is distracted from other operational duties.
5. It may lead to litigation. "Keep your eyes open for notices of class action lawsuits filed against the company," Daily advises.
6. It may hurt the performance of existing policies, through lower dividends, interest rates, and other factors.
7. It may hurt a company's financial strength, because managers may take greater risks to improve profitability. Some companies may find that the cultural leap from mutual to stock was too sudden, like jumping into a pool before you have learned how to swim. The mistakes they make as they try to build a competitive organization may be costly.
8. It creates the opportunity for the company to be taken over.
9. It eliminates any flicker of mutuality. The company becomes a stock company, managed for the primary benefit of shareholders.
10. The tax treatment of demutualization proceeds remains unresolved. Policyholders may need to file amended returns to preserve their potential rights to a refund of Federal and state income taxes. For more information, see www.demutualization.biz. You can also try to navigate the IRS' demutualization "Tax Trail" beginning at <http://www.irs.gov/individuals/article/0,,id=132472,00.html>.
11. Many policyholders miss out on the compensation due to them under demutualization. In the John Hancock and MetLife demutualizations 100,000 residents of Connecticut alone have not claimed \$60 million. See the list at <http://www.state.ct.us/ott/aboutdemute.htm>. Many other states have such lists.
12. The Consumer Federation of America is concerned that some policyholders will not be treated fairly in demutualizations. In a [letter to state insurance commissioners](#), CFA gives examples of seemingly unfair treatment and raises questions for commissioners to consider when they review demutualization plans.

These dozen points are repeated by dozens of other experts. One of them is former New York Life CEO Seymour Sternberg, who wrote the following in his article "A Contrarian Strategy: The Case For Remaining a Mutual Life Insurance Company:"

Lost in the mad dash to demutualize is the theoretical underpinning of why most insurers became mutual companies in the first place. In most businesses, the product is delivered at the time the company collects the money. Life insurance, annuities and long-term care insurance are unique products. They can't be held or seen or touched. The

policyholder pays premiums for 10, 20 or 30 years and receives nothing in return except the promise that the insurer will be there to pay that \$100,000 or million-dollar claim, to provide a retirement income for life, or to pay for a nursing home, should it be necessary. Under the circumstances, the stability of the institution 50 years into the future is the paramount commitment the company makes to its customers. That is why an insurer does not underwrite every policy or assume every risk that comes along. It may help you look good in the near term, but poor quality business is a time bomb that only weakens the company for the next generation. There has always been an understanding, often unspoken, that the CEO of an insurance company is not only responsible for today's results but also for the mortality experience 15 or 20 years down the road.

It's fair and reasonable to question what the effect of the stock market's focus on short-term results might be for an insurance company. Will it incent a company's leadership to forego investment in the future or to make expedient underwriting decisions in order to make the next big sale? In its simplest terms, can the policyholder's long-term interests be reconciled with short-term expectations?

One other issue needs to be considered carefully. As previously discussed, **once you're in the public market, unless your stock is maintained at a healthy level, you are vulnerable to takeover.** When policyholders buy a long-term product such as an insurance policy do they really want to read in The New York Times that the company they bought it from is being acquired by another company? Do they want to worry, after three acquisitions, just who is going to pay the claim when the time comes? Is there a segment of policyholders who is looking for stability, rather than optimal returns, for assurance that the company's name will be recognizable when the proceeds fall due in 35 years?

By remaining a life insurance company and sticking with our competencies, we remain a big fish in a small pond as a major life insurance company, which we feel is preferable to becoming a small fish in a big pond, competing with CitiGroup and Merrill Lynch. Simply doing what we do best in domestic markets and emerging markets is our most likely avenue for success. In the decision to remain a mutual, five factors carried weight — three minor and two major considerations. The minor ones were these:

1) **Remaining a mutual builds on the strength of our corporate culture.** For 155 years, our company has managed for the future. Our culture is oriented toward this financial stewardship: the Company's perspective as well as its management philosophy have always been long-term rather than short. And our agents, who represent us to the customer, are more comfortable with the mutual format.

2) **Mutuality differentiates us from the market. As more and more companies demutualize, mutuality confers a level of uniqueness.** It allows our agents to go back and tell clients and prospects that we're one of the few companies that remains a policyholder company, and that becomes a marketing advantage.

3) We have no need to raise cash. We have sufficient capital to fuel our future growth. (At the end of 1999, our surplus — or net worth — was over \$8 billion, with more than \$2 billion of that available for strategic acquisitions.)

The two most important considerations, however, were these:

1) We believe that mutuality, for reasons stated above, is consistent with the long-term nature of our product. **By remaining a mutual we are not forced to choose between short-term profits and long-term investments.**

2) And, finally, **remaining a mutual preserves our independence.** As I alluded to earlier, if our Board of Directors were to declare us a public company, they would be declaring that shareholder value is our primary measure of success. If a suitor can offer a significantly better price, we have essentially given up our independence. New York Life Insurance Company wants to be certain it can provide stability for its policyholders and eliminate for them the fear that if they buy a product from New York Life, when the payment comes due, it will be from another company.

CONCLUSION

Will our contrarian strategy prove to be the right one? The public will ultimately decide where they feel their money is most secure. **We are in a business that does not measure success by the stock market close on a given day, but by the decade, by the score, by the half century.** Time will tell, and time is on our side. For 155 years, New York Life has provided the kind of stability that life insurance demands and as a mutual company, it can continue to do so.

Other, smaller companies have reached the same conclusion as New York Life:

The Cincinnati Enquirer
February 17, 2002
Union Central Life sees no need to go public

During an era when many of his peers are taking their companies public, John Jacobs does not have such bold plans.

Mr. Jacobs, president and chief executive of Union Central Life Insurance Co., said the Forest Park-based company **has no need or desire to demutualize to thrive and survive in a maturing business.**

Instead, the \$5.5 billion-asset company plans to keep growing by attracting agents who prefer the mutual form of ownership instead of selling policies for much larger insurers that have been gobbled up in recent years as industry consolidation continues.

The mutual form of ownership means that an insurance company is owned by policyholders, not stockholders. Policyholders share in the profits of the company through such vehicles as lower premiums and, sometimes, dividends.

Embarking this year on its 135th anniversary, Union Central's strategy appears to be a cliché: **Why fix it if it's not broken?**

The company, operating with what Mr. Jacobs describes as a "traditional yet innovative strategy," posted record sales of \$477.6 million, up 35 percent from \$353.9 million

in 2000. The growth was fueled by life-insurance deposits reaching \$113 million last year, up from \$37.4 million the previous year.

Mr. Jacobs said Union Central has been able to grow internally, mainly by focusing on boosting the number of agents who sell products for the company instead of making acquisitions, purchasing a piece of a business or drastically changing how it operates.

"We've attracted more agents largely because we're going against the industry pattern," Mr. Jacobs said. "That includes not demutualizing, not forming a mutual holding company and still being 100 percent mutually owned."

Most insurers that have demutualized -- including industry giants Prudential Financial, MetLife, John Hancock Financial Services, and Principal Financial Group -- did so mainly to grow largely by acquisition, build a larger distribution system or expand into new businesses to boost revenues, said Len Savage, an insurance analyst at Foxx-Pitt Kelton in New York.

"If you're a mutual, it's harder to acquire other companies or put yourself in a position to be acquired, and sometimes, that's viewed as a competitive disadvantage," Mr. Savage said.

Yet some of the nation's largest life insurers have not gone public -- including giants New York Life Insurance Co. and Massachusetts Mutual Life Insurance Co. -- because they don't want to be under Wall Street scrutiny and distanced from policyholders.

"There's a lot less pressure to not demutualize," said Aaron Kloch, an insurance analyst at SNL Securities Inc. "Change is hard for life insurance companies because many policyholders have long-term relationships with them, and they don't like change."

Analysts also say there are still growth opportunities for mutually owned insurance companies that are well-positioned in their business, well capitalized, have a strong distribution network (sales force), good mix of products and are content with their business.

For Mr. Jacobs, not making acquisitions, becoming a mutual holding company or converting to a stock-owned company has helped Union Central keep a niche and continue to grow.

He said sales rose largely because 27 different agencies began selling products for the company last year, giving Union Central another 549 brokers or agents to sell products for it.

Mr. Jacobs said Union Central has been successful in attracting agents because it forms a partnership with them that allows them to run their businesses as entrepreneurs. He said it also offers them a centralized database system, and Union Central values the agency - client relationship. Mr. Jacobs also said that's why Union Central won't sell products on the Internet, something many life insurers have done as a low-cost distribution option.

He also said industry consolidation has helped Union Central boost its sales force. The reason: Many brokers and agents like the stability of selling products where they can still run their own agency. They're not tied to a company that they expect to be bought or merged by another company in which they have no relationship. That could lead to less business and less independence.

Manuel Martinez, owner of Martinez Agency in Escondido, Calif., severed ties with larger insurers in recent years that he thinks were preparing to go public or form a mutual holding company.

A reason: Many of those companies that went public are not quick to pass along cost savings to policyholders because they're more focused on increasing profits for shareholders.

Mr. Martinez said he likes Union Central because in recent years it has actually lowered costs for existing and new policyholders by lowering premium costs for clients as mortality rates have dropped.

"When you're an agent, and you're looking out for what's best for your clients, you want to get with a company that has such values and understand why they're important to you," he said.

Such arguments are more evidence why Mr. Jacobs is comfortable with Union Central's position.

"The mutual story is what attracts agents to us, so why demutualize and cut off the very positive thing that helps us grow?" Mr. Jacobs said.

Hundreds of websites have been set up to "assist" policyholders who never received their due compensation under a demutualization – for a "fee," of course. By law, unclaimed policy benefits and demutualization compensation are held in trust until claimants come forward. Last year alone, trustees took custody of \$22.8 billion, of which less than \$1 billion was claimed by owners and heirs.

According to one of these websites -- <http://www.demutualization-claims.com/>:

Between one-quarter and one-half of all life insurance policies go unclaimed, because it is generally up to family members to notify the insurance company when a policyholder dies, and virtually no effort is made to find lost beneficiaries. In addition to policy benefits, many policyholders are entitled to demutualization compensation.

The amount paid to each policyholder is based on a number of factors, including length of time the policy has been in force, face value of the policy, and total premiums paid. For many policyholders, the windfall arising from demutualization can be substantial, but millions of missing policyholders and heirs aren't aware they are entitled to receive demutualization compensation.

When John Hancock demutualized, it did not have current addresses for 400,000 policyholders. Prudential could not find 1.2 million policyholders entitled to receive compensation, and MetLife estimates 60 million shares of stock arising from its demutualization - worth billions of dollars - went unclaimed. Contact efforts were unsuccessful, due to name changes after marriage or divorce, unreported changes of address, expired postal forwarding orders and non-current beneficiary information.

According to a March 2006 *Milwaukee Journal Sentinel* article, nearly 700,000 Wisconsin residents are missing out on \$300 million, and those numbers are increasing rapidly due in part to demutualizations. "(The insurance companies) haven't been able to find policyholders, and those dollars have been sent to us," said a state official.

So much money is missing nationwide that state officials have set up a website, www.missingmoney.com, to locate policyholders and others with unclaimed money (this site is a better site to use than the many fee-based sites on the Internet).

There are plenty of cases where the risk associated with a company's newfound "flexibility" under demutualization has led to poor results.

The Phoenix Companies used their "flexibility" in part to invest in a basketball team and give their CEO a \$20 million retirement package:

Hartford Courant
July 9, 2006

Hartford's Phoenix isn't going down in flames like the mythical bird, but many people are wondering when the pressured company will take flight -- or whether bigger wings will swoop down on it.

The Phoenix Cos., independent for 155 years, has been slogging through turnaround efforts for about five years, and Wall Street is pushing for the company to be sold.

Whether the company or part of it will be acquired is uncertain, but some analysts say pressure is mounting. Even if the life insurance and financial services company isn't sold, it still faces intense challenges in an ever more competitive industry.

Little Phoenix played like one of the big boys in the 1990s, making acquisitions and diverse investments -- some international. Some worked well, but some eventually turned sour, and through layoffs and divestitures, the company has reduced its workforce by more than 30 percent since mid-2001, to 1,560.

A mix of bad luck, bad timing and weak execution of strategy spelled trouble for Phoenix, analysts say.

"I don't know where the turnaround is at this stage," said UBS analyst Andrew Kligerman. "I'm still waiting for the first phase." He doesn't dismiss the possibility of a Phoenix revival, but says, "clearly over the past five years, we've seen very little positive."

Phoenix's life insurance sales have picked up, but its asset management business has been struggling as customers move their money to other portfolio managers.

Phoenix, which lost nearly \$494 million from 2001 through 2003, has been posting profits again. But its returns on equity -- a measure of profitability -- fall well below the industry average.

The company's stock, at \$14.01 a share Friday, reflects investors' reservations, trading 20 percent below its \$17.50 debut in June 2001, but an improvement since its \$6.39 low in March 2003. Other former mutuals have done much better, with MetLife stock having more than tripled since its conversion, and Prudential having nearly tripled.

Phoenix's shares haven't topped \$17.50 for four years -- an irony in view of Phoenix's identity as a "wealth management" company targeting the rich and affluent.

The company's situation has bolstered the belief of some critics, including a former Phoenix chief executive and a retired vice chairman, that it should never have converted from a "mutual," or policyholder-owned company, to public stock ownership.

Just by becoming a stock company, Phoenix opened the door for potential acquirers.

Even a former Phoenix executive, who's loyal to its current management, but asked not to be named, figures the company would have been better off staying a mutual and wonders how the company will remain independent.

"It's hard to imagine that scenario," he said. "They're trying real hard to make a run of it. The demands of being a public company today are better suited for bigger companies. You're beholden to quarterly analyst expectations."

Former Phoenix chief executive John Gummere and vice chairman William B. Wallace, who both retired in early 1994, believe the 1992 merger with Home Life positioned Phoenix well and that it shouldn't have demutualized.

"Obviously I'm very disappointed in what I thought was the potential for the company," said Wallace, who had been Home Life's CEO. "It would appear they became more interested in the asset management business and less interested in the life business, which is what we were all about."

Gummere won't comment much on the successor he supported, Robert W. Fiondella, but said, "He led to the demutualization and doesn't deserve much credit for that."

Fiondella, who was president before becoming chief executive in 1994, vowed for years that Phoenix would remain a mutual. The reasons he gives for changing his mind are tied to the company's wide-ranging expansion strategy during the 1990s.

Phoenix ended up cutting its dividend scale for 2006, the first time in seven years, troubling some customers who will now have to pony up thousands of dollars more in premiums than expected so their policies don't lapse.

Some critics say the decision to convert was prompted by management's greed and desire for stock-based compensation. They say no one else benefited, even though policyholders got stock or cash totaling more than \$1 billion at the time.

``Demutualization in Phoenix's case was for the benefit of the senior executives," said Kelly Carlson, who was senior vice president in charge of retail distribution when he left the company in 1999. He still owns a small number of shares.

Young and Fiondella have said company strategy, not greed, led to the conversion.

Fiondella took heat for his \$20 million retirement package, which was announced while the company was losing money, but he still believes it was ``fair and reasonable." Critics say Fiondella was also too free with Phoenix's money in community affairs and marketing and too distracted with such pursuits, trying to build his own image. He recalls that **the company invested roughly \$14 million in the women's American Basketball League, which went bankrupt in 1998**, but he says the sponsorship built the company's image among women -- an important market.

Another article, from the January 4, 2003 *San Antonio Express-News*, paints a bleak picture of demutualization:

The only clue for the tens of millions of mutual insurance policyholders was a thick envelope that showed up unannounced in their mailboxes. It contained a prospectus that explained, in mind-numbing detail that sometimes stretched to 200 pages, the minutiae of these fundamental changes.

Mutual companies, ostensibly co-ops in which policyholders shared profits, were asking permission to morph into stock companies, capable of issuing shares to raise money. With that capital, they'd buy other companies and get bigger, or so the argument went.

Trouble is, no one noticed. Even as major insurers such as MetLife, John Hancock and Mutual of New York made the switch, there was little fanfare outside the insurance world.

It's estimated that 80 percent of policyholders flipped through the packets and most probably filed it or threw it away. The few who took time to realize they were being asked for their opinion cast their ballots overwhelmingly in favor of the change.

At some point, most policyholders received a check, or some stock certificates, as the consummation of the conversion. Checks were cashed, stock was held and life went back to normal.

And that, as they say, is about it.

Most policyholders never knew or understood what had happened, observers say. And the jury's out on whether anyone - insurers or the insured - benefited from the exercise.

"It makes sense for the attorneys involved, actuaries and accountants," said a cynical Larry Mueller, who runs www.demutualization.org, a watchdog Web site. "There's a short-term benefit for the policyholder, but in the long run, it's not in policyholders' benefit."

That's because the stock sometimes sells more cheaply at the initial public offering than it's worth, Mueller said. Policyholders are paid a price that predicts the company's performance. If the company does better than expected, the policyholders could be losing out of that long-term payout.

As recently as the mid-1980s, mutual insurance companies used to constitute at least 50 percent of the total life insurance business, according to a report by industry monitor A.M. Best Co.

Mutual policyholders are the de facto owners of the company, sharing in all profits and proceeds. Their annual dividends came as cash or a lower premium.

But as the industry grew, officials at various insurers felt the need for their companies to have access to capital in order to keep their businesses competitive through mergers, said Michael Albanese, a vice president at A.M. Best financial services.

The conversion of a mutual company to a stock company, experts say, can be accomplished through creation of a mutual holding company or through a full "demutualization."

Even with the payout to policyholders, he and others say, the gain from demutualization is questionable.

Through a complicated process, companies that made the move were required to set aside assets to match the policies. **But there's no ongoing scrutiny of the arrangements, Mueller said, which means policyholders might be losing some of their potential value.**

And the grand plan of the insurance companies hasn't come to fruition, Albanese says. They wanted access to capital markets and the ability to offer stock options to the sort of top-notch executives they felt would be needed to navigate the complicated waters of equity markets and acquisition.

A bear market ruined their plans.

"They got all wrapped up in the stock market frenzy," Schiff said. "They believed they could make acquisitions and do all of this great stuff. In the larger view, it hasn't worked out the way they thought it would."

Yet another article highlights the many pitfalls for policyholders under demutualization:

Christian Science Monitor
June 4, 2001, Monday

Probably most people don't know that when they buy insurance from a mutual insurance company they become a part owner of the firm.

"I was not aware of any rights at all," says Lloyd Taylor, a financial analyst, long retired, in Marietta, Ga. He bought some life insurance 60 years ago from Prudential Insurance Co. By now, his dividend more than covers his premium.

The other day, Mr. Taylor got in the mail a 1.7-pound "Policyholder Information Package" asking him to approve a plan for Prudential's demutualization.

"I'm flabbergasted," says Taylor. "It probably took 15 lawyers to write this thing. And they think I'm going to understand it? I don't know what to do."

If two-thirds of those casting ballots among Prudential's 11 million policyholders do vote yes, the Newark, N.J., insurance company will convert to a company owned by stockholders, not policyholders.

A key reason for mutuals' becoming stock companies, some observers say, is that their executives see a chance to get richer. They can reward themselves with big pay hikes and stock options. "It has become unseemly," says Jason Adkins, founder and legal counsel for the Center for Insurance Research (CIR), a consumer-advocacy group in Cambridge, Mass.

Will policyholders' insurance be as cheap in the long run with the switch to stock companies, if **profits go to stockholders and not to policyholders as dividends?**

Probably not, guesses Mr. Adkins, whose group led the drive to force mutuals wanting to convert to stock companies to properly compensate policyholders - their legal owners.