# Mutuality – Why it still works for some insurance companies

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# What we are going to talk about

History of Demutualization

Differences between Mutual and Public Company

Benefits and Challenges of being a Mutual Company

Why mutuality still works today

# What is a Demutualization?

- Conversion of a Mutual Life Insurance Company where policyholders have certain ownership rights into a public stock company, owned by shareholders
  - In one common method of demutualization, the surplus of the mutual company is fully transferred to policyholders
  - Requires an actuarial calculation to determine how to equitably divide the surplus among different classes of policyholders
  - Enough assets are put aside in a “closed block” to ensure the guaranteed benefits on the mutual company policies will continue to be paid

- Once a company goes public it has the ability to raise capital through the capital markets by selling stock

# Mutual Dividends vs. Corporate Dividends

- Similarity
  - Return a portion of earnings or unneeded capital

- Differences
  - Insurance dividends vary by class of policyholder
  - Insurance dividends are generally not taxable
    - Return of premium
  - Changes to the dividends usually due to
    - Corporate:  Earnings Performance
    - Insurance:  Changes to underlying experience

# Stock and Mutual Life Insurance Companies

| | Stock Companies* | Mutual Companies* |
|---|---|---|
| 1998 | 1167 | 248 |
| 2003 | 931 | 180 |
| 2008 | 741 | 132 |
| 2013 | 648 | 113 |

*Source: ACLI Life Insurers Fact Book 2014

# Many Large Companies Demutualized around 2000

| | 1998 | Today | Year Demutualized |
|---|---|---|---|
| Met Life | Mutual | Stock | 2000 |
| Prudential | Mutual | Stock | 2001 |
| ManuLife | Mutual | Stock | 1999 |
| Principal | Mutual | Stock | 2001 |
| | | | |
| New York Life | Mutual | Mutual | |
| Northwestern Mutual | Mutual | Mutual | |
| Mass. Mutual | Mutual | Mutual | |
| Guardian | Mutual | Mutual | |

# Drivers of Demutualization

- Shift of Consumer preferences from life insurance to annuities, mutual funds and other accumulation products
  - Aging population
  - Changes to the tax law related to life insurance products

- US Tax Law revised to limit tax deductions for dividends paid by mutual life insurance companies
  - Adopted in 1984, repealed in 2004

# Deregulation – Another Driver of Demutualization

- Deregulation of the financial services industry allowing commercial banking to enter insurance and investment banking

- Merger of Citigroup and Travelers in 1998
  - Created the world's largest financial services company
  - Need to raise capital in order to be competitive with expected future financial services giants

# Perceived Drawbacks of Mutual Company Model

- Mutual Company may be less efficient than a Stock Company
  - Less pressure to meet short term financial targets
  - Less pressure to manage expense levels down
  - Policyholders not likely to monitor company performance as closely as stockholders

- Some mutual companies track performance against stock companies

# Perceived Drawbacks of Mutual Company Model

- Emphasis on the permanence of the Mutual Company may make it unwilling to take on risk
  - May lag on new product innovation
  - But, mutual companies generally avoided some products that created issues for industry over the past 15 years

- Limited ability to use capital markets to raise capital
  - capital generally must emerge from the surplus contributions of existing policyholders
  - This may limit growth opportunities
  - But, mutuals are not having growth issues today

# Mutual Company Philosophy

- Mission is to provide financial security and peace of mind to current and future policyholders
- Prime Directive -- Insure permanence of company
  - To fulfill all current obligations
  - To fulfill mission to future generations
  - By maintaining superior financial strength
- No shareholders means no misalignment in managing for the best interest of policyholders
  - Policyholder interests are number one
  - Long term focus of mutual vs. possible short term focus of stock company

# Benefits and Challenges for Mutual Companies

- Benefits
  - Long-Term Focus
  - Alignment with Policyholders
  - Less necessity to follow the rest of the market

- Challenges
  - Increasingly, sales of non-par products means increasing percentage of policyholders are not participating
    - Universal Life, Fixed and Variable Deferred Annuities are non-participating
    - Some mutuals looking to have other product categories be participating
  - Future regulation may rely upon public accounting (GAAP)

# Conclusions

- Demutualization activity has slowed markedly as some of the drivers from 2000 have eased
- Mutual companies have learned how to remain competitive in an industry of primarily stock companies
- There are still some challenges for mutual companies
- The mutual company structure is still very successful today and the future appears to be favorable as well

# Questions?