

The Dark Side of Demutualization (or How to Make a Fortune From a Mutual Insurance Company)

The ALLIED Invasion

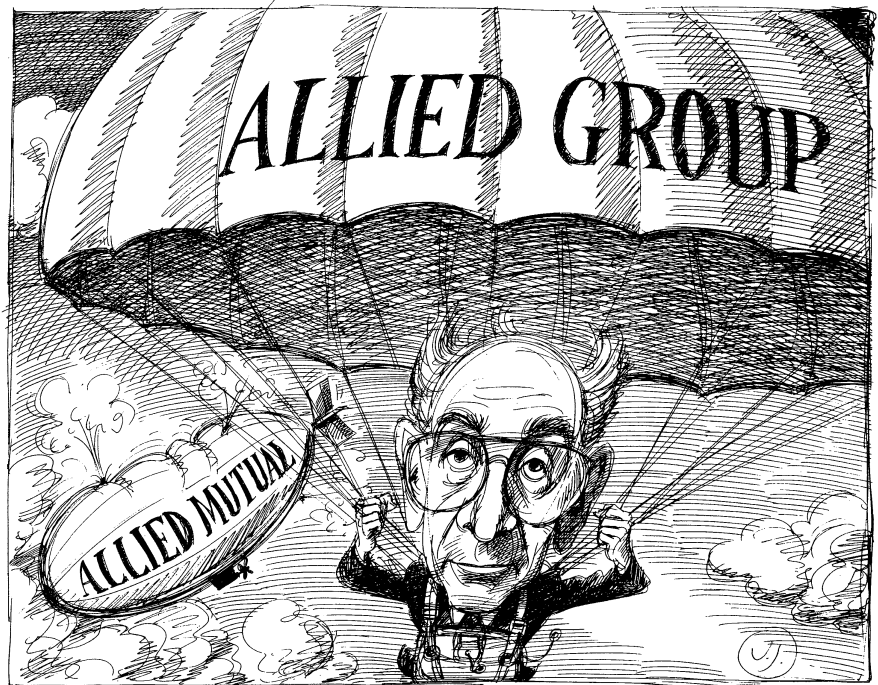
In theory a mutual insurance company is a wonderful thing: a collective where insureds pool their risk and resources for the common good. Because a mutual is not beholden to shareholders—it has none—its mandate is to serve its policyholders.

Mutual insurance has a long, noble tradition, and many mutuals are exemplars of prudence and success. One need look no farther than State Farm, America's largest insurance company, to see what has been accomplished under this form of ownership.

Although mutuals have done quite nicely for more than two centuries, the concept itself has been called into question of late. A small number of mutuals have gone so far as to demutualize, abandoning the cooperative form altogether. Equitable Life and UNUM are notable examples. It is ironic that, in an industry awash with capital, the most common objection to mutual ownership is that it is difficult for a mutual to raise capital, particularly equity capital. (Mutuals can't issue stock; they often raise money by issuing surplus notes, a form of long-term debt.) While access to the equity markets offers companies the opportunity to expand their capital, dozens of insurers, including AIG, Chubb, St. Paul, and Travelers, are now, in a sense, telling the stock market to shove it—they are repurchasing their shares by the truckload, shrinking their capital.

Another common objection to the mutual form of ownership is that mutuals can't grant stock options, thus making it difficult for them to attract and retain good people. We have not, however, noticed any correlation between policyholders' value and stock options. In life insurance, where policies are easily compared, most of the companies with the best 20-year interest-adjusted cost indices are mutuals. (This phenomenon is not unique to insurance. Vanguard Group, the highly efficient low-cost mutual fund giant, is a mutual.)

One capital-raising gambit used by some mutuals is a downstream holding company (a stock subsidiary that owns an insurance company) that sells shares to the public. Among those employing this approach are Allied Mutual, Employers



As chairman of Allied Mutual and Allied Group, John Evans faced numerous conflicts.

Mutual, Harleysville Mutual, Nationwide Mutual, and State Automobile Mutual. In these situations the mutual and the stock company generally share the same management, board of directors, facilities, employees, and agents. The problem with this structure is that it creates conflicts of interest; management is faced with two mutually exclusive responsibilities: providing policyholders with insurance at the most efficient cost, and providing shareholders with the highest return on their investment.

Policyholders of the mutual probably assume that conflicts arising from this problematic situation will be dealt with fairly, that management—which has a fiduciary responsibility to protect and preserve the mutual's assets (but usually owns shares in the stock company)—won't put its financial interests ahead of the policyholders'.

Employers Mutual, for example, the large Des Moines-based writer of commercial insurance, has balanced its policyholders' interests with those of its stock company's shareholders. Although Employers' managers could have raked in big profits for themselves by favoring the stock company,

they have acted responsibly, placing the policyholders' interests ahead of their own.

By way of comparison, policyholders of a large Iowa mutual located a few blocks from Employers have to wonder whether they've been given the shaft...

At first glance, the Allied Insurance Group appears to be a model insurance company. It is conservative, successful, and the antithesis of flashy—just what you'd expect of a company headquartered in Des Moines. Its core market is the Midwest, where it is primarily a writer of personal lines, which account for two-thirds of its \$800 million in premiums. Allied, which carries an A+ rating from Best, sells through multiple distribution channels: independent agents, exclusive agents, direct marketing, and banks. (Because of this approach as well as its dictatorial stance, Allied is often resented by its own agents, who refer to it as "the company you love to hate.")

Allied has kept its costs under control, set adequate reserves, and is a better-than-average underwriter, sometimes showing a combined ratio below 100. In some ways it is stodgy in the extreme: its "approach to

financial management" is "protective," meaning that it buys high-grade bonds and shuns common stocks.

Allied is actually two separate organizations: Allied Mutual, founded in 1929, and Allied Group, a stock company formed by the mutual in 1974. Allied Mutual owned 100% of Allied Group until 1985, when the latter company went public, selling a 21% interest. Today, Allied Group—which was once by far the smaller of the two companies—is worth four times as much as Allied Mutual. It has prospered and its management has grown rich while Allied Mutual has languished. Although the two companies are still affiliates, Allied Mutual has a negligible financial interest in Allied Group.

Therein lies one helluva story.

If you're a shareholder of Allied Group you might speak reverentially of John Evans, president and chairman from 1974 to 1994. (Now 69 and "semiretired," he serves only as chairman.) Evans is a short, serious-looking man with a bald pate and a smattering of white hair. He wears somber suits, white shirts, and traditional ties. Despite his low-key appearance, Evans is a wheeler-dealer who, between 1985 and 1993, engineered a dozen or so transactions—sales, purchases, poolings, transfers, stock repurchases, loans, etc.—that cumulatively made more than \$500 million for Allied Group. These transactions are noteworthy because virtually every one of them turned out to be a good deal for Allied Group (from which Evans received stock options, stock grants, and convertible preferred stock) and a poor deal for the party on the other side. Evans, in other words, batted 1.000 while his opponent struck out every time. Most intriguing, however, is that all of these transactions were with the same party—Allied Mutual, which Evans has run since 1964. (Evans was the third generation of his family to head Allied Mutual, which was started by his grandfather.)

Was it just coincidence that Allied Mutual, in which Evans had no financial interest, would fare so poorly in these transactions, while Allied Group, in which Evans and other employees and directors had a significant stake, would make out so well? When viewed as a whole, these complex inter-company transactions have now added more than \$500 million of value to Allied

Group—value that otherwise might have belonged to Allied Mutual's policyholders—but if they have provided any benefits to Allied Mutual we haven't detected them.

The transaction that set the stage took place on October 30, 1985, when Allied Group, then a wholly-owned subsidiary of Allied Mutual, consummated an initial public offering, raising \$16.8 million by selling 21% of its stock at \$5.33 per share—a price approximating book value. The proceeds from the offering did not go to Allied Mutual; they were contributed to Allied Group's insurance companies, thereby "increasing [their] underwriting capacity." (This increase would assume great importance later on.)

Whether Allied Mutual needed to raise capital is debatable. The company has long written at a reasonable premium-to-surplus ratio and its book of business—personal lines for the most part—has a short tail and is not particularly volatile. By arranging for its subsidiary's stock to be sold at book value (which was well below its intrinsic value) Allied Mutual was making a dilutive move akin to selling a 21% interest in a \$100 bill for \$15.

Even if raising capital by issuing stock at book value was justified, it's difficult to justify the granting of large amounts of stock options to employees at that low price—which further diluted Allied Mutual. Evans, who'd been running Allied Mutual for decades, received a bonanza for

engineering a deal in which part of the mutual's assets (Allied Group) was sold for less than takeout value. (He got options on 234,516 shares—about 1.6% of the company—while 11 other employees received options on a total of 475,943 shares.) These grants immediately separated Evans' interests from those of his employer, Allied Mutual, and its policyholders. From that moment on he would profit if Allied Group prospered, even if that prosperity was achieved to the detriment of Allied Mutual.

At the time of its public offering Allied Group was, according to its SEC filings, little more than a shell: "[Allied Group's] continued profitability is largely dependent upon the continued successful operation of Allied Mutual, which provides facilities, employees, and all services required to conduct the business of the [Allied Group] on a cost-allocated basis. All the officers of Allied Group are officers of Allied Mutual and two-thirds of Allied Group's directors are directors of Allied Mutual." Allied Mutual had 1,000 employees; Allied Group had none.

Allied Mutual and Allied Group also participated in a premium pooling agreement, which was explained in Allied Group's prospectus:

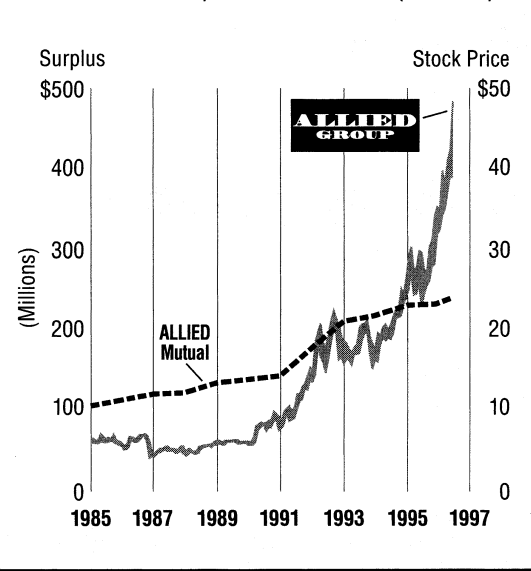
Allied Group cedes to Allied Mutual all of its insurance business and assumes 38% of all business in the pool. All premiums, losses, loss-settlement expenses, and underwriting expenses are prorated among the parties on the basis of participation in the pool...Allied Mutual provides data processing, professional claims, financial, investment, actuarial, auditing risk management, risk improvement, marketing and underwriting services, the costs of which are shared by the pool members [emphasis added]."

In plain English: Allied Mutual and Allied Group shared all premiums and expenses, with Allied Mutual keeping 62% of the total and Allied Group keeping 38%. As time went on, this arrangement would change dramatically—to Allied Group's benefit and Allied Mutual's disadvantage.

The following year, 1986, Allied Group started Western Heritage Insurance Company, a surplus-lines insurer whose marketing efforts would be carried out by Allied Mutual agents. (Allied Group's annual report referred to these agents as "a readily available distribution system.") Western Heritage did not pay Allied Mutual for the privilege of using its "distribution system," nor did it pool

ALLIED Mutual Languishes, ALLIED Group Soars

ALLIED Mutual's surplus vs. ALLIED Group's stock price



its premiums—which were quite profitable—with the other Allied premiums; the benefits accrued solely to Allied Group.

On January 1, 1987, Allied Group formed another company, Allied Group Information Systems (AGIS), “to provide all data processing services for the Allied companies.” Ironically, Allied Group had no employees of its own—it would use Allied Mutual employees to staff AGIS. AGIS would then turn around and sell the services provided by these employees back to Allied Mutual. Allied Group’s 1987 annual report noted that Allied Group received \$4.7 million in data processing fees from Allied Mutual and that “AGIS has already contributed to the profit base of Allied Group.” From a policyholders’ point of view (don’t forget, they’re the ones who owned Allied Mutual) it would have made more sense for Allied Mutual, which was much larger and had all the employees, to own AGIS and charge Allied Group for services. That, however, would have made Evans’ stock options less valuable.

On January 1, 1987, Allied Group’s share of the Allied pool was increased from 38% to 41% despite the fact that Allied Mutual had no pressing need to give up profitable business. (Its premium-to-surplus and gross-leverage ratios were far superior to the norms established by A.M. Best.) This pooling change was a boon for Allied Group; with a stroke of the pen (and at no cost) it increased its premiums by 9% and received a larger percentage of the pool’s assets. The increased assets corresponded with Allied Group’s increased responsibility for a larger percentage of the pool’s reserves. But since the Allied pool was mature and, in general, adequately reserved, Allied Group was taking on little risk. Yet it, rather than the Allied Mutual, would earn investment income on these assets before the claims were settled.

At Allied Group’s annual meeting in May of 1988 an unusual “executive equity plan” was introduced: John Evans and others were to receive 10-year stock options with an exercise price of 44¢ per share. At that time Allied Group’s book value was \$6.38 per share, making Evans’ 295,313-share grant worth \$1.75 million on day one. (Evans, who, like all employees, worked for Allied Mutual, received 46% of the options granted under the

plan. The options he received are now worth about \$13 million.) Although Allied Group’s shareholders had to approve the executive equity plan, such an occurrence was a foregone conclusion because Allied Mutual, which Evans had been running for 24 years, still owned 77% of Allied Group’s shares. “This majority stock ownership,” stated Allied Group’s proxy, “gives Allied Mutual the ability to determine whether the proposals presented at the annual meeting are approved.” Naturally, the stock-option plan was approved. Concurrently, stock options were offered to nine Allied Group directors (six of whom were also directors of Allied Mutual.)

In the late 1980s Allied Group was not the Wall Street darling it would later become, and its stock, which was then listed on Nasdaq, traded at a discount to book value. Earnings had been flat, but growth, which for the most part had been achieved by siphoning premiums and fees from Allied Mutual, had been impressive. Between 1984 and 1988 Allied Group’s premiums almost quadrupled.

Although Evans told Allied Group’s shareholders that the company had “an incredible future” and that its stock was “a favored buy,” it was hard to see where he was coming from. Yes, Allied Group was a good company, but how would it achieve above-average growth? In the ensuing years the answer became clear: Evans would engineer a series of transactions with

Allied Mutual—transactions that would make Allied Group (and its officers, directors, and employees) a fortune.

In 1988, “in recognition of [Allied Group] stock’s value for shareholders,” Allied Group spent \$1.2 million to repurchase shares at \$4.94, a price well below book value, and lower than the IPO price three years earlier. Clearly, Evans believed that the stock was a bargain. But why didn’t Allied Mutual, which had far more capital, buy the Allied Group shares, thereby profiting from this undervaluation? Evans, through his options and shares, would personally profit if Allied Group repurchased its shares at a price below their intrinsic value, but he wouldn’t profit if Allied Mutual bought the shares instead.

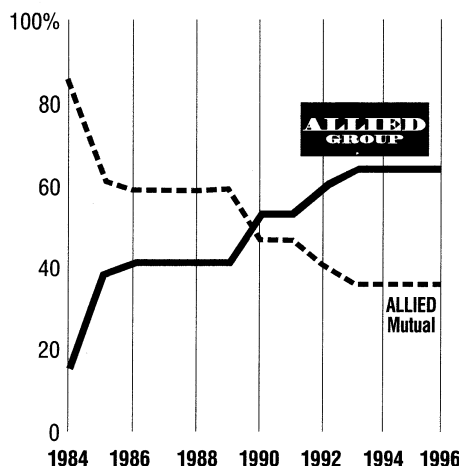
In 1989 Allied Group acquired Dougherty Dawkins, an investment banking firm. To finance the deal it borrowed \$7.8 million from Allied Mutual. Once again, the obvious questions: How did Allied Mutual’s policyholders benefit by bankrolling Allied Group? Why didn’t Allied Mutual, which had the capital, buy Dougherty Dawkins itself? One thing is certain: Evans would profit personally (through his shares and options) from a good deal made by Allied Group.

Eager to learn more about these unusual transactions, we left several messages for Evans at his Allied office, but our calls were not returned. When we finally tracked him down at his Pebble Beach home he declined to discuss matters, suggesting that we speak instead with Douglas Andersen, the current president of the Allied companies. Andersen’s office referred us to Jamie Shaffer, senior vice president and CFO, to whom we’d previously spoken, albeit briefly. Shaffer requested that we put our questions in writing—which we did. When we followed up, he said that he was too busy to respond.

In October 1989 the interlocking boards of Allied Mutual and Allied Group approved an Evans tour de force: a complex four-part restructuring plan that would nearly eviscerate Allied Mutual, all the while creating enormous value for Allied Group’s other shareholders. The basics were as follows: 1) Allied Group traded its subsidiary, Allied Life, to Allied Mutual in return for half of Allied

The ALLIED Insurance Pool

ALLIED Group’s percentage of the pool has quadrupled over the years.



Mutual's remaining interest in Allied Group, 2) Allied Mutual's 1,600 employees were transferred to Allied Group, 3) Allied Group established a leveraged ESOP (employee stock ownership plan), which gave the employees 37% of the company at a bargain-basement price, and 4) Allied Group's share of the Allied pool was increased from 41% to 53%.

Due to the "inherent conflicts of interest between the related parties," lawyers and investment bankers were hired by Allied Group and Allied Mutual to "insure the fairness of the restructuring plan." Allied Mutual was also represented by two of its outside directors, Hershel Langdon and Charles Colby. (Both would leave Allied Mutual's board in 1993. Colby then became a director of Allied Group, of which he now owns 17,896 shares, worth \$805,320.)

Despite the money lavished on shysters and bean counters to "insure fairness," the result of the restructuring should come as no surprise: Evans and Allied Group made a killing. And Allied Mutual? As they say in the fight game, it received a one-way ticket to Palookaville. From December 31, 1989 (right before the deal took place) to the end of 1996, its premiums and surplus have grown at paltry annual rates of 2.9% and 8.4%, respectively. During the same period Allied Group's premiums and stock have grown at annual rates of 17.1% and 29%, respectively.

Let's examine the transaction closely and see how this happened.

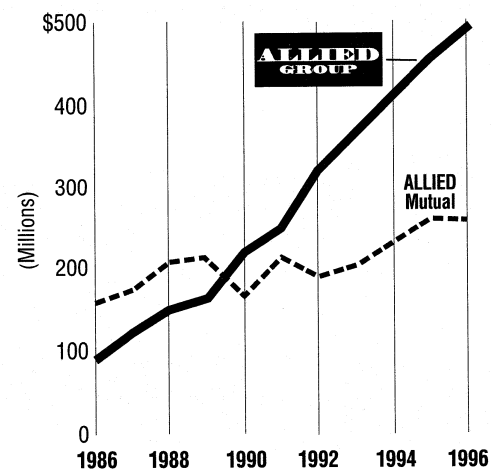
As the first leg of the deal, Allied Group "sold" its Allied Life subsidiary to Allied Mutual in exchange for 6,075,000 Allied Group shares.

Life insurance has always been little more than a sideline for the Allied companies. Allied Life was a piddling insurer (\$19 million in statutory surplus) that sold mainly through Allied property/casualty agents. It inherently lacked many of the strengths—distribution, efficiency, economy of scale—that the Allied property/casualty companies enjoyed. Nonetheless, it was valued at \$36.5 million—\$5.4 million more than its GAAP book value. Perversely, the 6,075,000 Allied Group shares that Allied Mutual parted with were valued at \$6.01 per share, an \$8-million discount to their book value of \$44.5 million.

Thus, Allied Mutual bought a dud of a

One Always Grows, The Other Doesn't

Premium Volume:
ALLIED Group has left ALLIED Mutual in the dust.



life-insurance company at a 17% premium to book value and sold a good property/casualty company at an 18% discount to book value. Based on price-earnings ratios the deal looks equally one-sided. Allied Mutual paid 13.4 times earnings for Allied Life and sold its Allied Group stock at 9.2 times earnings.

How could Allied Mutual's board of directors allow the company to enter into such a deal? One year before the restruc-



Allied Group sold its life-insurance company to Allied Mutual for 17% more than its book value and repurchased its own shares from Allied Mutual at an 18% discount to book.

turing, Allied Group (then 77% owned by Allied Mutual) had decided its stock was undervalued and repurchased shares at \$4.94. In the year following the repurchase, Allied Group posted results that Evans called "remarkable"—revenues rose 20%, earnings per share increased 23%, and book value per share grew to \$7.37. Yet Allied Mutual's board, spearheaded by John Evans and rife with conflicts of interest, now decided that Allied Mutual should sell a huge chunk of its Allied Group stock at an

adjusted price only slightly higher than the dirt-cheap price Allied Group paid to repurchase its shares a year earlier.

Today, the shares of Allied Group that Allied Mutual traded away are worth \$273 million, while Allied Life, which it received in return, is worth about \$50 million.

Six individuals who served as directors of both Allied Mutual and Allied Group owned shares or options in Allied Group and would stand to profit from the mother lode Allied Group would mine at Allied Mutual's expense. They were James Hoak, Jr., chairman of Heritage Communications; James Callison, president of Midwest Wheel and a director of Heritage Communications; William Hancock, a retired senior vice president of Allied Mutual; Mark Putney, CEO of Iowa Power and Light; Harold Evans, group vice president of Aluminum Company of

America, younger brother of John Evans, and recipient of \$75,000 in "management consulting services"; and John Evans himself, the supreme commander of the Allied companies.

We tried to contact each director (Mr. Hancock is deceased) but only one, James Hoak, returned our call. "I haven't thought about Allied for seven or eight years," he said during a cordial but uninformative conversation. "I don't really know the insurance business. I remember that there was a mutual and a stock company but I didn't even remember being on both boards." As for his stock options, Hoak, who told us he serves on "five or six other boards," said he thought he'd forfeited them when he ceased being a director.

Three other Allied Group directors—B. Rees Jones, a lifelong Allied Mutual employee; Donald Willis, president of Willis & Moore, a general insurance agency; and Harold Carpenter, president of George A. Rolfe Co., a manufacturer of agricultural equipment—had previously served on Allied Mutual's board but no longer owed allegiance to Allied Mutual.

Did Evans know that selling the property/casualty company below book value and buying the life company above book value might not be a good deal for the mutual? "Management believes that the future long-term profitability of property-casualty operations will be greater than the profitability of life operations," said Allied Group's proxy statement. *Continued*

As chairman, CEO, and largest individual shareholder of Allied Group, Evans would benefit from the swell deal Allied Group was getting. The proxy made that clear: "[Allied Group] expect[s] higher long-term profits...as a result of the Allied Life sale...[and] will realize an increase in book value per share, from \$7.27 to \$8.60." Conversely, Allied Mutual's tangible net worth would decline because of the deal.

The next two pieces of the restructuring were equally dexterous.

Allied Mutual's board of directors concluded that a leveraged ESOP would be a more "cost-effective means of providing benefits" to employees than the defined-benefit retirement plan in place. Of course Allied Mutual, the employer of virtually all personnel at both companies, could not, as a mutual, issue stock. So on January 1, 1990, its 1,600 employees were transferred to Allied Group, which then became the direct employer of all persons working for the Allied companies. After 61 years in business, Allied Mutual was bereft of employees.

Prior to this transfer, personnel expenses for Allied Mutual and Allied Group had been "allocated either according to the pooling agreement" noted Allied Group's proxy, "or on the basis of annual time and cost studies." Allied Mutual did not make a profit by providing Allied Group the use of its employees. This arrangement would supposedly continue once all the employees had been shifted to Allied Group: "[Allied Group] anticipates that similar cost allocation methods will be utilized in the future," said the company's proxy. (Three years later, that would change.)

Once the employees had been transferred, the leveraged ESOP was instituted. In granting stock to the employees, the percentage of Allied Group owned by Allied Mutual would decrease. If the ESOP paid full value for its stock, however, Allied Mutual would suffer no diminution. But if the ESOP got a bargain, Allied Mutual would, again, end up with the smaller "half" of the pie.

Bear in mind that in the preceding Allied Life swap, Allied Mutual's Allied Group stock had been valued at \$6.01 per share—a price befitting a Kmart blue-light special. Once that exchange was completed, Allied Group's book value rose from \$7.27 to \$8.60 per share (because it had repurchased shares below book value and

sold its life company above book value). Based on this increase in book value, Allied Group's intrinsic value was probably \$10 to \$11 per share. As you may have guessed, the ESOP (of which John Evans was a participant) didn't pay anywhere near that for its stock.

The deal worked like this: Allied Group contributed \$1 million to the ESOP, which then borrowed \$35 million (guaranteed by Allied Group) to buy, at \$6.66 per share, 5.4 million shares of Allied Group 8% Convertible Preferred stock. Each share paid an 8% annual dividend and was convertible into one share of Allied Group common stock. Thus, the ESOP was paying just 77% of book value to buy convertible preferred stock that was far better than the common: it had a liquidation preference and paid a 53¢ annual dividend versus 21¢ for the common. Assuming that a convertible preferred with such terms is worth a 25% premium to common stock, the ESOP was, in effect, buying common stock at \$5.33 per share—about half its true value. Allied Group's proxy stated the following:

The size of the ESOP was approved by the Compensation Committee of the Board of Directors of Allied Mutual...pursuant to the advice of Hewitt Associates and management. ["Management," of course, meant John Evans and company.] Under assumptions made by management...it was determined that the ESOP could result in a cost-effective means of providing employee benefits [and is] in the best interests of Allied Mutual...The projected present value of the required employer contributions to the ESOP over 15 years is approximately \$23,260,000. This is compared with the estimated present value of the required contributions to the existing defined benefit pensions plan over the next 15-year period, which is approximately \$28,229,000.

Allied concluded that the ESOP would save it a whopping \$5 million (present value) over the following 15 years. Immediately prior to the formation of the ESOP, Allied Mutual owned 66% of Allied Group. Immediately afterwards its interest was reduced to 38%. Today the 5.4 million shares the ESOP bought for \$36 million are worth \$243 million. Some savings!

As a result of the ESOP, Allied Mutual's interest in Allied Group was diluted and it missed out on about \$130 million of stock-market profits.

There was another justification for the ESOP (and, for that matter, the entire restructuring): to "generate additional surplus capital [emphasis added] to increase the business of Allied Group's property/casualty subsidiaries to take advantage of perceived

opportunities." As we shall see, the restructuring was not necessary to generate—and Allied Mutual did not benefit from—this additional capital. But the ESOP participants, including John Evans, did.

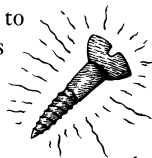
On January 1, 1990, the final piece of the restructuring was enacted: Allied Group's percentage of the Allied pool was raised from 41% to 53%. In its annual report Allied Group boasted that this pooling increase "gave [it] all the advantages of an acquisition without any of the drawbacks." Here's why. Allied's pool is a clean personal-lines business with better-than-average experience. Allied Group was taking on a big chunk of seasoned premiums without any of the risks that writing new business usually entails. As a result, in 1990 its premiums grew from \$163 million to \$219 million. This gain was Allied Mutual's loss. Its percentage of the pool dropped from 59% to 47%, and its premiums fell from \$213 million to \$168 million.

Allied Group benefited from the pooling change in another way: it assumed \$47.5 million of reserves from Allied Mutual and received \$47.5 million in assets on which it would earn investment income until those reserves were paid out. Evans proudly told Allied Group's shareholders that "our performance was enhanced by the transfer of assets accompanying the change in our pooling agreement."

Evans explained Allied Group's increase in the pool by noting that \$28 million from the ESOP stock sale had been contributed to Allied Group's property/casualty subsidiaries. This "infusion of capital," as he called it, allowed Allied Group to take on a larger share of the pool.

Evans' statement was baffling. The \$36 million generated from the sale of stock to the ESOP was an *infusion of debt* (because Allied Group guaranteed the ESOP's borrowings), not an infusion of equity. Had the Allied companies needed capital, Allied Mutual could have issued surplus notes, then used that additional capital to justify *shrinking* Allied Group's percentage of the pool. But Allied Mutual had no apparent need for additional capital. It's 1989 premium-to-surplus ratio was a modest 1.6-to-1. And Evans would not profit if Allied Mutual's share of the pool increased.

Jamie Shaffer, senior vice president and CFO of Allied Mutual and Allied Group, insisted that the pooling change was justified because Allied Group's insurance com-



panies were growing faster than Allied Mutual's and that the Allied Group companies were contributing a greater share of premiums to the pool.

Perhaps; but how is it that Allied Group ended up with the fast-growing insurance companies while Allied Mutual ended up with the slow-growing ones? In 1984 Allied Group had instituted the AIDCO program, which gave agents who wrote exclusively for Allied access to low-cost personal-lines products written through an Allied Group subsidiary, Allied Property and Casualty Insurance Company. According to agents and Allied Group employees, Allied Mutual policies are pricier than those issued through the AIDCO program and through another Allied Group subsidiary, Depositors Insurance Company, which bypasses agents entirely, soliciting business via direct mail and telemarketing. (On one occasion, when we called the Allied home office and asked if we could be referred to an agent, we were told that Allied could handle our needs directly, without one.) Since the market is competitive, it's not surprising that business would flow to the Allied companies with the lowest priced product. By 1996, AIDCO agents were responsible for 26.5% of the total premiums in the Allied pool.

Once the restructuring was complete, the relationship between Allied Group and Allied Mutual had been altered radically: Allied Mutual owned 37.1% of Allied Group and the ESOP owned 36.7%. Although Allied Mutual's surplus was 40% greater than Allied Group's, its premiums were now 25% less. Allied Group had all the property/casualty employees, and it had profited from the way its life-insurance company had been sold to Allied Mutual.

Evans would make millions of dollars (through his options and stock) as a result of these transactions. In his "chairman's letter" to Allied Group's shareholders in early 1990, he downplayed his cleverness. "Just because you're smart doesn't mean you can't be lucky," he wrote. (His invocation of "luck" reminds us of the scene from *Night After Night* in which an older woman, admiring Mae West's necklace, blurts out, "Goodness! What lovely diamonds," and West responds, "Goodness had nothing to do with it.") Evans' closing comments to Allied Group's shareholders were more telling: "The restructuring itself will yield immediate advantages and boost long-term profit potential. I don't know whether we'll

be lucky throughout the 1990s, but I expect us to be smart."

One might have thought that Evans, having created a situation that had enriched himself and his fellow employees so greatly, would allow the battered Allied Mutual the dignity of a standing eight-count. Indeed, Allied Group's 1989 annual report hinted that the carnage might be curtailed: "The proposed restructuring...is expected to provide the capital resources necessary for the growth of the property-casualty subsidiaries for the foreseeable future." Allied Mutual, however, was punch drunk and bloodied, and Evans, as relentless as Jake LaMotta, would, over the next few years, deliver a combination of body blows that would knock it clear out of the ring.

The following year, 1991, was a relatively good one for Allied Mutual—Evans didn't make it enter into any new transactions with Allied Group. The good times, unfortunately, would not last forever.

In February 1992 Allied Group completed a public offering in which it issued 3,881,250 new shares at \$8.22 per share. In one sense this was a strange deal: Allied Group was issuing stock at a 10% discount to book value, which, of course, diluted Allied's Mutual's interests. But it was also dilutive to Evans—who has crowed that he's a "serious investor who watch[es] the stock price."

But Allied Group would make up for issuing shares on the cheap by assuming a bigger portion of the Allied pool. To do



"It is the fruit of man's labor that makes a mutual insurance company great."

And you, as a mutual insurance-company executive, are entitled to a bite of that fruit.

Learn how to achieve greater wealth and rid yourself of those avaricious policyholders, all while enjoying the view from our Stanford White clubhouse adjoining the famed Shinnecock Hills golf course. Full links, lawn tennis, and 12-meter yacht privileges included.

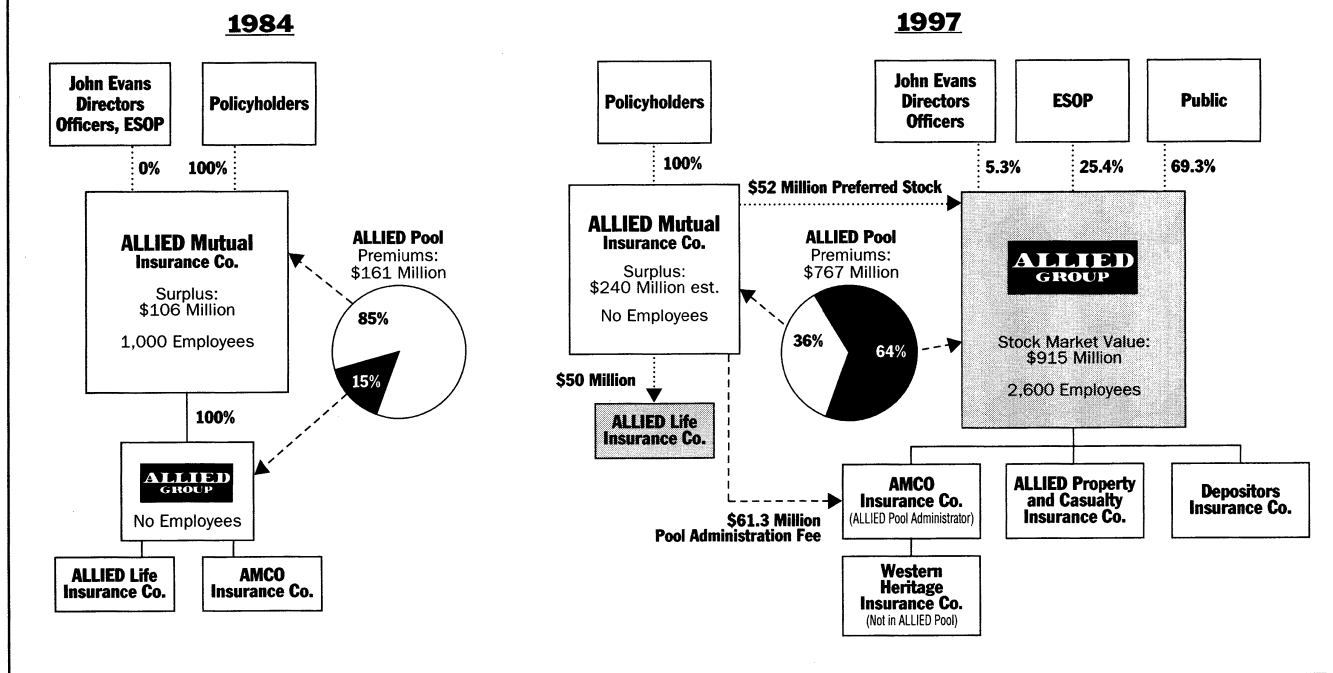
The Policyholders Be DamnedSM

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The Pomp of Power: The ALLIED Companies—Then and Now

Public Co. Shareholder Transactions



that, however, it needed more statutory surplus. ("What we needed was capacity," it told shareholders.) The \$30 million raised in the offering hit the spot—it was contributed to Allied Group's insurance companies, allowing them to "increase [their] participation in the Allied pool" from 53% to 60%.

Why, one wonders, did Allied Mutual permit its share of the pool to be reduced? One "objective" of the restructuring two years earlier had been to "fully utilize [Allied Mutual's] capital resources." Writing less business seems contrary to that goal. In fact, Allied Mutual could have bought the shares that Allied Group was issuing and still have had the bucks to increase its percentage of the Allied pool.

Because of the pooling change, Allied Mutual's premiums declined 10% in 1992, to \$191 million, a figure only 9% higher than 1987's premiums. By comparison, Allied Group's premiums had soared from \$121 million to \$320 million over five years.

Allied Group has always taken a cautious approach to new business. "We've never been so driven by growth," Evans told Allied Group's shareholders with a straight face, "that we entered territories blindly." He didn't mention that when you can assume premiums from a mature pool like Allied's, growth is not much of a con-

cern. After all, why stretch for new business—with all the risks that entails—when the pool's profitable renewal business was, apparently, theirs for the asking?

Between November 1992 and February 1993, Evans, who floats like a butterfly and stings like a bee, would execute four deft moves in rapid succession. By March, the once proud Allied Mutual would be reduced to little more than a spectral shell, done in by its doppelgänger, Allied Group.

The first transaction occurred in November, when Allied Group issued to Allied Mutual 1,827,222 shares of perpetual nonconvertible 6¾% preferred stock, valued at \$28.50 per share—an implied worth of \$52 million. In return Allied Mutual relinquished 4,111,250 Allied Group shares then trading at about 12⅞. Allied Group's 1992 annual report said that this "exchange helped Allied Mutual increase its investment income and met one of our priorities by providing long-term capital at a fixed cost." Let's examine those statements.

Since the preferred-stock dividend was \$1.92 per share, Allied Mutual would receive \$3.5 million a year in perpetuity. By contrast, Allied Group's common stock paid out 34¢ in 1993, which would have yielded Allied Mutual \$1.4 million. Thus it was factually correct to say, as Allied Group did, that Allied Mutual's "investment

income" would "increase."

On the other hand, Allied Mutual's "look-through" earnings plummeted. Allied Group earned \$37 million in 1993. The 4,111,250 shares that Allied Mutual traded away represented a 23.9% stake in those earnings, so Allied Mutual was essentially foregoing \$8.8 million (\$37 million in earnings times 23.9%) to pick up an extra \$2.1 million in dividends (\$3.5 million from the preferred minus the \$1.4 million common dividend).

Allied Group's 1992 annual report noted the obvious—that the preferred-for-common swap "will increase earnings per share for the holders of the common stock if [Allied Group's] fully diluted earnings per share exceed the cost of the [preferred stock's] dividend of \$1.92 per share." (Allied Group's earnings, not surprisingly, exceeded the cost of the preferred stock dividend.)

Jamie Shaffer, Allied Group's chief financial officer, defended the preferred-for-common swap by noting that both companies had obtained fairness opinions. He also told us that at that time Allied Mutual had been "criticized for having too great an investment in subsidiaries." In the 1996 Allied Group annual report, however, Shaffer pointed out what a good deal Allied Group had made. He called the preferred—

in which Allied Mutual was bagged—a “source of low-cost capital.”

The whole transaction seemed strange from the start. Why would Allied Mutual want to own \$52 million of unregistered, illiquid Allied Group preferred stock that paid 6¾%—and not a basis point more—until the end of time? Allied Group, apparently, wouldn't have touched such a piece of paper. Its \$608-million investment portfolio contained no preferred stock, and the average maturity of its bonds was six years. By contrast, the \$52-million slug of Allied Group preferred on Allied Mutual's books represented 12.7% of its \$394 million in investments and 22.4% of its policyholders' surplus. To make matters worse, long duration assets such as perpetual preferred stock are an inherent mismatch with the short duration of Allied Mutual's liabilities (reserves).

Today the 4,111,250 shares Allied Mutual traded away are worth \$185 million; the preferred stock, however, is still worth about \$52 million. Some deal.

On January 1, 1993, Allied Group's participation in the Allied pool increased from 60% to 64%, while Allied Mutual's decreased to 36%. More significantly, the pooling agreement between the two companies was amended: AMCO Insurance Company, an Allied Group subsidiary, replaced Allied Mutual as the “pool administrator.”

During the years that Allied Mutual had been the pool administrator, expenses had been allocated based upon each company's participation in the pool (e.g., a 25% participant picked up 25% of the expenses). But under the amended agreement, AMCO charged the other pool members fees greater than its actual expenses: 12.85% of written premiums for underwriting services, 7.25% of earned premiums for unallocated loss-settlement expenses, and .75% for premium collection services—20.85% total. Since Allied Group's expense for these services was about 18.85% in 1993, it immediately made a 2% profit on Allied Mutual's share of the pool (which contributed \$4.65 million to Allied Group's earnings that year).

The amended pooling agreement was contrary to the spirit of Allied Mutual's 1990 transfer of employees to Allied Group, the purpose of which had been to “provide for

employee incentives and benefits in light of statutorily-required amendments” to Allied Mutual's defined benefit plan. The ESOP, as you recall, was supposed to be a cost-effective way for the Allied companies to provide employee benefits—not a means for Allied Group to profit from Allied Mutual. In fact, Allied Group said at that time that it “anticipate[d]” that personnel expenses for it and Allied Mutual would continue to be allocated the way they always had been. The amended pooling agreement altered that allocation significantly.

In 1993, Evans told Allied Group's shareholders that “property-casualty is a nickel and dime business,” and that one must pay attention to “every penny.” Evans is an expert at doing just that—especially when the pennies belong to Allied Group, in which he owns stock and options. “Having [AMCO] named administrator of the Allied pool,” he boasted, “is an opportunity to flow every dollar of savings straight to the bottom line”—Allied Group's bottom line.

Jamie Shaffer was more ebullient, *exclaiming* that he felt “a sense of pride in the growth plan” he'd helped to structure. “AMCO has new opportunities to profit from increased efficiencies,” he said of the amended agreement, “and other participants have more predictable expense levels.” Shaffer was right on the money: Allied Group did have new opportunities to profit, and Allied Mutual's expenses were more predictable—*more predictably higher*.

“If we didn't already have our current financial structure,” Shaffer blabbed in Allied Group's 1993 annual report, “I'd be lying awake nights trying to invent it. Our relationship with Allied Mutual through the pooling agreement is such a plus. The

mutual company can concentrate on building surplus to assure policyholders of its continued solvency; our property-casualty segment can run lean enough to earn an attractive return on equity for you.” At that moment, Allied Mutual's surplus was \$209 million—approximately the same as Allied Group's—yet its premium-to-surplus ratio was an ultraconservative 1-to-1, versus 1.72-to-1 for Allied Group. It seems that Allied Mutual's policyholders were already *more* assured of their company's solvency than were Allied Group's policyholders.

Shaffer's comments raised many questions: Why was “earn[ing] an attractive return on equity” good for Allied Group but not for Allied Mutual? How did taking a smaller portion of the pool and paying AMCO fees allow Allied Mutual to “concentrate on building surplus?” And why, if Allied Mutual has concentrated on building its surplus, has its surplus plodded along at a marginal rate during the greatest bull market in history? Between January 1, 1993 and December 31, 1996, Allied Mutual's surplus grew from \$175.5 million to \$231.5 million, a 7.17% annual rate. During the same time Allied Group's earnings per share and stock grew at annual rates of 15.7% and 25.5%, respectively. (Since Allied Group's books are kept according to GAAP, policyholders' surplus—a statutory accounting concept—is a less meaningful measure of its success than earnings per share or stock price.) Finally, why are slow growth and paltry profits a better way for Allied Mutual to “assure” its “continued solvency” than the strong growth and hefty profits that Allied Group has racked up?

Six years earlier, in its 1987 annual report, Allied Group extolled the virtues of the *shared-expenses* pooling agreement then in place: “Participating in the pooling agreement *produces more stable underwriting results for all companies in the pool* [emphasis added] and reduces the risk of loss for any one participant by spreading the risk among all the participating companies.” By 1996, Allied Group was singing out of a different hymn book: “The [amended] pooling arrangement provides [the Allied companies] more predictable expense levels,” said the company's 10-K, and “AMCO has opportunities to profit from the efficient administration of underwriting, loss adjusting, and



premium collection activities...”

To see the effect the amended pooling agreement has had on the fortunes of Allied Mutual and Allied Group, one need only compare the two company's underwriting results. In the three years preceding the amendment, Allied Group, whose share of the pool ranged from 53% to 60%, experienced a cumulative underwriting loss of \$56.7 million; Allied Mutual's underwriting loss was \$36.2 million. (Both companies still made money due to investment income.)

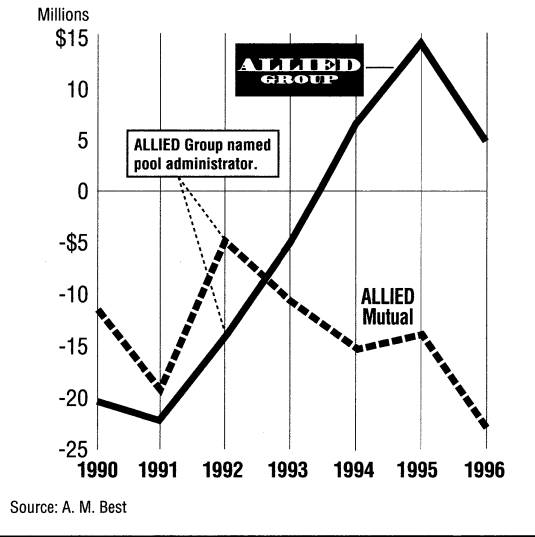
Once the amended pooling agreement took effect, however, Allied Group began showing underwriting profits while Allied Mutual's underwriting losses increased. Over the next four years Allied Group earned \$21.4 million from underwriting. Allied Mutual, burdened by the amended pooling agreement, lost \$63 million from underwriting. (See chart at right.)

Since premiums and claims are pooled, all members of the Allied pool have virtually the same “pure loss ratio” (62.5% in 1996). So how did Allied Mutual lose money while Allied Group made money? The answer lies in the “pennies” Evans was counting. Last year Allied Mutual's underwriting expenses and loss-adjustment expenses equaled 45.3% of premiums earned. By comparison, AMCO's expenses totaled 32.5%.

Let's take a closer look at the effect the amended agreement had on both companies' results. In 1996, the four members of the Allied pool—Allied Mutual (36%), AMCO (46%), Allied Property & Casualty (12%), and Depositors (6%)—had a combined underwriting loss of \$17.7 million. Had expenses been allocated *pari passu*, Allied Mutual, with its 36% share, would have lost \$6.4 million (36% of \$17.7 million). Instead, with its higher expenses, it lost \$23 million. Conversely, Allied Group's \$5.3-million underwriting profit would have been an \$11.4-million loss, but for the amended pooling agreement that allowed it to charge fees to, and earn profits from, Allied Mutual. The result: Allied Group's income was boosted by \$16.7 million (and Allied Mutual's loss was deepened by the same amount). That meant that after taxes, Allied Group's 1996 earnings got a positive jolt of \$11.9 million, or 58¢ per share.

Dirty Pool? Underwriting Results

Allied Mutual and Allied Group were once equal participants in the Allied pool. That changed in January 1, 1993, when AMCO (an Allied Group subsidiary) was named pool administrator. Since then Allied Group has recorded underwriting profits from the pool while Allied Mutual has reported increasing losses.



(Thus, without the amended pooling agreement, Allied Group's 1996 earnings per share of \$2.31 would have been \$1.73 per share—25% less.) Earnings were boosted in 1993, 1994, and 1995, in the same manner.

If Allied Mutual's directors hadn't approved the amendment to the pooling agreement, Allied Group wouldn't have achieved such rapid earnings growth, and its stock wouldn't have reached such lofty levels. At a recent price of 45, it is trading at 16 times the last 12 months' earnings of \$2.83 per share. If one were to adjust Allied Group's earnings downward by 25% (factoring out the underwriting differential between Allied Group and Allied Mutual), Allied Group's trailing 12 months' earnings per share would be only \$2.12. Assuming a



“Alfred and I plan to demutualize.”

multiple of 12 times earnings (slower growth, lower multiple) the stock would be changing hands somewhere around 25½.

In June and July, Evans sold 100,000 Allied Group shares at prices ranging from \$38.81 per share to \$44.77. During the same months his wife Jane registered 100,000 shares. (Shares are generally registered prior to their sale.)

Unlike Evans, Allied Mutual never got to profit from the spectacular rise in Allied Group's stock over the last few years. Just seven weeks after the amended pooling agreement took effect, Allied Mutual, under Evans' direction, sold the last of its holdings—1,462,500 shares at \$16.44. In its annual report, Allied Group noted with self-serving arrogance that “the sale of the mutual's shares served all stockholders by increasing the float without diluting earnings or book value.”

Thus, when the dust settled, Allied Mutual had sold its entire interest in Allied Group, given up 64% of the Allied pool, parted with all its employees, and—worse—was stuck paying fees to Allied Group for various services. Today Allied Group is worth about \$915 million. And what did Allied Mutual receive for parting with everything? Not much: \$24 million in cash, \$52 million of Allied Group preferred stock, and Allied Life, worth about \$50 million. The grand total: \$126 million.

After the whirlwind of activity that led to riches for Allied Group and emasculation for Allied Mutual, Evans could have rested on his laurels. He was now quite wealthy and, when you get right down to it, there's not much you can spend your money on in Des Moines, anyway. But he was eager to replay the success he'd had with Allied Group, this time using Allied Life, of which he was chairman, as the medium. (As you may recall, Allied Mutual had repurchased Allied Life from Allied Group in an unusual 1990 restructuring, giving up Allied Group stock that would later be worth \$273 million.)

In November 1993 Evans arranged for Allied Life to go public. As in the past, the offering was no bonanza for Allied Mutual. It sold shares at \$11.16 each (about book value) and received \$19 million in cash. Engineering this small public offering must have consumed a great deal of Evans' time;

otherwise why would Allied Life's "compensation committee"—Harold Evans and James Callison, who were also directors of Allied Mutual and Allied Group—have granted Evans ten-year options on 26,650 shares?

There's an old saw that a hooker has the best product in the world: *she sells it but still owns it*. The same might be said of Evans. As chairman of Allied Group he'd sold Allied Life back to Allied Mutual, profiting handsomely from the deal. Now he would profit once again from the sale of Allied Life, through options granted to him. (Douglas Andersen and Jamie Shaffer, Allied Group's current CEO and CFO, respectively—both of whom have been at Allied for ages and made a bundle as a result of the previous deals—each got options on 13,325 Allied Life shares.)

The Allied Life options were a relatively minor deal, even for a penny-pinching potentate like Evans—he'll probably make less than \$750,000 from them over time. That's because Allied Life is a small company (\$80.7 million in revenues, \$46.5 million of statutory capital) with no mutual affiliate from which to siphon premiums and fees. In fact, it had to *pay* Allied Group \$4.7 million in fees for "human resources," "joint marketing," and computer services over the last three years.

Evans made his *big* money from Allied Group and Allied Mutual. According to the ever-handly *Insurance Salary Survey* (P.O. Box 604, Palatine, IL 60078, [847] 934-6080), his cumulative compensation for the four years ending in 1995 was \$8.9 million, making him, as far as we can tell, the highest paid mutual property/casualty executive in the country. Edward Rust, for example, chairman and president of State Farm (which is 50 times larger than Allied) got \$3.5 million during the same period, and Bruce Kelley, president and CEO of Employers Mutual and EMC Insurance Companies (a Des Moines company the same size as Allied) got \$1.4 million.

Despite their lower pay, Rust and Kelley did much better jobs for their mutuals than Evans did for his. From the end of 1985 (when Allied Mutual took Allied Group public) to the end of 1996, Allied Mutual's surplus grew from \$102.8 million to \$231.5 million—an annual rate of 7.66%. During

the same period State Farm's surplus grew from \$10.12 billion to \$30 billion and Employers Mutual's surplus grew from \$98.2 million to \$410.8 million—annual rates of 10.38% and 13.89%, respectively.

So why did Evans get paid so much? That question is best put to the interlocking boards of Allied Mutual and Allied Group. But while we're on the subject of Evans' compensation, why did *Allied Mutual* own something called Allied Jet Center, Inc., which was, apparently, the corporate moniker for a Learjet? Did Allied Group share the cost of maintaining the Learjet, and did Evans use it to fly to his homes in California? Why, if it was once necessary, did Allied Mutual, as Jamie Shaffer informed us, get rid of the jet a

couple of years ago? Did that decision have anything to do with Evans' stepping down as CEO at the end of 1994 and spending more time in California?

Although Evans relinquished the titles of CEO and president, he remained chairman of all the Allied companies, and his imprimatur was everywhere. A photo accompanying Allied Group's 1996 "message to shareholders" shows Evans in a standing pose while Douglas Andersen and Jamie Shaffer sit at a table in front of him.

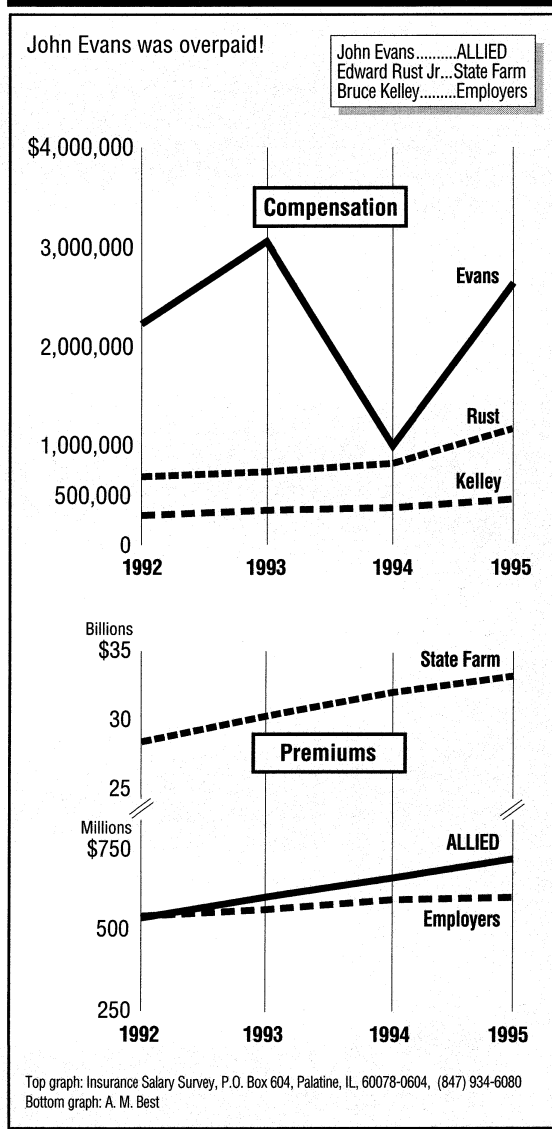
Celebrating its tenth year as a public company, Allied Group used the opportunity to rewrite history: "We achieved growth the same way we achieved greater profitability: by implementing strategies that reflected...our Iowa-rooted conservatism [emphasis added]."

Implying that a regional brand of conservatism had something to do with Allied's success was vintage Evans bunkum. Conservatism is a disposition to preserve that which is established, a tendency towards gradual change rather than sudden shifts. Evans' contorted stratagems—from thimblerrigging the Allied pool to deracinating Allied Mutual's labor force—cannot, by any stretch of the imagination, be labeled conservative. And that label is too simplistic for Iowa, with its intriguing contradictions, as well.

Iowa has always had a predilection for moderation, as well as, in the words of historian Dorothy Schweider, "a strong impulse toward social reform": before the Civil War it passed prohibition laws, and abolitionist feelings ran strong. Iowa embraced the Republican party (the party of Lincoln), granted constitutional rights to black men, and was home to the first state university that admitted women. Iowa, as John Gunther noted, is "the heart of agrarian America," yet the Populist party, which swept through neighboring western states like a prairie fire, never took hold there; but native-son Henry Wallace was the country's vice president from 1941 to 1945 and ran for president in 1948 under the Progressive ticket. Iowa voted for Dukakis in 1988 and Clinton in 1992 and 1996.

In short, "the Iowa-rooted conser-

Small Insurance Company, Big Salary



vatism” to which Evans refers is misleading. But Iowa is filled with well-educated, hard-working, churchgoing, temperate folks who eschew ostentation and would be repulsed by Evans’ feculent business dealings—if they only knew.

“We’ll take a calculated risk,” Evans told Allied Group’s shareholders in 1996, echoing the basic principles of insurance, “but we won’t trust to chance.” That sums up Allied Group’s interaction with Allied Mutual: it seems that little was left to chance. Allied Mutual was incapable of making a good deal. Allied Group (in which Evans had a big stake) could do no wrong, acquiring through a variety of maneuvers: the Allied insurance companies that grew the fastest, loans from Allied Mutual, a quadrupling of its share of the Allied pool, Allied Mutual’s employees, and fees for computer- and investment-management services from Allied Mutual. Allied Group relieved itself (at Allied Mutual’s expense) of its overvalued capital-intensive life-insurance company in exchange for undervalued shares of the reliable property/casualty company, bought back its shares in exchange for a pungent

perpetual preferred stock, and garnered a lucrative contract to “administer” the Allied pool.

It’s hard to discern any risk in these transactions, much less a *calculated one*. (Actually, Evans’ greatest risk was that Allied Mutual’s policyholders would notice what was going on and string him up from the highest tree.)

Although one of the purposes, ostensibly, for taking Allied Group public was to generate additional capital for Allied Mutual and its subsidiaries, Allied Mutual didn’t need additional capital, much less need it so badly that it should have sold its birthright: Allied Mutual’s cash proceeds from the sale of its Allied Group shares totaled \$24 million.

As for Allied Group, over the years it raised \$86 million from various public stock offerings, but spent \$83 million repurchasing its shares—\$31 million in cash and \$52 million in preferred stock—approximately what it took in from the public.

The open-market repurchases bring up the familiar issue of Evans’ dichotomous behavior. In February 1993, for example, Allied Mutual had, under Evans’ direction,


blown out the last of its Allied Group stock, receiving \$16.44 per share. What was the purpose of this sale (other than to “serve” Allied Group)? Allied Mutual had no pressing need for capital and its balance sheet was better than Allied Group’s.

Within a year Evans would do an about-face and oversee Allied Group’s *repurchase* of shares at a *higher* price—\$16.96 per share. This would prove to be as good a buy as Allied Mutual’s sale was bad: over the next three years Allied Group’s stock tripled. Once again, Evans profited from Allied Group’s propitious repurchase but lost nothing as a result of Allied Mutual’s untimely sale.

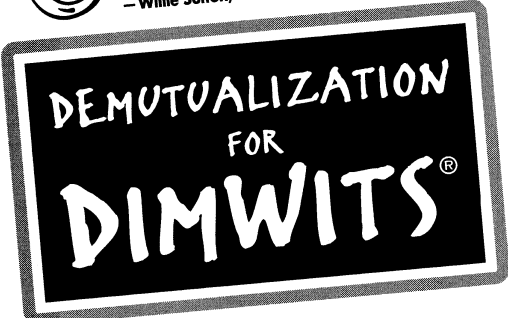
The sale of Allied Mutual’s final block of Allied Group stock is even more puzzling in light of recent changes in Allied Mutual’s asset mix. For quite a while Evans avoided common stocks, investing primarily in high-grade bonds. At year-end 1992, Allied Mutual had \$175 million of surplus and \$397 million in assets, but just \$2.2 million in stocks—0.6% of assets. In 1996, Allied Mutual finally caught a touch of bull-market fever and raised its stock portfolio to 4.4% of assets, or \$23 million (which is \$1 million less than it received from its last sale of Allied Group shares). Had Allied Mutual simply held these Allied Group shares it would have made an additional \$42 million.

Although Allied Mutual hasn’t had an equity interest in Allied Group since 1993, the preferred stock it owns allows it to “nominate for election” (read *appoint*) two of the ten directors on Allied Group’s board. Given the inherent conflicts of interest between the two companies, these directors should play the role of Allied Mutual’s champion and protector. To do this, however, they would need to be independent of Allied Group and its management. (It goes without saying that they shouldn’t have any financial interest in Allied Group.)

Were it not such a brazen disregard for propriety, Allied Mutual’s selection of Evans and his brother Harold to represent the company’s interests on Allied Group’s board would be farcical, because it’s difficult to imagine two directors more ill-suited than these. On the other hand, Allied Group’s shareholders had every reason to fancy Evans: he’d masterminded the intricate chain of events that had made them a fortune—at Allied Mutual’s expense.



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Whether Evans' dismal record at Allied Mutual (compared to his splendid record at Allied Group) is attributable to bad luck, ineptitude, or conflict of interest doesn't matter; he has done a miserable job for Allied Mutual's policyholders and shouldn't be their nominee for Allied Group's board.

In fact, if an outraged-and-determined New York journalist has his way, Evans won't be on Allied Mutual's board, either: he'll be booted out, along with all the other board members. This journalist, one David Schiff, is now an outside, independent nominee for the board, and has submitted a plan to liberate the company from Evans and Allied Group and return at least \$385 million to policyholders. (For more on this, see the following article.)

Evans and his pals will, undoubtedly, defend their orchestration of the Allied Mutual and Allied Group intercompany transactions. They will assert that these deals were reviewed and approved by boards of directors, coordinating committees, investment bankers, lawyers, and, in some instances, the Iowa Insurance Department. They will declare that advisors were hired and fairness opinions were issued; that certain matters were voted for by Allied Group's shareholders. They will state that Allied Mutual's policyholders duly elected every director. They will note that financial statements were gone over by independent auditors and that the insurance companies were examined by state insurance departments. They will aver that Allied received high ratings from Best and Standard & Poor's, and that documents were filed with the SEC, Nasdaq, and the New York Stock Exchange. And they will protest that our analysis has been made with the benefit of hindsight—that no one could have foreseen that each and every deal would be a boon for Allied Group and a bust for Allied Mutual. They may even say that they are shocked—shocked that things turned out so badly for Allied Mutual. (Or perhaps they'll take a different tack and maintain that Allied Mutual has done...admirably!)

But so what if sumptuously rewarded investment bankers and lawyers—surprise!—signed off on transactions? Big deal if low-paid bureaucrats and overworked regulators approved, but missed the ramifications of, intricate pooling arrangements and stock transactions. Allied Mutual's directors—the last line of defense—were charged with the responsibility of watching



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out for the policyholders. John Evans may have been their friend, colleague, or brother, but their allegiance rightfully belonged to Allied Mutual. Whether the directors' poor decisions were due to negligence, ignorance, or bad luck—the disembowelment of Allied Mutual Insurance Company happened on their watch.

We'll be the first to admit that calling

attention to directors' disposition to be rubber-stamping yes-men is a bit like complaining that an outhouse stinks. Unfortunately, insurance-company directors often serve the same function as Calvin Coolidge, who, according to Will Rogers, "didn't do anything, but that's what the people wanted done."

Although complacency is not a desirable

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trait in a mutual-insurance-company board, it may not be too damaging a quality when a company is run by people like Bruce Kelley or Ed Rust. On the other hand, giving John Evans a pliable board is like giving a two-year-old a chainsaw—something bad is likely to happen.

There's an investment angle to this story, and it is the sale of Allied Group stock. (For the record, we are neither long nor short and don't intend to take a financial position.) Allied Group has profited by riding—no, by *taking*—Allied Mutual's coattails. From 1985 to 1993 it grew rapidly by increasing its share of the Allied pool from 38% to 64%, and its earnings were boosted by outsmarting Allied Mutual in a variety of ways. Since 1991, however, Allied Group's annual premium-growth rate has slowed to 14.75% (10.3% since 1994). Earnings per share have grown much faster, though—23.6% compounded annually—in part because of fees charged to Allied Mutual (which accounted for 25% of Allied Group's 1996 earnings). But Allied Group's relationship with Allied Mutual is approaching a state of entropy—there isn't as much left to reap as there once was (Allied Mutual made \$12 million in 1995 and \$6.8 million in 1996), and whatever is reaped now will be less meaningful to Allied Group. (Allied Group made \$52.3 million in 1995 and \$51 million in 1996.)

Although its earnings were up almost 50% in the first half of 1997 due to improved experience in personal auto and homeowners, Allied Group may be sitting on the equivalent of a toxic waste dump: the *manner* in which it has achieved much of its growth over the years. If Allied Mutual's policyholders decide that they're mad as hell and aren't going to take it anymore, they might stage a revolt that culminates in the overthrow of Evans and the board, the elimination of excess fees paid to Allied Group, and the reversing of a decade's worth of cheap-jack maneuvers and gossamer transactions. Such an occurrence would have a devastating effect on Allied Group's earnings, balance sheet, and stock price (and a correspondingly beneficial effect for Allied Mutual's policyholders).

It is possible, of course, that this apocalyptic scenario is no more than the fanciful dream of a quixotic muckraker. Evans may be many things, but he is not stupid; Allied Mutual and Allied Group are intertwined through a variety of long-term contracts


and agreements that were designed by well-paid lawyers.

Yet we sense a turning of the tide, a move towards reform. Not so long ago, shareholders of public companies were disenfranchised too, but activists—at first a few small individuals, then corporate raiders, public pension funds, and mutual funds—demanded accountability. This

simple truth is often forgotten: mutual insurance companies are not the property of their directors or employees—they belong to their policyholders.


Policyholders' long period of quiescence may be coming to an end. And if it does, that may cause a few sleepless nights for John Evans, Allied Mutual's directors, and Allied Group's shareholders. ■


ALLIED Mutual Chronology


1929
 Allied Mutual formed in Iowa. Amended articles of incorporation later state that "the purpose and object of the corporation shall be to engage in the business of insurance...upon the mutual plan."


1964
 John Evans, 36, succeeds his father as head of Allied Mutual.


1974
 Allied Mutual forms a downstream holding company, Allied Group.


1985
 Allied Group goes public, raising \$16.8 million by issuing shares at a price approximating book value. Allied Mutual's ownership decreases to 79%. Allied Mutual's 1,000 employees provide all services for Allied Group and administer the Allied pool.

1986
 Stock options granted, including 234,516 to John Evans, Douglas Andersen and Jamie Shaffer each get 43,268.


1986
 Allied Group forms Western Heritage Insurance Co., which doesn't cede business to the Allied pool even though it markets through a "readily available distribution system"—Allied Mutual agents.

1987
 Allied Group forms Allied Group Information Systems (AGIS) and begins charging fees to Allied Mutual. Allied Group increases its share of the Allied pool to 41%.


1988
 Evans receives 10-year options to purchase Allied Group stock for 44¢ per share. (Book value is \$6.38 per share.) Other employees receive similar options. Allied Group directors (many of whom also serve on Allied Mutual's board) are offered Allied Group stock options.


1990
 Big restructuring plan: Allied Group sells Allied Life to Allied Mutual for 17% premium to book value and repurchases its own shares from Allied Mutual at an 18% discount to book value. (By 1997 Allied Life is worth \$50 million and Allied Group's repurchased shares are worth \$273 million.)

Allied Group's percentage of the Allied pool is raised to 53%. "[Increasing the pool] gave us all the advantages of an acquisition without any of the drawbacks," says Allied Group.


1991
 All Allied Mutual employees are transferred to Allied Group. Allied Group's ESOP borrows \$35 million (guaranteed by Allied Group) to buy Allied Group convertible preferred stock at a bargain-basement price, thereby diluting Allied Mutual. Allied Group employees will make \$243 million as a result.

Allied Mutual's ownership of Allied Group is now reduced from 78% to 40%. Allied Group's employees own 37%.


1992
 Allied Group's share of the Allied pool increases again—to 60%. Allied Group issues \$52 million of 6³/₄% nonconvertible preferred stock to Allied Mutual in exchange for 4,111,250 shares of Allied Group owned by Allied Mutual. Allied Group later refers to this preferred stock as "a source of low-cost capital." Today, the preferred stock is worth \$52 million, but the shares Allied Mutual parted with are worth \$185 million.

1993
 Allied Group's share of the Allied pool increases to 64%. AMCO (an Allied Group subsidiary) replaces Allied Mutual as the administrator of the Allied pool. Breaks tradition and begins charging fees to make a profit. Evans calls this deal "an opportunity to flow every dollar of savings straight to the bottom line"—Allied Group's bottom line.


As a result, Allied Group earns \$21.4 million from underwriting over the next four years while Allied Mutual loses \$63 million.


1994
 Under Evans' direction, Allied Mutual sells the last of its Allied Group stock at \$16.44. Says Allied Group: "The sale of the mutual's shares served all stockholders by increasing the float without diluting earnings or book value."


Allied Life goes public. Evans, Andersen, and Shaffer get stock options.

1994
 Allied Group repurchases stock at a higher price than that at which Allied Mutual sold out. Allied Group's stock triples in next three years.

Allied Mutual's executives apparently dislike traveling on scheduled flights: the company owns a Learjet.

1995
 Evans receives \$8.9 million in compensation between 1992 and 1995. He is now *Allied Mutual's* nominee for Allied Group's board.

1997
 Allied Mutual is worth \$240 million. Allied Group is worth \$915 million. Evans is still chairman of Allied Mutual, Allied Group, and Allied Life. His shares are now worth \$15.5 million.

1997
 David Schiff is nominated for Allied Mutual's board by dissident policyholder. Will attempt to gain seat held by James Callison. Also seeks to boot out the current board, reverse previous transactions with Allied Group, and return at least \$385 million to Allied Mutual's policyholders. Power to the policyholders!





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The Liberation of Allied Mutual

How I Plan to Seize Control of Allied Mutual

by David Schiff

I'm a fan of mutual insurance; it's worked for a long time. I'm also a fan of stock insurance companies. Many have done well for their policyholders and their shareholders.

The concept of mutuality, however, is under attack. In New York, which is noted for its conservative insurance regulation, Governor Pataki has proposed a nasty mutual-holding-company law that would allow mutuals to put their insurance companies into holding companies and sell stock in these holding companies to—who else?—the public.

In theory this may not *always* be bad; in practice it stinks. Nonetheless, many mutual-insurance-company executives embrace demutualization because it's a way for them to expand their companies' capital and engage in that great American pastime—making acquisitions. Whether that's good for the policyholders is, apparently, beside the point. Once a mutual is partially converted to a stock company, its executives can wrap their hands around the stuff that dreams are made of—stock options—and, with a little “luck,” make a bundle, like John Evans. Although Allied Mutual isn't the only mutual insurance company to have taken a beating from its stock-company affiliate, it's the most egregious example I've ever come across.

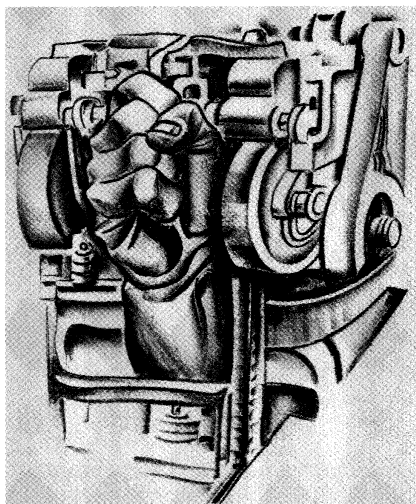
Last year I traveled through Iowa, which has 149 domestic mutuals, and visited several of the largest, some of which have publicly-held affiliates and some of which don't. (Iowa is on the front lines of the demutualization business, and Allied was one of the earliest to leave the trenches and go over the top.) I didn't meet with Allied—neither Evans nor Andersen was available—but I'd seen Evans do his shtick at insurance conferences over the years and was vaguely familiar with the success of Allied Group's stock.

When I delved deeper into the Allied Insurance companies this summer I became appalled—not just by the clever deals and asset shuffling, but by the shameless way Evans and his fellow executives boasted of their exploits to Allied Group's shareholders (e.g. “Having [AMCO] named administrator of the Allied pool is an opportunity to flow every dollar of savings straight to

[Allied Group's] bottom line”). Evans' hubris left me aghast. How, I wondered, was it possible to preside over the transfer of more than \$500 million of value from Allied Mutual to Allied Group without someone—a regulator, a consumer activist, a strike-suit lawyer—screaming bloody murder? Didn't *anyone* care about the policyholders? After all, Allied Mutual—all mutuals—are supposed to be run for the benefit of their policyholders.

When Kent Forney, a partner at Bradshaw, Fowler, Proctor & Fairgrave, in Des Moines, taught law, he used to make this analogy: “A policyholder's interest in the surplus of a mutual insurance company is roughly akin to a spouse's dower right, which is an inchoate right that can't be enforced until there's a dissolution of the marriage by divorce or death. Similarly, a policyholder's interest in the surplus can't be enforced until there's dissolution of the insurance company.” But, notes Forney, unlike a spouse's dower right, the value in a mutual insurance company belongs to the policyholders—they just don't have the individual right to compel the mutual to pay it out to them.

Somewhere along the way Allied Mutual seems to have forgot that its purpose was not to provide stock-market profits for Evans and his fellow employees. “The purpose and object of [Allied Mutual],” states the company's amended and restated articles of incorporation, “shall be to engage in



Policyholders of Allied Mutual, unite!

the business of insurance...upon the mutual plan.” Evans and the other Allied Mutual directors were fiduciaries; they were supposed to watch out for Allied Mutual, not worry—as those who were on both boards had to—about earning a high return on equity for Allied Group.

As I researched the Allied article—reviewing financials, reading documents, pondering transactions—I came to the conclusion that I wouldn't entrust Evans with the screw-off cap of an empty bottle of muscatel, much less the directorship of a large mutual insurance company. I was reminded of Alexander Woollcott's quip that a stockbroker is a man who takes your fortune and runs it into a shoestring. Woollcott apparently never met the chairman of a mutual insurance company who owned stock in its publicly-held affiliate.

I imagined that Evans had some convoluted rationalization for the disparate results experienced by Allied Mutual and Allied Group—something along the lines of the 1968 Associated Press dispatch from Vietnam quoting a U.S. Army Major saying “It became necessary to destroy the town to save it.”

But Evans didn't return my calls, nor did any of the other directors besides Hoak, who displayed a curious inability to recall details concerning his tenure on both boards.

It was around this time that I decided to do what anyone in the world is entitled to do: run for Allied Mutual's board, take control of the company, and set things straight. You see, I have as much right to be on Allied Mutual's board as John Evans does. “Directors need not be residents of Iowa,” states Allied Mutual's articles of incorporation, “and need not be Members [policyholders] to qualify for election to office.” In fact, the requirements are surprisingly simple: “Nominations for membership on the board of directors...[must be] presented in writing, signed by the Member...at least 60 days prior to” the annual meeting. That's it.

Since Allied Mutual has about 100,000 policyholders, I knew it wouldn't be difficult to find someone to nominate me. But I wanted to keep my intentions under wraps—this was a sensitive subject, after all—so I asked my ex-wife, the writer Joyce Walter (whose novel, *The Hallie Lawrence Story*, is one of the funniest books I've ever read), if she had any objections to becoming an Allied Mutual policyholder. Joyce knows as much about insurance as I know about

Hugo Gallert, “Machinery and Large-Scale Industry 44,” Courtesy Mary Ryan Gallery

Schiaparelli cocktail dresses, but she's always been a champion of the masses and was glad to help. So I located an Allied agent, took care of the arrangements, and paid a \$200 premium. Her policy arrived in the mail three weeks later, along with a document signed by Douglas Andersen, Allied Mutual's president, stating that she "is a member of the company and is entitled to vote...at all meetings."

In compliance with Allied Mutual's requirements, Joyce formally nominated me in a letter addressed to Evans and Andersen. (I drafted the letter and she signed it.) To ensure that the nomination would arrive promptly, I personally took it to Federal Express.

I also enclosed a letter outlining my reasons for seeking election to Allied Mutual's board, and suggested that it would make matters easier for me (and better for the policyholders) if the current board would, in accordance with Article 9, Section G, resign *en masse* immediately after appointing me (and my slate of first-class fiduciaries) as directors of Allied Mutual. To show that there were no hard feelings, I offered to send each Allied Mutual director a bottle of Dom Perignon upon his resignation.

Assuming that the directors reject my offer—as I expect them to—I'll wage a proxy fight and get elected at Allied Mutual's annual policyholders meeting, which is scheduled for one o'clock on Tuesday March 3, 1998, at the home office in Des Moines. Since Allied Mutual has a staggered board, only one seat, that held by James Callison, will be up for grabs this year.

Before I get into the details of my plan, I'll pose a rhetorical question: Can a lone muckraker, armed with a Power Macintosh 6500/250 and a budget that can barely buy a round-lot of Allied Group stock, walk through the mean streets of Des Moines, and wrest control from an entrenched chairman and his obliging understrappers?

Ordinarily that would be unthinkable. But Allied is no ordinary mutual: it is a vassal bound in feudal service to a tyrannical lord. It has seen its assets sold for *bupkis*, its employees taken, and its premiums diverted. It is encumbered by administrative fees levied by Allied Group, and, not surprisingly, is only marginally profitable. The final insult: Allied Mutual's policyholders generally pay higher premiums than Allied Group's policyholders do for essentially the same coverage.

In short, Allied Mutual is like a pile of oily rags (the hazard we were warned of in Insurance 101): it's an explosion waiting to happen. That's why I can overthrow the board. Ultimately, people will not allow such an inequitable situation to continue. That Evans has, for so long, pressed down upon the brow of Allied Mutual a crown of thorns is a testament to policyholders' ignorance, regulatory folly, a lack of scrutiny, and a general sense of complacency. But that's coming to an end.

Because Allied Mutual's policies tend to be more expensive than Allied Group's, Allied Mutual's policyholders are not benefiting from their company's surplus; they'd actually be better off with Allied Group policies. Allied Mutual's *real* beneficiary is Allied Group; it receives administrative fees and, through the Allied pool, the *use* of Allied Mutual's surplus, which enables the Allied companies to write more premiums, thereby allowing AMCO to

earn more from its administrative fees.

There's a good solution to this situation, and it's the backbone of my campaign for the board. Allied Mutual should reverse the myriad transactions in which it was bested by Allied Group: the pooling changes, the stock swaps, the administrative fees—everything. Since that may involve technical difficulties (and since Allied Group won't immediately agree to this), Allied Mutual might have to hire lawyers and consider seeking some kind of compensation for at least a decades' worth of sniggering schlock-house transactions. Although Allied Mutual was once much larger than Allied Group, its \$240 million of surplus is now about one-quarter of Allied Group's \$915 million market cap. Perhaps the two companies could simply split the difference—\$675 million—and do away with legal bickering.

Even if it receives a large payment from Allied Group, Allied Mutual won't have the wherewithal to administer its book of business (after all, it has no employees). There-

AN URGENT MESSAGE TO POLICYHOLDERS OF

ALLIED Mutual Insurance Company

Under the reorganization plan I've proposed to your company's directors you would receive a dividend averaging \$3,850 per policy.

Until 1985 your company, ALLIED Mutual, owned 100% of ALLIED Group. Today, after a series of intercompany transactions, swaps, transfers, sales, and poolings, your company has a negligible interest in ALLIED Group.

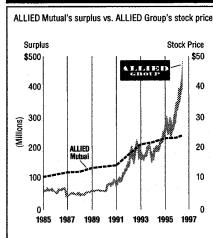
These intercompany dealings were masterminded by John Evans, who was and still is chairman of your company and of ALLIED Group.

ALLIED Group is now worth \$915 million. John Evans, ALLIED Mutual employee, and certain directors have made over \$250 million.

Yet your company has suffered, foregoing at least \$500 million of value.*

You can put an end to your company's bad management and arrange for \$385 million to be returned to you, the policyholders.

ALLIED Mutual Languishes, ALLIED Group Soars



Act Now!

For more information write to:
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1-ALLIED Group is worth \$915 million. Allied Mutual's surplus is \$240 million. Considering this \$675 million differential, \$500 million in value foregone appears conservative. 2-Source: ALLIED agents and ALLIED Insurance Group employees. 3-\$240 million may be available from surplus and \$385 million from the sale of reserved rights and reserves. ALLIED Mutual has about 100,000 policyholders. A distribution of \$385 million equates \$3,850 per policyholder. 4-ALLIED Mutual's expense ratio is significantly higher than that of AMCO, which manages the ALLIED pool. If a company in the ALLIED pool had the same expense ratio, ALLIED Mutual would save \$15.7 million per year. This would translate into a 6% savings per policy.



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Dear ALLIED Mutual Policyholders:

ALLIED Mutual is your insurance company, yet it has been run in a manner that has benefited ALLIED Group, a New York Stock Exchange listed company.

For the last 35 years your company, ALLIED Mutual, has been under the dominance of its chairman, CEO, and president, John Evans. Beginning in 1985 your company entered into a series of transactions with ALLIED Group, of which Evans was also chairman, CEO, and president—and largest individual stockholder, to boot.

These intercompany transactions have made at least \$500 million for ALLIED Group and enabled John Evans and ALLIED Group's other employees to collectively make more than \$250 million.

...but they have cost your company, ALLIED Mutual, a fortune. Furthermore, your company's policies are now often more expensive than those issued by ALLIED Group's insurance companies.¹

Incredibly, John Evans still serves as chairman of your company and of ALLIED Group—a classic conflict of interest.

Since 1985 your company's "policyholders' surplus" has grown at an annual rate of 7.66%—a dismal low result. In comparison, ALLIED Group's common stock has compounded at an annual rate of 21%. As of the February 28 proxy filing, John Evans owned 343,490 shares of ALLIED Group stock now worth \$115.5 million.

Liberate ALLIED Mutual Insurance Company!

What's my angle? I'm the editor of *Schiff's Insurance Observer*, an independent newsletter that analyzes the insurance business. I believe in the principle of mutual insurance and I'm distressed by the way it's practiced at ALLIED Mutual.

As part of my reporting I've become an independent outside nominee for ALLIED Mutual's board of directors. (By the way, I'm waiving all compensation, fees, proceeds, or distributions from ALLIED Mutual.) My agenda calls for ALLIED Mutual to distribute \$385 million to YOU, the policyholders. My plan, which has been delivered to ALLIED Mutual's board, will accomplish the following:

- Give you a \$3,850 dividend per policy.²
- Reduce your premiums.³

Your company needs to be emancipated from the management that has served it so poorly.

John Evans, his brother Harold Evans, James Callison, and their associates should be removed from ALLIED Mutual's board...

...and YOU can do that.

It's time to put an end to the management that has hurt your company.

Here's what you can do:

As a policyholder YOU elect the directors of ALLIED Mutual. Your company's annual meeting is held on the first Tuesday in March—that's March 3, 1998. In early January ALLIED Mutual should be sending you a proxy with which you may cast your vote.

Vote against John Evans' candidate, James Callison. And vote for David Schiff.

It's your money at stake.

Sincerely,

David Schiff
David Schiff
Editor

P.S. Learn all the details in the October issue of *Schiff's Insurance Observer*.

An ad that Schiff's Insurance Observer is running in *The Des Moines Register*.

The Authority on Auto Insurance

Auto Insurance Report is the only publication dedicated to sophisticated reporting on the largest property and casualty insurance market in the United States.

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<h2 style="margin: 0;">Auto Insurance Report</h2> <p style="margin: 0;">The Authority on Insuring Personal and Commercial Vehicles</p>	
<p style="margin: 0;">Vol. 3#27/123 April 29, 1996</p>	
<p style="margin: 0;">The FRONT PAGE gives you a quick look at hot news.</p>	<div style="border: 1px solid black; padding: 5px;"> <p style="text-align: center; margin: 0;">Inside</p> <p style="margin: 0;">Countersignature laws go down. Page 3</p> <p style="margin: 0;">State Farm tops list of big spenders in California lobbying. Page 3</p> <p style="margin: 0;">Nevada fights fraud harder. Page 3</p> <p style="margin: 0;">Storms hurt earnings. Page 3</p> <p style="margin: 0;">Court upholds insurance lobbyist's bribery conviction. Page 8</p> </div>
<p style="margin: 0;">SOLID REPORTING makes every story a must.</p>	<div style="border: 1px solid black; padding: 5px;"> <p style="text-align: center; margin: 0;">The Grapevine</p> <p style="margin: 0;">Louisiana Passes No-Pay, No-Play But With Wild Rate Rollback Twists</p> <p style="margin: 0;">The insurance industry wanted the Louisiana state legislature to pass a law that would prevent uninsured motorists from suing for pain and suffering damages resulting from an auto accident.</p> <p style="margin: 0;">As the old saying goes, beware what you wish for . . .</p> <p style="margin: 0;">At the 11th hour, the legislature did indeed pass such a "no-pay, no-play" bill (H196), but at the same time it mandated a 10% rate rollback on bodily injury insurance rates. And if 40% of the market succeeds in arguing that it can't justify the 10% rollback, then insurers will have to rebate 25% of premiums to all drivers</p> <p style="margin: 0; font-size: small;">Please see GRAPEVINE on Page 3</p> </div>
<p style="margin: 0;">THE GRAPEVINE is a weekly column of inside scoops, with updates on job changes and more.</p>	<div style="border: 1px solid black; padding: 5px;"> <p style="text-align: center; margin: 0;">Growth Clouds Results</p> <p style="margin: 0;">Colorado Auto Majestic For Some, But Becoming Rocky For Others</p> <p style="margin: 0;">In recent years, Colorado has been a good place for selling auto insurance. On that point most insurers agree. Will it continue? That's where it gets more complicated.</p> <p style="margin: 0;">Because the state is growing quickly, it has made room for many new competitors. It has also brought existing companies a book of business that has a high level of new customers mixed in with long-term customers. A number of insurers contacted last week reported that these factors are making it hard to get a firm hold on where the market is headed. Some are certain that tougher times are coming as claims rise and competition holds prices down. Others see a continuation, at least in the near-term, of the current favorable marketplace.</p> <p style="margin: 0;">Back in the 1980s, when most state personal auto insurance markets were performing poorly, Colorado was among the weaker states. It didn't help when a giant hail-</p> <p style="margin: 0; font-size: x-small;">Please see COLORADO on Page 5</p> </div>
<p style="margin: 0;">The STATE FOCUS provides thorough statistics and detailed analysis of key markets.</p>	<div style="border: 1px solid black; padding: 5px;"> <p style="text-align: center; margin: 0;">In November, California Ballot Will Again Be Tort Reform Battleground</p> <p style="margin: 0;">California voters just rejected three tort reform ballot initiatives in March. But they're going to be faced with another three in November in an ongoing battle between business interests and lawyers with a major impact on insurers. And supporters of a failed no-fault ballot initiative are vowing to try again in 1998.</p> <p style="margin: 0;">The March initiatives would have introduced strict no-fault, would have made it more difficult to bring a class action shareholder suit, and sought to curtail the contingent fees lawyers earned on lawsuits that settled quickly.</p> <p style="margin: 0;">The state's trial lawyers, through the Consumer Attorneys of California, raised millions of dollars to fight the initiatives in March, and simultaneously they were collecting names to put a counter-initiative on the ballot. Depend-</p> <p style="margin: 0; font-size: x-small;">Please see BATTLEGROUND on Page 2</p> </div>

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fore, it should sell its \$300 million in premiums (which had a 62.5% pure loss ratio last year) to the highest bidder. Investment bankers (not the ones who did the fairness opinions) can handle this, and I wouldn't be surprised if Allied Mutual gets \$125 million, maybe more. As a matter of fact, Allied Mutual's book of business would fit quite nicely with Allied Group's operations.

What will Allied Mutual be worth when this has been accomplished? Well, it started with \$240 million in surplus. Add \$125 million from the sale of its book of business, plus whatever is received in settlement from Allied Group (half of \$675 million?). Throw in \$20 million or so for the equity in its loss reserves and the total is somewhere between \$385 million and \$725 million.

Whatever the final figure turns out to be, it belongs to the policyholders. Since there are approximately 100,000 of them, that's \$3,850 to \$7,250 apiece. Whether the best way to distribute this is by declaring a dividend, by liquidating Allied Mutual, or by some other means, is a matter that will require the assistance of accountants and lawyers (doesn't everything?). We'll hire the best when I'm Allied Mutual's chairman, and get the money back to the policyholders as soon as possible. (By the way, I'm waiving all compensation and director's fees, and Joyce will waive any proceeds or distributions that would ordinarily be due her as a policyholder.)

To kick off my campaign for Allied Mutual's board I've placed an ad in *The Des Moines Register* (see previous page), briefly explaining the situation and seeking the support of policyholders. Although the election is five months away, I have a feeling that it will turn out to be an uneven battle: Evans and the other Allied Mutual directors won't stand much of a chance. Through their actions they have demonstrated that they aren't fit to be on Allied Mutual's board, and their agenda—whatever it is—has not served the policyholders.

I have a suspicion that once Allied Mutual's gimcrackery gyrations, chop-shop poolings, and irreconcilable conflicts of interest are exposed to the light of day, the policyholders, the regulators, the press, and the public will demand change. The time is right, and I hope my actions will serve as an inspiration for mutual policyholders, as a wake-up call for regulators and legislators, and, at long last, as deliverance for the true owners of Allied Mutual.

Power to the policyholders! ■