Along the Corn Belt Route

A Matter of Principal by David Schiff

No one in his right mind goes to Des Moines in the middle of January. The average temperature is 17°, and when the wind is blowing or the snow is falling, it seems colder. The streets, empty in summer, are particularly bleak in winter. Despite Iowa's negligible unemployment, the downtown area is dotted with empty storefronts and crumbling buildings.

On January 23, 1998, I found myself in Des Moines—with good reason: a war was raging over the fate of America's mutual insurance companies and I was at ground zero, The Henry Wallace Auditorium, where a public hearing on Principal Mutual's application to convert to a mutual life insurance holding company was about to be held.

At that moment, Principal was one of the largest mutual-life-insurance companies in America. A conservative estimate of its value is $10 billion—about $15,000 per policyholder.

A handful of smaller mutual insurers had previously converted to mutual holding companies. Those conversions had taken place in the dark ages—1996 and most of 1997. (Prior to that, a mutual converting to a stock company generally paid off its policyholders in full for their ownership rights.)

One can't pinpoint when the situation began to improve, but from my perspective it was September 1997, when *Schiff's* ran a 13-page article, "The Dark Side of Demutualization," detailing how, over more than a decade, at least $500 million of value had been shuffled from Allied Mutual to its publicly traded stock-company affiliate, Allied Group, and how Allied Mutual's honchos, particularly chairman and CEO John Evans, had made a fortune in the process.

In a related article, "The Liberation of Allied Mutual," I announced my plan to wage a proxy fight to gain control of Allied Mutual's board on behalf of its policyholders. (I waived all compensation and had no hidden agenda. My motivation was simple: outrage.) I kicked off my proxy campaign with a $7,500 five-column ad in *The Des Moines Register*.

Later, many would say that my articles, combined with an almost unheard-of tactic—a proxy fight at a large mutual—raised the consciousness of the insurance world. In the ensuing months, hundreds of articles appeared in scores of publications, from *BestWeek* to *The Wall Street Journal*, and I made speeches and appeared on radio and television. Regulators, rating agencies, activists, agents, and Wall Street began paying closer attention to the behavior of America's mutuals.

At the same time as I was delving into the sleazy world of Allied Mutual, Jason Adkins, a public-interest lawyer from Cambridge, Massachusetts, was almost single-handedly doing quiet battle against a not-dissimilar perversion of mutuality: the mutual-holding-company movement, which was spreading across the midwest like a horde of locusts.

I didn't yet know Adkins, but in July 1997 I called him at the Center for Insurance Research, which he'd founded in 1991. We chatted briefly, but our paths would not cross again for several months. We met in person on October 8, 1997, at a public hearing on New York's proposed mutual-holding-company law chaired by Assemblyman Pete Grannis, who would play an key role in preventing this legislation from being enacted in New York (see "The Revolution Will Not be Televised," *Schiff's*, February 1998).

At the landmark New York hearing, Adkins made an articulate, reasoned statement. (My statement was cut short by the late hour). Afterwards, we went to a cheap joint around the corner from City Hall and had a beer and a bite to eat. Adkins is a charismatic fellow brimming with passion, commitment, and infectious good spirits, and as we chatted we discovered many shared interests.

To invoke the ending of the film *Casablanca*, this was the beginning of a beautiful friendship. Over the next ten months, the two of us—he, an activist lawyer, and I, a writer thrust into the unlikely role of activist—would attend hearings, meetings, forums, and conventions. We would run the gauntlet at state legislatures, slogging through the muck of insurance regulation. We didn't just have ringside seats at an ugly spectacle put on by some of America's greatest mutuals: we stepped into the ring ourselves and faced a giant bare-knuckled adversary who had no regard for the rules established by the Marquis of Queensbury.

As we waded deeper into the mire of mutuality-turned-upside-down, there would be countless all-nighters, dozens of trips, and innumerable phone conversations at one in the morning. In fact, Adkins is probably the only person in the world besides me who feels like having a two-hour chat about mutual insurance at that hour.

In retrospect, the Principal hearing on January 23, 1998 was a turning point in the mutual-holding-company war. From then on, a giant mutual could no longer take for granted that it could slip an abusive conversion plan through the system without encountering informed opposition. Big mutuals seeking unfair conversions were now on notice that they would have to overcome independent guerrillas whose motive—fairness—was so simple that it was *baffling* to many. These guerrillas couldn't be bought off by money, because that wasn't what they were seeking. They wouldn't compromise, either, because their cause was a matter of principle, and principles aren't something that *can* be compromised. And they couldn't be beaten by truth and facts, because both were on their side.

The mutuals, of course, had many advantages: they colluded through trade associations and ad hoc groups, they filled state capitals with their lobbyists, and they lavished money on lawyers, investment bankers, and consultants.

But power and money can't *always* force acceptance, as the mutuals quickly came to understand. Despite their financial might, they didn't fare well in the court of public opinion—once people started to understand what was really happening. Soon, the mighty Prudential and John Hancock would desert the sinking ship of the mutual-holding-company advocates, announcing full demutualizations in which their policyholders are slated to receive 100% of the companies' value. The four large Canadian mutuals would do the same, and MONY (which had previously announced a full demutualization), would no longer be a part of the support group for the mutual-holding-company movement.

As this article is being written, MetLife, having been thwarted in its plans to become a mutual holding company, has hired Goldman Sachs and is pondering its options. The smart money is betting that a full demutualization is at the top of the list.

How I came to be involved in the war over the fate of the American mutuals is a shaggy-dog story about a lackadaisical writer who, having nothing better to do, knocked about the wide open fields of the Midwest, searching for meaning and looking for a reason to believe—and, by the way, dropped in on some insurance companies while he was there.

My involvement with Allied Mutual, and with mutual holding companies, arose by chance. In April 1996, shortly before I turned 40, I got engaged. (This would be my second marriage.) In late July, after my fiancée and I returned from a three-week trip hiking through the Swiss mountains (where we found no trace of insurance companies), we abruptly ended our relationship.

I felt relief from the end of a relationship that had soured, but that was replaced by anxiety that caused me to wonder where I went wrong and to try to make sense out of confusion.

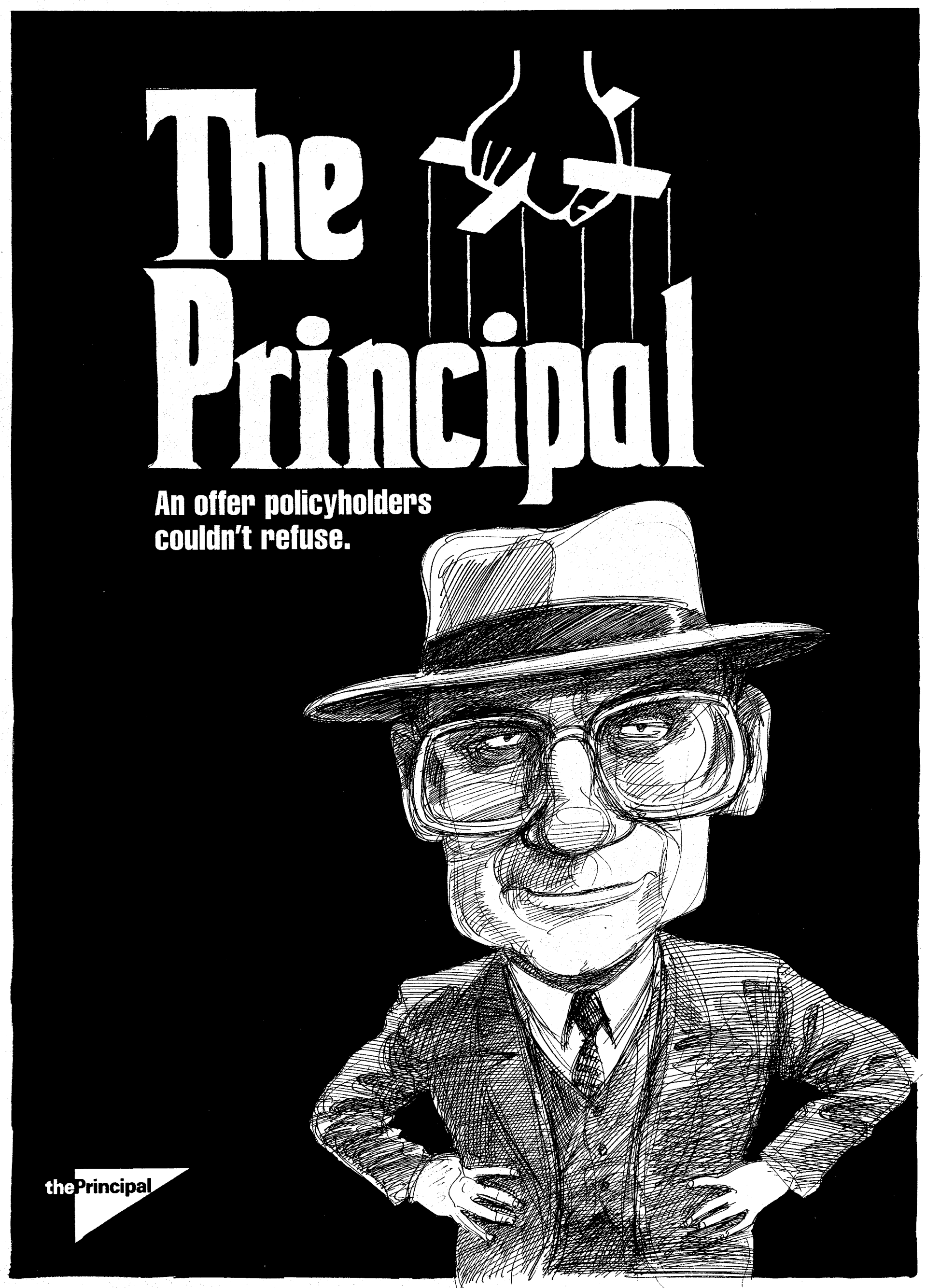
I realized that I needed to clear my head and do something different, something meaningful. But what?

I decided to sell my insurance business (Emerson, Reid & Company, a wholesale general agency that specializes in New York State Disability), and spend time hiking, traveling, writing, and reading. I wanted to get away from people and crowds and the culture I was used to. I wanted to see a part of America that I hadn't explored—Iowa, South Dakota, and North Dakota—and drive through fields and small towns and write about what I saw and felt. (Because of the nature of this publication, I planned to write about the insurance industry, too.) I soon eliminated South Dakota and North Dakota from my agenda—not many insurance companies there. Iowa, on second thought, seemed like plenty of ground to cover.

I had been interested in Iowa ever since I'd read that it had more towns with fewer than 1,000 people than any other state. I envisioned Iowa as the embodiment of rural small-town American values—a place where folks were honest, government was clean, people didn't put you on "hold" when you called, and insurance companies believed in the golden rule.

I imagined the Iowa zeitgeist to be far removed from that of my hometown, Manhattan, where Wall Street and money—and *more* money—seemed to have permeated the fabric of daily life and were beginning to annoy the hell out of me. The Disneyfication of 57th Street and Times Square, the hum of construction, and the rise of the garish Trump International Tower across the street from my office were enough to turn New York, at that angst-ridden moment of my existence, into a place that I disdained, but, perversely, needed as much as oxygen.

Iowa, by contrast, symbolized a pastoral state filled with nice towns where people knew their neighbors and didn't bother to lock their doors. I knew that I wouldn't run into Donald Trump in the middle of



David Drury, Chairman and CEO of Principal Mutual in Des Moines endless cornfields, nor would I encounter cigar-smoking 26-year-old money managers wearing Zegna pinstripes who speculated with their clients' funds while siphoning off 20% of the profits (but absorbing none of the losses).

Over the next two years I would discover that my initial vision of Iowa was both right and wrong. It is filled with decency, but there is a hollowness, too, and a similar decay and hypocrisy to that found in New York. All one has to do to see both is to look closely.

I arrived in Dubuque, which is on the banks of the Mississippi in eastern Iowa, on a Saturday night in mid-August 1996. The only thing I knew about Dubuque was *The New Yorker's* famous 1925 dictum that the magazine would *not* be "edited for the old lady in Dubuque."

At eleven in the evening the town was eerily silent. Nothing was open on Main Street except the Silver Dollar Cantina—a spacious saloon with a decent bar band cranking out decent bar-band music.

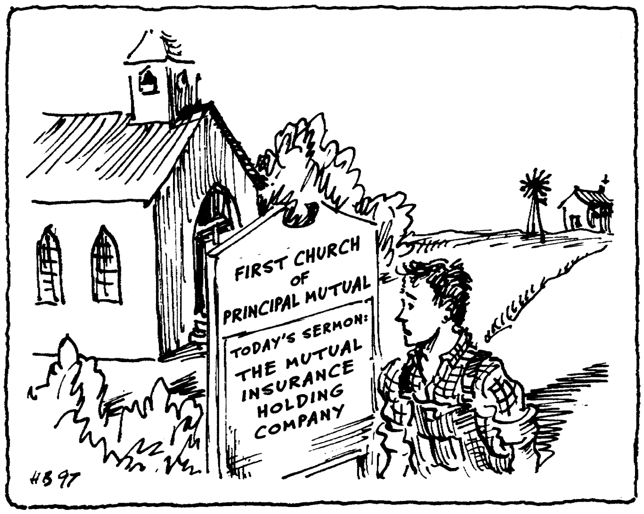
My impression of Iowa as staid was immediately jolted by five young ladies at the bar, two of whom were particularly attractive. They were having a bachelorette party, and were dressed for the occasion in tight-fitting, low-cut cowgirl clothes that caught the attention of every man in the place. Equally attention-getting were the dildos on ropes that they swung around the way a hipster in a zoot suit swings a key chain. (One girl carried her dildo in a holster.) Try as I might, I couldn't imagine any of these young ladies becoming an "old lady in Dubuque." On the other hand, I didn't picture them reading *The New Yorker*, either.

I got into my car and drove around. Just off Main Street was a small bridge that crossed the Mississippi at a narrow point. I soon discovered the Riverboat Casino, open 24 hours a day. It was past midnight, but this bright, garish, clanging hellhole was packed with people pumping the slots on all three floors.

The casino, apparently, is considered good, clean family fun. It has a special section where kids can be deposited while their parents try their luck at games of chance, the odds overwhelmingly against them. Outside the kids' room, a sign lays down the law: "Possession of any firearms within the casino without the express written permission of the Iowa Racing and Gaming Commission is prohibited."

In theory, a casino bears similarity to an insurance company—it calculates odds, takes in money in exchange for risk, and pays out less than it takes in. That, of course, is just theory. These days, it seems that the market is so soft that many insurance companies are writing business (giving odds) that no rational casino operator would offer.

Gambling is a big business in Iowa. In 1995, $7.5 billion was bet on various forms, including casinos, the lottery, bingo, dog racing, and horse racing. Statewide casino attendance was 16.9 million people, and gross casino profits were $590 million, about five percent of what Principal Mutual is worth.



I blew out of Dubuque early the next morning and was tempted to head south along the Mississippi to Davenport, where Bix Beiderbecke, one of the earliest white musicians to influence the way jazz sounds, was born 95 years ago. Beiderbecke, who is celebrated each summer in Davenport, was an alcoholic who played piano and, more famously, cornet. During his 28 years on earth he helped revolutionize America's great indigenous art form. Beiderbecke (and, more importantly, Louis Armstrong) changed the music from an emphasis on the ensemble to an emphasis on the individual and on the improvised jazz solo built upon the song. That Davenport, 800 miles north of New Orleans, was one of the birthplaces of swing, seems as unlikely as the fact that there are almost as many people working in the insurance industry in Des Moines as there are in Hartford. (Hartford is home to Aetna, Hartford, Travelers, and many other insurers. For generations it was *the* insurance town.)

I decided to forgo Davenport, however, because it is part of the Quad Cities (which include Bettendorf, Moline, and Rock Island), with a total population of 200,000. That was about 200,000 more people than I wanted to be with.

I drove north across eastern Iowa, instead, through a gently rolling terrain of winding roads, small rivers, valleys, trees, and bushes. About 50 miles to the south was Interstate 80, an endless stretch of blacktop that slices through the middle of Iowa. I abhor the Interstate System—it is not the "ribbon of highway" that Woody Guthrie sang of—and I kept I-80 at a safe distance, making the trip to Des Moines on a circuitous backroad route that was akin to going from New York to Chicago via Memphis.

As I passed by fields of corn and soybeans, rolled bales of hay, white farmhouses, small towns, and churches, I didn't realize that this trip would begin a defining series of events in my life. As I drove through the wide, empty Main Streets of the American heartland, I had no idea that I would become embroiled in what is now the biggest issue in the insurance industry: who ends up with the $300 billion in value of America's mutual insurance companies. I had no idea that the Hawkeye State, with its 119 tiny county mutuals, and its hard-working, God-fearing folks, was also a province where mutual insurance companies could be ravaged beneath the eyes of the regulators. I had no idea that the men who ran America's great mutuals were as likely to be their brothers' fleecers as their brothers' keepers. I had no idea that, 120 miles away, the first mutual holding company—AmerUs (previously American Mutual)—was coming into existence and would, five months later, go public in an abusive subscription-rights offering. I had no idea that I would soon be in Des Moines regularly, and that I would run for the board of one of Iowa's largest property/casualty mutuals. And I didn't really comprehend that the combination of a giant insurance industry and an underfunded state insurance department is as dangerous as a spark in a grain elevator.

I passed a roadside sign that told me I was entering Arlington, "where the hills and the prairie meet." Arlington is old white buildings in need of a paint job, grain elevators, and a defunct filling station. The main street is familiar: desolate, wide, and empty. Arlington has an empty bank, a new bank building, a Church of Christ built in 1896, and an American Legion hall. Some time ago an old feed mill went out of business and became the Motown Lounge, which also went out of business.

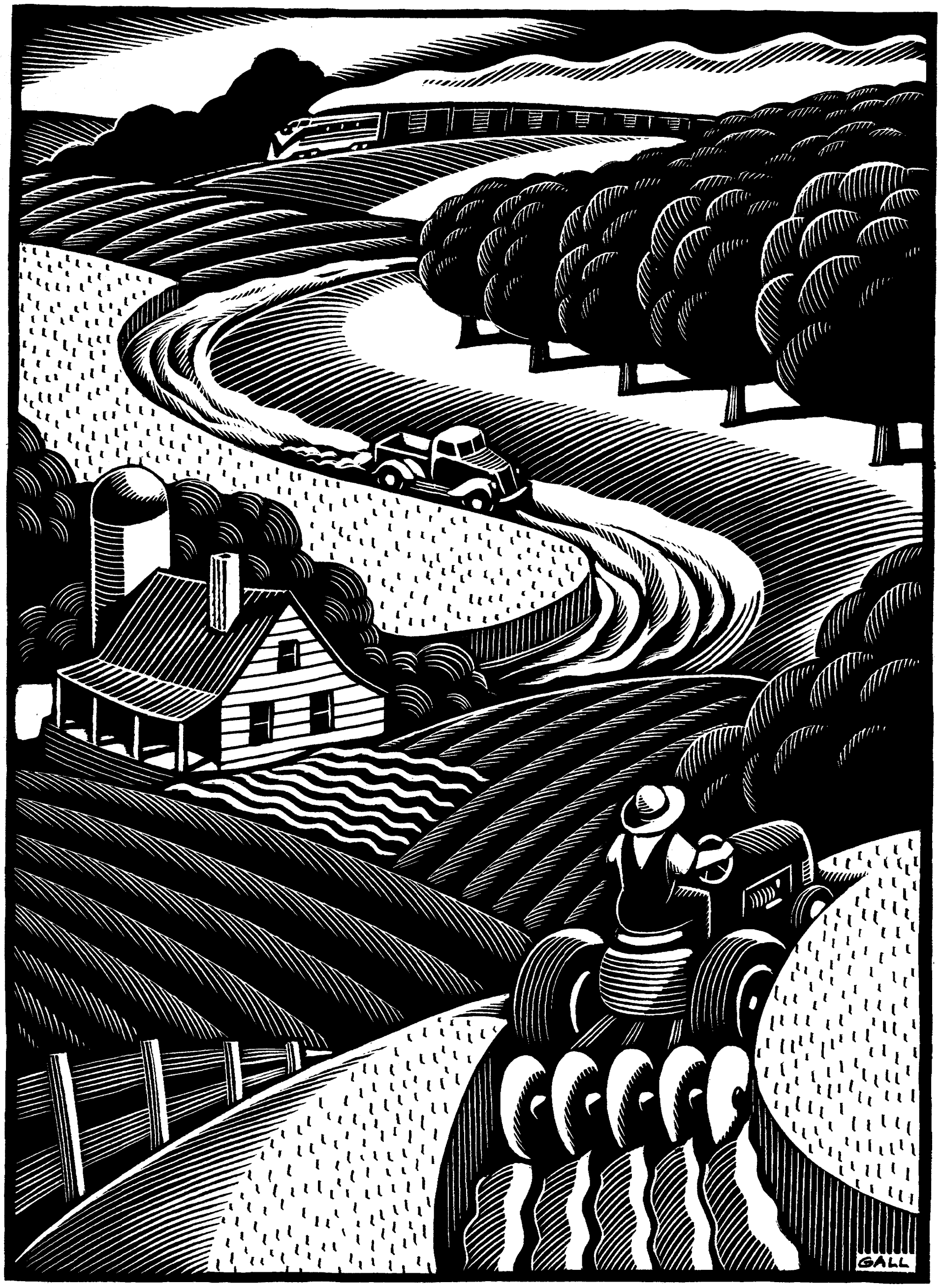
As I left Arlington I noticed that the land was flatter, that the roads were now long and straight. The terrain was broken by a few trees, some farmhouses, and poles strung with telephone wires. I imagined that people around here might go to tractor-pull contests or pickup truck races.

When I reached Oelwein, northwest of Waterloo and 50 miles south of the Minnesota border, I followed the "Corn Belt Route" for a short while. The Corn Belt Route was the Chicago Great Western Railway, which connected Chicago, Minneapolis, Kansas City, and Omaha via a hub in Oelwein.

Railroads were once the biggest business in America. Their steel rails were as important to American commerce as phone lines and cables are now. Change, however, is constant, and change—automobiles, paved roads, highways, Interstates, and airplanes—put many railroads out of business. At one time or another, almost every railroad in America defaulted on its obligations. The Chicago Great Western went bust in 1908 and again in 1935. It was taken over by the North Western in 1968, which in turn became the Chicago & Northwestern Railway, then CNW Corp., before being taken over by Union Pacific. Today, all that's left of the Chicago Great Western is a patchwork of rails-to-trails hiking and biking paths.

I continued my trip on empty dirt and gravel roads that cut through farmland. Occasionally, I'd pass over a small stream on a one-lane bridge, and every mile or so I passed a lonely farmhouse, just sitting there in the middle of nowhere.

I was somewhere near Waverly, which is north of Janesville and south of Horton, and it was overcast and raining lightly when I heard Don McLean singing "American Pie" on the car radio for the second time that day. In February 1959,



David Schiff's visit to Iowa, August 1996

near Clear Lake 60 miles away, a small plane crashed, killing Buddy Holly, the Big Bopper, and Richie Valens. That was "the day the music died," sang McLean.

I headed south along country roads, gravel and dirt crunching beneath the wheels. The fields, planted with hybrid seed corn, bore the mark of seed producers, generally Pioneer or DeKalb. Selling hybrid seed corn is a better business than farming hybrid seed corn. Unless there's a drought, flood, hailstorm, windstorm, or dust storm, there's usually plenty of corn, which keeps prices low and farmers struggling. Natural catastrophes raise prices, but only because farmers have been hurt and don't have enough to sell.

Producing commodities is a hard life and a tough business. Insurance isn't a tough life, but it's a hard business. More than ever, insurance is a commodity. There will always be good years, but many have forgotten that there will also be bad years—really bad years. The fertile Iowa countryside was, in a way, similar to the fertile conditions in the insurance industry. A boom was building as—with rising stock and bond markets—the fear of a few years earlier had vanished. By the summer of 1996, the recession that had ended in 1991 was becoming an increasingly distant memory, and insurance executives, enjoying the fruit of prosperity, were starting to feel a sense of empowerment that would escalate into conviction that their investments would never decline, that their acquisitions would all be above average, and that they could make money writing business that they had never made money on before.

Not far from Marshalltown—near where David Drury, Principal Mutual's chairman and CEO, grew up—I passed the old Lincoln Highway, later renamed Route 30. Begun more than 80 years ago, it was the first cross-country "highway." (Actually, it was just a series of dirt roads, at first.) Thirty miles farther south was the dreaded Interstate 80, which stretches from New York to San Francisco. In *Open Road: A Celebration of the American Highway*, Phil Patton writes: "The Interstates were created not so much to bind the nation together as to keep things flowing." I stayed off I-80, but many pass through Iowa on its wide expanse of expressway, stopping only to grab a meal at McDonald's. For a traveler moving at 75 miles an hour, the rows of corn become an endless blur, the rolling hills and small communities don't exist, and Iowa—from the Mississippi to the Missouri—can be crossed in a little over four hours.

I arrived in Des Moines on a hot afternoon and went for a walk. Des Moines, with a population of 193,200, is as clean as an operating room and as exciting as an airport lounge. It is an orderly city where people blend in as they go about their business. It is no great melting pot and there are no soapbox messiahs on the street corners.

The city is filled with insurance-company office buildings, with the skyline dominated by 801 Grand Avenue, Principal Mutual's 44-story postmodern skyscraper. The downtown business district is connected by a $2\frac{1}{2}$-mile network of enclosed second-story skywalks that has rendered the streets almost as empty as those of the small towns I had passed through.

That's not to say that Des Moines is devoid of charm. According to the Department of Economic Development, Iowa is ranked as the fourth "most livable" state, and auto insurance rates are among the lowest in the nation. Des Moines doesn't have traffic jams, street hustlers, or piles of garbage. (It doesn't have much in the way of nightlife or restaurants, either.) Iowa is known for its excellent educational system, and when I asked people if they liked living in Des Moines, they usually responded, "It's a good place to raise a family."

Just before evening I went for a jog. As I headed east, crossing the Des Moines River on an abandoned railroad bridge, the setting sun painted the low, faded buildings in a soft light. Downtown's offices and skywalks receded, and east Des Moines, bathed in warm, golden light, was transformed into an Edward Hopper landscape of old brick buildings and desolate streets. When I eventually turned around and headed back to downtown Des Moines and the setting sun, I was running towards my future—although I didn't know it as yet.

Before I'd left New York, I had spoken by telephone with insurance agents and insurance-company employees throughout Iowa. (I met with several of them as I traveled the backroads). I also made appointments with some of the bigger property-casualty companies in Des Moines. It was the end of August, however, and many people were off on vacation.

I tried to get an appointment at a company with which I was vaguely familiar, whose senior people I had seen briefly in New York some years earlier. It was among the largest property-casualty companies in Iowa, and, therefore, a logical one to visit.

As it turned out, no one at Allied Group was around to see me.

To be continued.

Our next issue will explore the dramatic events at the Principal Mutual public hearing, particularly the dubious testimony given by Principal's chairman and CEO, David Drury, and by Principal's investment banker, Howard Silverstein, a managing director at Goldman Sachs.

We'll also report on the outcome of the proposed merger of Allied Mutual into Nationwide (and the concurrent $1.6-billion acquisition of Allied Group by Nationwide), which, if approved under the proposed terms, would bring to a shameful conclusion what is perhaps the most offensive series of events at a mutual insurer in modern times. As we went to press, the matter was in the hands of Iowa's insurance commissioner Terri Vaughan and assistant attorney general Anuradha Vaitheswaran. ■