



Who Owns a Mutual Insurance Company?

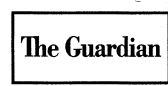
In a simpler time, before the technological breakthroughs that led to the inventions of reload stock options, golden parachutes, and other executive bonanzas, it was well known that mutual insurance companies were owned by their policyholders.

Now, as mutual insurers seek to turn themselves into mutual insurance holding companies and financial-services conglomerates, mutual insurance executives, with the help of well-paid lawyers and investment bankers, are renouncing the axiom that policyholders are owners.

 "Principal...is a mutual company, owned by its policyowners. Dividends are paid only to policyowners."
1984: Principal Mutual brochure

 "The issue of whether or not policyowners actually 'own'—with that word—a mutual insurance company, is one that lawyers have argued about for many years."


January 23, 1998: Principal Mutual chairman & CEO, David Drury, in sworn testimony. (David Drury has worked at Principal since 1966.)

 "A mutual company is owned by its policyowners. We work for the benefit of our policyowners."


1998: Joseph D. Sargent, president & CEO, Guardian Life, on the company website

"Since this is a mutual company, you are more than a customer, you are an owner."


1998: Northwestern Mutual president & CEO, James Ericson, in a form letter welcoming new policyholders

 "We do not agree, however, that discussion of case law or 'ownership' of a mutual insurer is either necessary or helpful. At best, it will only serve to demonstrate that there are conflicting legal and academic theories as to whether these rights constitute 'ownership' rights."

January 20, 1998: William B. Fisher, vice president & general counsel of Massachusetts Mutual, in a letter to the NAIC on behalf of his employer, Guardian Life, Northwestern Mutual, and others.

 "Unlike stock insurance companies, which are owned by investors who may have no other connection with the company, mutual insurance companies are owned by their policyholders... Unlike stock companies, mutual companies exist solely to serve the needs of the policyholders, and not to provide investment profits to shareholders."

April 17, 1998: Website, National Association of Mutual Insurance Companies


 "Under our current mutual structure... you [the policyholder] have *voting rights*—to elect members of the company's Board of Directors, and you have *contract rights*—the benefits and provisions outlined in your insurance or annuity contract."

1998: Brochure signed by David O'Maley, president & CEO, Ohio National, a mutual insurance company. [O'Maley said nary a word about *ownership rights*.]

 PROVIDENT MUTUAL

"It is the policyowners who own [Covenant Life]."

September 8, 1993: Robert W. Kloss, president, Covenant Life (a mutual that was subsequently merged into Provident Mutual), in a letter to the Board of Corporators.


 "It's a very difficult question that can't really be answered in terms of a mutual life insurance company."

April 7, 1998: Robert W. Kloss, CEO of Provident Mutual, at an insurance department public hearing, in response to the question, "Do you believe that policyholders own the company?"

 thePrincipal

"[Policyholders who are] members maintain majority control [of Principal Life after its conversion to a mutual insurance holding company]."

November 7, 1997: A brochure signed by Principal Mutual's chairman & CEO, David Drury, regarding the company's proposed mutual insurance holding company conversion.

 "The directors of a stock corporation [such as a converted mutual] have a fiduciary duty to manage the corporation for the benefit of its *shareholders* collectively [emphasis added]."


February 24, 1998: Richard W. Skillman, a tax attorney at Caplin & Drysdale, in a letter to the IRS on behalf of the Mutual Life Insurance Company Tax Committee, to which Principal Mutual paid \$91,123 in 1997. [This letter was uncovered and first made public by Joseph Belth, editor of the *Indispensable Insurance Forum*, P.O. Box 245, Ellettsville, IN 47429, (812) 876-6502.]

 CREDIT SUISSE

FIRST BOSTON

"Checklist for Investing in Mutual Deals... Demonstrated commitment to balancing interests of shareholders and policyholders, *rather than to interests of policyholders alone* [emphasis added]. Demonstrated commitment to returning any excess capital to shareholders."

November 7, 1997: Credit Suisse First Boston research report by Caitlin Long, *The Mutuals Are Coming!*

 "It is our opinion that [Ohio National's mutual insurance holding company conversion] is fair to policyholders."

February 12, 1998: Credit Suisse First Boston "fairness opinion" for Ohio National's conversion which provides "no consideration" to policyholders. Credit Suisse First Boston has provided investment banking services to Ohio National, and is acting as its "financial advisor" in connection with the conversion. Credit Suisse First Boston has the right to manage the company's IPO and is providing advice concerning the granting of stock options to Ohio National's management.



"Own a piece of the Rock."
Prudential's famous slogan



"We have concluded that our policyholders would benefit most from a full demutualization [as opposed to a mutual insurance holding company]. Such a move would distribute the full value of the company to eligible policyholders, and at the same time maintain their insurance benefits."

February 1998: Arthur F. Ryan, Prudential's chairman and CEO, on his company's decision to break with the mutual-life-insurance-industry cabal and acknowledge that policyholders are owners.

The Bucket's Got a Hole in It: Mutual Insurance Bait and Switch

MUTUAL INSURERS USED TO SAY that their policyholders owned the company—no longer. Now, a \$300-billion fleecing is being attempted. It involves mutual insurance companies and their trade organizations, lawyers, investment bankers, lobbyists, and assorted cronies. Their goal: converting mutuals into mutual insurance holding companies.

Although a full demutualization has always been considered an equitable means of converting a mutual to a

stock company, mutual executives now bristle at the thought of giving their policyholders stock or cash. They also dislike the idea of being accountable to shareholders, even though these same executives are eager to get their hands on stock options and other “incentives.”

Hence the invention of the mutual insurance holding company—a neutron-bomb corporate reorganization that wipes out the policyholders’ equity but leaves the mutual’s officers and directors standing—and very rich.

The Facts	Full Demutualization	Mutual Insurance Holding Company
The Players	UNUM, Equitable, MONY, Prudential, and all four major Canadian mutual life insurers	MetLife, New York Life, Principal Mutual, Provident Mutual, John Hancock, Massachusetts Mutual, Northwestern, Guardian, AmerUs, Ameritas, Ohio National, FCCI Mutual, Pacific Mutual, and others
Who owns the mutual?	The policyholders	Mutual-insurance-company CEOs refuse to answer
What policyholders (members) receive	100% of the company	“Membership interests”
Value received by policyholders	Stock or cash. In Prudential’s case, estimates range from \$20 billion to \$30 billion.	Membership interests with “no independent value”
Control of company upon conversion	Shareholders (the former policyholders). SEC regulations provide protection.	Policyholders get one vote regardless of the size or number of policies they own. Accordingly, the directors and officers control the mutual insurance holding company through nomination requirements that are impossible to meet.
Who profits?	Policyholders	Officers, directors, employees, and outside shareholders
What the policyholder is told	Transaction is fair because policyholders receive 100% of the value of the company	Transaction is fair because nothing has really changed. Policyholders will control the company and “benefit.”
What the SEC is told	Policyholders will receive valuable securities	Policyholders will receive “membership interests” which have no value and are not securities.
What the IRS is told	The company is controlled by stockholders, to whom the board owes a fiduciary responsibility.	The company is controlled by stockholders to whom the board owes a fiduciary responsibility. Company is not controlled by policyholders.
Conflicts of interest	Minimal	Abundant
NAIC’s involvement	Not clear	Drafting a “white paper.” Hopelessly confused and torn by varying interests.
The investment bankers	Goldman Sachs and others	Goldman Sachs and others
The attorneys	LeBoeuf, Lamb; Debevoise & Plimpton; Sidley & Austin; Lord, Bissell & Brook, and others	LeBoeuf, Lamb; Debevoise & Plimpton; Sidley & Austin; Lord, Bissell & Brook, and others

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Provident Breaks Covenant with Policyholders

A Report from the Battlefield

On the sunny afternoon of April 6, 1998, David Schiff got into his beat-up 1987 Saab and headed from Manhattan towards the Valley Forge Hilton in Pennsylvania. The purpose of Schiff's trip was to speak at a public hearing held by the Pennsylvania Department of Insurance regarding Provident Mutual Life Insurance Company's plan to convert to a mutual insurance holding company. This would be the third mutual-insurance-holding-company hearing Schiff had spoken at in as many months. In late January he had gone to Des Moines for Principal Mutual's hearing (which will be the subject of an article in the next issue), and in February he had flown to Florida for an afternoon to make a brief speech at FCCI Mutual's hearing, which was held at the Orlando airport.

Schiff had hopes that his visit to Valley Forge would be more bucolic; he had visions of the countryside where General George Washington had spent the winter of 1777-78, and was surprised to discover that the Valley Forge Hilton is adjacent to the King of Prussia Mall, an endless concrete stretch of late-20th-Century commerce.

Provident Mutual, located in nearby Berwyn, is a sizable company: it has \$37 billion of life insurance in force, \$8 billion in assets, \$844 million in equity, an over-funded pension plan, and 300,000 policyholders. It was important to Schiff for many reasons, not the least of them being that as a result of its 1994 acquisition of Covenant Mutual, it lays claim to being America's oldest insurance company.

Covenant, founded in 1717 as the Presbyterian Minister's Relief Fund, was incorporated in 1759 with the catchy moniker, "The Corporation for Relief of Poor and Distressed Presbyterian Ministers, and of the Poor and Distressed Widows and Children of Presbyterian Ministers." As far as Schiff could tell, the only "relief" that Provident was providing under its mutual-insurance-holding-company plan of conversion was to relieve policyholders of their ownership in Provident. As a result, Schiff felt compelled to go within spitting distance of the giant shopping mall and object to Provident's plan,

which, like all other mutual-insurance-holding-company plans to date, is a paradigm of conflicts of interest, inadequate disclosure, misleading statements, and other nasty characteristics that decent people tend to find objectionable. (Among the decent people who object to Provident's plan are the Reverends David Ross Drain and Michael Shea, plaintiffs in a class-action lawsuit against Provident.)

Schiff's agenda was overt: he planned to make a public statement at the hearing and ask a few easy questions to Provident's management and its "experts"—Derek Kirkland of Morgan Stanley and Ken Beck, an actuary at Coopers & Lybrand. (It is a small world. Two weeks earlier Schiff and Beck had spoken at an intimate mutual-insurance conference sponsored by the Fells Road Group, and Coopers & Lybrand is the firm hired by the Iowa Division of Insurance to investigate Allied Mutual.)

At seven o'clock that evening, Schiff went to the Hilton's lobby to meet with Joseph Belth, the 68-year-old founder and editor of *The Insurance Forum*. Although Schiff and Belth have known each other for about eight years and speak frequently (sometimes several times a day), this was their first face-to-face meeting.

Belth, who sold life insurance in the 1950s, is professor emeritus of insurance in the Kelley School of Business at Indiana University. He is a towering figure in the field of insurance journalism; for 25 years he has been exposing deception, fraud, and shady behavior in the life-insurance industry. His method involves resolute tenacity, voluminous knowledge, and the skillful discovery of important material through freedom-of-information laws (and, of course, through confidential sources.)

Belth has published his newsletter without ever missing a monthly deadline. (Schiff, whose publishing schedule is rather quirky, admires Belth's consistency as well as his content.) Although *The Insurance Forum* probably has the largest circulation of any independent insurance newsletter, like all insurance publications it is obscure when measured by the standards of mainstream popular journalism. Nonetheless, Belth received the George Polk Award in 1990, an honor on a par with the Pulitzer Prize. (Other winners include Edward R. Murrow, David Halberstam,

Seymour Hersh, and I. F. Stone.)

Belth is a precise and exacting man: determined, stubborn, and a stickler for detail. His appearance is plain and straightforward, as is his prose. His words are carefully chosen and his arguments are as clean as the windows at Saks during the Christmas rush. If one were to define Belth in a word, it might be this: fair.

Over the previous year, Belth had become increasingly disturbed by the actions of the nation's richest and most powerful mutual life insurance companies. As a result of their quiet assault on state legislators, at least 16 jurisdictions have passed laws permitting mutuals to convert into mutual insurance holding companies. Provident, whose very name implies prudence and frugality, is not the first life insurance company to attempt such an abusive conversion, nor is it the largest or even the most egregious. It is notable nonetheless, if for no other reason than it is the one in which Belth—who has not made the rounds of NAIC meetings and public hearings recently—has chosen to draw a line in the sand and prepare to do battle. His weapon of choice is a time-honored one which, throughout history, has changed the world—words.

Belth is not alone in his concern about the mutual-insurance-holding-company conversion scheme, although in all of America there are only a few others who share his passion and outrage. Indeed, for those few, the inequity of what the mutual industry is attempting has become an exhausting obsession. One charter member of this concerned cadre is Jason Adkins, a firebrand from Cambridge, Massachusetts. Adkins, who founded the Center for Insurance Research—a tiny nonprofit public policy and advocacy organization—has led a behind-the-scenes counterattack against the mutuals. He has represented policyholders, filed lawsuits, sought injunctions, drafted position papers, attended dozens of NAIC meetings and public hearings, and argued so effectively against the giant mutuals that he has earned their lasting enmity.

It is a sad commentary on the current state of mutuality that at a Business Strategy Network conference in New York last month, "Restructuring of the Mutual Insurance Industry," Michael Sproule, executive vice president and chief financial officer of AmerUs, (formerly American Mutual and



now the ugliest mutual-insurance-holding-company conversion of them all), lambasted Adkins by implying that his goal was money. In 1997 Sproule received \$610,102 in compensation plus options on 60,000 shares of AmerUs stock. His pay last year alone is more than the 38-year-old Adkins, who graduated from Harvard Law School, has made in his *entire* career, which has been devoted to public-interest work. It is hard to say whether Sproule's comments were the result of ignorance, avarice, or an inability to understand why a man would speak out (at considerable personal expense) against something he believes is wrong.

Adkins, who since the beginning of this year has worked at a start-up law firm, Adkins & Kelston, knows all too well that there is little money on his side—that the big money is made representing the mutuals in their march to the sea. Money, however, is not what motivates Adkins, nor is it what drives the dedicated young activists at the Center for Insurance Research—Paula Isola, Brendan Bridgeland, and Aaron Bartley—all of whom are making a difference.

The final, and perhaps most unlikely member of the Belth-Adkins cadre of mutual-insurance-holding-company opponents, was Schiff, an affable curmudgeon from New York, who, unlike Adkins and Belth, dislikes being called a “consumer advocate.” (To him the phrase implies a knee-jerk reaction rather than a reasoned decision. Besides, is there anyone who claims to be a “consumer *adversary*?”) Schiff leads a comfortable life. Before becoming a full-time muckraker he worked in the insurance and securities businesses for 20 years, and served on six corporate boards. (He has only one directorship now, but plans to double that when elected to Allied Mutual's board.) A recent article in *Grant's Interest Rate Observer* said the following:

The indispensable element that Schiff brings to the subject, beyond his considerable experience and knowledge, is a burning outrage. He is up in arms about the mutual insurance holding company, and has no use for the [subscription rights demutualization], either...

Resembling a certain Marquis Roux of Corsica, who, during the Seven Years War of the 18th century, distinguished himself by declaring war upon Britain in his own name and private capacity, Schiff is moving against a Des Moines-based enterprise, Allied Group, a downstream stock company connected to Allied Mutual. An exposé last fall in *Schiff's Insurance Observer* documented conflicts of interest and questionable shuffling of assets between the stockholder-owned company and the mutual life insurance operating company. Not stopping there, Schiff ran for a seat on the board of Allied Mutual with the announced intention of kicking out Allied Group's management and “mak-

ing the policyholders whole.” To date, he has not succeeded, although, like the marquis, he has caused his adversary to learn his name.

As Schiff and Belth met in the hotel lobby, they shook hands for the first time. The two men sat down on a couch and began exchanging information about the latest outrages and developments in the mutual-insurance-holding-company battles. Before they headed to the hotel restaurant for dinner, Schiff took four books by Belth from his briefcase and asked Belth to inscribe them, which he did.

Jason Adkins, who has logged many miles fighting against unfair conversions, was not at the dinner table that night, nor would he be at the hearing the following day. He had sent a letter of protest to the commissioner announcing his boycott of the proceedings. In his opinion it was impossible to prepare for the hearing because there was “no access to information, no established rules or rights, and no clear purpose.” In short, according to Adkins, “it would be no hearing at all.” Belth and Schiff had little doubt that Adkins would be proved correct.

The hearing commenced at 8:56 the following morning. It was presided over by Deputy Commissioner Gregory Martino, rather than by Commissioner Diane Koken, who had recused herself because of a significant conflict of interest: for the 22 years preceding her appointment as commissioner in 1997, she had worked for Provident Mutual, most recently as general counsel, vice president, and secretary. Given Pennsylvania's hostility to mutual policyholders, the specter of Commissioner Koken's conflict of interest loomed large over the proceedings and their aftermath.

Eight other members of the department were on hand, along with three representatives from Tillinghast-Towers Perrin, the actuarial firm retained by the department. At the table to the deputy commissioner's left and speaking on behalf on Provident were Robert Kloss, president and

CEO; James Potter, executive vice president and general counsel; Derek Kirkland of Morgan Stanley; and Ken Beck of Coopers & Lybrand. Their statements may as well have been lifted directly from the official mutual-insurance-holding-company conversion playbook.

During the course of the day people went to the microphone and commented on Provident's plan. Many were outraged by it, although several agents and others spoke in favor.

As the day wore on, Schiff began to wonder when he would get to speak (he had been the third person to sign up on the speakers' list). Perhaps it was coincidence, but neither Belth nor Schiff got to speak until after lunch, by which time the reporter from *The Philadelphia Inquirer*—the only paper covering the event—had left. When Belth's turn came, he read a brief prepared statement. His objections included the following: “1) the plan involves termination or dilution of our ownership interests without compensation [Belth is a policyholder], 2) the plan creates the possibility of conflicts of interest for officers and directors, 3) the plan would prevent our participation in the future growth of the organization, 4) the plan may result in a reduction of policy dividends in the future.” Belth then read 10 pointed questions and returned to his seat.

From that moment on, he was a whirlwind—writing letters and commentaries, demanding answers, disseminating material, and uncovering incriminating documents, including an internal memorandum that Potter, Provident's general coun-



Drawing by Frank Cotham. © 1998 The New Yorker Magazine, Inc.

sel, had faxed to Lynne Fitzwater, the insurance department's counsel, on February 25. The memorandum, "Consumer Advocate Activity at Principle [sic] Mutual's Public Hearing," described the activities of Schiff and Adkins and closed by saying, "It was incumbent upon the Iowa Commissioner to approve or disallow each question in order to minimize the redundancy and not waste time..."

Kloss, Provident's president, began his response to Belth by saying, "Thank you for your comments and we appreciate your support as a policyholder..." Kloss, in fact, had *thanked* every speaker, whether their statements were pro or con.

It was then Schiff's turn to speak. When he finished an hour later, Kloss would not thank him, and Adkins' predictions would be borne out.

The following is an edited version of what took place:

SCHIFF: How long have you been at Provident Mutual?

KLOSS: Since November 1, 1994.

SCHIFF: And prior to that you were...

KLOSS: ...at Covenant Life Insurance Company.

SCHIFF: How many years had you been there?

KLOSS: Is this relevant to the plan?

SCHIFF: It's very relevant.

KLOSS: I'll be happy to answer your questions about the plan; I will not be happy to answer questions about the past.

SCHIFF: Would it be fair to say that you have a deep familiarity with both Covenant and Provident Mutual and most aspects of the company?

KLOSS: I believe I do.

SCHIFF: Are you familiar with the sales practices of the company and have you been in the past?

KLOSS: I repeat, I'm here to deal with the plan. I'm not here to waste the Department's time.

SCHIFF: It's simply a yes or no question.

STEPHEN MARTIN, deputy chief counsel for the Pennsylvania Insurance Department, intervened.

MARTIN: [To Schiff] One thing I do want to make clear from the beginning is this is not going to be a cross examination. If you have comments, I'll be happy to include them on the record. If you have questions regarding the plan of conversion and how it will apply to policyholders, I will be happy to allow those on the record.

SCHIFF: If he simply answered the ques-

tion it would save a lot of time. [To Kloss] Do you believe that the policyholders own the company?

KLOSS: I've made this statement several times today, Mr. Schiff. I think you've heard me three times make the statement about ownership. It's a difficult question that can't really be answered in terms of a mutual life insurance company. [Kloss's standard line was that policyholders have *policy contract rights* and *membership rights*. Like other mutual executives seeking to convert their companies to mutual insurance holding companies, he will no longer say that policyholders are *owners* of the insurance company.]

SCHIFF: Do you believe that your salespeople told policyholders—or are you aware that they told policyholders—that they were the *owners* of the company?

GREGORY MARTINO, deputy insurance commissioner for the Pennsylvania Insurance Department, intervened.

MARTINO: [To Schiff] That is way beyond commenting on, and asking questions about, the plan of conversion.

SCHIFF: They're simple questions that can be answered yes or no. If we don't want to get to the truth—I thought that was the purpose of a public hearing.

Deputy chief counsel STEPHEN MARTIN intervened.

MARTIN: [To Schiff] That is the purpose—to hear your comments and to hear what you have to say about the plan.

SCHIFF: It's relevant what the management believes and what they tell the policyholders in their written statements and what they have told them previously. This goes to the essence of the company. [To Kloss] Have you ever said that the policyowners own the company?

KLOSS: I'm going to stick with my comment, sir.

Deputy commissioner MARTINO intervened.

MARTINO: [To Schiff] There are many people after you who want to make comments who have been waiting patiently all day.

In fact, there were only three speakers after Schiff, and their comments took about an hour. The hearing concluded early, at 4:18 in the afternoon.

Schiff spent the next few minutes requesting that Provident submit sales literature, training materials, and opinions from lawyers, accountants, actuaries, and investment bankers.

He then asked a question of James Potter, Provident Mutual's executive vice president, general counsel, and secretary.

SCHIFF: [To Potter] When did you request

the no-action letter [from the SEC]? Can that be disclosed or is it top secret?

POTTER: They will be part of the record. It was a confidential request, and the confidentiality period ran today [April 7], so as of today the SEC released its confidentiality treatment of the no-action letter. So it is all available in the public file.

When Schiff received the SEC's no-action letter the following day it became apparent that the decision to keep it confidential belonged solely to Provident. Debevoise & Plimpton, Provident's attorney, had written to the SEC asking for confidential treatment on the grounds that it "believe[d] that publication of the matters set forth in the Letter prior to the public hearing on the Plan would have an adverse effect on the conversion process." Incredibly, the insurance department received this letter at least two weeks prior to the public hearing but permitted it to remain a secret.

The no-action letter stated that the confidentiality period ran until April 7 "or such earlier date that any information...is made publicly available by or on behalf of" Provident. [Emphasis added.]

Since Provident was not bound by any confidentiality requirements of the SEC, it could not have been "released" from any confidentially treatment on April 7. It was Provident's request and decision to keep the information confidential.

On April 17, Schiff wrote to Deputy Commissioner Martino and asked him to request Mr. Potter to submit a sworn affidavit stating that the SEC would not permit Provident to release the request for the no-action letter, and the no-action letter, prior to April 7, 1998.

After more comments, Schiff addressed Kloss.

SCHIFF: [To Kloss] You were the president of Covenant Mutual. Covenant was run by a group above the Board of Directors called "Corporators." You wrote them a letter in September of 1994 [the correct date was actually September 8, 1993] and you said, "It is the policyowners who own the company"—the company being Covenant Mutual.

Covenant Mutual was a mutual like Provident, and it was merged into Provident. That's why I was curious when you changed your thinking [about who owns a mutual]. Is there a particular time period?

KLOSS: Mr. Schiff, I wish you'd deal with relevant subject matters.

Deputy commissioner MARTINO intervened.

MARTINO: Mr. Schiff, as I mentioned here earlier...

SCHIFF: [To Kloss] You mentioned you had considered various alternatives [to a mutual insurance holding company]. Approximately how much is Provident Mutual worth? This goes to the essence of value because you're asking policyholders to vote on something [the conversion] and

there are alternatives. They may choose not to go for this.

KLOSS: We did not engage investment bankers or actuaries or accountants to do a fair evaluation of what Provident Mutual would be worth.

SCHIFF: Do you have an approximate idea? You mentioned growth by acquisition in your testimony.

KLOSS: It would be most inappropriate to speculate what a company is worth without doing the appropriate work.

SCHIFF: So wouldn't it be most inappropriate to recommend a [conversion] without doing that type of work?

Deputy commissioner **MARTINO** intervened.

MARTINO: [To Schiff] Again, I'm going to...

SCHIFF: Let me ask Mr. Kirkland [a question.]

Derek Kirkland is the co-head of Morgan Stanley's Global Insurance Group, and had given testimony on behalf of Provident Mutual earlier. Morgan Stanley is Provident's financial advisor, and Kirkland had stated for the record that Morgan Stanley is "continually involved in the valuation of securities..."

Kirkland said that his firm had become familiar with Provident over the past several years, "having provided investment banking advisory services to the company in connection with analyzing its restructuring alternatives." He also submitted an exhibit containing a list of recent insurance industry stock offerings that were lead or co-lead by Morgan Stanley. Kirkland also said that his firm planned to deliver a fairness opinion regarding the mutual-insurance-holding-company conversion to Provident's board in the near future.

SCHIFF: [To Kirkland] Do you have an opinion about what Provident Mutual is worth?

KIRKLAND: No. We have not evaluated what Provident Mutual is worth.

SCHIFF: I take it you're familiar with the Morgan Stanley index of mutual companies and life insurance companies?

Deputy commissioner **MARTINO** intervened.

MARTINO: I'm not sure where you're going and I'm not sure what that has to do with it.

SCHIFF: I'd like to get some understanding of what the company is worth. Am I being told that no one in this company—including the investment bankers—has any idea?

MARTINO: I tell you what—we recognize your question for the record. If they can respond to that, they will do that.

SCHIFF: [To Kirkland] What percentage of GAAP book value do [life insurance companies] trade at?

KIRKLAND: There's a wide, wide variation.

While that's true, the average life insurance company was then selling for approximately twice its GAAP book value.

SCHIFF: [To Kirkland] Would you say that a good life-insurance company would sell for a multiple of GAAP book?

Deputy commissioner **MARTINO** intervened.

MARTINO: You're going way beyond the scope [of this hearing].

SCHIFF: [To Martino] I don't know what the scope is. What could be more essential to the plan of conversion than understanding what the financial ramifications of alternatives are to policyholders? We have experts here and this is a perfect opportunity to get them to answer questions.

Deputy chief counsel **STEPHEN MARTIN** intervened.

MARTIN: [To Schiff] This is not the forum for cross examination of the experts or the company representatives. This is the forum for you to use your expertise—which is considerable—and tell us what it is about this plan that you do not care for or what you believe is not in the best interest of policyholders.

SCHIFF: [To Kloss] I think Provident policyholders should be told approximately how much the company could be sold for—a rough estimate. If it were twice book—and there are approximately 300,000 policies—that could be \$5,000 per policyholder.

Policyholders can't possibly make an informed decision unless you provide them with the proper information, which you have not done.

In this brochure you sent [to policyholders], you said the plan "maximizes the value of our subsidiaries." Who does it maximize value for? I take it that it is not the members since I assume that you have written in your [request for a] no-action letter that the members "have no expectation of profit." Is that correct?

KLOSS: The SEC letter will be part of the record.

Although Provident's request for a no-action letter was a damning document that had been kept secret by Provident and by the Department of Insurance, Schiff's assumption was correct. The request for the no-action letter stated that a membership interest in Provident Mutual Holding Company "simply does not entail for a member any 'reasonable expectation of profits.'"

SCHIFF: [To Kloss] Do you expect that over the next 10 years you will issue stock to the public?

KLOSS: I can't answer that today. That will be a board decision based upon proper circumstances and facts. At the time there are no plans.

Four months earlier, on December 17, 1997, Provident's accounting firm, Coopers & Lybrand,

had written to the Internal Revenue Service on Provident's behalf stating the following: "Although such a public offering is not being contemplated to occur simultaneously with the Conversion, the enhanced capital resulting from such an offering is one of the principal reasons why the conversion is being considered. It is the Company's intent to undertake such an offering at the appropriate time when the optimum market conditions exist."

Schiff asked Mr. Kirkland a question.

SCHIFF: [To Kirkland] Will the members of Provident Mutual Holding Company profit from [the conversion]?

Although Schiff suspected that Provident's request for a no-action letter had said that policyholders had "no expectation of profits," he was curious to hear what Morgan Stanley—which was giving the thumbs up on the conversion—had to say.

Mr. Kloss interrupted, and did not permit Kirkland to answer the question.

KLOSS: Mr. Schiff, it would be inappropriate to answer that question.

SCHIFF: A man who has written the fairness opinion! It would be inappropriate?

Deputy chief counsel **STEPHEN MARTIN** intervened.

MARTIN: Mr. Schiff, this is not cross examination. This is not the forum for that.

SCHIFF: Which is the forum for that, then?

MARTIN: We can't permit this kind of cross examination. That's not why we're here.

SCHIFF: These are the essential questions, and if we eliminate the essential questions, you're right—there's no purpose being here. Let me ask one more question. [To Mr. Kirkland] Is there any value to a mutual holding company membership? Yes or no? Or is it worthless?

KIRKLAND: [No answer]

SCHIFF: Okay. I'll request that the Department ask the company to answer.

MARTINO: You can certainly put those in the record. You can ask your questions.

The following week Schiff submitted a letter to Deputy Commissioner Martino seeking various documents under statutes governing access to public records.

He also asked Martino to request that Provident provide answers to 38 questions.

Copies of Schiff's letter will be sent for free to any subscriber of *Schiff's Insurance Observer* who provides a self-addressed envelope stamped with 55¢ of postage.

For those interested in Provident Mutual—and in the mutual-insurance-holding-company-conversion process—we recommend ordering the "Provident package." It consists of the April, May, and June issues of *The Insurance Forum*, and is available for \$25 from *The Insurance Forum* at P.O. Box 245, Ellettsville, IN 47429, (812) 876-6502. Don't be a cheapskate. Order now. ■





THE INSURANCE BEAT

On the Road

V. J. DOWLING, of Dowling & Partners Securities, may well be the best insurance analyst in the world. In-the-know investors prize his Hartford-based firm's research for its insight, clarity, and—yes—wit. Indeed, savvy institutional investors look forward to Monday mornings simply because they know that Dowling's *IBNR Insurance Weekly* will be on their desks when they arrive at work. (Don't even *bother* calling about this report unless you're prepared to shell out around \$20,000 per year—a bargain for such valuable material.)

Dowling and his team of analysts are ubiquitous, scouring the country for information. Although they log endless miles by plane, the firm owns also owns a DowlingMobile—a custom-built Dodge Ram Van RoadTrek whose amenities include four seats up front, a cut-out floor, raised ceiling, bathroom, tables, microwave, beds, kitchen, television, two cellular phones, cellular faxes, computers, and an office area. It is, in Dowling's words, a "poor man's private jet."

Dowling, intrepid researcher that he is, has been known to roam America in this specially equipped vehicle, investigating insurance companies in out-of-the-way locales. During one "summer vacation" he even made the rounds with three little Dowlings in tow. ("Hey Dad, can we skip Yosemite and visit Mercury General again?")

Schiff's Insurance Observer would love to hitch a ride on the next road trip.

The Company You Keep

IN 1994 NEW YORK LIFE, a mutual insurance company, spent \$2.5 million recapping its landmark Madison Avenue headquarters with 26,000 gold-baked tiles and recovering the building's five-story spire in gold. It has never been suggested that Sy Sternberg, New York Life's chairman and CEO, has put any of that gold in his own pocket. Indeed, such an act would be inappropriate.

When Mr. Sternberg testified at a New York Assembly hearing on mutual insurance holding companies chaired by

Assemblyman Pete Grannis last fall, he spoke of New York Life's great sense of tradition. He explained that New York Life had "a mutual culture" and was "a cooperative." Describing his job as a "stewardship," Mr. Sternberg—in all seriousness—told the inquisitive Grannis that "the customers control the company." (He forgot to mention that less than 1% them are sent a ballot to vote for the board of directors.) Such forgetfulness aside, Mr. Sternberg, who truly feels his policyholders' pain, said that if New York Life were to demutualize and give its policyholders stock—stock which might be worth \$10 billion or so—the policyholders might one day "wake up and read about some venture capital firm making a hostile bid for New York Life Insurance Company."

Under this grisly scenario, policyholders who owned shares might lose sleep deciding how to reinvest the proceeds they'd receive upon New York Life's takeover. That clearly troubles the compassionate Mr. Sternberg, who articulated why he favors the mutual-insurance-holding-company approach, where management will be entrenched and policyholders, who will have received nothing, won't have to worry about a takeover: "I want to be able to go back to our policyholders and say to them, 'You are still in control and you will be in control. Do not lose sleep.'"

Mr. Sternberg's concern for his policyholders' sleeping habits is undoubtedly the reason he laid to rest one of the nagging issues at the heart of the debate over mutual insurance holding companies and their publicly-held subsidiaries: conflicts of interest. "In the real world," Mr. Sternberg said, "and the real world is 99% of the time—there is an *absolute* alignment between what the mutual policyholders want and what these outside shareholders would want."

Although we always thought that policyholders wanted insurance at the lowest possible cost and shareholders wanted the highest possible return—desires that are mutually exclusive—Mr. Sternberg explained that if, under the mutual-insurance-holding-company structure, New

York Life's stock company were to do an IPO, its prospectus would state that "management will tilt in the direction of the mutual policyholders."

He then addressed a situation that, according to his previous statement, had only a 1% chance of happening: "If, in fact, there is a *conflict*, we will vote in favor and make management decisions in favor of the mutual policyholders. That will be explicitly stated in any S-1 [prospectus]." Then Mr. Sternberg gave a "specific example"—that of Express Scripts, a New York Life subsidiary that issued shares to the public

six years ago. (New York Life currently owns a 44% stake worth about \$650 million.) Mr. Sternberg assured the skeptical Grannis that New York Life would, if it became a mutual insurance holding company, "bias

decisions [in the stock company] towards the policyholders," rather than towards public shareholders.

Mr. Sternberg's testimony sounded rather like what Huckleberry Finn might have called "a stretcher," which is why we decided to take a peek at Express Scripts' proxy statement for ourselves. And guess what we found? The situation at Express Scripts was only 180 degrees different from that described by Mr. Sternberg, who, as it happens, is a director of Express Scripts.

Under a section titled "Certain Relationships and Related Transactions," Express Scripts' proxy statement explains that "in an effort to minimize conflicts of interest with New York Life, 'any material transaction with a related party' [read New York Life] must be approved by the Audit Committee directors, a majority of whom may not be officers, directors, or employees of New York Life or its subsidiaries. In fact, this provision is *written into Express Scripts' bylaws* and may not be changed without "the affirmative vote of a majority of the outstanding Class A common stock." (New York Life owns Class B stock.)

We're the first to admit that it would be unfair to indict Mr. Sternberg's entire testimony merely because the most important part of it was wrong. Likewise, we're sure that Mr. Sternberg would be the first to admit that, when he said directors would "bias" their "decisions" towards policyholders rather than shareholders, he didn't mean to imply that these directors would violate their fiduciary responsibilities. As New York Life's attorney, Woolcott Dunham of Debevoise & Plimpton (who was sitting to Mr. Sternberg's right), surely knows, directors must make their own decisions and can't be legally bound to vote the



way New York Life tells them to vote. And, as even a Debevoise & Plimpton summer intern knows, corporate directors have a fiduciary responsibility to act in the interests of *shareholders*, not policyholders.

No one who knows of Mr. Sternberg's fine reputation would ever accuse him of intentionally misleading the State Assembly's standing committee on insurance. That is why there can be no doubt that Mr. Sternberg's failure to tell the committee of *his own conflict of interest*—that he personally owned 3,000 shares of Express Scripts (current value about \$250,000)—was an oversight made by a man who stays up late worrying that his policyholders might one day awaken to the news that their company is the target of a hostile takeover. Nor should even the most hardened cynic think less of Mr. Sternberg because he forgot to mention that his son owns 180 shares of Express Scripts (worth about \$15,000).

As Mr. Sternberg testified, New York Life is a "cooperative" run by its policyholders. Although he didn't say that policyholders are "owners," Webster's Collegiate Dictionary said it for him; it defines a "cooperative" as "an enterprise or organization owned by and operated for the benefit of those using its services." As one of New York Life's 3,000,000 policyholders, Mr. Sternberg is, therefore, an owner of the company. While there are those who might say he behaves as if he owns the *whole* company rather than just one-three-millionth of it, such statements are unseemly.

On the other hand, we must fess up to the shameful admission that we are a tad wary of Mr. Sternberg's intentions. So the next time we pass that grand Italian Renaissance base of New York Life's 70-year-old limestone tower, we'll cross Madison Square Park and take a gander at the building's spire—just to make sure that Mr. Sternberg has not made off with any of those 26,000 golden tiles.

Politics and Insurance

WE'RE NO FAN of New York's superintendent of insurance, Neil Levin, a Republican whose actions on the mutual-insurance-holding-company front are a combination of gross ignorance and political toadying.

It is ironic that while Levin has been fronting for MetLife and New York Life to get legislation passed that would enable them to strip their policyholders of \$40 billion or so, he has been actively pursuing a fair cause (although in financial terms, a far smaller one)—seeking the recovery of

funds from European insurers on behalf of Holocaust victims. Of course, recovering assets for Holocaust victims plays well in an election year (especially in New York, where a Republican governor, Pataki, and a Republican senator, D'Amato, are running for re-election). The proposed mutual-insurance-holding-company bill, however—which is perhaps the largest expropriation of private property ever attempted by legislative means—is sufficiently complex that it has doesn't lend itself to a sound bite on the evening news.

Another irony: although Levin favors the mutual-insurance-holding-company bill—which deprives individuals of private property rights—he steadfastly defends the private property rights of insurance companies at a time when many other commissioners and elected officials are calling for across-the-board rate cuts in response to the profits racked up by auto insurers. Levin, rightly so, has resisted such demagoguery.

Levin favors competition, which he believes (as do we) inures to the benefit of consumers over the long term. According to John Calagna of the New York Insurance Department, New York has reduced bureaucracy and introduced flex rating (so that any rate change of 7%, either up or down, can go into effect right away). The result: rates declined 0.6% last year.

Insurance is not a monopoly, and practices that encourage competition are good for consumers in the long run—although such practices can lead to unpleasant market dislocations. Intense competition, failure, and fluctuating prices (like a soaring S&P 500), are all part of the free market.

One would hope that when auto insurance experience deteriorates, rates begin to rise, and consumers start complaining, Levin will still favor the free-market approach.

On the other hand, it's unlikely that he'll be insurance commissioner when that time arrives, and that two Republican incumbents will then be running for re-election.

The Devil Inside Sandy Weill

ON MARCH 31, *The Wall Street Journal* reported that two senior executives at Salomon Smith Barney, a subsidiary of Travelers Group, were fired from their jobs. The reason: they shared pornographic material with associates via the firm's e-mail system.

According to Carol Heimann, a Travelers Group spokesperson, this is a violation of the company's policy "prohibiting the electronic transmission of

offensive images or text." This policy applies to *all* Travelers Group companies. Indeed, Salomon Smith Barney's employee handbook states that Big Brother is watching you closely: "There is no personal privacy when you use Salomon Smith Barney's equipment and services...[the firm] may monitor, copy, access or disclose any information or files that you store, process or transmit."

Possession of pornography is, of course, perfectly legal. Ms. Heimann and Travelers, however, refused to provide us with copies of the images that resulted in the employees' dismissal, nor would they describe the images or tell us who decided that the images were "offensive." She also declined to say what standard Travelers applies in making such decisions.

Indeed, we were unaware that Sandy Weill, Travelers' chairman and CEO, was such a bluenosed prig, especially in light of Weill's own *obscene* behavior: the many hundreds of millions of dollars of options he's

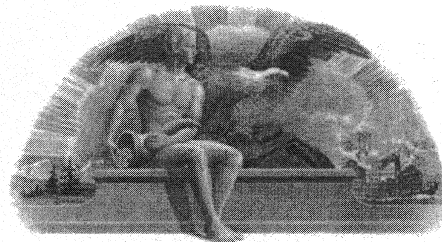


Illustration on Travelers Group's stock certificate

been granted; the eyesore five-story neon orange umbrella logo he emblazoned on the company's New York headquarters; and his executive responsibility for the despicable sales practices of Primerica Financial Services, the sleazy life-insurance bucket shop formerly known as A. L. Williams.

According to *Liar's Poker*, Michael Lewis's classic account of Salomon Brothers in its mid-1980s heyday, hotshot bond traders and salesman were then known as "Big Swinging Dicks." The irony of that reference will not be lost on anyone who takes a gander at a Travelers Group stock certificate: it depicts an Adonis-like nude man holding a cornucopia. Although the man's private parts are concealed, the cornucopia—a massive, curved goat's horn—protrudes a good 20 inches or so from the man's groin. This conspicuous phallic symbol represents—we assume—abundance, fertility, and potency.

If you want to keep your job at Travelers—and, perhaps, at Citigroup—don't e-mail a picture of that stock certificate to your associates. ■