

PANEL DISCUSSION

THE HOLDING COMPANY STRUCTURE AND  
THE LIFE INSURANCE COMPANY

1. Purpose, scope, and function of the holding company.
2. Activities more easily engaged in by the holding company than by the life company.
3. Activities available to the holding company but not available to the life company.
4. Reasons why a holding company may be inappropriate in a given situation.
5. Effect on the future of life business
  - a) organization,
  - b) earnings,
  - c) taxation.
6. Usefulness for mutual companies.

CHAIRMAN ROYCE N. SANNER:\* I think that in the holding company phenomenon—which I prefer to call it instead of the holding company problem, which seems to me to assume something that has hardly been proved—there is somewhat of a sense of panic. One gets this feeling when he reads the *National Underwriter* or any of the various other journals of our business and finds that another two companies have joined the group of “me tooism.” Moreover, there are many meetings being held on the subject throughout the country. Because of this it is incumbent upon the actuarial profession to look at this whole subject objectively and analytically.

With respect to the holding company question, the role of the actuary certainly ought to be the keynote for this particular forum. If there is any hope of sorting out the real meaning of this move in our time and its implications for the future, it lies with the organization which holds itself out as the ordinate profession in this business.

With regard to the sense of panic, there are several indicators, which I will recite merely to put this presentation in context. According to one count, forty companies during 1967 either formed or announced the development of a holding company structure. According to a very fine set of articles in the magazine called the *Insurance Advocate*, there were 373 insurance companies which were a part of a holding company structure.

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Last winter the publication of a report by a special committee established under the auspices of the New York Department of Insurance indicated some deep concerns and made numerous suggestions on how to deal with these problems from its point of view. An NAIC subcommittee is currently at work studying the question of the need for new laws in this field.

These are simply indicators of the phenomenon and are of little help in analyzing it. Let us start with the question, "What is a holding company?" The term has been used very loosely. For example, you have heard about the holding company problem, the holding company idea, the holding company advantage. These appear in a number of different structural contexts. I would like to identify at least three of those structural contexts simply as a preliminary to our discussion.

Type 1 is the situation in which a general business corporation becomes the owner of one or more stock life insurance companies. This general business corporation then is regarded as a holding company. The general corporation may own other types of businesses in addition to the insurance company.

Type 2 is the situation in which there are subsidiary arrangements. This is the typical situation for the mutual insurance organizations. You will find mutuals owning one or more business corporations engaging in businesses other than the insurance business. These businesses range from being closely related to the insurance business to being very indirectly related to it.

Type 3 is a situation of conscious parallelism. In this kind of situation you find companies operating in tandem with one another, and the particular relationships will differ. You may find interlocking directorates between the two organizations, or you may find that they have the same set of shareholders even though the shareholders are a widely dispersed group of people.

An example of this latter kind is the Government Employees Groups, under which the new companies were formed by making an offering to existing stockholders. Here they have a broad body of shareholders who are basically the same group of people with essentially the same management organization.

As a working hypothesis for our discussion, I would like to suggest this definition of a holding company: "A holding company involves a set of circumstances under which a single manager or management group can direct the affairs of two or more business entities, at least one of which is an insurance company."

The question then arises, "Why the move to holding companies?" What is this all about? What is the purpose of it?

MR. JOSEPH R. PICKERING: In the situation where a general business corporation owns a stock life insurance company, a mutual company could likewise—at least in theory—own or control a holding company.

The discussion of the ramifications of life insurance companies and holding companies has involved a great deal of criticism. Opposition has been expressed to life insurance companies' becoming involved in businesses which are unrelated to their basic functions. However, the life insurance companies already are very heavily committed to businesses unrelated to life insurance in their regular investment commitments.

For example, during the thirties the largest life insurance company in the United States was also the largest farmer in the United States. It is apparent that life insurance company existence depends on other business besides life insurance. In addition there are a number of other reasons why the holding company is an advantageous way of getting more involved in these businesses.

I have seen this done on the basis of integrated financial security marketing. By this I mean that it has become quite apparent that the customers of life insurance companies are purchasing other financial services in addition to life insurance. The holding company structure facilitates life company stockholders' having these additional profit sources. For example, if a life insurance salesman is talking to a customer, endeavoring to sell him on life insurance, he can likewise, through this new structure, have a side-by-side sale of several other kinds of financial services, such as fire and casualty insurance or even mutual funds. Thus, in turn, he makes additional profits for his stockholders and himself. This is one of the strongest reasons I have seen for companies to enter this type of arrangement.

CHAIRMAN SANNER: Charles Percy, when he was chairman of Bell and Howell, said in effect, "Are not too many of us, having created companies by making superior products, continuing to be oriented by the products themselves rather than by the people who consume them?"

This kind of reasoning for broader product orientation for insurance companies really relates to the question of whether you as product innovators in this business are going to be oriented to these products rather than to the consumer whom you serve. It may be that the consumer need will be outside the traditional insurance product lines, and, therefore, your capability to serve the consumer may require you to go outside the conventional lines of insurance in order to meet those needs.

**MR. CHANDLER L. McKELVEY:** It seems to me that there are two different things involved in this integrated financial security structure.

The first is that the life insurance industry finds itself in a declining position in the competition to attract savings. Of course, it is perfectly legitimate to attempt to preserve a particular situation.

However, the other part of this is that there are many instances of companies selling a full line of products, and I think that there are significant limitations on the one-stop selling idea.

My company, Sentry Insurance, is essentially an all-lines fire-casualty-life insurance group. We did a lot of talking about one-stop selling ten years ago, and even five years ago. Today our salesmen sell all lines of insurance. However, we do not talk about one-stop selling nearly so much.

I think that for us, and from what I can determine for many others, this has not turned out to be the panacea that perhaps we thought it would be.

There are perfectly valid financial reasons to attempt to get hold of healthy organizations within the same general scope of business, but, on the other hand, you can also let yourself be carried away.

**CHAIRMAN SANNER:** Would you suggest that the scope of activity of a given life insurance company be the limit of the capability of one man to bring the products of that organization to the market?

**MR. McKELVEY:** No, I am only saying that one of the advantages that I have seen presented, and I think both of you have touched on it, is that having all these products will substantially strengthen your sales force. Well, it may or it may not.

It seems to me that the idea of having a broader financial base within your group of companies, a broader group of services, is more valid than the hope of strengthening the sales force.

**MR. PICKERING:** In addition to the traditional concept of one-stop selling, we could have a different kind of sales organization, one which I would call "finders and closers." They could, for example, have a mutual fund closer, a fire and casualty closer, a life insurance closer. However, in relation to all of these, one individual may do all the finding of these people.

One of the most important things I have seen in the materials which have been published is that which I call the "statutory investment restrictions on life insurance companies."

The holding company, since it is a general business corporation, is not subject to the investment restrictions to which the life insurance companies are subject by law. This means that the stockholders of a life insurance company by becoming the stockholders of a holding company can have more choices available to them to obtain a maximum yield on their investments.

A life insurance company cannot, because of its statutory restriction on investments, really enter into a number of opportunities which a general business corporation can. Just the fact of having more choices available is an advantage.

MR. McKELVEY: I think there is some fear in the life insurance business and even more in the fire and casualty business of being subjected to the same rules as other kinds of business in relation to profitability. I have a feeling that, if you were part of a general insurance company conglomerate or general business conglomerate and had to compete for the resources of that conglomerate group, compared with other possibilities, it might be a rather frightening thing.

CHAIRMAN SANNER: As actuaries, what in your judgment is our role in these expanded business operations?

MR. PICKERING: We have always bragged that we are at least part of management, and often among ourselves we have said that we are the most important part of management. Here comes along a very complex and certainly very pervasive change in thinking about insurance company management; I feel, therefore, that we had better be involved in it or we are going to find ourselves not even involved in management but merely technicians.

A second big point, along the technical line, is that the whole idea of the restructuring of stock life insurance companies into a holding company implies transfer of assets from the life insurance company to the holding company. How much can you transfer out of the life insurance company, or, to put it another way, how much surplus should a life insurance company have, given the kind of valuation restrictions, the kind of premiums, and the kind of deferred earnings which we have?

MR. McKELVEY: It is hard to overemphasize the importance of that point.

We have really evaded the question of what minimum acceptable surplus is and what becomes surplus surplus in a life insurance company?

This is going to become very important, I think, to us, in our dealings and relationships with the regulatory people.

I think that unless we are able to come up with a generally accepted rule of thumb or device for measuring when a company has, in fact, some extra surplus to its credit, the insurance department, and whoever else is going to become involved in regulating this, are going to be very interested in the details of our business. They are going to get deeply into the management of our accounting functions to insure that skulduggery does not occur.

One of our defenses against that would be a really good and acceptable definition of what constitutes a minimum, safe surplus amount.

I certainly agree that we do not have it at this point.

MR. PICKERING: What has been stated about the advantage of a holding company from a federal income tax point of view is in relation to other businesses, businesses which are not life insurance. They may be related but not life insurance. This comes about through the 1959 Income Tax Act, which prohibits consolidated income tax returns of a life insurance company and another kind of company. Any subsidiary you end up holding becomes a part of the insurance company assets. Then any increase in assets without a corresponding increase in investment income will increase taxes. With a holding company, which is a general business corporation, you do not have this kind of problem.

Another problem is the payment of dividends by a subsidiary. The parent company, because of the way in which the policyholder's share and the company's share of investment income work, does not get, if the subsidiary is not a life insurance company, a full 100 per cent washout of the intercorporate dividend as a general business corporation does.

Another advantage of the holding company structure is what has been called the "access to venture capital." The holding company, again because it is a general corporation, seems to give the stockholders more choices in seeking additional capital. This is known as "leverage." The holding company, being a general business corporation, owns part of the stock of the life insurance company and can use this stock as collateral to borrow money to finance growth or diversification. Obviously, the expectation is that the earnings from such growth or diversification will exceed the cost of the borrowed money.

MR. McKELVEY: That strikes me as pure utopia. When everyone tends to regard this whole phenomenon with a little bit of suspicion, why are the companies doing it? Certainly the state regulatory people are very

nervous about the whole thing. There is really a question raised, at least in many people's minds, as to the ethics and the purposes of the holding company.

It seems to me that there is involved here a question of investor confidence. Everybody thinks we are doing something a little slippery. Are they going to be more eager to put money into that which has essentially the same base as before? It seems to me that you have to reach pretty far to say that is an asset.

MR. PICKERING: A life insurance company, if it is unable to borrow money, can only raise additional capital by issuing more shares of stock, for which the life insurance company stockholders would have to put up the cash if they do not want to dilute their control. Wouldn't you prefer to borrow at 7 per cent and make 15 per cent to net 8 per cent for the stockholders who have not put up a nickel?

CHAIRMAN SANNER: The life insurance companies are utilizing, to a very large extent, an access to the capital market. The sale of any kind of life insurance policies, particularly cash value policies, is really borrowing against the promise of the organization. It raises capital through a debt apparatus in a very broad sense.

The reference to the point on leverage is certainly an interesting one. Here you can in effect double the leverage. What you are really doing is borrowing the leverage or borrowing the ability of all your shareholders to borrow. By taking what was formerly your shareholders' stock and making that an asset of the holding company and then pledging that stock, if you will, on the issue of a debenture against the holding company, you have as your real leverage the utilization of the borrowing capabilities of all of your shareholders and, theoretically, by pyramiding, you can do this over and over again.

Now, at some point would you limit your accessibility as a matter of competition in the capital market? I do not know the answer to this. I do not think that attempts of holding companies to go to the capital market have been adequately tested yet, so that no really firm comments one way or the other can be made.

With regard to the assets which do not get their full and fair treatment on the balance sheet of a life insurance company, you can give them a more proper representation. You can state your nonadmitted assets on the statement of your holding company and, therefore, ostensibly utilize those assets for borrowings to expand your business.

MR. McKELVEY: Our parent companies are mutual fire and casualty companies, and they do in fact own two holding companies at this time. I think, in relation to holding companies' owning other companies, the advantages to a mutual organization are primarily dependent upon obtaining some changes in the statutes of the various states. However, there certainly is no question but that in the variable annuity and mutual fund areas it would be very nice to have an intermediate holding company.

I also think that a holding company could be of real advantage to a mutual company if it provided the ability to invest in ways different from those the current investment statutes allow. I think you are all aware of the fact, however, that there is a pretty direct prohibition in most of our states against engaging in an investment program indirectly that you are prohibited from doing directly. Therefore, that kind of advantage is not generally available as yet.

CHAIRMAN SANNER: There is one sort of theoretical factor in relation to the stock company situation and the mutual company situation which needs to be faced and solved. This is the perpetual nature of ownership in a stock company in comparison with temporary ownership in a mutual company. If I have purchased a share of stock in a stock company, I have put up venture capital, and, therefore, I am a perpetual owner in a corporation that is a perpetual corporation. Now, upon my death, assuming that I hold this stock throughout my life, that share of stock passes to my heirs and continues to be a valuable asset. When I purchase a mutual policy, however, I become a temporary owner of the mutual company. Here my ownership or membership is coterminus with the policy I am purchasing from the organization. As a result, I am in a different posture as an investor to the extent that I have put up part of the capital on which this mutual organization operates; the organization may have a duty to me to produce a return on that investment during the period that I am a member.

MR. LYLE H. BARNHART: I think we should consider the regulation of this very seriously. There was a suggestion made that we might put a holding company on top of a holding company to provide more leverage. My feeling is that actuaries should be sort of autonomous and leaders in the regulation of this movement so that the proper relationships could be kept in perspective.

CHAIRMAN SANNER: I shall quickly touch on the regulatory aspects of holding companies. There are two main lines of development going on which you will want to watch very closely. One of these is in connection with the New York report, and whatever is going to come out of that report will be of tremendous importance for the future patterns of this business. The second is the current NAIC study, which follows on the heels of another study made by NAIC. Therefore, the NAIC is deeply concerned.

What this means to me is that one of the disadvantages of looking toward the possibility of a holding company is the legal uncertainty surrounding it. The pure fact of uncertainty, wherever it may lead, is an important business fact in the kind of arrangements that you make. Of course, I am not suggesting that this means that you should steer clear of it altogether.

MR. NORMAN F. BUCK: I have been thinking of how fast we in this supposedly staid business of life insurance really can move when the occasion requires. Not quite two years ago the Institute of Life Insurance set up its Task Force on the Future Outlook, to take a look ten years ahead. When we started, one of the first things we considered as likely to happen in the ensuing ten years was the formation of holding companies. As the year went along, we began playing down this aspect of our forecasting because it was already happening; by the time our report came out last December, we were hardly mentioning it because it was no longer in the future. We have shown that we can move quickly, at least on some things. Maybe we can get together and move quickly on some others.

MR. JAMES F. MACLEAN: My company is a mutual company. Last year the legislature of Nebraska passed a law enabling life insurance companies to own 100 per cent of the stock of other financial institutions. We already had a law on the books which enabled us to own 100 per cent of the stock of other insurance companies. Therefore, in this very structured context, a mutual life insurance company in Nebraska can be a holding company. What I would like to do is to have the mutual life insurance actuaries start to thinking about this and to using some of their famous ingenuity in this area.

MR. PICKERING: We really did not get into the disadvantages, but there is another kind of disadvantage that occurred to me.

It arises when several different kinds of organizations are selling different products to one customer. When that happens, it puts a pressure

on the underwriters in the life insurance company. Suppose the customer purchases a large fire and casualty policy, and you would want to deny life insurance coverage to his uninsurable son. Here you get different kinds of pressures from those that you are normally accustomed to in the life insurance business.

MR. E. FORREST ESTES: Control of life insurance companies by holding companies may not always be in the best interests of the life insurance industry. I am thinking of two instances which have come to my attention during the past five years. The first had to do with men who controlled a holding company which had purchased the controlling interest in a life insurance company; these men were not conversant with life insurance operations, yet they assumed management functions in the life insurance company, to its detriment. The second was the use of a holding company to transfer, to itself and thence into the pockets of the men who controlled it, money from a life insurance company in which it had a controlling interest, to the detriment of the life insurance company and its policyholders.

This is not intended as a reflection on the legitimate use of the holding company concept, but it does point up some undesirable possibilities.

CHAIRMAN SANNER: When there is a major shift of business organization, such as I think we are witnessing in the insurance business today, it behooves the core professional society, as well as people with regulatory responsibility for this business, to look closely and carefully at the dangers that a new trend would indicate.

MR. WALTER L. RUGLAND: It seems to me that the holding corporation concept is that the holding corporation has the umbrella and the funds to maintain the stability of its satellites. If these satellites are one or more life insurance companies, which comes first, the holding corporation's obligations to its stockholders or to the policyholders? If a satellite company begins to have difficulties and the holding company's first obligation is to its stockholders, its action should presumably be to dispose of that company to some other corporation which might be more entrepreneurial and willing to gamble a bit more. I wonder if the panel would comment on the possible secondary position which policyholders might find themselves in?

MR. PICKERING: I do not see a great deal of difference in this question in regard to a holding company owning a life insurance company or

a family owning all of a life insurance company. I think this is something that the regulators have to be aware of regardless of the corporate structure itself. After all, the insurance regulators do have a responsibility; they do have to be sure that the life insurance company is going to be operated in the public interest and not detrimental to it.

**CHAIRMAN SANNER:** Regulatory inquiry and application imply disclosure and identification of persons in a special position of fiduciary relationship. When you have gone to the public with these insurance contracts, many of them without full disclosure, this likewise has a bearing upon the situation. As you know, people purchase insurance policies on the reliance of the fine reputations of the companies and of the agents who represent them. They do not know much about what is in these policies, but they are relying upon you. The insurance industry proceeds on the assumption that this is the fact, whether or not they will admit it. This being true, we are really dealing with a problem which is not a function of who has the control here but of identification of the controlling interests of the company.

**MR. P. WILLIAM FORESTER:** There are several points that may be considered when a life insurance company becomes part of a general business corporation. The life insurance company stockholder may increase the liquidity of his ownership by trading his shares for a much more marketable security listed on the New York Stock Exchange. In fact, this can be considered the major motivation for the change in some cases of closely held life companies. At the same time, the parent general business corporation gains a stability in profits from the life insurance company operations that would not be available from its regular business.

When the general business concern becomes the parent, the actuary has the very important responsibility of explaining the nature of life insurance company profits to the holding company. As an example, it may be difficult for managers of a general business concern (and outside investment analysts) to comprehend that, when sales increase, life insurance company "profits," as displayed in the NAIC annual statement blank, may decrease. The significance of life insurance reserve valuation methods and their effect on the emergences of profits may be a difficult concept to explain to people not oriented to life insurance operations. The actuary should assume the responsibility of explaining this phenomenon.

**CHAIRMAN SANNER:** We have indicated a number of considerations regarding a holding company type of structure, some of which may cut in

favor of you and others which may cut against you. However, we still have not touched upon some very important ones.

I would like to suggest that the Society of Actuaries does need to address itself, especially with its capability of being objective and analytical, to the question that has been brought forth here. I think that too many organizations in their meetings and in their publications have an axe to grind of one kind or another. Ideally, it seems to me, it is the role of the professional to lay aside, in his professional capacity, the axes—to lay aside even the traditions unless he first questions them or analyzes them. In this context the whole holding company question or problem or phenomenon, whichever you want to call it, as related to the future of the Society is not quite as vague and whimsical as it might otherwise be.