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Principal Announces Demutualization 'Study'

A Blow to the Mutual Holding Company Movement

In 1997 and 1998, America's largest mutual life insurance companies unleashed a full-fledged assault on the concept of mutual insurance. Using their money and political might, they lobbied and lied in an attempt to pass mutual-insurance-holding-company (MIHC) legislation that was antithetical to the concept of mutuality and not in the best interests of their policyholders. (About half the states eventually passed some form of MIHC legislation.)

Although the death knell for the MIHC concept—especially among large mutuals—has been ringing since mid-1998, the MIHC concept would not rest in peace. Like a zombie, it kept rising from the grave, threatening to devour mutual policyholders. (The financial-services reform legislation passed last year included a provision—courtesy of the National Association of Mutual Insurance Companies—that would usurp state regulation by permitting a mutual insurance company to redomesticate if its state of domicile doesn't permit MIHCs.)

On March 1, the remnants of the once omnivorous MIHC movement were dealt a significant blow. The Principal Financial Group, by far the largest MIHC, threw in the towel on the concept it had promoted so strenuously, announcing that its board of directors "had authorized management to study potential benefits of a demutualization and the possible conversion of Principal Mutual Holding Company to a stock company. As part of the study, the company will assess corporate structural alternatives to effectively achieve its strategic objectives."

In a press release, J. Barry Griswell, Principal's president and CEO, wrote: "The time is right to study demutualization as a means to fully access the capital markets to enable growth and to continue to meet the needs of customers today and into the future."

While it's conceivable that Principal will merely "study" the concept of demutualization, it seems unlikely that it would announce such a "study" if it wasn't fairly confident that, upon completing the "study," it would plan to demutualize.

Why the Public Announcement?

Unlike AmerUs—a mutual holding company that had taken its life-insurance company public (and therefore had to be concerned with the SEC's rules governing disclosure)—Principal Mutual Holding Company has no shareholders. It's regulated by the Iowa Department of Insurance, not the Securities and Exchange Commission. Principal *is not required to issue a public announcement* about a "study" that it plans to conduct in the future. In fact, the mere announcement of the "study" *creates* expectations among Principal's policyholders, agents, and employees. (In the past, we have estimated that the average Principal policyowner/member would receive about $15,000 if the company demutualized and were sold to a third party.)

In conjunction with the announcement of the "study," Principal has prepared new marketing material and guidelines. "Now that the company is studying demutualization, clients will have questions," the company advised agents. "There are new forms to use, and you must be extra cautious in servicing policies/contracts."

Principal told agents that "a letter, *Important Information for New Owners*, will be sent to owners of new policies/contracts issued after March 1. It informs them of the study *and that newer policy/contract owners are not likely to receive any compensation from a possible demutualization*." [Emphasis added.]

Principal has also created forms to notify existing customers that "if [a] demutualization is pursued, certain life, disability, and annuity transactions (surrenders, cancellations, lapses, terminations, nonrenewals, or ownership changes) could jeopardize" those clients' eligibility to receive any distribution of value.

In conjunction with the disclosure of its "study," Principal has added new "service-request forms" that require signatures from policyholders indicating that they have read and understood the notice about the "study."

Principal has also added a host of disclaimers to its marketing material, and at least 12 new service-request forms have been added for life, disability, and annuities. (The forms refer to ownership changes, cancellations, 1035 external exchanges, terminations of annuities, variable-life full surrenders, and election of current-yield benefit option). Agents have been instructed to destroy paper versions of the old forms, which are now obsolete.

Principal's corporate call center now includes a recorded message about the company's demutualization "study" (800-986-3343, option #6), and "specially trained staff" people are available to provide more "information."

A Discredited Concept

When Joseph Belth wrote about the mutual-insurance-holding company in the December 1997 issue of *The Insurance Forum*, he called it "a flawed concept."

With the abandonment of MIHCs by most of the large mutual life insurance companies, and with Principal's announcement on Wednesday, the MIHC has now become a *discredited* concept.

Principal Mutual began the process of converting to a mutual holding company in 1997 (if not earlier) and managed to squeeze its plan through in 1998. In converting to a MIHC, however, Principal had to pull out all the stops: inadequate disclosures, dubious statements, outright inaccuracies, and testimony by the company's chairman and investment banker that lacked credibility, to say the least.

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When the public hearing on Principal Mutual's conversion plan was held in Des Moines on January 23, 1998, the MIHC concept was going strong. General American (which failed 19 months later) had recently converted, and AmerUs's stock price was near an all-time high (it has subsequently collapsed). The National Association of Insurance Commissioners was drafting a "white paper" whitewashing MIHCs (it would be obsolete on the day it was finished). And state legislators were enacting MIHC laws without understanding their ramifications.

Although a handful of mutuals had completed conversions, none had met with any real opposition. That would not be the case with Principal.

For some time prior to the hearing, two ardent foes of abusive mutual-insurance-company transactions had been working 16-hour days to stop the onslaught of the mutuals' abuse, and—although outmanned and outgunned—planned to make a stand at the Henry Wallace Auditorium in Des Moines, where the Principal hearing would be held.

In a better insurance regulatory world, the two men—Jason Adkins, a public-interest lawyer, and David Schiff, an insurance observer—would never have met. But they were united by their outrage at the perversity of what was transpiring at mutuals, and by their disgust at a system so turned on its end that the very people whose job it was to protect the mutual policyholders' interests were the ones trying the hardest to enact plans inimical to the policyholders' interests.

Adkins and Schiff were determined to put an end to the MIHC movement, and the first all-out battle happened to be Principal.

The events that unfolded in the Henry Wallace Auditorium coincided with a turning point in the mutual-holding-company war. The battle that took place that day in Des Moines, and in the ensuing months, has never been chronicled in detail, but it was closely observed by a small circle of lawyers, investment bankers, and actuaries who make good livings from mutual conversions, and by large mutuals that were considering MIHC conversions.

As for Principal Financial Group's "study" on the potential benefits of demutualization, it's expected to be completed during 2000.

We've been working on an article about the battle over the Principal's MIHC conversion for ages. Some of it may be in the next issue of Schiff's Insurance Observer—*if we get around to it.*

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