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SCHIFF'S

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INSURANCE OBSERVER

Snake Hip Shuffle at Allied Mutual

Nowhere to Run

Orson Welles once said that a movie studio is the best electric train set a boy could have. Welles, whose indulgences were legendary, was no expert on the insurance business, but if he were, he might have concluded that a mutual insurance company is the best piggy bank a boy could have.

On September 19 we published a 24-page October issue—double the usual length. The issue contained the most important article we've ever written: 16 pages on the conflicts of interest and intercompany asset shuffling at Allied Mutual, which inured to the benefit of its affiliate, Allied Group, and to John Evans, then chairman, president, and CEO of both companies. That we're not a savvy publisher was illustrated by the fact that we neglected to make this our front-page story. Instead, we stuck it on page six, after an article on the vicissitudes of the variable-annuity business.

The article caused a stir, nonetheless, as did David Schiff's announcement that he intended to liberate Allied Mutual by gaining a seat on its board, booting out Evans and his cronies, seizing control, and making the policyholders whole. That Schiff planned to do this while waiving all compensation perplexed Allied's rapacious managers, who assumed he *had* to have an ulterior motive. Douglas Andersen, current CEO of Allied Group and Allied Mutual, suggested that it was to sell more newsletters (for more on that see page 25).

The events following the publication of our Allied article have been intriguing. The Iowa Department of Insurance confirmed it was investigating the Allied transactions, and the escalating battle between Schiff and Allied has received considerable press coverage. In addition, Allied, Evans, and others have been hit with a lawsuit charging them with, among other things, waste of corporate assets, breach of fiduciary duties, the transfer of more than $500 million in value, and other improper behavior.

Allied Group, which claims the suit is without merit, has gone to unusual and ignominious lengths to thwart Schiff's

John Evans, Chairman of Allied Mutual and Allied Group

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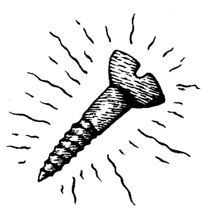

Threat from within! An ugly asset grab is underway.

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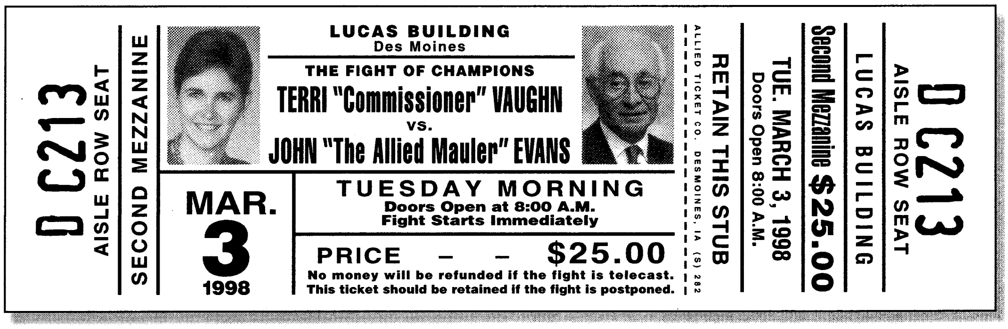
quest for fairness. Although Schiff was duly nominated for Allied Mutual's board by his ex-wife and Allied Mutual policyholder, Joyce Walter, Allied claimed the nomination was invalid because it had, by "error," sent Walter an Allied Group policy rather than an Allied Mutual policy. (Joyce Walter filed a complaint with the Iowa Department of Insurance, and Allied eventually corrected its "error.")



Then, when Colorado Springs attorney (and Allied Mutual policyholder) Lloyd Kordick nominated Schiff, Andersen responded in writing, saying "*Iowa law requires*" that Schiff, in order to qualify for office, be an Allied Mutual policyholder "*prior to election.*" Kordick, who recently won a class-action suit against Allied Group for its refusal to pay no-fault medical bills required by Colorado statutes, wrote back to Andersen asking for "the statutory citation for this rule." Andersen refused to provide this—for a very good reason: there is no such law.

In December, the company attempted to rig the election by giving 1,600 Allied Group employees a free Allied Mutual policy along with a proxy allowing them to appoint John Evans to represent their interests. (In a mutual, each policyholder is entitled to one vote, regardless of the size of his policy.)

During the past few months, Allied has constantly changed its appraisal of Schiff. "He's a writer from New York City," Andersen initially told *The Wall Street Journal* in September. "What does he know?"

In an October letter to agents, Andersen characterized Schiff as "a self-appointed expert" who was pursuing a crusade against Allied "for the apparent benefit of gaining notoriety."

By the time Allied Mutual went to court in late December to block Insurance Commissioner Terri Vaughan's order to hold a fair election (by sending out ballots, for example), Allied's lawyers (including Bruce Foudree, the Insurance Commissioner who approved Allied Mutual's IPO of Allied Group in 1985) were describing Schiff as "a well-financed corporate raider." (For the moment, Vaughan's order has been stayed, pending a hearing.)

Such blather aside, neither the interlocking management of Allied Mutual and Allied Group—nor John Evans in particular—has ever responded to the specific issues raised by our article, namely, that between 1985 and 1993 John Evans masterminded a dazzling array of transactions between Allied Mutual and Allied Group, which included sales and purchases of stock and assets, pooling changes, cost adjustments, loans, employee transfers, stock options, ESOPs, stock swaps, repurchases, fee agreements, corporate formations, marketing deals, acquisitions, and public offerings.

Evans' metastatic corporate transformations were overseen by interlocking board members consisting of longtime friends and associates, many of whom, like Evans, were faced with irreconcilable conflicts of interest: although they were Allied *Mutual* directors, they were shareholders of Allied *Group*.

Virtually every deal benefited Allied Group and John Evans at the expense of Allied Mutual. The bottom line: Allied Mutual, which once owned *all* of Allied Group, today has a net worth of $250 million; yet, because it's burdened by fees paid to Allied Group, makes a mere $6 million a year. Allied Group, on the other hand, makes about $60 million and has a stock-market capitalization of $850 million. Evans and Allied's directors, officers, and employees have not done badly as a result: their shares are worth $250 million.

Allied, not surprisingly, has had difficulty explaining how this divergence occurred. Is it possible that a dozen or more deals—which Allied claims were "a direct result of comprehensive analysis and of information compiled from the most highly respected independent legal and financial advisors available"—were simply an amazing run of bad luck for Allied Mutual and, concomitantly, an incredible run of good luck for Allied Group? Is it possible that Allied Mutual and Allied Group flipped a coin 12 times in row and, in each instance, the coin came up tails for Allied Mutual and heads for Evans and Allied Group? And, if such a scenario is true, should a man so cursed by fate be allowed to serve on Allied Mutual's board?

Yet Evans is only cursed while wearing

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the guise of Allied Mutual. He has become rich from Allied Mutual's misfortune, and now divides his time between Pebble Beach, Palm Springs, and Des Moines.

One securities analyst who has had concerns about the way property/casualty mutuals have been treated by their publicly-traded stock-company affiliates, is Peter A. Russ, of Laidlaw Global Securities. "I was at an investment conference in 1996," he recently told us, "and I said to Andersen—in front of everyone—that it seemed as if he were cherry picking [putting good business in the stock company and bad business in the mutual], and I asked him if that was fair to the mutual's policyholders. His answer was that the regulators *hadn't told him not to do it* and that it was good for Allied Group's shareholders. He was very direct about it—and that seemed to satisfy everyone in the room."

Indeed, no less an authority than Morgan Stanley Dean Witter has praise for this approach. In a research report, "Twilight of the Traditional Mutuals," Michael Blumstein and G. Alan Zimmerman extol the virtues of downstream stock subsidiaries (such as Allied Group) that are affiliated with mutual insurance companies (such as Allied Mutual): "One advantage is that growth can be controlled by gradually increasing the percentage of business received by the stock subsidiary." Between 1984 and 1993, for example, Allied Group's percentage of Allied Mutual's premiums increased from 15% to 64%, while Allied Mutual's ownership of Allied Group decreased from 100% to zero.

The Morgan Stanley report cites "other useful features" such as "keeping unattractive business in the mutual rather than in the stock company and letting the mutual absorb earnings volatility from storm losses." Allied Mutual—could it be sheer coincidence?—is the recipient of the bulk of the Allied Companies' crop and hail risk, as well as a disproportionate percentage of the overall companies' expenses.

Although the Morgan Stanley authors were in kneepants when John Evans started at Allied Mutual, the ploy they describe isn't novel. As any sharkskin-suited bunko artist could tell you, there's no shortage of shell games—or of patsies.

Every gunslinger on Wall Street seems to know what almost every insurance commissioner does not: that when a mutual forms a publicly-traded affiliate, it's an almost surefire arbitrage for the insiders—at the expense of the policyholders. In a Smith Barney report, "Demutualizations: What They Are, Why You Care," Colin Devine explains that "the biggest drawback of the mutual insurance holding company structure is that it, in effect, creates two different classes of owners—stockholders and mutual members—each of whom has very different motivations that relate to the fundamental premises under which the company is operated." We might add, the same applies for a mutual insurer's publicly-traded downstream stock company.

Credit Suisse First Boston's must-read, "The Mutuals Are Coming," shamelessly provides a "checklist for investing in mutual deals," which includes the following item: "Demonstrated commitment to balancing the interests of shareholders and policyholders, rather than the interests of policyholders alone. Demonstrated commitment to returning any excess capital to shareholders."

(Is there really such a thing—outside of the insane world of Wall Street—as "excess capital"?)

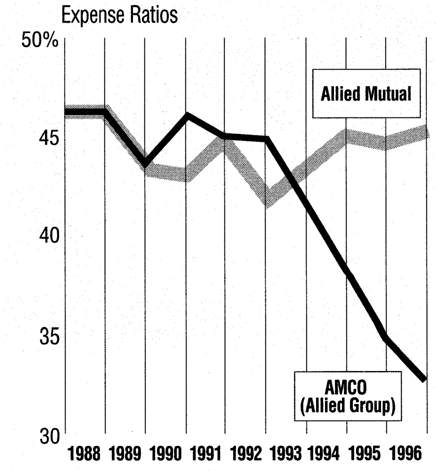
Nelson Algren advised that one should "never play cards with a man called Doc." We'll keep that in mind when we sit in Allied Mutual's boardroom with John "Doc" Evans. And we'll also remember W.C. Fields' remark: "I always keep a supply of stimulant handy in case I see a snake—which I also keep handy."

When we attend the Allied Mutual annual meeting on March 3, we'll be bringing a hip flask full of Jack Daniels—in case we see Doc Evans. ■

Stick it to the Mutual: Expense Ratios

Prior to the January 1, 1993 pooling change in which Allied Group (through AMCO) replaced Allied Mutual as the pool administrator, both companies had similar expense ratios. (The expense ratio equals losses plus loss-adjustment expenses expressed as a percentage of premiums. All other factors being equal, a lower loss ratio is better than a higher one.)

Since the pool-administration change, AMCO's expense ratio has plummeted while Allied Mutual's has actually increased.



Source: A.M. Best

Allied Mutual Goes Nowhere While Allied Group Hits the Jackpot: Annual Earnings

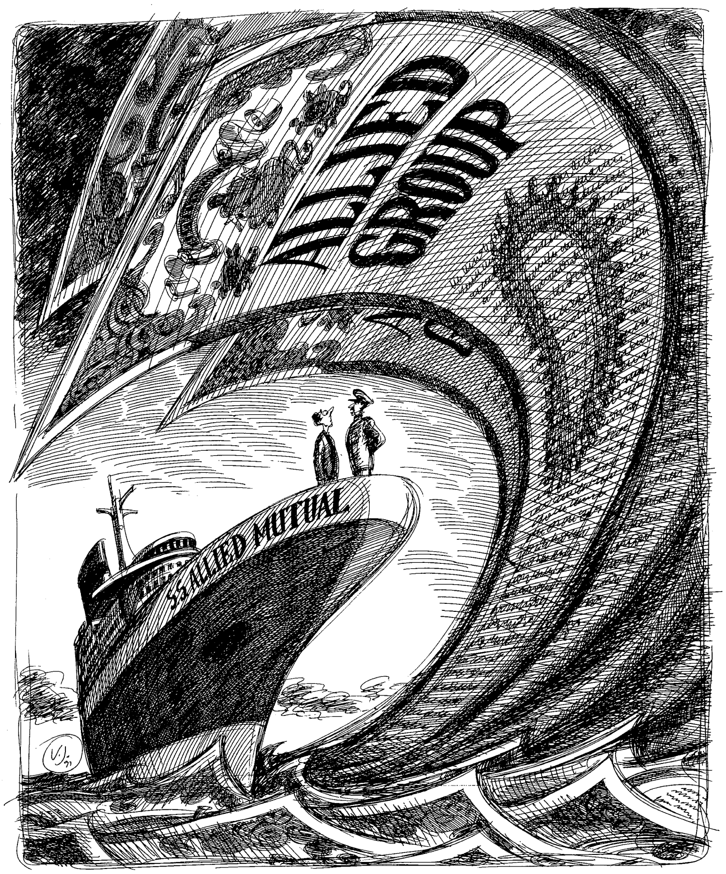
Allied Mutual's earnings have been stagnant for over a decade, while its former subsidiary, Allied Group, has cleaned up. The bulk of Allied Group's earnings have come from AMCO, which took off after it was named administrator of the Allied pool on January 1, 1993, and began charging Allied Mutual fees. Western Heritage, which was never included in the Allied pool—even though it sold its products through Allied Mutual's agents—has also prospered.

($000)	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
ALLIED MUTUAL[1]	$7,265	$9,851	$4,154	$9,673	$9,028	$2,839	$15,111	$6,287[2]	$9,876	$12,162	$6,872
ALLIED GROUP, INC.[3]	$8,388	11,667	10,301	12,718	12,456	17,009	28,675	39,922	47,625	52,377	51,084
Allied Group's P/C Co's[4]											
AMCO	4,464	2,417	845	5,658	(68)	2,936	8,619	18,986	36,099	37,993	46,319
Allied P&C	734	441	181	433	(1,845)	973	1,913	1,723	3,100	2,704	870
Depositors	696	556	262	547	(591)	600	1,670	1,343	1,501	1,298	303
Western Heritage	(39)	(1,286)	159	1,657	1,607	1,795	$3,735	3,484	3,047	2,773	5,669
Allied Group's P/C Co's	$5,855	$2,128	$1,447	$8,295	($897)	$6,304	$15,937	$25,536	$43,747	$44,768	$53,161

1-Statutory accounting. 2-Excludes Allied Mutual's non-recurring capital gain of $24,051,000. 3-GAAP accounting. 4-Statutory accounting. Source: A.M. Best

Allied Mutual's Mean Mistreatin' Blues

Allied Group: Anything Goes



From the moment Allied Mutual engineered the IPO of its subsidiary, Allied Group, John Evans and his cohorts, who in many instances served on both company's boards, engaged in an abundance of intricate transactions involving conflicts of interest not usually faced by mutual insurance companies. These conflict-of-interest transactions were by no means a necessity. Rather, they were the result of choices Evans and the interlocking boards consciously made.

Evans and the others could have avoided conflicts of interest had they preferred to, but to have done such would have meant forgoing the opportunity to make $50 million—and perhaps more—from stock, options, equity, and other means not generally available under the mutual structure.

There are 1,200 mutual insurance companies in America, and only a small percentage are involved in situations in which the directors and officers personally own stock in subsidiaries or affiliates. In fact, many in Evans' shoes would have tried to avoid the appearance of a conflict of interest. That, however, has not been Evans' style. We aren't aware of any other mutual that has engaged in such extensive intercompany conflict-of-interest transactions as Allied has, nor are we aware of any other situation in which the stock company and its directors and officers have achieved such spectacular results while the mutual has, in effect, been folded, spindled, and mutilated.

In this article we'll examine two questionable transactions that indicate Evans' and Allied's willingness to go to the boundaries of decent behavior, if not beyond. (We'll examine more transactions in future issues.) If there is a recurring theme to these transactions it is this: a pattern of arrogance. Allied's directors and officers benefited—or attempted to benefit—from transactions that were, at best, of dubious value to Allied Mutual. Indeed, once Evans got going, his behavior became compulsive; the only thing that made him stop, apparently, was retirement.

We hope that what happened at Allied Mutual will never again happen at a mutual insurance company. Unfortunately, Iowa and 15 other states have passed laws permitting an abusive structure—the mutual insurance holding company—to exist. If these laws are not repealed soon, it is likely that the fate of Allied Mutual will become the norm rather than the exception.

Iowa's insurance law states that "no insurance company...shall loan any portion of its funds to an officer, director, stockholder, employee, or any relative or immediate member of the family of an officer or director." The reason for this provision is obvious: insurance companies are big pools of capital, and it would not be in the public interest to have their fiduciaries dipping into this pool.

In 1987, however, Allied Mutual decided it wanted to lend money to some of its senior executives, and hired Davis, Hockenberg, Wine, Brown, Koehn & Shors to look into the matter. On March 9, Frank Camp, a lawyer at that firm, wrote to Jamie Shaffer, Allied Mutual's chief financial officer: "It appears that, as with many other activities, there is no hard and fast answer to your question regarding loans by an *affiliate* [emphasis added] to an officer, director or employee."

Camp warned Shaffer that any transactions "must be substantially arm's length, or on terms generally available in the market. Keep in mind that because Allied Group is a reporting company under the securities laws and regulations, related-party transactions may need to be disclosed in the appropriate reports to the SEC."

After receiving a legal memorandum, Allied Life Insurance Company made mortgages on farmland owned by Ben Adams, Allied's fixed-income manager, and on land owned by the mother and children of Jim King, Allied's equity manager. In addition, Allied Mutual's finance company held the mortgage on farmland owned by John Evans' wife Jane.

On February 17, 1989, Robert Howe, Iowa's Deputy Insurance Commissioner and Chief Examiner, wrote to Allied concerning this dubious extension of credit. Allied's assistant treasurer, Michael Kean, responded that it was Allied's "fervent wish to avoid questionable asset types," and did his best to justify the loans. Astonishingly, one justification was that Allied Mutual "allowed" its financial services companies to "solicit" Allied employees "as *an additional employee benefit* [emphasis added]." He called this "an accommodation by Allied Mutual," rather than what it was—a disgraceful benefit for executives.

Howe cited Iowa's insurance code: "No part of [an insurer's] capital shall be directly *or indirectly* loaned to any officer, director, stockholder, or employee of the company or to a relative of any officer or director of the company." (John Evans was chairman, president, and CEO of Allied Mutual and Allied Group, and chairman of Allied Life; he was also a large stockholder of Allied Group.)

Howe concluded that "Allied Mutual appears to be, in effect, loaning its capital" to Evans, King, and Adams, "in apparent violation" of the insurance code.

Shortly thereafter, the loans were removed from Allied's books.

On November 2, 1992, Allied Group issued to Allied Mutual 1,827,222 shares of perpetual non-convertible $6\frac{3}{4}\%$ preferred stock valued at \$28.50 per share—an implied worth of \$52 million. In return, Allied Mutual relinquished 6,166,875 Allied Group shares trading at slightly more than $8\frac{1}{2}$. This was an appalling deal for Allied Mutual: it was forgoing \$8.8 million of Allied Group annual earnings (and the prospect of higher future earnings) in exchange for illiquid Allied Group preferred stock that paid a \$3.5 million annual dividend—and not a penny more.

The deal was a big winner for Allied Group, however, which noted that the swap "provid[ed] long-term capital at a fixed cost." Jamie Shaffer, Allied Group's chief financial officer (and Allied Mutual's, too), would later go so far as to call the preferred stock a "source of low-cost capital."

Today, the preferred stock Allied Mutual received is still worth about \$52 million, while the Allied Group shares it traded away—which represented a controlling interest—are worth \$170 million.

Why did Allied Mutual's board (chaired by John Evans and stacked with Allied Group shareholders) approve such a deal? How could they exchange \$8.8 million in earnings for \$3.5 million in dividends? The party line spouted by Doug Andersen, current CEO at Allied Group and Allied Mutual, is that Allied Mutual received a fairness opinion from an independent investment bank and that the transaction was approved by the Iowa Department of Insurance.

Conning & Company, a well-known investment firm specializing in the insurance industry, did indeed provide Allied Mutual with a fairness opinion—one of the worst we've ever seen. In "arriving at our opinion," Conning said it took into consideration many things, including financial statements, research reports, forecasts by management, and a host of other data. However, "in rendering our opinion," Conning said it found certain "factors relevant." The first three were

HOW TO WIN FRIENDS AND INFLUENCE PEOPLE

Endorse David Schiff in his Quest to Gain a Seat on Allied Mutual's Board of Directors

~

Among those who have endorsed Schiff as a candidate for Allied Mutual's board of directors are the following:

Kenneth Adelman	President of Commodore Solutions Technologies, former U.S. Arms Control Director, former U.S Ambassador to the United Nations
Jason Adkins	Founder of the Center for Insurance Research, Attorney
Peter Black	Retired professor of finance and former trustee of Babson College
Jeremy Cooke	President of Investors Insurance Group, past president of the National Association of Professional Surplus Lines Organizations
Conrad Foa	Chairman of Foa & Son, past president of the Insurance Brokers Association of New York, board member of the National Association of Insurance Brokers
James Grant	Editor of *Grant's Interest Rate Observer*
Mark Green	Public Advocate of the City of New York, former New York Consumer Affairs Commissioner
Walter Harris	CEO of Tanenbaum Harber Co.
James Hunt	Former Vermont Insurance Commissioner, Life Insurance Actuary
Robert Hunter	Director of Insurance at the Consumer Federation of America, former Texas Insurance Commissioner
John Katzman	Founder and president of The Princeton Review
Richard Katzman	CEO of Kaz, Inc.
Douglas Libby	President of Seneca Insurance Company
Steve Markel	Vice chairman of Markel Corp.
Andrew Marks	CEO of MLW Services
Douglas Moat	Chairman of The Manhattan Group
Ralph Nader	Consumer advocate
Alan Press	Past president of the National Association of Life Underwriters
John P. Schmitt	Partner at Patterson, Belknap, Webb & Tyler
Andrew Tobias	Author
Mark Wells	Publisher of *The Insurance Journal*

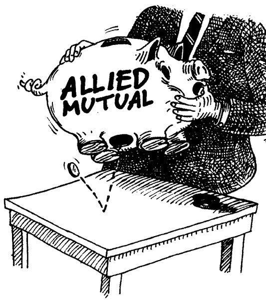
If you'd like to endorse Schiff, simply send a letter, fax, or e-mail doing so.

What's in it for you? You'll be entitled to buy *anything* you want from Mr. Pig's House of Insurance—for just 100% of its usual price. And that's not all. As a full-fledged endorser you'll take pride in knowing that you spoke out on an important issue. Finally, once Schiff is chairman of Allied Mutual's board you'll receive a letter of thanks from him on Allied Mutual stationery. (Schiff will personally pay for the stationery and postage.)

Sign up now!

the most important.

The first factor, incredibly, was this: "The transaction would...[create] a security that would have a fixed carrying value; absent the transaction the future growth of Allied Group's shareholder's equity...would cause Allied Mutual's investment in Allied Group to constitute a progressively disproportionate position among Allied Mutual's assets."



In other words, because Allied Mutual's $52 million of Allied Group $6^3/_4$% preferred stock would not appreciate, Allied Mutual wouldn't be faced with the *predicament* of owning too much common stock in Allied Group—common stock whose "future growth" was, apparently, so assured that it would "constitute a progressively disproportionate" amount of Allied Mutual's assets. In short, Conning opined that Allied Mutual was better off with a security that wouldn't increase in value than with one that would increase rapidly!

We called Conning to learn more about this intriguing notion—that it's better to own securities that don't appreciate—but were advised that the company doesn't comment on its fairness opinions.

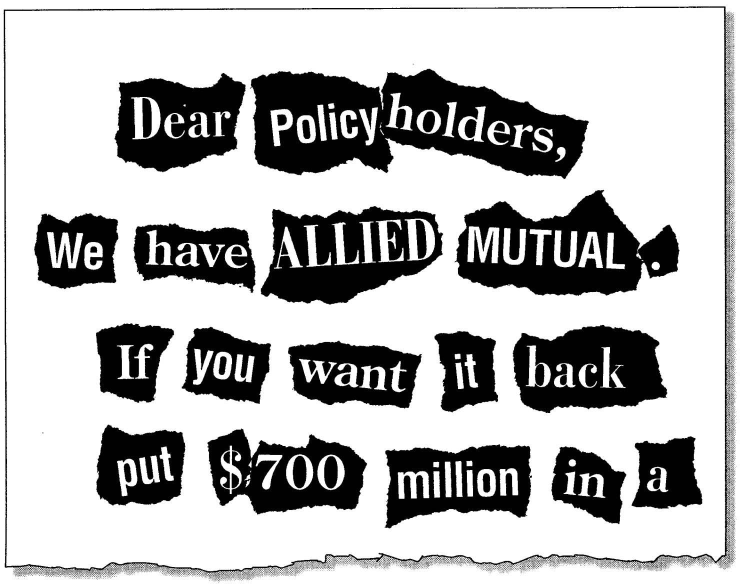
Conning's second factor for proclaiming the deal "fair" had to do with market timing.

Conning's third factor was another stunner: "The positive impact...on the capital structure of Allied Group will improve Allied Group's access to capital markets to support future growth." (Mind you, Conning was supposed to be stating why the deal was fair to Allied *Mutual.*) Conning continued: "Allied Mutual benefits from such growth due to economies of scale in shared resources and facilities."

As it happened, Allied Mutual would *not* benefit from economies of scale in shared resources and facilities because AMCO, an Allied Group subsidiary, would soon replace Allied Mutual as the Allied "pool administrator." As a result, Allied Mutual's costs for underwriting services, unallocated loss-settlement expenses, and premium collection services were fixed at 20.85% of premiums, while Allied Group was given, in John Evans' words, "an opportunity to flow every dollar of savings straight to the bottom line." [Note the graph and table on page 3. Pay special attention to AMCO's expense ratio and earnings beginning in 1993.]

Is it possible that Allied Mutual's board never informed Conning that, within weeks of the issuance of its fairness opinion, Allied's pooling arrangement would be materially altered, thereby undermining Conning's opinion? Is it possible that on November 2, Allied Mutual had no plans whatsoever to alter its pooling arrangement? (As a result of the pooling-administration change, Allied Group made an extra $20 million or so last year—at Allied Mutual's expense.)

The Iowa Department of Insurance told us that pooling-administration changes must be filed at least 30 days in advance. According to an Allied Group Form S-3, the pooling-administration agreement between Allied Mutual and Allied Group was amended on December 14, 1992—six weeks after Conning issued its opinion that the preferred-for-common stock swap was fair to Allied Mutual. One can consequently infer that Allied Mutual and Allied Group filed for the pool-administration change no later than November 14, just 12 days after Conning's opinion was issued. (The exact date of Allied's filing remains a secret because, like many of their intercompany transactions, it is shielded by Iowa's Holding Company statute. Our Freedom-of-Information-Law request for access was refused.)



A note from Allied Group?

Although Insurance Commissioner David Lyons made the unfortunate decision to approve the November 2, 1992 transaction, he did so only with reluctance.

In a letter to Allied Group he said that his counsel and staff had reviewed the material and that he had "given special attention to the fairness opinions which, while not providing all that I would have liked to have seen, nevertheless do provide what is minimally necessary for our purposes."

Evidence that the Iowa Department of Insurance missed the ramifications of the amended pooling agreement—on which it apparently stamped "no objection"—can be found in the 1994 examination report of Allied Mutual conducted by the Department. The report describes the pooling arrangement as if expenses were still prorated among the companies based upon their percentage of the pool, when, in fact, Allied Mutual paid a disproportionate share of the expenses.

Examining insurance companies is a demanding task—too many companies and not enough time or resources—and everyone makes a mistake now and then. The Insurance Department followed its customary practice and, prior to signing off on the examination report, sent a copy to Allied Mutual, which did not call the inaccuracies to the Department's attention.)

Current Commissioner Terri Vaughan (who, unlike many commissioners, knows insurance), should take whatever steps are necessary—promulgating rules, instituting legal action, and stamping the word "objection" on Allied's past pooling changes—to rectify the situation at Allied Mutual.

And while she's at it, she shouldn't approve Principal Mutual's plan to reorganize as a mutual insurance holding company.

You don't need a weatherman to know which way the wind blows. ■

Why We Hate Mutual Insurance Holding Companies

The Top Ten Reasons

1. Mutual policyholders' ownership rights are confiscated without their approval. Corporate laws generally require that at least a majority of ownership interests vote in favor of a reorganization. Under MIHC laws, however, policyholders' ownership rights can be eliminated by a majority of *votes cast* (usually only a small fraction of eligible votes), rather than by a majority of all eligible votes.

2. Policyholders receive no tangible value in return for this confiscation, nor do they receive any transferable rights.

3. The executives who run the MIHCs will receive stock, options, and other forms of transferable equity in a newly-formed intermediate stock holding company. Thus, they become owners and are able to parlay their ownership into cash—a right denied to the insurance company's previous owners (the policyholders).

4. Ownership of equity by directors, officers, and employees produces irreconcilable conflicts of interest between the fiduciaries (management) and the beneficiaries (policyholders). Management is faced with mutually exclusive responsibilities: providing policyholders with insurance at the most efficient cost, and providing shareholders with the highest return on their investment.

5. Once a mutual's executives and directors become equity participants, they stand to benefit if the publicly-traded holding company prospers, even if that prosperity is achieved to the detriment of the policyholders of the insurance company.

This tendency has been noted in the publicly-traded downstream subsidiaries of mutual insurance companies. The most notorious example is that of Allied Mutual and its stock affiliate, Allied Group. Between 1985 and 1997, $700-million of value was transferred from Allied Mutual to Allied Group via a host of transactions: asset sales, transfers, pooling changes, stock buybacks, asset shuffling, intercompany swaps, purchases, loans, and the reallocation of expenses. Virtually every one of these transactions turned out to be a good deal for Allied Group (which is owned by management and public stockholders) and a poor deal for Allied Mutual (which is owned by its policyholders).

Ironically, this debacle took place in Iowa, the first state to pass MIHC laws, and the only state in which a publicly-held MIHC (AmerUs) is domiciled. Incredibly, Iowa noted for *good* insurance regulation.

6. Assets that now belong solely to the policyholders will be transferred—either by dividend, loan, or corporate opportunity—to the intermediate holding company.

American Mutual Holding Company, the first MIHC—and the only one to have had an IPO for its intermediate holding company (AmerUs Life Holdings)—admitted in an SEC filing that its insurance subsidiary, AmerUs Life Insurance Company, could upstream "$40 million in [annual] dividends...without obtaining the approval of the Iowa Commissioner [of Insurance]." It also admitted that AmerUs Life Insurance Company could "loan up to $120 million without prior regulatory approval" to its publicly-held holding company.

7. AmerUs Life Holdings went so far as to say that its "ongoing ability to pay dividends to its shareholders and meet its other obligations, including operating expenses and any debt, is *primarily dependent* upon the receipt of sufficient funds from AmerUs Life in the form of dividends, interest payments, or loans."

8. A mutual insurance company is a cooperative form of organization. The concept of mutuality is fundamentally at odds with the stock-company concept of outside ownership.

9. Better forms of reorganization already exist. A mutual insurance company can do a *full demutalization* by giving stock to all its policyholders. In such a transaction no capital leaves the company and policyholders receive full value for their interests.

10. The downside of a *full demutalization* is well known: it *doesn't* provide windfall profits for the directors and officers of a mutual insurance company! ■

The Big Fix: Mutual Insurance Holding Companies

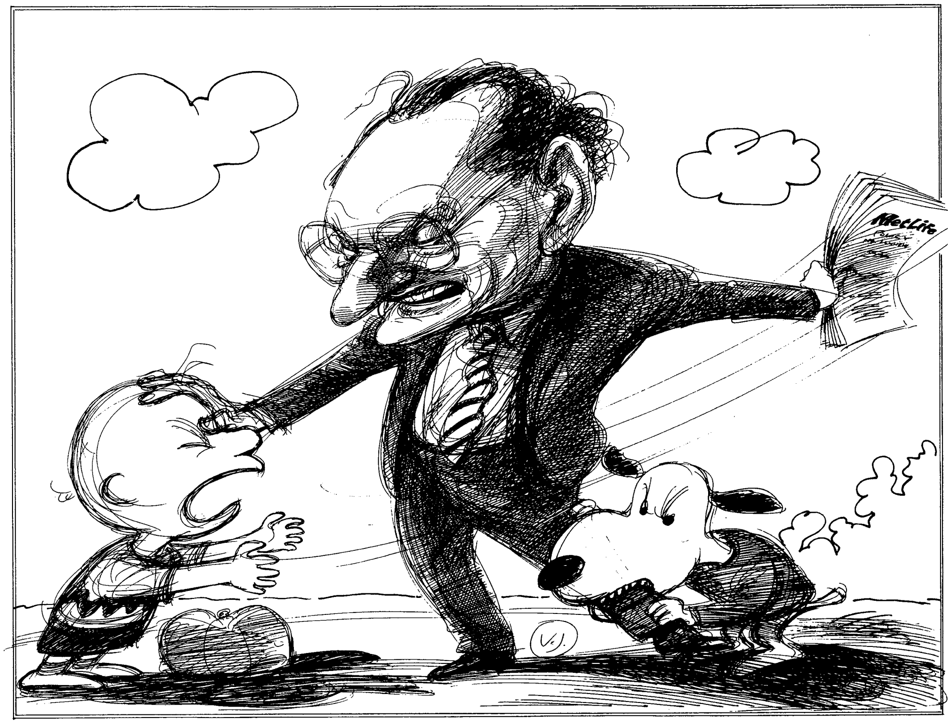
Mr. Kamen's Opus

As through this world I've rambled,
I've seen lots of funny men.
Some rob you with a six-gun,
Some with a fountain pen.

—Woody Guthrie

A mutual insurance company is a wonderful concept: selling insurance to policyholders "at cost." A mutual can do this because it has no shareholders—it's a cooperative owned by its policyholders and run for their benefit.

Harry Kamen, chairman and CEO of New York's largest mutual, Metropolitan Life (MetLife), apparently has a different notion of a mutual insurance company: he thinks it should be run for the benefit of its *management.*



Chairman Harry Kamen tries to turn MetLife into a Mutual Insurance Holding Company.

In the last two years or so, Kamen and the bosses at many of America's largest mutual life insurers have quietly lobbied legislators with the goal of enacting laws permitting mutuals to reorganize as "mutual insurance holding companies." These laws permit mutuals to deprive their policyholders of ownership rights, create conflicts of interest that favor management, and siphon corporate opportunities to companies owned by directors, officers, and employees.

That such unprecedented anti-consumer laws have actually been *passed* in 16 jurisdictions—with little in the way of public hearings—can be ascribed to the complexity of the subject and to the mutuals' political and financial clout. America's mutual insurers, which provide coverage to 70 million policyholders, have $1.1 trillion in assets and are worth about $250 billion.

In New York, a bill *drafted* by a trade organization (the Life Insurance Council of New York, of which MetLife is the largest member), would, if it becomes law, allow a mutual such as MetLife to, via the miracle of a regulatory pen stroke, transform itself into a stock insurance company owned by a publicly-traded holding company that, in turn, will be *controlled*—but not necessarily owned—by a newly-minted mutual insurance holding company.

Mutual-insurance-holding-company laws make no provisions for the safeguards required of other corporations, nor do they require disclosures to policyholders that owners of other widely-held companies are entitled to receive. The conversion from a mutual to a mutual insurance holding company doesn't even require the approval of a majority of eligible votes. In fact, as New York's bill is drafted, MetLife's conversion only requires the approval of a single policyholder.

Once converted to a mutual insurance holding company, the former mutual insurance company would no longer be owned by its policyholders or run for their benefit. Policyholders receive nothing for having this value extinguished.

Under New York's bill (which is only marginally better than the laws passed elsewhere), policyholders would merely retain contractual *policy* conditions *they already possess.* They would also become "members" of the mutual insurance holding company, but membership doesn't come with much in the way of privileges. (Membership interests can't be sold or transferred, and members—thanks to an SEC "no-action" letter the mutual requests—are precluded from receiving dividends. Worse still, if a policyholder dies or his coverage lapses or is canceled, his membership interests evaporate.)

Mutual-insurance-holding-company directors, officers, and employees, not surprisingly, fare much better. They stand to make $100 billion over time if mutual insurance holding companies become the law of the land. They could get unlimited amounts of stock, options, and other forms of equity, and *their* equity—unlike that of the policyholders—wouldn't be in the form of membership interests: it would be in publicly-traded stock of the intermediate holding company. Thus, the officers and directors of the mutual insurance holding company would have a personal financial interest that's in direct conflict with the interests of the policyholders and "members" they supposedly represent. This sort of divergence has proven disastrous for mutuals and mutual policyholders in the past. At Allied Mutual, which had a similar structure, policyholders have lost out on $700 million as a result of financial maneuvers that benefited the company's directors, officers, and employees (see "The Dark Side of Demutualization," *Schiff's Insurance Observer*, October 1997 and pages 1 through 6 of this issue).

Proponents of mutual insurance holding companies (such as Kamen) argue that the prospect of enormous self-enrichment never entered their minds and didn't affect their decisions. They say that their life-insurance companies *desperately* need this new legislation because unprecedented changes in the marketplace put $200-billion behemoths such as MetLife at a disadvantage that threatens their very survival. As Eugene McCarthy remarked years ago, "We don't declare war anymore; we declare national defense."

If Harry Kamen's bill becomes law, policyholders' rights could be diverted to a company owned by MetLife's officers, directors, and outside shareholders. Corporate opportunities that now belong to MetLife—the *mutual* MetLife—can also be diverted.

The sting doesn't end there. Policyholders will, in fact, be *more* disenfranchised than they already are (even though that's hard to imagine) because the insurance company will no longer be run for their benefit. Policyholders won't even be given shares in the event of an IPO. (Some *might* get non-transferable subscription rights permitting them to buy stock at the same price as outsiders, but even that is not assured.)

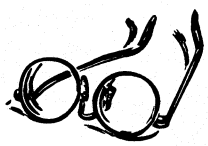
Furthermore, because the mutual insurance holding company will control 51% of the *voting* stock in the downstream public company (but not necessarily *any* of the *economic value*), the public company won't be accountable to outside shareholders, who tend enforce some sort of market discipline. But then, mutual-insurance-company directors aren't really accountable to the owners (the policyholders) now, either. But at least their present mandate—to run the mutual for the policyholders' benefit—is generally not muddled by the self-interest of stock ownership in a publicly-traded affiliate (Allied Mutual and a few others being notable exceptions). As Richard Shinn, former president and CEO of MetLife testified at a 1978 U.S. Senate hearing, "The reason for being a mutual-life-insurance company is to provide insurance *at cost* [emphasis added] to the insuring public."

How much say do policyholders have in the corporate governance of their mutual insurance companies? Almost none. In New York, for example, ballots *aren't even sent* to most policyholders. Only 25,000 of New York Life's 3,000,000 eligible policyholders received a ballot last year, and of these, 1,168 voted. Just 44,000 of MetLife's 12,000,000 participating policyholders voted. Less than 1,000 of the Guardian's 633,659 participating policyholders received proxies, and of these, 150 were returned (we'd bet that a large percentage of these were from employees).

John Harley, Guardian's vice president of government relations, recently explained to the New York State Assembly's insurance committee, his company's general disregard for policyholders' voting input: "Since these votes are typically on a noncontested election, *only one proxy would need to be returned* [emphasis added] to have a facially valid election under the current regulations. If there were a contested election, the law requires a different process in which many more proxies would be sought by competing slates, and the returns would be substantially higher...However, such a situation has never arisen."

There's a good reason why such a situation has never arisen: it is overwhelmingly difficult for an outsider to gain a seat on the board of any New York mutual. For example, just to be *nominated* for MetLife's board, one would have to obtain the signatures of 12,000 MetLife policyholders (0.1%). Because policyholders only get one vote regardless of the number of policies they own, a policyholder with a dozen $10-million policies has no more say in his company's affairs than a policyholder with a $1,000 policy.

It's no better at smaller mutuals. In 1957, New York law was amended to make it tougher for policyholders to exercise their rights and get on a mutual's board; the minimum number of policyholders needed to be nominated was raised from 100 to 500. In a memo to Governor Averell Harriman, New York's superintendent of insurance, Leffert Holz, provided a remarkable rationale for this legislation: "A small company...is *at the mercy of* a small group of persons because the policyholders reside in a *fairly confined geographical area* and it is *a simple matter to obtain signatures* in the making of independent nominations. The *company becomes the prey* of designing individuals" [emphasis added]. Mind you, the "designing individuals" Holz spoke of were the mutual's own policyholders!



As any outsider who has ever run for a corporate board knows, the law, the rules, the money, and the power are stacked in favor of those already in control—regardless of whether they've done a good job. Led by Harry Kamen and others, mutual insurance companies have declared war—rather, *defense*—on their policyholders. They have argued that since policyholders don't *know* that they're "owners" or think of themselves as "owners," they aren't losing anything in a mutual-insurance-holding-company conversion.

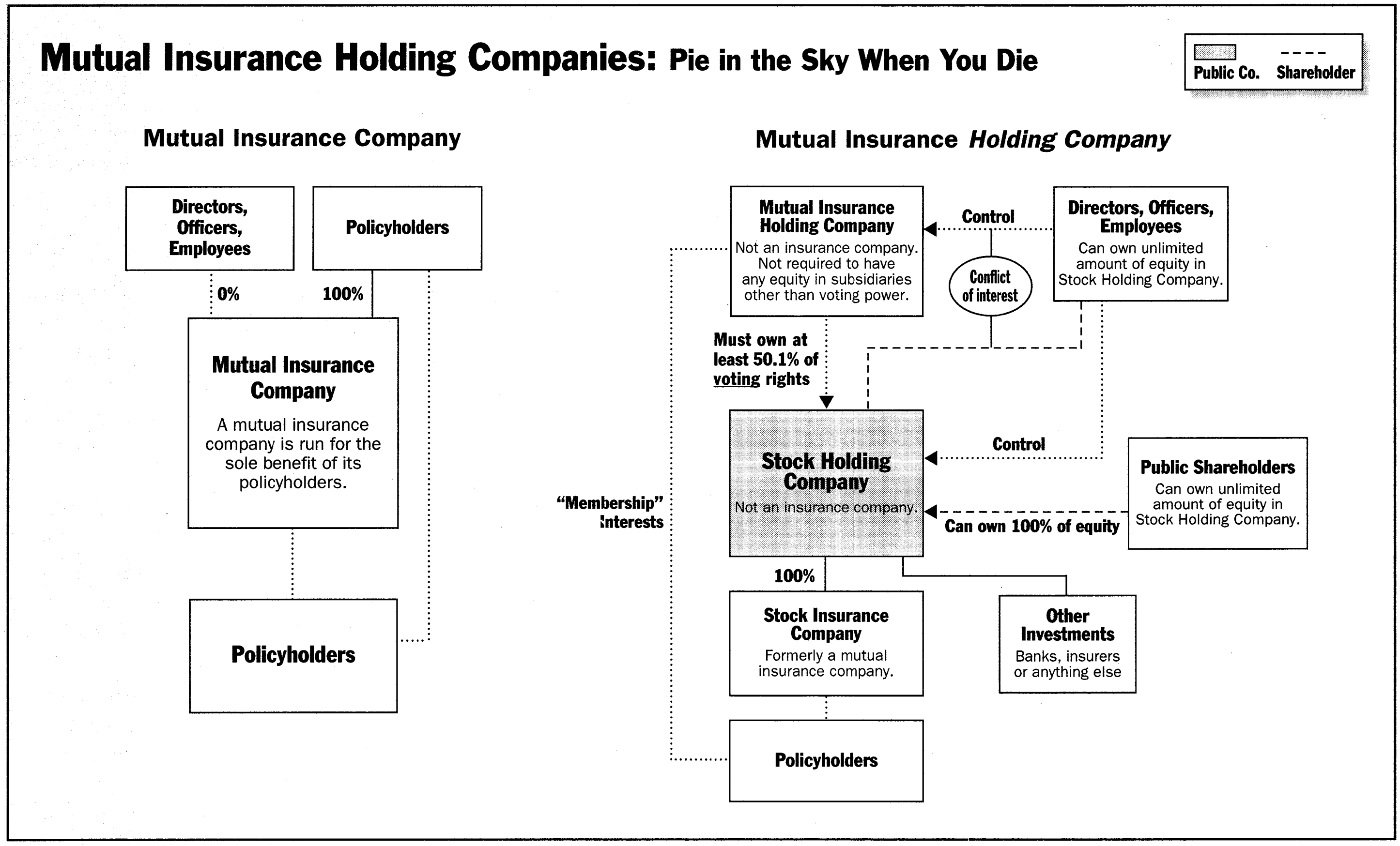
We've answered this illogical statement in several ways. One role of regulation is to protect people's rights, whether or not they're aware of these rights. Suppose, for a moment, that Harry Kamen's grandmother had set up a trust for him but hadn't told him about it. Let's also suppose that David Schiff was Harry's trustee. Just because Harry wasn't aware of the trust and, therefore, didn't *think* of himself as an owner of it, would that give Schiff the right to pocket the money? According to the logic proffered by mutual-insurance-company executives, the answer is yes. (Don't worry, Harry, if Schiff were your trustee you'd get every last penny in the trust.)

Even if we believed the specious argument that policyholders aren't "owners," their rights to buy insurance "at cost" and to have the mutual insurance company run for their benefit, are rights that have value. These rights are extinguished in a mutual-insurance-holding-company conversion.

Mutual executives and their pettifogging shysters have also argued that policyholders had no "expectation" of ownership when they bought their mutual policies. Richard Hemmings, a partner at the Chicago law firm Lord, Bissell & Brook, echoed that argument in an 11-page, 25-footnote paper, "Who Owns a Mutual—A Legal Perspective," which was submitted to the NAIC Mutual-Insurance-Holding-Company working committee. Hemmings, whose firm "represents a variety of mutual insurers interested in conversion options," predictably concluded that "a mutual policyholder is not an 'owner' of an insurer."

(That conclusion raises the obvious question: If the mutual policyholder doesn't own the company, who does?)

While policyholders may not all have had an *expectation* of ownership (most don't even understand how an insurance company works) mutual executives *did* have expectations when they took their



jobs, and one of these was that they would never own stock in their employer, since it was a mutual insurance company.

Hemmings even went so far as to say that Prudential's famous slogan "Own a piece of the Rock" is merely "advertising hype." Yet mutual-insurance-company executives (and political appointees like New York's insurance commissioner Neil Levin) argue that mutuals' directors, officers, and employees are entitled to stock options and equity in the to-be-formed public subsidiaries of mutual insurance holding companies.

Is "Own a piece of the Rock" really just "advertising hype?" We asked Bob DeFillippo, vice president of public relations at Prudential, to comment on Hemmings' statement.

"It's not true," he said emphatically. "As Prudential exists today—as a mutual insurance company—our policyholders are our owners." Interestingly, Prudential hasn't used its famous slogan for ten years. "We're using customer testimonial advertising," DeFillippo said. "The Rock is now more central to the logo." As for corporate governance, he noted that six of Prudential's 24 directors are appointed by the chief justice of the New Jersey Supreme Court.

In Pennsylvania—where mutual policyholders are treated like satanists at a revival meeting—Old Guard Mutual, which had recently celebrated its centennial, carried matters to the extreme, when, in late 1996, it turned down a $27.5 million offer from Donegal Group that would have given each policyholder money, and proceeded with an IPO that gave most policyholders nothing. Old Guard's justification for relieving its policyholders of the burden of extra cash was that Donegal's offer was "contrary to the best interests of Old Guard, including its policyholders, *agents, employees, suppliers, and communities they serve*" (emphasis added). Had Old Guard's CEO, David Hosler, asked our opinion, we'd have looked him in the eye and said, "Have you, at long last, no sense of decency? Take care of your policyholders, not your suppliers." Instead, Old Guard's management chose to rake in millions of dollars in stock and options. (In February 1997 the Center for Insurance Research filed a lawsuit challenging the constitutionality of the Old Guard conversion; that suit is pending.) Those eager to make money "Hosler-style" may want to catch his talk at the 1998 Insurance Company Restructuring Summit, to be held at the Scottsdale Princess Hotel in late February. One of the topics he plans to cover is "litigation update." (Also on hand to give a talk will be Richard "policyholders aren't owners" Hemmings.)

Other subjects to be addressed at this great summit include the following: "Protecting the Board and Regulator from Criticism," "Management and Employee Benefits in the Demutualization Transaction," and our favorite, "Holding the Dream: Is it Possible to Demutualize Without Losing Control?—Utilizing Federal and State Statutory Provisions to Maintain Control."

Why, you may ask, if Harry Kamen's mutual-insurance-holding-company law is so bad, haven't MetLife's directors objected to it? We wondered about that, too, so in October we called nine of MetLife's directors: Curtis Barnette, chairman and CEO of Bethlehem Steel; Joan Ganz Cooney, chairman of Children's Television Workshop; Burton Dole, chairman of Nellcor Puritan Bennett; James Houghton, retired chairman of Corning; Harry Kamen; Charles M. Leighton, chairman and CEO of CML Group; Allen Murray, retired CEO of Mobil; Hugh Price, president and CEO of the National Urban League; and Ruth Simmons, president of Smith College.

We wanted to discuss the New York bill with these folks. We wanted to ask them if they had gone over it line by line, as we have. We wanted to know whether they had any doubts about the bill. (After all, several members of the National Association of Insurance Commissioners' mutual-insurance-holding-company working committee have expressed grave concerns about the whole mutual-insurance-holding-company concept.)

Although we made repeated efforts to reach these MetLife directors, not one returned our calls. We did, however, hear from a perturbed John Goldstein, MetLife's media relations manager. "Why are you calling everyone?" he asked. We explained our concerns and, after a pleasant conversation, he said he'd set up meetings, send us information, answer questions, and put us in touch with the appropriate people.

That was the last we ever heard of Goldstein—who thereafter did not return our calls—a pity, as we especially wanted to talk to Joan Ganz Cooney of Children's Television Workshop, Hugh Price of the National Urban League, and Ruth Simmons of Smith College. We thought that as heads of large nonprofit organizations they might be sensitive to MetLife's policyholders. After all, Children's Television Workshop, the National Urban League, and Smith College don't give *their* officers and directors stock options, and aren't contemplating stock offerings that would cut out their constituents—not yet, anyway.

So why would these people approve of Kamen's stick-it-to-the-policyholders bill?

First, it's unlikely that they'd be serving on *any* major corporate board if they were the sort who questioned executive compensation, objected to stock-option grants, stood up to management, or generally raised a ruckus.

Second, it's prestigious to be a director of a giant life-insurance company. The pay isn't bad and there are perks, privileges, and connections to be made. MetLife, for example, is generous with its policyholders' money. In 1996 it supported over 500 nonprofit organizations. It made more than $27 million in contributions and committed $38.5 million in loans and equity through its Social Investment Program.

Between 1993 and 1996, Children's Television Workshop received $12,000 and the National Urban League got $400,000. MetLife's in-house printing, publishing, and graphic-arts units also did work for the National Urban League at no charge. Smith College's Ms. Simmons didn't join MetLife's board until 1995. The following year Smith College got $110,000 from MetLife. (It's worth noting that Kamen and Simmons both serve on Pfizer's board, and that Kamen is a trustee of Smith. Kamen is also on Bethlehem Steel's board, and Bethlehem's chairman and CEO, Curtis Barnette, is on MetLife's board.)

We have no way of knowing whether MetLife's corporate largesse affected Cooney's, Price's, and Simmons' feelings about Kamen's mutual-insurance-holding-company bill. We suspect, however, that these donations made them receptive to Kamen's point of view.

There are other plausible reasons why a MetLife director might not be opposed to New York's mutual-insurance-holding-company bill. For example, we doubt that all of the directors even *understand* it. And we can say with absolute certainty that they wouldn't understand it if it were explained to them by Harry Kamen. Our reason for this opinion is Kamen's testimony at the October 8, New York Assembly hearings (see the following article).

It was there that Kamen played the nimble equilibrist—a man whose avuncular facade cloaked a barrage of cynical assertions, Janus-faced dissembling, and charlatanic flimflammery. Although Kamen's words were spoken softly, the harshness of his message will not soon be forgot. His testimony marked the opening act of a drama that will shake the mutual-insurance industry to its core. We believe that in the end the interests of the policyholders will prevail—that the cynical custodians of other people's money will eventually be discredited ...which is exactly what happened in the insurance industry during the first decade of the twentieth century.

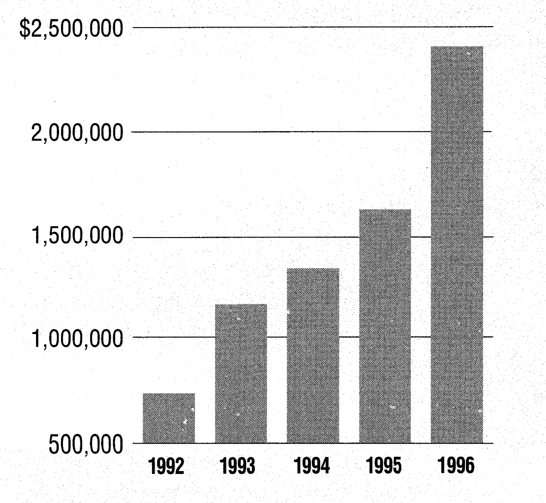
Mutual insurance holding companies are an oxymoronic combination—mutual ownership *and* stock ownership—that produce irreconcilable conflicts of interest that will do irreparable harm to policyholders. That they have been concocted by mutual executives is nothing short of an outrage. The insurance industry is already held in contempt, and the actions of Kamen and his cohorts will be viewed as scandalous. Coming on the heels of deceptive sales practices and abusive underwriting techniques, mutual-insurance-holding-company mania will lead to a tragic ending that will damage policyholders and insurance companies.

Almost as shameful as the mutual companies' duplicity has been the veil of silence upheld by mutuals that *don't* favor these laws, and by stock companies, investment banking firms, and large insurance agencies. With the exception of a handful of individuals, no insurance-company president, major insurance broker, insurance association, or anyone in a position of power at a stock company or mutual has publicly spoken out against these abusive mutual-insurance-holding-company laws and conversions. And yet, in private, many of these same people acknowledge that not only are the mutual-insurance-holding-company laws seriously flawed, but that the conversions that have taken place, or are being proposed, are abusive.

With such deafening silence it's no wonder the insurance industry is held in scorn.

Up, Up and Away: Kamen Hits the Jackpot

Compensation for Harry Kamen, Chairman and CEO of MetLife



Source: Insurance Forum

The Revolution Will Be Televised

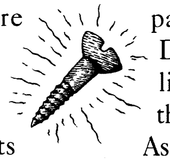
A Hard Rain's A-Gonna Fall

Past and present converged in New York on October 8, 1997, at 14 Vesey Street—a landmark designed to resemble Philadelphia's Independence Hall—at a public hearing held by the State Assembly's standing committee on insurance. The day's subject was a bill (A.7057-A/S.5628) that, if passed, would permit mutual life insurance companies to restructure themselves as mutual life insurance holding companies—hybrids of mutual and stock companies that steal policyholders' ownership rights while permanently entrenching the life-insurers' directors and officers and, incredibly, rewarding them with the ownership that now belongs solely to the policyholders.

That the hearings were held at all was a testament to the persistence and dedication of one of the industry's unsung heroes, Jason Adkins, founder of the Center for Insurance Research in Cambridge, Massachusetts. Adkins, a boyish 38-year-old Harvard Law School graduate whose patrician good looks belie the soul of an outraged reformer, did not, as did many of his classmates, opt for a career at a white-shoe law firm. Inspired by Ralph Nader, for whom he had worked, Adkins formed an organization in a field apt to induce yawns at cocktail parties: that of public-interest issues affecting policyholders, especially mutual policyholders. This was not a lucrative career choice, and Adkins, who's starting pay was $24,000 a year—no benefits—is familiar with constant underfunding and cheap accommodations. Along with a tiny band of devoted associates, he's used to scrounging for funds, applying for grants, and stretching a buck. His voice is often hoarse, the result of endless phone calling, all-night drafting sessions, and the ordeal of taking on the entire mutual insurance industry and the political forces it has bought. He loves his work and exudes constant energy and infectious enthusiasm. (As of January, Adkins has been pursuing his mission through a law practice, Adkins & Kelston.)

Adkins' work will save policyholders tens—perhaps hundreds—of billions of dollars. Nonetheless, at this moment he's known best by mutual executives who question his motives and view him with fear and scorn, using their vast wealth and power to fight him. It's a battle they will eventually lose, however, and Adkins deserves a vote of confidence from anyone concerned with fairness and the best interests of policyholders.

The New York bill Adkins was opposing was a legislative technicality: an amendment to Article 79 of the insurance code. Similar amendments have been passed in 15 other states and the District of Columbia without public hearings. The ramifications of these acts are just starting to be felt.



As in other venues, New York's bill is the result of back-door politicking paid for by the state's big mutuals—MetLife, New York Life, Guardian Life, and others—who have spent millions on contributions, lobbying, and legal fees. The bill, not surprisingly, is also supported by insurers' attorneys—Debevoise & Plimpton, Sidley & Austin, and Lord, Bissell & Brook—who have thus far not been struck by lightning when they say, for example, that policyholders don't "own" their mutual insurance companies.

Governor George Pataki, who owes his position to Senator Alfonse D'Amato, has also embraced this perverse restructuring of the insurance code, as has his novice insurance commissioner, Neil Levin, who began his career as one of D'Amato's legislative assistants. Prior to becoming insurance commissioner Levin served as the state's banking superintendent, and before that was a vice president—but not a partner—at Goldman Sachs. (D'Amato's "investing," you may recall, was not transacted through Goldman, but with one of the nation's sleaziest bucket shops, now-defunct Stratton Oakmont, which allowed the senator to make $37,000 by day-trading penny-stock IPOs foisted on the public by boiler-room salesmen.)

The October 8, 1997 hearings brought almost a century's worth of progressive New York regulation to a full circle: exactly 92 years, one month, and one day earlier, the landmark Armstrong Committee had commenced *its* investigation into the unsavory dealings of New York's life-insurance companies. That investigation, which was held at City Hall—just a short walk from the site of the 1997 hearings—unveiled an array of corrupt business practices, conflicts of interest, and intimate connections between the largest New York life insurers and the big New York banks and brokers. As the hearings progressed, it became clear that many directors and officers of the insurance companies had abused the trust of their policyholders to reap undeserved financial gain.

The Armstrong Investigations revealed, among other things, that the life insurance companies had funneled political contributions to the Republican Party at the state and national levels, justifying these on the grounds that it was in their interest to have federal, rather than state, supervision of insurance (a wonderful irony given the industry's present abhorrence of federal regulation).

To fully appreciate the impact of the Armstrong Investigation, one must remember that many of the protections we now take for granted were considered outrageously radical at that time. In 1905, for example, the U.S. Supreme Court *struck down* a New York law that ameliorated bakers' harsh labor conditions by limiting their workweek to six 10-hour days. The Court's rationale was that such a law violated individual "freedom of contract." It would take 33 years and economic upheaval before the constitutional right to "life, liberty, and property" included a federal minimum wage—25¢ per hour.

Marquis James, Pulitzer-Prize-winning historian and Metropolitan Life Insurance Company's authorized biographer (*The Metropolitan Life: A Study in Business Growth*, Viking Press, 1947), wrote of that era: "Working people remembered the long-standing opposition to organized labor; to the eight-hour day; to workmen's compensation; to the abolition of child labor and contract labor; to inspection of mines, factories, and workshops; to the use of public funds for the relief of private distress in hard times. Certainly the Metropolitan Life Insurance Company was the avowed champion of none of those measures"—even though its clients numbered some 5,000,000, the majority of them working-class people who owned industrial life policies.

The turn of the century was also an age of reform. Muckrakers like Ida Tarbell (*The History of the Standard Oil Company*) and Upton Sinclair (*The Jungle*) reshaped the public consciousness with their exposés, leading to antitrust enforcement and consumer-oriented legislation such as the Pure Food and Drug Act and the Meat Inspection Act.

The event that sparked the Armstrong Investigation was a wildly extravagant costume ball given by 28-year-old James H. Hyde, who had inherited a controlling interest in Equitable Life. As *Vogue* recently noted, "this was one of the most splendid parties of the Golden Age, whose decorations simulated the gardens of Versailles. Against this ersatz prettiness, a contra dance was given in costume after the manner of the French court during the reign of Louis XIV." The architect Stanford White called it "the most gorgeous affair I ever saw." Marquis James described it somewhat differently: "The affair was as garish as anything New York had seen." The wanton extravagance of Hyde's grand bash, the money for which had ultimately come from Equitable's coffers, led to infighting for control of Equitable, which led to newspaper headlines, which led to a public clamor for investigation.

The Armstrong Investigations were big news and received the sort of attention now reserved for matters like the O.J. Simpson case. "The press was represented as at a murder trial," James wrote. "There were writers, photographers, and sketch artists." The city's many daily papers covered the hearings relentlessly, vying "to be the first to print each new bit of evidence."

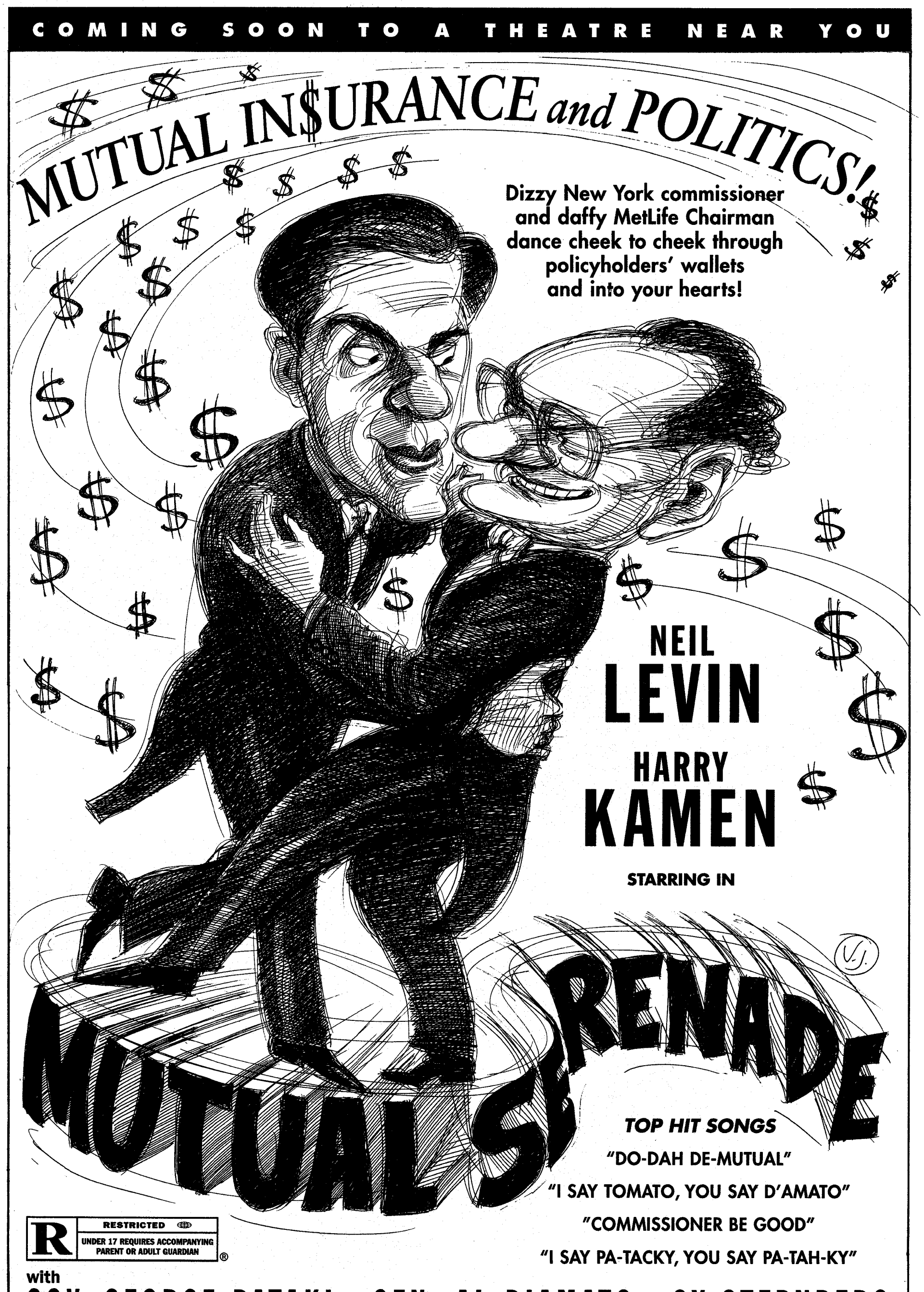
(The October 8, 1997 hearing, by contrast, received scant attention. No television cameras were in attendance, and New York City's one remaining daily broadsheet, *The New York Times*, devoted less than two columns in the metro section to the day's events.)

The star of the Armstrong Investigations was Charles Evans Hughes, a spare 43-year-old lawyer with a reddish-brown beard who was then best known for his investigation into gas rates in New York City. James wrote that Hughes's examination was "courteous, persistent, and penetrating." Although most witnesses (insurance company officers and directors) were reluctant to talk, Hughes persevered through endless questioning. "This method built up, day by day, a voluminous record over which one without Mr. Hughes's card-index mind and remarkable memory could not have retained mastery."

In the end all the dirt was exposed: the payoffs to judges, lobbyists, and politicians, the outrageous compensation schemes, the intimate and unsavory connections between Equitable and Kuhn Loeb, and New York Life and Morgan. Then, as now, the big life insurers were in cahoots with each other. New York Life had lent Metropolitan Life's president money at a 1.5% interest rate; Metropolitan returned the favor by lending New York Life's president money on similar terms.

Metropolitan also made low-interest loans to its senior executives, which were "parked" with Vermilyea & Company on December 31, so that they wouldn't be disclosed on year-end financial statements. The loans were then repurchased two days later according to terms set in advance.

Also exposed were interlocking insurance directorships among major banks, fraudulent financial statements, and secret control of banks and securities firms. As in recent life-insurance sales-



practices scandals, it was revealed that life-insurance-company dividends "fell far short of estimates." Control of many of the life insurance companies was maintained by the executives through the abusive use of perpetual proxies.

"The public service rendered by Mr. Hughes had lifted a comparatively obscure lawyer into national prominence," wrote James. According to the *Spectator*, an insurance journal of the day, "the revelations he wrung from witnesses aroused a storm of indignation that swept over the country and created a demand for the reorganization of the great life insurance companies that could not be resisted." The *Spectator* added that although the proceedings were "sickening," they would "prove eventually a blessing to the business of life insurance."

Among the reforms to be enacted as a result were the limitation of expenses, the prohibition of tontine insurance, the standardization of policy forms, the requirement that insurance companies file detailed financial reports, the inception of triennial examinations, and the institution of new elections with wider policyholder participation.

Hughes's triumph paved the way for him to become governor of New York in 1906, Associate Justice of the U.S. Supreme Court in 1910, Republican candidate for president in 1916, and Chief Justice of the U.S. from 1930 to 1941.

The Armstrong Investigations also led to the mutualizations of Prudential and Metropolitan in 1915, and of Equitable Life in 1925. Haley Fiske, who became Metropolitan's president in 1919 at the age of 67, called Metropolitan's mutualization the "crowning act" in the company's evolution. In 1917, at a gathering of the company's field managers, he issued a powerful statement long since forgot by the top echelons at MetLife: he declared Metropolitan to be "not primarily an insurance company; it is a public institution."

October 8, 1997 was a cool morning, and the area just west of City Hall, where the state assembly's mutual-insurance-holding-company hearings were being held, lacked the gleam of prosperity prevalent in some other parts of New York City. On Wall Street, to the south, limousines lined the curbs, waiting for investment bankers; a few blocks uptown, in Tribeca, lofts once inhabited by impecunious artists were now occupied by well-heeled executives. But prosperity had not embraced the urban miasma west of City Hall, and the sense of an earlier, grittier era was as obvious as a port-wine stain on a white-linen suit.

Broadway, the main thoroughfare of lower Manhattan, is not the "great white way" of Times Square several miles uptown, and the side streets—Barclay, Park Place, Murray, and Warren—have the look of age and urban decay.

A block north of 14 Vesey stands the Woolworth Building, an elegant 1913 tower that tapers to a graceful crown. Like 14 Vesey, it was designed by Cass Gilbert, who was also the architect of New York Life's headquarters, built in 1928 on the site of the original Madison Square Garden. Woolworth's 60-story "Cathedral of Commerce," once the tallest building in New York, is replete with Gothic details and vaulted mosaic ceilings. It still dwarfs most of the surrounding buildings.

A few blocks west, at 101 Murray Street, stands the College of Insurance, an odd concrete mélange of Bauhaus and Moderne that houses the best insurance library in the world—a gift of Shelby Cullom Davis and his wife Kathryn (for more on Davis see "Grandfather Knows Best," *Schiff's*, June 1994). Two blocks east, at 59 Murray, is New York Dolls, downtown's "#1 adult establishment," whose featured performers, among them Heather Hooters and Plenty Uptop, have little in common with such legendary ecdysiasts as Gypsy Rose Lee and Sally Rand.

Into this seedy neighborhood of discount stores, bargain suppliers, 19th century cast-iron buildings, wholesale outlets, and novelty purveyors streamed a horde of mutual-insurance-company executives and their lawyers. (In fact, many mutual-insurance-company executives *are* lawyers.)

The hearing was chaired by Alexander "Pete" Grannis, a Democrat who throughout his 22-year career in the state assembly has taken a keen interest in insurance. Over the course of the day, numerous speakers would appear before Grannis (who is knowledgeable and impressive) and the other committee members (most of whom are far less informed), and give reasons why they favored or opposed the bill. The most significant testimony would come from Harry Kamen, chairman and CEO of MetLife, and Neil Levin, New York State insurance commissioner, who would display, respectively, a shocking callousness toward policyholders and a startling lack of knowledge. We shall focus on their comments rather than on those made by Jason Adkins, Ralph Nader, and James Hunt (former Vermont commissioner), who were articulate, disinterested opponents of an ill-conceived bill. Nader, in particular—slightly disheveled in his trademark drab dark suit and white shirt—delivered a rousing off-the-cuff speech. (David Schiff also testified. Since he's a political neophyte who tends to be a bit groggy in the morning, he foolishly *requested* a speaking slot late in the day. By the time he got on, only one of the 11 committee members [Grannis] remained, and the auditorium was half empty.)

Commissioner Levin kicked off the proceedings by giving his version of reality. He testified that the bill was driven by "modern market forces which dictate that if a mutual company is precluded from opportunities for growth—if demutualization is the only option—then those market forces will overtake the mutual insurer and the long-term results for New York's mutual policyholders would not be favorable." He proceeded to describe the bill, making several mistakes along the way. He even went so far as to state that "the bill prevents any attempt by the officers and directors to gain any meaningful control of the company"—a ludicrous remark since the officers and directors and *already* control the company.

Levin, who has said he'd prefer to see the 50 state-insurance regulators replaced by one mediocre federal regulator (a job for which he is well qualified), has already developed a reputation in Albany as an unbearable boss, and insurance-department employees speak of "doing time in Levin-worth."

Thus began the exchange between Pete Grannis and Neil Levin. [We have excerpted the following from the day's testimony and have edited participants' statements.]

Grannis began. "You talked about whether or not policyholders are owners of mutual companies. Your view is that they are not. If they don't own the company, who does?"

"I would tell you this was the same legal debate that goes on in the world of mutuality and thrifts," Levin replied. "We can get into a debate on law. I think the truth of the matter is that this shouldn't even be a subject for argument because we are treating it as though it's a legal right."

"So, in your view, the policyholders do own the company."

" Well, again, this can be argued both ways, and I've seen this in my experience—"

"I'm asking for your *view*, because your view will be critically important in analyzing these plans should they come before you."

"I will tell you that my view is that policyholders have a contractual relationship with the company. They have a package of rights to elect directors," said Levin, neglecting to mention that most policyholders don't even receive ballots, and that it is virtually impossible for them to elect anyone other than the candidates nominated by the board. "I will tell you that they have beneficial rights. Without getting into the legal policy as to who owns the company, I will tell you it's my belief that their rights confer upon them ownership of the mutual insurance *holding* company."

"I'm trying to find out who you think owns the *mutual* before it gets to the mutual insurance holding company!"

"We could say, theoretically, the policyholders."

Grannis persisted. "But under this bill the mutual insurance holding company can sell 49% of its insurance company, and the policyholders are entitled to virtually nothing."

"Well, they get subscription rights," Levin blundered. (In fact, there's no such guarantee.) "The bill says that when 49% of the insurer or some of these intermediate holding companies are sold publicly—that cash, that value, goes somewhere. It goes upstream to the mutual insurance holding company, which we just said the policyholders own 100% of."

Levin was wrong again. The policyholders' "membership interests" don't give them any way to get at that "value" to which he referred, and it's unlikely that money from a public offering would go *upstream* to the mutual insurance holding company, in any event. The whole *purpose* of the proposed structure is to have assets and value downstream of the mutual insurance holding company, all the while allowing the directors and officers to maintain control through the mutual insurance holding company. The bill explicitly states that the mutual insurance holding company "shall not be authorized to conduct any business other than that of a holding company, except for the acquisition, ownership, management and disposition of its assets and all actions reasonably incident thereof."

"Under your proposal," Grannis said, "policyholders would be given subscription rights to buy something they already own. If they're the owners and are given subscription rights to buy what they already own—but don't have any cash—they can't afford to buy what they already own."

"Again, the policyholders have complete ownership," insisted Levin. "They have not lost any value. When they get subscription rights, they don't have to exercise those rights—the value accrues in the mutual insurance holding company, and they still have 100% ownership. Their ownership value is in no way undermined or diminished."

The logic of Grannis's point was lost on Levin. If, as Levin stated, the subscription rights *do* have value, then policyholders who can't afford to exercise their subscription rights—or simply don't want to put up more money—are, in fact, *losing* something. On the other hand, if Levin's other statement is correct—that policyholders aren't losing anything by *not* exercising their subscription rights—then that can only be true if the subscription rights *don't* have value. And, if that's the case, then policyholders are indeed receiving nothing in the mutual-insurance-holding-company-conversion and subsequent IPO.

It was early in the day, but the commissioner's exasperating answers made us long for a lunch break.

Grannis tried a different tack. "Who do you consider your constituents in this process?"

"Policyholders and consumers are the primary concern. We attempted to *empower* policyholders," said Levin, in what was surely his most astonishing assertion, "but mutuality is not necessarily in their best interest, nor is full demutualization. We have to recognize that mutuality doesn't guarantee you're going to have the best management and the best decision making. It also doesn't mean you're going to be the most efficient operator. If these mutual insurers are truly handicapped, we will ultimately create dinosaurs, because they will be unable to grow with the times."

Levin didn't explain how mutuals such as State Farm, Prudential, MetLife, Northwestern, and others have managed to become so large and successful *without* any external capital.

Levin continued. "With full demutualization," of which he is apparently no fan, "one lesson the financial community learned in the 1980s is that there is nothing worse than having financial institutions lugging around capital that they do not know how to deploy.

"So to force life insurance companies to fully demutualize—to lug around surplus equity capital that they don't necessarily need but will be forced to deploy on a less-than-timely-and-strategic basis—is also not necessarily in the policyholders' interests."

Of course, if the mutuals fully demutualized by giving policyholders—who own the company—all the shares in the converted insurers, then the insurance companies wouldn't have any "excess capital" to lug around: they would be stock companies with balance sheets identical to the ones they already have.

"You're not confident that life insurance companies can handle themselves in the free market?" Assemblyman Grannis asked Commissioner Levin, an alumnus of Goldman Sachs, a bastion of free-market exponents.

Grannis asked a simple question. "Are you aware of any companies that have done badly for their shareholders since they demutualized?"

There are, of course, some obscure mutuals that have experienced less-than-stellar results after demutualization, but Levin didn't seem know that, so he wallowed away: "Full demutualization—to all of a sudden take a company that has not been exposed to market discipline and to give it a huge capital injection and say, 'You are forced to confront institutional investors and equity analysts, and deploy your capital otherwise your share price is going to get beaten down'—I don't know if that's in the best interests of the policyholders."

"You're not confident that they can handle themselves in the free market?" Grannis asked the commissioner, an alumnus of Goldman Sachs, a bastion of free-market exponents.

"Some can, some can't. Some companies are going to want to be all things to all people. Others are going to be niche players. Others are going to want to affiliate across industry lines," said Levin, who had clearly mastered the buzzwords that insurance executives spout to the callow greenhorns who work for big money-management firms.

"Can I ask who you consulted in putting this bill together?" said Grannis.

"I arrived on the job on April 7. There was a draft bill which had come from an industry working group. As the industry can tell you, I personally got involved in the sessions. The only outsider we brought in was when we got into corporate governance: Ira Millstein, from Weil Gotshal & Manges, a nationally recognized figure on corporate governance."

Ira Millstein is indeed an elder statesman of the corporate-governance movement, and is best known for his role in the boardroom coup at General Motors that resulted in the ouster of chairman and CEO, Robert Stempel.

We recently called Millstein to ask what input he provided Levin, how much time he put in, and how much he got paid. He didn't call us back, but we'd be mighty surprised if a man like Millstein—a champion of *accountability*—thinks that it is proper for a company's owners to have no say whatsoever in electing the board of directors. And yet that's the situation at virtually all mutual insurance companies. And there sat Neil Levin, avowed champion of "policyholders and consumers," advocating a departure from an already bad tradition that would imperil policyholders and emasculate what little nongovernmental protection they have.

Assemblyman Ivan Lafayette, who once ran for the board of a mutual savings bank as an insurgent candidate, raised an important issue—that under the bill a mutual-insurance-holding-company conversion could be approved by just two-thirds of the policyholders who vote, rather than two-thirds of all policyholders, or even a majority of policyholders.

"We wrestled with this," said Levin. "We've looked at all the ways we could possibly make communication meaningful and could make the vote representative of the policyholders' feelings. We did as much as we could on the corporate governance side—beefing up the use of outside directors. But the problem is, insurance regulation is very paternalistic, especially when it comes to mutual insurance companies. It's basically grown up as though policyholders are not capable of making decisions for themselves."

Those who remember Leffert Holz's memo to Averell Harriman—those who understand the behind-the-scenes political maneuvering—know that the laws have been drafted to insulate the managements of mutual insurers, not to empower the policyholders. In the case of true mutuality—where a company "exists solely to serve the insurance needs of [its] policyholders," as the National Association of Mutual Insurance Companies succinctly puts it—then perhaps it is not so bad to insulate management. But once mutuality has been breached—whether by a mutual insurance holding company or by a downstream stock company in which management (or anyone else) is permitted to have an equity interest—then such insulation and lack of accountability are intolerable.

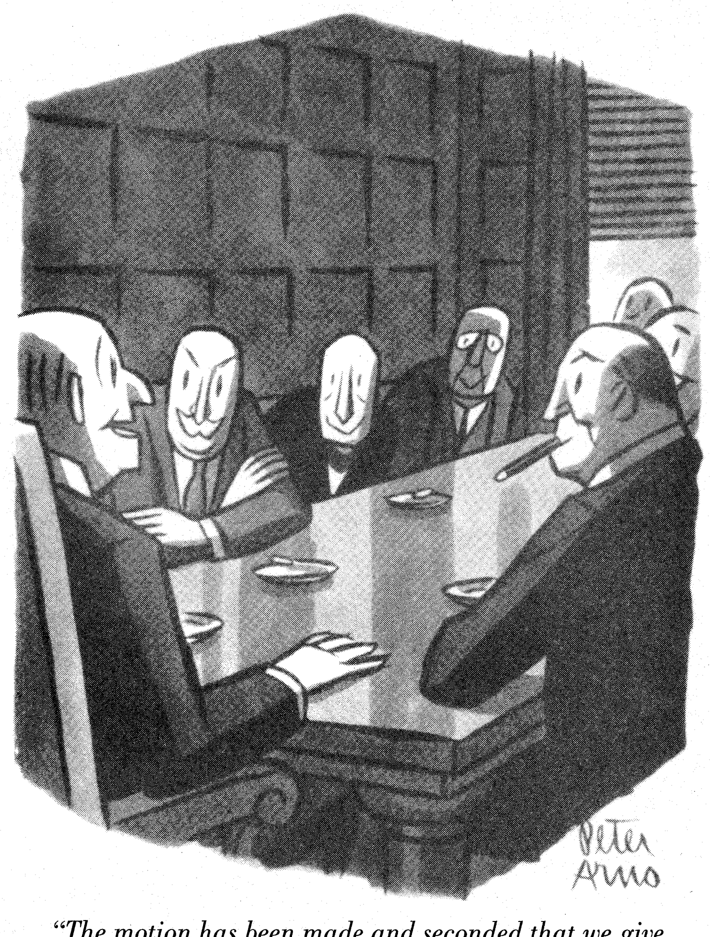
Levin continued. "You know, everybody gets the right to vote," he said, ignoring the fact that a negligible percentage of policyholders receive ballots or proxies. "The challenge is: 'How do you get people to actually exercise their right to vote?' One of the things we require here is that a statement on the plan be mailed to all policyholders.

"We are trying to figure out how to take an environment with policyholders who either aren't enfranchised or don't feel that they are enfranchised, and make them feel enfranchised in this process." Levin didn't bother to explain how they got disenfranchised in the first place. "I understand what the rub is: two-thirds of those who vote. But how do you make policyholders—who have a history of not voting—vote? Can we fine them if they don't vote? I mean, what can you do?"

Levin explained the mechanism that would purportedly keep the system honest and provide protection for policyholders: "We've got enough class action attorneys out there who will be waiting around and watching to see if independent directors fulfill their duties. But my point is, short of imposing a fine on policyholders for not voting, I don't know how you make them vote."

We suggest that Levin make a study of what is perhaps the finest mutual insurance company in America—Northwestern Mutual, "The Quiet Company®," which annually gets about 25% of its policyholders to vote—in uncontested elections.

How does it do this? Through *communication*. Every year each Northwestern policyholder receives an annual report, proxy statement, and proxy card. Northwestern's 1996 annual report is 24 pages. It includes a description of the company, a financial summary, a letter from the president, information about agents and policyholders, three pages describing financial results, and two pages showing the company's income statement and balance sheet along with relevant charts. The report lists all 25 trustees (directors), only two of whom are company employees. Since Northwestern is a mutual, none of its trustees own stock in the company or its subsidiaries. The proxy pamphlet gives a brief description of the qualifications of the persons proposed by the board for election as trustees. The annual report also advises policyholders that "if you are interested in a more detailed report on the company's financial condition, we will be happy to send you a copy of the company's Consolidated Financial Statements."



"The motion has been made and seconded that we give ourselves a raise in salary. All those in favor say 'Aye.'"

Drawing by Peter Arno; © 1949 The New Yorker Magazine, Inc.

But Northwestern doesn't stop there. It includes a four-page "Report of the 1996 Policyowners Examining Committee." This committee is composed of outside policyholders who are allowed to "make an independent and completely unrestricted evaluation of the company's operations, management, and strategic plans." The 1996 committee, for example, included Sarah Jewel, executive vice president of Washington Mutual Bank (the nation's largest thrift, with $100 billion of assets) and four other qualified individuals.

Jewell, by the way, is not a typical corporate director. An avid hiker, she serves on the board of REI, a cooperative that sells outdoor gear. She's also on the boards of Blue Cross of Alaska, a nonprofit health insurer, and Washington Water & Power, a billion-dollar utility. For five days she and the other members of the Policyowners Examining Committee visited Northwestern, reviewing and analyzing it in depth.

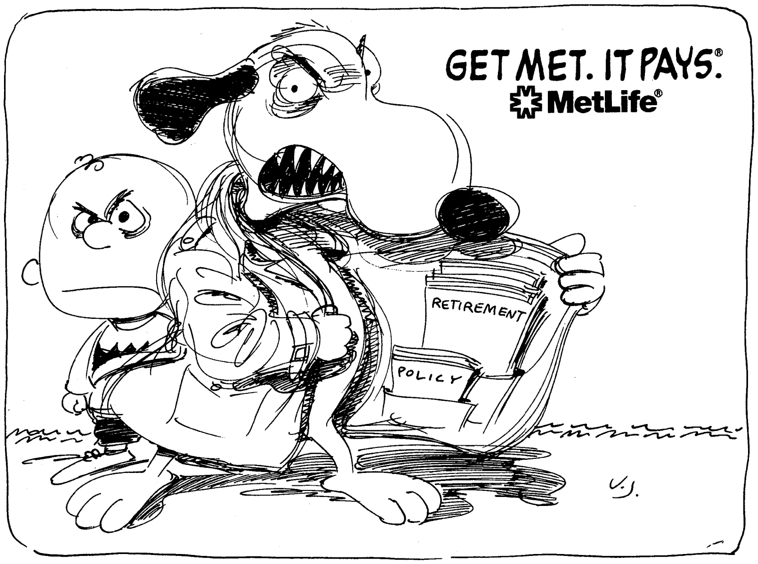
We asked Jewell why she took *vacation* time to examine her life insurance company—for no compensation. "It gives one a tremendous insight into how a successful company is run," she responded. "How does one address the issues of growth and competition when you don't have the stock-market gun to your head? Any opportunity to get insight into a successful management team is worth my time.

"It's noteworthy that Northwestern's management really understands that it serves at the pleasure of its policyholders. The purpose of the Examining Committee is to make sure that it stays true to that mission." Jewell agreed that a mutual insurance holding company—in which the directors, officers, and employees owned shares in a downstream subsidiary—would create a "conflict of interest."

Levin's assertions notwithstanding, Northwestern has proven that policyholders *will* vote when given meaningful information about material transactions that affect them. The reason New York's bill permits a conversion to be approved by only two-thirds of the votes cast is simple: mutual insurance companies would have a hell of a time getting a majority of policyholders to vote for something that's so bad for them. As Joseph Belth, editor of the indispensable *Insurance Forum* writes, "The mutual-insurance-holding-company concept is fundamentally flawed. If [the] implications were disclosed to and understood by the policyowners...we think most [of them] would vote against the reorganization. On the other hand, if strong safeguards that are not present in existing and proposed laws were added to protect the ownership interests of policyowners, we think prospective shareholders would be reluctant to invest in the reorganized enterprise." [Belth won the George Polk Award—one of journalism's highest honors—in 1990. His writings comprise the most important body of journalistic work on the life insurance industry. We urge anyone with even the slightest interest in insurance to read *The Insurance Forum*. Subscriptions are dirt cheap—$75 per year. The publication's address is P.O. Box 245, Elletsville, IN 47429. The phone number is (812) 876-6502. Tell them Old Man Schiff sent you.]

Levin summed up. "This bill, as currently configured, provides the most protections to policyholders as compared to pure mutuality or full demutualization." Then he cut short his testimony at the most important New York public hearing on insurance in 92 years by saying, "Mr. Chairman, I unfortunately have to leave for a prior commitment," and turned the microphone over to the deputy superintendent, Greg Serio.

A couple of hours later it was Harry Kamen's turn to speak. He had the misfortune of following Ralph Nader, which is akin to taking the stage in Vegas after Wayne Newton has done a four-hour gig. Responding to Nader's challenge to a televised debate, Kamen joked that "having just heard his eloquence, I'm not sure a televised public debate would provide a level playing field for me."



After introducing himself, Kamen made one thing perfectly clear: "I am not a robber baron. I learned a lot of the business from Dick Shinn [the former chairman], who is not a robber baron."

Kamen said he supported Neil Levin's statements. Then he attempted to debunk an estimate made earlier by Jason Adkins that the average MetLife policyholder could receive $3,000 worth of stock upon a full demutualization. "We, of course, hadn't been asked and hadn't made an examination, but just dividing our $12 billion of capital into our 12,000,000 participating policyholders, I believe that a more correct figure would be less than $1,000, on average."

Kamen's words did not sit well with us. We suspect that there would be no shortage of suitors for MetLife at a price equal to two or three times its $12 billion of capital. Aegon, AIG, General Electric Credit, ING, Travelers, and others would no doubt be eager to acquire MetLife using their stock as currency. Such a deal would be tax-free for MetLife's policyholders and would probably be accretive for the acquirer. In fact, if the acquirer were to "downsize" MetLife by, say, giving Harry Kamen—who is a lawyer, not an actuary or insurance salesman—a pink slip, that alone would create $62.5 million in market value (Kamen's $2.5 million in compensation times GE's multiple of 25).

Kamen's comments virtually acknowledged this: "Our stockholder-owned competitors, who have access to the equity markets, can raise more capital more readily. Also, they can use stock instead of cash to pay for acquisitions. This is a keen advantage when stock prices are greatly inflated—as we think they are today. A stock company can buy with inflated stock by paying with its own inflated stock."

Kamen listed several recent multibillion-dollar deals in which companies were acquired at sizable multiples of book value, noting that "not only do these illustrate the power of stock as an acquisition currency, but they also show what acquisitions cost these days." Yet moments before, he had contended that MetLife, a giant life-insurance and financial-services company, was only worth the value of its capital.

Kamen then switched tactics and made a political appeal. "If we do not have the flexibility that the mutual-insurance-holding-company law will give us, we may find that in the ongoing worldwide industry consolidation, MetLife and the other mutuals in New York will end up behind the competition instead of in front of it. That would not be good for us. It would not be good for our policyholders. And I submit it would not be good for the State of New York or the City of New York. The continued viability of the mutual life industry is important to New York State. These companies generate tax revenues, they employ thousands of New Yorkers, and they stimulate economic activity that sustains jobs for many thousands more.

"MetLife has more than 10,000 employees in this state, and over $3.6 billion invested in real estate and residential and commercial loans in New York," said Kamen, as if that justified anything. Kamen did not tell the committee that last year more than 80% of MetLife's premiums came from *outside* New York. Nor are we aware that a MetLife agent has ever told a potential policyholder that jobs in New York would take precedence over that policyholder's interests.

Harry Kamen switched back into the "mutual" mode. "At MetLife, our policyholders have always been management's number one concern, and their fair and equitable treatment our top priority."

As for the conflict of interest created by allowing management and the public to own stock (while policyholders are stuck with "membership interests"), Kamen explained that away: "We already serve a variety of constituencies."

He proceeded to enumerate these constituencies. Although he had the decency to list policyholders first, he quickly plunged into the twilight zone: "We have bondholders who purchased our surplus notes in the amount of $2.5 million, and we have to pay them interest and principal when they are due."

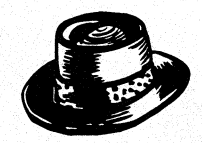
Kamen calling MetLife's bondholders "constituents" is like a gambler calling his loan shark a constituent. The rights of MetLife's creditors are spelled out in indentures, and are subordinate to the rights of policyholders. Payment of interest and principal on MetLife's surplus notes can only be made with the prior approval of New York's superintendent of insurance. Kamen, the co-author of "Commentaries on Debenture Indentures," is well aware of this, and, in fact, is quite a wrangler as a bondholder. In the 1980s, MetLife sued RJR Nabisco when its bonds declined in value after a management-led LBO proposal. Although the *Atlanta Constitution* reported that court papers revealed that MetLife had made a "confidential study" concluding "that covenants with bondholders did not prevent RJR from accepting" such a proposal, Kamen argued that, the language of the covenant notwithstanding, the RJR buyout violated an "implied covenant."

At the October 8, 1997 hearing, Kamen didn't utter a word about his "implied covenant" to run MetLife for the sole benefit of its policyholders.

Instead, he said that "in New York City alone we have 30,000 residential tenants at Peter Cooper Village and Stuyvesant Town. They are a very demanding group of tenants, and we have to provide them with excellent service, maintenance, and improvements. They are another *constituent* group."

To anyone who knows a bit of history, those words were sickening. In the first place, Stuyvesant Town and Peter Cooper Village are *investments*, just like any other piece of property, loan, bond, or stock MetLife owns.

Stuyvesant Town was built in 1943 under the aegis of Robert Moses, *The Power Broker* of Robert Caro's Pulitzer-Prize-winning biography. Moses, who controlled the most important New York "public authorities," conceived the project and, under the guise of "slum clearance," used his vast influence to condemn 18 city blocks to make way for it. He arranged huge tax abatements for Metropolitan Life, which would "finance" and own the project. Marquis James's history of Metropolitan explains that "ordinarily it would have been impossible to acquire such a huge tract of land in the heart of the city at a price within reason." With Moses's help, it was possible.



The critic Lewis Mumford described Stuyvesant Town's stark 13- and 14-story red-brick boxes as "police-state architecture." Although the majority of the 12,000 residents evicted from 18 condemned blocks were blacks and Puerto Ricans, Metropolitan's chairman, Frederick Ecker, insisted that only white married couples be allowed to live in the rent-controlled housing built with state and city subsidies.

"Mr. Ecker told a newspaper reporter that no provision had been made for Negro tenants," wrote James, "since he believed that would be 'to the detriment of the city...because it would depress all the surrounding property.'" Metropolitan's policy was upheld in the courts, although laws forbidding such discrimination were subsequently passed.

As for Kamen's supposed 30,000 "constituents" in Stuyvesant Town and Peter Cooper Village, if they're like most New Yorkers, they can't stand their landlord. Until recently Stuyvesant Town wasn't wired for air conditioning, and its tenants have battled MetLife over rent increases.

So much for Kamen's "constituents."

Kamen then flipped on the "mutual" switch, assuring the committee that policyholders would "continue to be our number-one priority for as long as we retain the mutual form of organization in the form of a mutual life insurance company or a mutual insurance holding company."

Kamen returned to the specifics of the bill. "Several Assembly members asked whether anything of value would be received by policyholders at the time of conversion and the raising of new capital, other than subscription rights. This is not and should not be required in the bill.

"Now, confidentially—and I would ask my competitors here in this room to cover their ears—MetLife is considering a special dividend to policyholders as one of the options, should we convert to a mutual insurance holding company and successfully raise capital in the marketplace."

Such generosity! Kamen was "considering" giving policyholders what—by an *implied covenant*—they already owned! Kamen, of course, didn't discuss the size of the special dividend, how it would be accomplished, or whether it *could be* accomplished.

Kamen's kind words for the bill that could allow MetLife's directors, officers, and employees to hit the stock-option jackpot did not stop there. "In fact," he continued, "the mutual-insurance-holding-company structure *crystallizes* the value that policyholders have in the company through the holding of stock." If that were true—if the value of the membership rights was so *crystal* clear—why hadn't Kamen lobbied for a law in which a mutual's directors, officers, and employees owned *membership rights*, rather than stock? These membership rights could be on terms similar to those belonging to policyholders: they could be nontransferable, nonsalable, non-dividend-paying, and they could disappear when their owner left the company or died. (One can easily surmise why such a non-security wouldn't be too appealing to Kamen or anyone else.)

As for a full demutualization—giving 100% of the stock to the policyholders—that, according to Kamen, is fraught with pitfalls. "It's time consuming, it's very costly, it can divert management attention from the day-to-day business of running the company, but more importantly, it is an all-or-nothing proposition with all values fixed at a single point in time." He cited the example of Equitable's smaller policyholders, who received cash rather than shares which subsequently appreciated. But isn't cash preferable to a nebulous membership interest?

Pete Grannis—who is far more patient than we—had some questions. "What is the demographic profile of your customers?"

"The bulk of them are middle-market, non-wealthy people," replied Kamen.

"Who," Grannis prompted, "would be less apt to take advantage of a subscription right offered to them."

"I think the overwhelming majority of

our policyholders would be in an economic position to participate."

Grannis cited the experience of past mutual-insurance-company subscription-rights offerings. "Virtually none of the policyholders exercised their rights."

Kamen, incredibly, expressed surprise at this fact. "Certainly all the mutual holding company policyholders I know in New York City would be very interested in subscription rights in an IPO because of the almost immediate increase in value." Of course, the policyholders of Kamen's acquaintance probably live within walking distance of his Park Avenue apartment, and may, like Kamen, have second homes near the beach on Long Island's east end.

As for the "almost immediate increase in value"—that has been due in large part to something one would hope MetLife would not want to participate in: the underpricing and abusive nature of the IPOs for mutual insurers (and for mutual savings & loans) rather than some magic inherent to *all* IPOs.

Finally, Grannis expressed concern about the sort of information MetLife would provide policyholders before they voted on their company's proposed reorganization as a mutual insurance holding company.

Kamen's response, although he apparently didn't realize it, was a stinging indictment of New York's bill as well as of reorganizations (or proposed reorganizations) such as those of Ameritas, AmerUs, FCCI, and Principal Mutual: "I think our lawyers would make sure that we're complete and open in the disclosure," he said. "*We would view that just like an SEC disclosure.*"

New York's bill does not even come close to such a requirement, nor do the laws of any other state. New York's bill requires that policyholders receive "a true and correct copy of the plan, or a summary thereof, approved by the superintendent, and such other explanatory information as the superintendent shall approve or require."

To date there have been less than ten mutual-insurance-holding-company "information statements," and those have had an alarming tendency to omit material risk factors and potential adverse effects that might occur as a result of the reorganizations. In fact, they have generally contained misleading language along the following line: "The plan will not *in any way* increase premiums or contributions, or diminish policy benefits, values, guarantees or other policy obligations." Such all-encompassing inherently unknowable guarantees are unusual in SEC filings—so unusual, in fact, that we don't recall ever seeing anything remotely like that in any of the *thousands* of prospectuses, 10-Ks, or offering memorandums we've read.

An SEC document would usually be written this way: "Although the board of directors believes the plan is in the best interests of the company, *there can be no assurance* that the plan will not increase premiums, diminish benefits, reduce values..." This would probably be followed by a host of "risk factors" or "investment considerations." And, of course, the cover of the prospectus would be emblazoned with a warning in bold type.

Most importantly, no SEC prospectus would be accompanied by a letter from the issuing company urging that one purchase the securities. Principal Mutual's information statement, however, is preceded by a 6-page letter from the chairman, in which the following phrases are accentuated in oversized bold type: "benefits for you," commitment to mutuality," "increases our flexibility," and "enhance[s] our financial strength." In the upside-down world of mutual insurance holding companies, dubious benefits are highlighted in bold, while material risks that would cause policyholders to vote "no" aren't even disclosed in fine print!

If Harry Kamen—a lawyer who, presumably, is well versed in corporate finance and securities law—really wanted to make sure that policyholders got a fair shake, he'd have seen to it that New York's bill required full SEC disclosure *and* the approval of at least a majority of policyholders—with policyholders' votes *weighted* based on the value of their policies.

Perhaps nothing is more telling than MetLife's annual report, which is only sent to policyholders (or others) who *request* it. The 1991 report was addressed "To Our Policyholders." The 1992 report was addressed "To Our Policyholders and MetLife Associates." Since 1993—the year Harry Kamen became chairman and CEO—the report has been addressed "To Our Customers and MetLife Associates." Contrast that with Northwestern's annual report, which is addressed to "Dear Fellow Policyowners."

MetLife can adorn its ads and brochures with the lovable Peanuts characters; it can donate huge sums of its policyholders' money to charitable causes; but its words and political actions speak louder than its billions. The policyholders aren't really thought of as owners, they are, as Kamen puts it, "customers."

A pundit once said, "nothing is illegal if 100 businessmen do it." America's mutual insurers can join together in a conspiracy; they can hire the fanciest lawyers and place lobbyists in every state capitol; but in the end, their audacious mutual-insurance-holding-company maneuvers will backfire. Before too long their affronts to decency, fairness, and mutuality itself will unleash a wave of rage and a sense of betrayal that will explode in front-page headlines, exposés, and—yes—national hearings.

We can picture *60 Minutes'* Mike Wallace ambushing Kamen before a national audience ("Mr. Kamen, you made $2.5 million last year. Why is it that you deserve stock options, but that the policyholders—who *own* MetLife—don't deserve anything?). We envision mutual directors being grilled in Washington by a latter-day Charles Evans Hughes, the steady gaze of network cameras capturing each embarrassing moment.

But before all that comes to pass—before it's too late—we want to say something that Clint Eastwood's Dirty Harry might have said to Harry Kamen: "The Magnum .45 of fairness and public opinion is cocked and pointed at your head. The only unknown is whether there's a bullet left in the chamber. So think about it long and hard, and ponder this question: 'Do you feel lucky, Harry? Do you feel lucky?'" ■

Neil Levin's 'Enemies List'?

Top Secret Photo

We recently needed a photograph of Neil Levin, so we asked our trusted circulation manager, Sarah Woodruff, to call the New York Insurance Department and ask for one. Sarah called Karen Eldred of the department's public affairs office, who said she'd look into it. A while later she called back and told Sarah that Neil Levin said he didn't want to be in our publication.

Assuming that what we were encountering was simply a failure to communicate, we called Eldred and explained that all we wanted was the official photo of Levin—you know, the one that gets sent to the press and appears on the Insurance Department's website.

Eldred made it quite clear that Sarah had got the story straight and that we weren't going to get a copy of Levin's press photo.

"Who paid for that picture," we asked, "and who pays for all the press releases Levin sends out?"

Eldred turned us over to her boss, John Calagna, with whom we'd had a couple of pleasant chats some years back. Doing time in Levin-worth must not agree with Calagna—or perhaps we just caught him on an off day—because he informed us that although the state had paid for Levin's picture and for the press releases bearing Levin's name, we were not going to get the picture. Calagna added that he (Calagna) had made the decision.

"How much did the department spend on photos of Neil Levin?" we asked.

He didn't have that figure at the tip of his tongue, and it's been over a month and we still haven't received an answer.

"What's the role or purpose of the Public Affairs Office?" we inquired. "Is it to advance a political agenda?"

"We're not a political office. We're here to explain the department's positions on issues, to release information that's public, and to respond to questions from the media."

We informed Calagna we were a member of the media and that the photo in question was a public document and that if we wanted to, we could file a Freedom of Information Law (FOIL) request.

Go ahead, said Calagna, "FOIL me."

"Does Levin have any additional comments?" we inquired.

"I don't think he has anything to add."

"Does he know anything about insurance?

"I think he knows a lot about insurance."

Thus ended our delightful conversation with John Calagna. We then called a friend in the press and asked him to send us the picture of Levin, which he was kind enough to do.

We're not sure what to make of this episode, although we wonder if somehow our brokers' license will be revoked (we're planning to let it lapse anyway) and if our name will be moved several notches closer to the top of Neil Levin's "enemies list."

In mid-January *The Wall Street Journal* reported that Levin had written to Principal Mutual the previous month informing them that, for various technical reasons, their mutual-insurance-holding-company plan wasn't "fair and equitable" to New York policyholders. Thus, if they were to proceed with the plan in its current form the company could lose its license to do business in New York.

Levin's gambit—to take charge of the mutual-insurance-holding-company debate—is exactly what it appears to be: a political ploy. It's an example of a bad commissioner doing the right thing for the wrong reason. After all, Levin is still gung-ho on mutual insurance holding companies.

As for Mr. Calagna, we shall refrain from suggesting that he go FOIL himself. ■

Schiff '97 Concert Tour: Live at the 'Big I'

Waltz Across Iowa

In the fall of 1997 David Schiff hit the road and headed for Des Moines. While he was there he did what tourists usually do: peruse files at the Department of Insurance, visit Allied Mutual headquarters, and meet with assorted insurance-industry folks. He also spent an hour on the air at WKUCB, the local public radio station, discussing feats of magic, prestidigitation, and illusionism: in particular how the great mandrake, John Evans, made $700 million of value disappear from Allied Mutual and reappear in Allied Group. Indeed, so powerful a conjurer was Evans that he was able to fill the otherwise empty pockets of Allied Mutual's directors, officers, and employees with $250 million, as well. Jonathan Narcisse, the host of the radio show, didn't appear surprised by Schiff's story, noting that it reminded him of *The Rainmaker*. He also said, with a laugh, that he hoped Schiff's plane didn't blow up on the way back to New York.

Before heading home, Schiff met with Bob Skow, senior vice president of the Independent Insurance Agents of Iowa. Skow, a CPCU, former independent insurance agent, and former state legislator, already knows just about everything there is to know about insurance in Iowa, still he was kind enough to afford a muckraker from New York City a couple of hours.

The following is the interview that took place:

SKOW: David, tell us a bit about yourself, about your background. How did you get in the insurance business?

SCHIFF: My family had a large insurance brokerage in New York called Schiff Terhune. I was in college and my stories weren't selling to the *New Yorker*, so I ended up needing a job. I worked at Schiff Terhune for five years before getting into the investment and investment-banking business. I worked at a variety of firms doing corporate finance and securities analysis and never expected to get back into the insurance business because I was really interested in finance. But in 1987 I bought a troubled wholesale insurance brokerage in New York called Emerson, Reid & Company. We turned it around and sold it at the end of 1996. I was president of the company, but over time I became less and less involved in the day-to-day operations.

In the late 1980s I got back to writing. I wrote for *Barron's* in 1988 and 1989. Then I was a contributing editor at *Worth* magazine for a couple of years. Along the way I started a newsletter for my insurance business. It was just something to send to clients, but gradually it became a real publication. It took me four years before I thought people might even pay for it; as it turned out, they would. I think of myself as a writer and analyst as opposed to a publisher.

So that's my main thing these days—writing *Schiff's Insurance Observer*. My goal is simple: to write the sort of stuff that I'd like to read.

In the late 1980's and early 1990's I wrote a lot about financial strength. I wrote about Executive Life before it failed. I was skeptical of the financial speculation at life insurance companies. In 1992, 1993, and 1994 I was probably best known for writing about A.M. Best. I wrote many articles criticizing their ratings, especially the fact that they wouldn't downgrade companies even when they knew these companies were weak. And I backed that up with a lot of evidence. I was widely quoted when I said that A.M. Best was "the Will Rogers of insurance rating agencies: it never met an insurance company it didn't like."

In 1994 I wrote an article explaining why Best was going to start downgrading large property/casualty companies below A-. I thought this was a great piece, a major analysis. But nobody picked it up. Then, a little while later The Home was downgraded and Continental was going to be downgraded. Financial strength suddenly became important! Best was trying to gradually shift companies down to lower ratings without disturbing things. They were always afraid of yelling "fire" in a crowded theater. But there's nothing wrong with yelling "fire" in a crowded theater if there's a fire, and it was my contention that there was one.

But Best has changed. They've improved, no question about it. They are not completely there yet, but they have toughened their standards.

Muckraking

SKOW: Many of the traditionalists in the insurance industry, whether they are journalists or companies like Best, would probably call you something of a maverick. Obviously you get into investigative journalism, which is kind of a different approach to insurance journalism. What is your response to the critics who say you're the kind a person who likes to attack successful business people, a person who approaches the nontraditional way of looking at things? Obviously those are charges you have heard before. What is your response?

SCHIFF: Well, to be honest, I've only heard it once, and that's from Allied Group. *Schiff's Insurance Observer* has been sued once (by Century Industries), and the case was withdrawn. The plaintiffs' lawyer wrote me a letter of apology, and I'm currently seeking sanctions.

When people have something to hide, they avoid the real issues. I've written Allied 30 questions—at their request—but they won't answer them. Allied's answer is that "Schiff is smearing us for his own gain, for notoriety." I say, "Let's discuss the issues." But they won't do that.

I'm critical, but, I think, fair. I analyze matters, do the work, and call it as I see it. Some of the trade publications have a different goal. Their reporters don't have as much time as I do to go through the issues. That's not necessarily their mission, either. They report the news—tell you what happened yesterday or last week. I'm trying to look ahead. Wayne Gretzky said, "Don't skate to where the puck is, skate to where it's going to be." So I'm trying to look at where things are going, or at what has happened but hasn't been reported.

Insurance doesn't get a lot of coverage. It's a giant industry, but until there were some failures five or six years ago, you hardly ever read a story about the industry. It's a fascinating industry with intriguing dynamics. To a large extent, insurance is a commodity. There are many players, and it's extremely competitive in a lot of areas. I don't consider myself an industry critic; I'm a journalist and an analyst. I'll criticize things if I think they are wrong, or if I see behavior that's not proper.

SKOW: Are you able to be more objective because your publication isn't dependent upon advertising like some of the other trade journals are?

SCHIFF: I can't speak about others' mindsets. A publication can take advertising and be objective. I don't seek ads, but I've run a few over the years.

SKOW: You briefly brought up the Century case, where your publication ran an article about Century's operations—which they didn't take kindly to—and filed a $50 million lawsuit. Tell us a little more about that.

SCHIFF: Century is a sleazy penny-stock company run by a bunch of promoters, and it had a financial interest in a company called Underwriters Financial Group (UFG), which I wrote about in 1995. I called UFG "The worst insurance brokerage in America." It was traded on the American Stock Exchange. It subsequently went bankrupt. The premium trust funds disappeared, several people involved have pled guilty, and the CEO was recently indicted.

Century had dealings with UFG and issued press releases making wild financial boasts. Some of the company's principals have been involved in nebulous insurance dealings as well. So I wrote an analysis of the company. I happen to be a connoisseur of unusual accounting practices—a field in which Century excelled. (They ultimately had to reverse major accounting entries.) They didn't like the article, so they sued me. A lawsuit is often an attempt to silence journalists, because defense costs are so high. But as I said earlier, Century dropped the suit and I'm seeking sanctions.

I've been sued before: Dow Jones and I were sued in 1990 over an article I wrote in *Barron's* pointing out why three publicly-held art gallery chains were in weak shape. (All the companies subsequently failed or their stocks became virtually worthless.) The case never went to trial; it was thrown out of court. Nuisance suits are a cost of doing business.

SKOW: You clearly have not been shy, as evidenced in some of your past articles: Reliance, USF&G, Conseco, Prudential, ISO. Some of those boys are pretty big. If I may use a David and Goliath approach, obviously you've taken on some of those giants. What have been the results? Have these allegations been found to be valid?

SCHIFF: I wrote about Prudential Property & Casualty several years ago when the company had an A- Best rating even though it was petitioning the Florida Department of Insurance for relief saying it faced "an unreasonable risk of insolvency." But I wasn't criticizing Prudential—I was criticizing Best's rating of the company. (PRUPAC is now rated B++.) As for USF&G, I wrote a history of the company. The interesting thing about USF&G is that several times over the last 100 years, it made terrible mistakes that brought it to the verge of insolvency. As a matter of fact, in 1934 it had to get loans from the Reconstruction Finance Corp., a government bailout. I didn't criticize USF&G—for the most part it offers a decent product. But that's different from saying a company's stock is good or bad. There are a lot of mediocre companies that might be attractive investments if the price is right. There are a lot of wonderful companies that are unattractive investments at too high a price. I merely chronicled some of the difficulties that USF&G had over the years. I guess my conclusion—that it's difficult to take a company like USF&G and turn it into a company that's going to earn a 15% return on equity over the long term—sounds critical. But I am skeptical. Nobody has ever turned around a company like that.

SKOW: Would you say that some of your articles have led to investigations by regulators—investigations by legal authorities? Obviously in many instances you've been on the cutting edge of some stories.

SCHIFF: My article about Allied has prompted the Iowa Insurance Department's investigation. Numerous people I've written about have gone bankrupt, been indicted, pled guilty, or gone to jail—subsequent to my articles. I think I've been ahead of the curve.

In early 1996 I wrote an article about H. W. Kaufman Financial Group, a surplus lines broker doing about $300 million in premium. A class-action lawsuit was recently instituted against the company. My article was cited.

You mentioned Reliance Group. I wrote my first piece on it in early 1992. At that time a number of insurance companies had failed, and Reliance was very leveraged. I went through an analysis of the company's financial structure and concluded that Reliance Insurance Company's preferred stock was a *buy*. I actually recommended the purchase of their preferred stock! More recently, I've criticized Saul Steinberg, the company's chairman and controlling shareholder. His compensation has been outrageous. He has gotten $6 million a year, yet Reliance hasn't performed well and the shareholders have done poorly.

Last year I wrote an article called "Reliance Group Can't Jump." Reliance had put up the money for an "African-American-owned" company called Sable Insurance Company that's licensed in California. If you want to pretend that this is a minority-owned company, when, in fact, Reliance Group paid for it, has de facto control, and administers the services, go right ahead.

Iowa: Where the Tall Corn Grows

SKOW: Tell us about the Iowa insurance industry. Last year you came to Iowa for the first time and did some investigation.

SCHIFF: I didn't come to Iowa to do an investigation; I came to Iowa because I'd never been to Iowa. I wanted to knock around and travel through cornfields. I like rural America. I live in New York and love the city, but when I get away I like going to little towns. I like to hike and camp and go up into the mountains or to the desert. I've driven and traveled all over America. So I came to Iowa, drove around the back roads—through cornfields—and interspersed the trip with visits to insurance companies. And I was very impressed. I was planning to write a story about all the wonderful companies in Iowa. I'm interested in regional insurance companies. Property/casualty is a regional business; life insurance less so: mortality doesn't vary much by region, and the money is made from investments. In the property/casualty business, however, you've got to know the territory. Often that's what separates the good companies from the bad.

Here in Iowa, there are 119 county mutuals, with anywhere from a few hundred thousand dollars of surplus to maybe a couple of million. Clearly they know their market and know what they're doing. A lot of them, as you know, are reinsured with Grinnell and IMT. But they can do a good job. It's a local business, property/casualty. That's not to say that State Farm, which is a national company, hasn't been able to succeed; obviously it has. State Farm is the largest writer of automobile insurance in Iowa. The number two company is Allied.

I'm impressed by Iowa. It's got a well-educated labor force. A big "problem" right now is that there are more good jobs than there are people to fill them. Everybody I speak to says he's having trouble hiring. Iowa is a nice place with a lot of good insurance companies: Grinnell, Employers, United Fire & Casualty. It's ironic that I ended up writing about Allied. Allied is the largest domestic property/casualty company, at least in terms of premiums. I didn't meet with Allied when I was here, although I had seen them over the years. They used to go around hyping their stock, and when they came to New York I attended conferences at which they spoke.

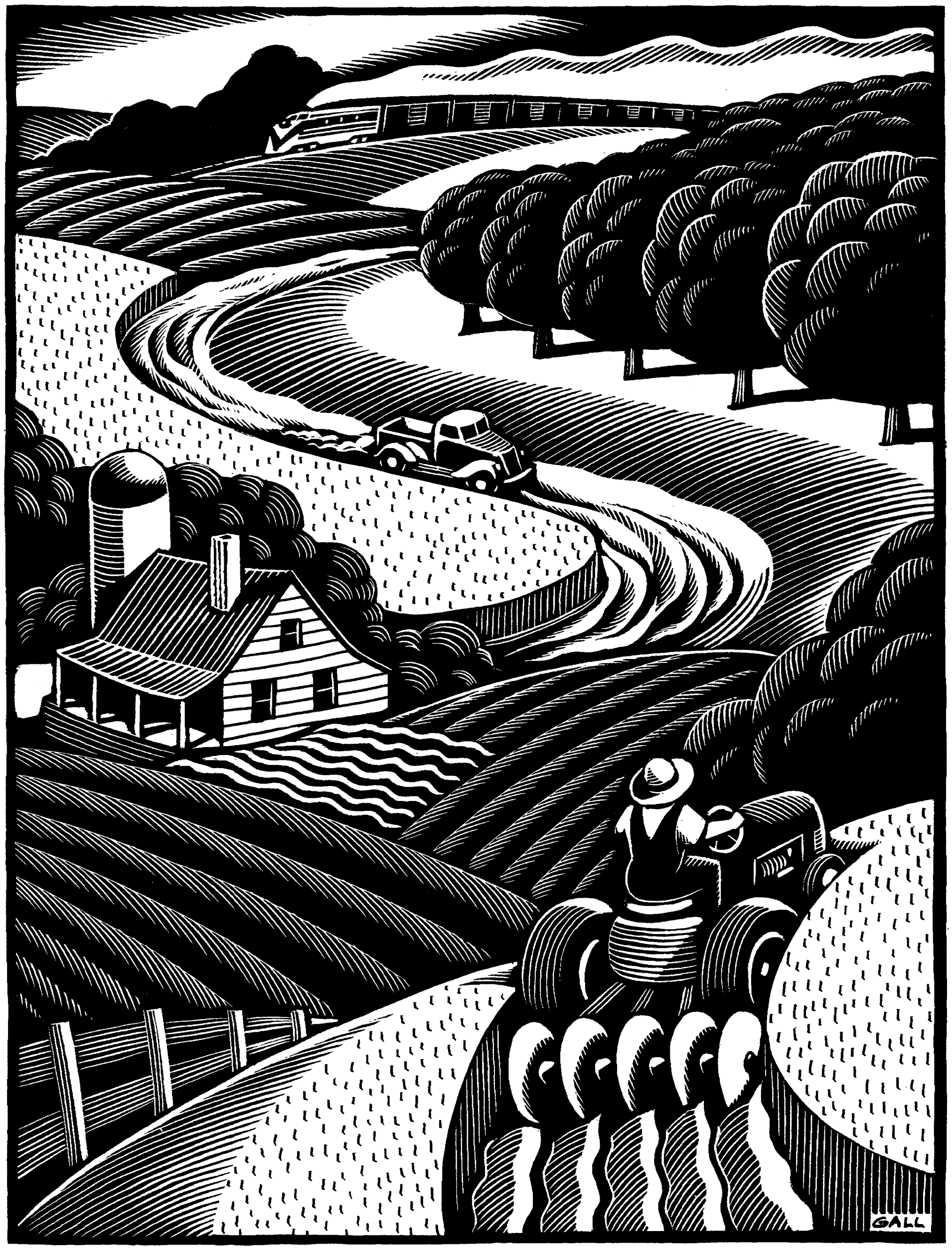
SKOW: Your October issue included an article titled "The Dark Side of Demutualization, or How to Make a Fortune From a Mutual Insurance Company." It's about Allied Mutual and Allied Group. Maybe you could tell us a little bit about what you found in Iowa.

SCHIFF: What I found was something very unusual. Allied is a mutual insurance company that set up a downstream stock company (Allied Group) and took that downstream stock company public. Not many mutuals have done this. The problem is that right off the bat this sets up conflicts of interest. John Evans was the president, chairman, and CEO of both companies. When you have the same guy running both companies he's serving two masters: at the mutual, he's supposed to get the best deal for the policyholders; at the stock company, he's trying to earn the highest return for shareholders. Those goals are irreconcilable.

Other companies have set up similar structures: Employers Mutual, for example. Yet Employers has managed to be extremely fair; they have gone out of their way to be fair to the policyholders and not take advantage of them. Bruce Kelley (the CEO) is a good guy. As to whether Allied has treated its policyholders unfairly, let's look at the record. Over the years, Allied Group (the stock company) and Allied Mutual have engaged in numerous intercompany transactions. They weren't forced to do these; Evans simply chose to do them. These transactions involved "conflicts of interest." Those aren't my words, they're Allied's words. And the sad thing is that in virtually every one of those situations Allied Mutual ended up with a poor deal and Allied Group ended up with a good deal. The same people managed both companies, yet Allied Group ended up making a lot of money and Allied Mutual didn't. As a result, John Evans and Allied Group's directors, officers, and employees have made about $250 million. And Allied Mutual's policyholders have lost out on over $700 million. Their company has been gutted. It has been hit with fees and transaction costs and sold assets at high prices. Its premiums were shifted to the stock company. New companies were formed that charged fees to the mutual. Allied Mutual is the punching bag, as far as I can tell. Of course, I've asked Allied's executives how this happened. I've made about a hundred calls to the directors and officers. I've written them letters. They simply won't respond.

SKOW: Where do you perceive this going? You have asked for a place on the board of directors. Why have you done that?

SCHIFF: I'm running for the board because this situation is so egregious that I just couldn't write an article and leave it at that. Nobody was sticking up for the policyholders. Who was watching out for their interests? In theory the insurance department is, but if I wasn't causing this stink by running for the board nothing



David Schiff's visit to Iowa, summer 1996.

would be happening. By the way, I don't blame the insurance department—they have a tough job—I blame Allied's directors and officers. So I'm running because I'm outraged. And you don't have to be a policyholder to be outraged. You don't have to be a resident of Iowa to be outraged. You can live in New York and still tell right from wrong. You know, I like the insurance business—it's something I understand and have some expertise in and—maybe—can make a difference in.

SKOW: Some might suggest, though, that you have a conflict of interest in writing an article, telling the story, and then turning around and positioning yourself for a run for the Board of Directors. What's your response to that? What's in this for David Schiff?

SCHIFF: There's no conflict of interest. A conflict of interest means that my financial interests are different from those of the mutual's. John Evans has a conflict of interest. He owned stock in Allied Group and would profit from Allied Group's making money, yet, he was calling the shots at Allied Mutual, too. He could engage in transactions that would hurt Allied Mutual, but make money for Allied Group, and for himself. It's not a conflict of interest for a journalist to run for the board of a company and serve as an outside director. As a matter of fact, I've waived all fees and compensation. I didn't want to be accused of being in this for the money.

SKOW: What do you say to those who charge that this is nothing but a public relations ploy on your behalf to sell more subscriptions to your newsletter?

SCHIFF: There are only a few people who have said that and they all happen to be senior officers of Allied Group. But I'll point this out: if I wanted to sell subscriptions through sensationalism why would I pick on Allied? I don't have many subscribers in Iowa. Most of my subscribers are where the biggest insurance companies are: New York, California, Texas, Illinois, Florida, Connecticut, and Massachusetts. I think I may have 20 subscribers in Iowa. So why would I pick on a company that most of my subscribers haven't heard of? Even though Allied is a billion-dollar company, it's obscure compared to State Farm and Allstate: these are 50 times Allied's size. If I wanted to attack somebody just for the sake of attack, I could, but it wouldn't sell subscriptions. Subscriptions are sold through direct mail—not newspaper headlines.

SKOW: Are other journalists picking up on this story?

SCHIFF: It's been picked up extensively. It's been written about in all the major insurance trade publications and *The Wall Street Journal*. *The Des Moines Register* has written many pieces about it, and *The Des Moines Business Record* has, too. This thing is going a lot further. Something shocking has happened, and I'm not going to let up. It has attracted national attention, but it will attract much more—$700 million of value has been shifted from Allied Mutual to Allied Group. I believe that the people responsible for this will not be on the board of Allied Mutual much longer. Before we go on, I'll say this: I've challenged Evans, Andersen, Shaffer—anybody from Allied Group—to a debate. I haven't heard a response, but I'm glad to debate any of the issues with them in any reasonable public forum. I'll come to Iowa; they don't have to come to my hometown.

By the way, my campaign has been endorsed by many people across a broad spectrum—Alan Press, past president of the NALU; Conrad Foa, board member of the NAIB; Jeremy Cooke, past president of NAPSLO; Ken Adelman, former U.S. Arms Control Director and former U.S. Ambassador to the United Nations; Ralph Nader, and many others.

Mutual Insurance Holding Co's

SKOW: Where do you see demutualization going? Some states have legalized the practice. The National Association of Insurance Commissioners is currently studying the process. Is this a trend we are going to see? Are we going to see the mutual companies of yesterday become the stock companies of tomorrow?

SCHIFF: Well, technically, Allied isn't a demutualization. The big issue these days is the mutual insurance holding company, which is not a demutualization. I prefer demutualization. If the directors of a mutual believe that the policyholders are better served by a holding-company structure, I think the proper way to do that is to demutualize and give shares or money to the policyholders. The policyholders are the owners of a mutual company. They are the ones who should be the beneficiaries of a change in corporate structure.

SKOW: What's your opinion of the Iowa mutual holding company law?

SCHIFF: It's bad—extremely flawed. It further disenfranchises the policyholders and puts them at serious risk. Policyholders have very little say in the governance of their companies as it is. That's one reason why management likes the mutual-insurance-holding-company structure. A mutual insurance holding company is neither a stock company nor a mutual; it's something in between. It is a mutual in the sense that the board of directors will be elected by the former policyholders, and therefore, for technical reasons, can never be thrown out. Yet the directors and officers will get stock options or equity in the stock company.

I don't think that the executives, directors, and employees of a mutual should own equity in a downstream or upstream stock company. It places their interests at odds with those of the policyholders. If you don't like mutuality, do a full demutualization. Pay off the policyholders, give them the stock, and operate as a true stock company. But a lot of mutual executives don't want to be accountable to their owners.

SKOW: Do you see it changing though? Take a company like ISO, which has been a nonprofit entity—overnight it becomes a for-profit entity. What are the conflicts we are seeing out there? Where do the consumers fall in all this?

SCHIFF: ISO is a different situation, because it was owned by insurance companies. They are big boys and are able to make their own decisions. I'm not for a lot of insurance regulation; I'm for a free market. On the other hand, I believe that the purpose of regulation—or one purpose—is to protect the policyholder. The small policyholder, in particular, can't understand a lot of these things. And one thing a mutual policyholder should be able to count on is that he's not being taken advantage of. That's basic corporate governance.

SKOW: Is state regulation adequate?

SCHIFF: I don't think federal regulation would be better. I think a lot of these things have gone too far and that there will be a backlash against it. I doubt the mutual-insurance-holding-company law will pass in New York—certainly not in its present form. There is strong opposition to it. On the other hand, there's a lot of money behind these bills, and people don't quite understand them. Most of the mutual-insurance-holding-company laws are stealth laws. The issues didn't get any public debate—and they are complicated, important issues.

The basic principle is this: mutual-insurance-company executives should not own stock in their affiliates, because that gives them the incentive to make money in a way that is not in the best interests of the policyholders. I want to see the policyholders' interests aligned with those of the executives of their company.

At Metropolitan Life, for example, Harry Kamen, the president, gets $2.5 million a year. Well, he doesn't think that's enough. He feels he needs stock options, too. But Metropolitan is owned by its policyholders. If Kamen wants it to be a stock company, then he should demutualize and give the policyholders stock.

SKOW: What's your response to some of the mutual companies saying that the only way they can retain good employees and get capital is to do these downstream holding companies?

SCHIFF: If they believe that's the best thing, then they should do a full demutualization. And in a full demutualization you give the policyholders stock. But the reason that many mutuals don't like that is that once you've done a full demutualization, suddenly most of the stock is going to be owned by "outsiders." The guy who's been the president of that company might get fired. The Board might get kicked out. The company might be taken over. The mutuals say they want the free market—to have stock and options—but they don't want the accountability.

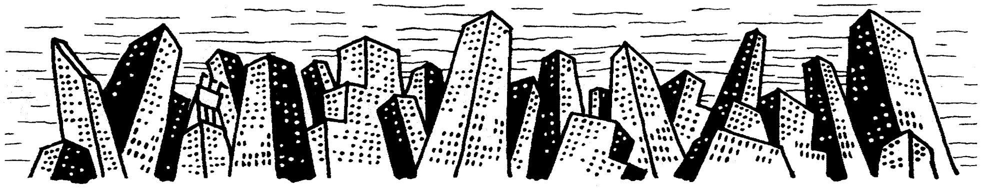
SKOW: So you are saying they want the best of both worlds.

SCHIFF: For the managers it's the best of both worlds, for the policyholders it's the worst of both worlds. Since mutuals are owned by the policyholders, their interests are the ones that should be served, not those of the managers.

SKOW: I think we are in the period when there are going to be these changes, there are going to be these tests out there. I find all of this very interesting.

SCHIFF: I agree with you. There's one more thing I'd like to add. I love the insurance industry and am fascinated by it. It's a terrific industry and, contrary to popular opinion, is not filled with rogues and con men. Companies like Allied are a black eye on the industry, and they reflect badly on everybody else. As we all know, the insurance industry is not beloved by consumers to begin with. People have negative feelings about insurance. They're never going to feel happy that they have to spend money on it. And if they have to "use" their insurance by dying or having a car crash, they aren't going to be happy either. It's not like buying a new TV set or a new car. That's just the nature of the business.

But there are a lot of insurance companies that I admire, and there are many people in this industry whom I admire. I can tell you from the calls I've got, most people wouldn't call me a critic of the industry. I'm a critic of an aberration, of a company (Allied) that has done something different from everybody else, and done it in a way that hurts its policyholders. And that hurts the industry. ■



THE INSURANCE BEAT

Yankee, Come Here

THE CAPTIVE INSURANCE Companies Association recently announced the birth of an exciting new domicile: the Republic of Panama, whose principal export is bananas.

Conveniently situated south of Costa Rica and north of Colombia, Panama offers a year-round steamy tropical climate and an international banking system well-versed in money laundering. Although the *Balboa* is the official currency, the dollar is welcomed as legal tender.

As for the regulatory climate, "rigorous" is not the word one hears bandied about. For a mere $250,000 an insurance company can write any line of business it chooses. Taxes on premiums, capital gains, and profits, are, of course, nonexistent. (Whether *profits* will be existent is a separate matter.)

Unlike Bermuda, Panama is not chock full of four-star hotels and beautiful golf courses. But insurance companies can write at a 5-to-1 premium-to-surplus ratio, and underwriters can avail themselves of nearby Colombia's endless supply of coca leaves.

On the downside, 35% of *reserves* must be invested in "locally authorized instruments." But, to paraphrase an old line, "Reserves? We don't need no stinkin' reserves."

Viva Panama!

The Sally Field Syndrome

UPON WINNING her second Oscar, Sally Field famously blurted out to a worldwide audience, "You like me. You really like me."

Herbert Haag, CEO of Partner Reinsurance, a Bermuda catastrophe reinsurer, has never even been nominated for an Academy Award, but, like the pert star of *Places in the Heart*, he too seeks validation.

Last year, Partner Re, which had 31 employees and $1 billion in capital, acquired Societé Anonyme Française de Réassurances for about $900 million. Speaking of his company's big, bold, expensive acquisition of a large multiline insurance company in a far-off land, Haag told *Risk & Insurance* that a group of overpaid, momentum-oriented greenhorns thought highly of what he was doing.

"All the analysts said they liked it," said Haag, referring to Wall-Streeters for whom one year constitutes the long term.

We've said it before and we'll say it again: when senior insurance-company executives start taking management advice from 27-year-old analysts and mutual-fund managers, it bodes ill for the industry.

In the meantime, however, Wall Street analysts like Haag. They really like him.

Cheesy

THE CHICAGO BOARD OF TRADE, home of the not-very-active catastrophe-insurance option, has some new competition in the speculative arena: The Chicago Mercantile Exchange, which recently announced it had begun trading in cheddar cheese futures.

While we, as speculators, have never dabbled in "cat" options, we've always been interested in cheese. As a matter of fact, we are "long" gruyère and gorgonzola and "short" port salut and provolone.

Whether the proximity of the cheddar pit to the catastrophe pit will prompt any insurance companies to hedge their cheddar exposure remains to be seen.

Nunsense

A FRONT-PAGE STORY in *The Baltimore Sun* reported that USF+G is evicting the Sisters of Mercy, an organization of nuns, from Provincial House, which is owned by USF+G. Although the company had generously allowed the nuns to remain there for five years without paying rent, it now wanted the space back.

It's unfair to expect USF+G to permit the nuns to occupy a valuable piece of real estate permanently; but it's hard to imagine a worse public-relations nightmare, says Jay Erbe, Jr., USF+G's vice president for administrative services "There are public relations rules so basic they don't ever have to be written," he told *The Sun*. "At the top of the list is this: you never, ever throw nuns into the cold."

Erbe tried to justify matters by noting that USF+G had money worries of its own: "This is a company that was fighting for its financial health six years ago. Two years ago we had cash-flow problems."

That last sentence will come as a surprise to anyone who read USF+G's 1995 financial statement. In a section entitled "Management's Discussion and Analysis of Financial Condition," the company noted that it had "cash flow from operating activities of $399 million," and that "management believes that internal and external sources of cash will continue to exceed USF+G's short-term and long-term needs."

In the words of an old tune recorded by Jimmy Rushing (Count Basie's lead singer), "It's a sin to tell a lie." On the other hand, the tenth commandment states: "Thou shalt not covet thy neighbor's house..."

Saul Steinberg Strikes Again

ALTHOUGH RELIANCE INSURANCE has traditionally sold its products through brokers and agents, it has now decided to sell auto insurance directly to car owners through a new company, Reliance*Direct*, which is modeled after Geico.

A car owner we know recently received a piece of junk mail from Reliance*Direct*. "Unlike other insurance companies," the letter explains, "Reliance*Direct* only insures good drivers. And to reduce your rates even further, we've also eliminated the middleman. So your rates are never inflated by agents' commissions and sales fees." Indeed, perhaps the only thing that might inflate Reliance*Direct*'s rates is Saul Steinberg's $6-million salary.

Reliance*Direct*'s pitch continues. "When we created Reliance*Direct*, we made sure to provide you with excellent service and promptly paid claims. Which is why A. M. Best rates us 'A- (Excellent)' for paying claims."

That, of course, is a whopper. The quality of Reliance*Direct*'s service and of its payment of claims has nothing whatsoever to do with its Best rating. As Best explains: "The objective of Best's rating system is to provide an overall opinion of an insurance company's ability to meet its obligations to policyholders." In short, a Best rating refers to an insurer's financial strength, not to how well it treats its customers.

We give Reliance*Direct* a special "F" rating for being misleading.