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Is the Mutual Life Insurance Company an Endangered Species?

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Summary: The search for alternative ways to access the capital market has led to heightened activity and interest in demutualization and the formation of the mutual holding company. Panelists examine the history, growth, and the purpose of mutual life insurance companies, and the needs under current changing conditions—legal, economic, and market. Experts share their perceptions relating to company management, regulators, and advisors.

The discussion includes:

- *Recent activities among supporters and opponents of mutual company structure*
- *Differences between mutual insurance holding company and full demutualization*
- *Variations in state regulatory requirements and the concerns of the regulators*

Mr. Brian C. Campbell: I'm going to give an overview of the recent developments within the mutual company industry, and then give some background on the mutual holding company (MHC) and demutualization transformations. Then we're going to hear from Bob Broatch who is with UNUM, who will give a pro-demutualization point of view. Finally, we'll hear from Steve Sperka, who is with Northwestern Mutual. He will give a pro-mutual point of view. After Steve finishes, we'll open the session up for questions.

The first thing you might be wondering is what is driving mutual companies to feel endangered. There are a number of external pressures influencing the actions of all insurance companies. These include economic and regulatory concerns, changing demographics, changes to the insurance marketplace, and the adequacy of current distribution channels. In addition, there has been a blurring of the lines between financial services firms, where banks and mutual funds are increasingly competing with insurance companies for premium dollars. To be successful and profitable in this volatile environment, a company needs to have access to a suitable amount of

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capital at a reasonable cost. Mutual companies are finding they are limited in their ability to access capital.

As of 1965, the U.S. had approximately 150 mutual companies. Since that time, there has been a steady decline in the number of mutual entities. At the current time, there are only about 70 mutuals left, and very few large ones at that. It's not inconceivable that there will be no large mutual companies left in a few years.

An indication of why the number of mutual companies has been declining can be found by looking at recent financial results. By looking at statutory return on capital, mutual insurance company returns over recent years have lagged the returns of stock companies. The same relationship has been exhibited for operating margins, where mutual companies have shown lower margins than their stock counterparts. Finally, it can be shown that premiums and net operating gains (after federal income tax) for mutual companies have lagged stock companies in recent years as well. These results have not gone unnoticed by the management of mutual companies and has forced them to seriously consider the conversion to an alternate structure.

Now that I've covered why mutual companies might be looking for an alternative structure, I'd like to talk about the concerns of regulators when it comes to evaluating a mutual company transformation. Regulators are primarily concerned with policyholder protection. They will not allow a transformation to be completed if policyholders are not fairly protected. As such, they would like to be involved in the development of any enabling legislation. In addition, regulators would like to have the final authority on any transformation, to be involved in its implementation, and to have the ability to monitor the transformed company on an ongoing basis. They are concerned with the solvency of the transformed company, and, ultimately, don't want to allow a company to transform if it is not going to be able to meet the policyholders' benefits. As such, regulators will pay close attention to asset quality concerns and the potential for a rating downgrade.

Now that I've defined some of the regulator's concerns, I'll discuss some of the attributes of the mutual holding company structure. Earlier I demonstrated a typical structure before and after an MHC transformation. Before the transformation, a mutual insurance company (MIC) sat alone. After the transformation, an MHC sat atop an intermediate holding company (IHC) which sat atop a stock insurance company (SIC). Before the conversion to an MHC, there is a bonding of member voting rights and policy rights whereas after the MHC restructuring, the member rights and the policy rights are split. The MHC maintains the member rights, whereas the SIC gets the policy rights. A key component of mutual holding company legislation is that it requires the MHC to retain at least a voting majority in the downstream IHC. This means a portion of the voting rights can be sold to outside investors. An important element to consider is that member rights do not necessarily equal economic rights. There have been some instances where legislation has allowed the splitting of these rights. Therefore, a company could sell off 100% of their economic rights in the IHC, but the member rights need only have a majority in the MHC. Down below the IHC resides the new SIC, which

is the transformed MIC. The SIC now has the policy rights and is where any closed block would reside.

Policies issued after the transformation are issued by the stock company. A subsequent full demutualization should be easier, especially if a closed block has been established. A serious limitation to an MHC transformations is that only a handful of states have enacted enabling MHC legislation. By the end of this year, it's expected that about half of the states will allow it. But some large states have not, including New York and Indiana, and neither of them is expected to pass legislation anytime soon.

Next I'll discuss the attributes of a demutualization in order to demonstrate some differences between the two types of transformations. Unlike MHC, almost all states have enabling legislation for a demutualization, so legislation is not going to hold up a company wanting to demutualize. In a demutualization, the mutual company pays equity shares to eligible policyholders to compensate them for forfeiting their ownership rights. There are several ways a company can choose to pay out equity shares. They can pay them out as cash or stock. They can pay them out as subscription rights. Not all states allow this because it is somewhat controversial. It amounts to giving policyholders the right to buy something that they arguably already own. Another option is pay the equity shares into trust. When this is done, the policyholders get stock, but it's placed in trust and they cannot sell it for a specified period of time, such as five years. This can be beneficial to the converting company since it removes the stock from the economic markets and gives the company time to gain stability in their share price. A company could also use a combination of any or all of these equity share distribution options. Finally, by completing a demutualization, a company undergoes a loss of mutuality. Unlike the MHC structure, which still has a mutual entity on top, a demutualization represents a full conversion to a stock insurance company.

Some advantages of an MHC transformation are that it is faster and cheaper than demutualization, and it gives the company protection from immediate takeover, and it offers the ability to reward management with stock. Another advantage is the concept of *creeping demutualization*, which means that as an MHC issues more and more stock, they look more and more like a stock insurance company. There's the argument that analysts will begin to think of them as the same thing. This would presumably allow an MHC to raise capital at a similar cost as a stock insurance company of similar risk. AN MHC may also have tax advantages over a mutual structure. A recent IRS ruling said that converted MHC companies do not have to pay the mutual surplus tax, while still retaining the mutuality concept. Some final advantages are current management employment remains safe and no cash is paid out.

Disadvantages of an MHC include that the MHC voting majority may impede access to capital. There's only one MHC company that has actually completed an initial public offering (IPO), so analysts don't necessarily know what to expect from these kind of companies. This lack of understanding may push up the cost of capital. Additional disadvantages to the MHC structure are the additional reporting required.

This includes completing separate closed block statutory statements, GAAP statements, and tax statements, as well as tracking the progress along the glide path and computing the deferred dividend liability (DDL). The glide path is established when the closed block is funded and represents the expected ratio of closed block assets to liabilities, at various points in the future, required to maintain the current dividend scale. The DDL is a measurement of the current deviation of the closed block funding from the glide path. In addition, almost all MHC legislation calls for the transforming company to complete a triennial opinion on the adequacy of the closed block. Finally, the MHC will likely shorten management's performance time horizon significantly. It has been said that mutual companies have the benefit of being very long-term focused, whereas stock companies just don't have that luxury.

A key advantage to full demutualization is efficient access to capital markets. Since a demutualization represents a full conversion to a stock ownership structure, the cost of capital will likely be the same as for other stock insurance companies of similar risk. It also commits a company to measurement by market standards, which could also be a disadvantage if the company is not ready for such scrutiny. It forces a company to become much more efficient with regard to expenses and the allocation of capital and much more focused on profits. Another advantage of a demutualization is it can be financially rewarding to the policyholders that receive an equity share. Further, it enables stock-based incentive compensation strategies, where stock options can be used to attract and retain key personnel. Finally, it allows the use of common stock as an acquisition currency and eliminates the mutual surplus tax.

Many of the disadvantages to demutualizations are the same as those for MHC transactions. They include establishment and accounting for a closed block, triennial opinions for closed block adequacy, DDL, glide path issues, and a dramatic shortening of management perspective. Finally, a full demutualization is extremely expensive and time consuming.

Last, I'd like to mention a few alternatives to an MHC and demutualization that a mutual insurer could consider. They include issuing surplus notes, entering into a joint venture, creating a stock subsidiary, or completing a merger with another mutual company between. Although all of these are viable ways of increasing capital, they are somewhat limiting.

That concludes my remarks. Our next speaker will be Bob Broatch. Bob is senior vice president and chief financial officer (CFO) of UNUM and has been named CFO of the merged UNUM-Provident Companies. Mr. Broatch has extensive experience in the insurance industry. Prior to joining UNUM in 1996, he was senior vice president of finance for Aetna. He also has previous experience with Primerica, the Hartford Insurance Group, and Arthur Andersen. Mr. Broatch is responsible for the worldwide financial function at UNUM. He is focused on the creation of shareholder value through identification and execution of appropriate strategies, and he has a proven track record in realizing value through executing strategic acquisitions and divestitures. Mr. Broatch is a frequent speaker on issues and topics including today's timely topic of demutualization. He is active in civic and industry affairs, he

holds an MBA in Finance from the AMS Tuck School of Dartmouth College, and a B.S. in Economics from Trinity College.

Mr. Robert E. Broatch: We were the first major company to demutualize 12 years ago. I'd like to say we started a trend before there was a trend in demutualization. I'll sort of guide the discussion with the UNUM story, the soon-to-be UNUM Provident story on demutualization. Let's start at the beginning. On November 6, 1986, UNUM demutualized after 140 years as a mutual company. We've been a public company for just over 12 years, which is not very long when you think about how our history spans 150 years as an insurance company. It wasn't easy or cheap, but certainly from my perspective, it was the right thing to do to become a public company.

Back in 1986 when we were a mutual company, UNUM was largely in the employee benefits business. Most of that was either medical business or group pension business, neither of which exist at UNUM today. Therefore, the company that existed prior to demutualization does not exist today. Not only is UNUM a stock company today, but the lines of business it is in are totally different. We're out of the pension and medical business. I'll take you through how that happened because it was really an indirect effect of demutualizing. We had to be involved in businesses that were going to be successful. Markets are not going to allow you to be a public company very long if you're not successful in where you're focusing your efforts. At the time we demutualized, we were having a pretty good growth record--21% growth in earned premium.

We demutualized for these reasons, but also for access to capital and accountability and the ability to really retain and attract key people. I mentioned access to capital. We needed capital because we were growing at 21%, but we also wanted capital because we wanted to have stock as a currency to do acquisitions. The other thing was accountability, and I think public markets and particularly shareholders are a wonderful measure in discipline of making sure that management stays focused on its strategy and executes well in that strategy. I think the accountability is a really fundamental part of the idea of demutualizing; it certainly was in UNUM's part. We have about 9,000 employees. To attract and retain employees, we give stock options, so there's an absolute alignment between performance and rewards for that performance. That was something we wanted to do as part of the demutualization.

Just a quick mention on how we completed our demutualization. We issued 50 million shares of stock, and over 20 million of those shares went to our policyholders. They got \$520 million worth of stock. They got another \$133 million in cash. If you add those two together, that's about \$650 million and that was the book value. We were one of the first companies and only companies to go out at book value. Most of the demutualizations, as you know, have gone out at less than book value. We also issued 29.5 million shares in an IPO, and we learned a few lessons. In hindsight, I'm not sure that was the wisest thing to do. We did an IPO at the same time we demutualized, and we raised capital approaching \$1.3 billion. The proceeds raised in the IPO (\$749 million) cost us \$48 million. The \$48 million it cost to go public was a combination of accountant and actuarial fees. The

actuarial fees were not the largest in the group I must admit. Most of the money went for the attorney, accountant, and investment banking fees. We raised \$133 million in cash, which we gave to our policyholders. A policyholder that had a policy valued at under \$2,500 got cash rather than stock. We used cash and stock to compensate the policyholders, and those policyholders who have kept their stock have done very well over time. In fact, 8% of the people that own our company today were original policyholders back in 1986 when we demutualized.

As a result of doing an IPO at the same time we became a public company, we doubled our capital base in less than one year. We went from a book value of \$650 million prior to demutualizing to \$1.3 billion after raising capital. The difficulty is that Wall Street wants a return on that capital. We came right out of the box at a stock price of \$25.50, which climbed for a couple of months but within six months, the stock price was depressed. That happened because our return on equity had dropped to 9%, which was a result of the IPO proceeds being left in Treasury bonds, and not earning an attractive rate of return, as demanded by shareholders. In retrospect, I think we underestimated the importance of not having excess capital around.

I'd like to talk about UNUM's period as a public company, roughly 12 years, as a series of three four-year periods. I'll highlight a couple of things about that first four-year period (1986–90) after we became a public company. I said we had excess capital sitting around near the first year, but we also had a poor performing health business and a poor performing disability business. Within a year of being a public company, we exited the health business and started to turn the disability business around. This was an important step since the disability business is our main business today. By the time we got to 1988, we're sitting with the excess capital and we didn't have an acquisition to deploy it on, so we ended up doing a \$500 million stock repurchase. We issued stock and within two years we bought it back. The lesson there is you don't complete an IPO unless you have a plan for how to invest the proceeds. That was a lesson hard learned because our stock didn't perform until we started to really demonstrate to Wall Street that we were active managers of capital. By 1990, real estate and mortgages became problematic assets for everyone in the insurance industry, and certainly UNUM didn't escape that. As a result, our price/earnings ratio dropped to under 10 times earnings. We learned a lesson during that first period, and I would call that a lesson in learning to be a public company.

The next phase, 1991–94, could be titled, "Maturing As a Public Company." This was characterized by a period of getting out of more businesses and trying to figure out what we would be when we grew up. At the start of this period, we were in every business. We had an agency, a brokerage, all lines of business for each, and we had no market share in any of them. Becoming a public company forces you to be number one or number two in every market you're in or you're not going to be around. We were gradually starting to rationalize who we were, and what we were all about during this period. We bought Colonial for \$600 million, which was the first major acquisition we did. It was a stock-for-stock pooling-of-interest type of transaction. We were also added to the Standard & Poor's (S&P) 500. You might not think that's a big deal, but within three days of being added to that list, our

stock went up 10%. That's because every index fund has to own an S&P company, so all the index funds ended up buying UNUM and just drove the stock up 10% overnight. During this period, we began growing our core business, which we had then defined as disability. We got out of a lot of businesses that weren't performing for us and began focusing on businesses in which we thought we had a chance to succeed.

Another dramatic event for us during this period was we got out of the individual non-cancellable, own-occupation disability business. This is somewhat ironic since UNUM is the group disability leader and Provident is the group individual non-cancellable leader in the country. We'll be back in it June 30, 1999.

I'd characterize the last period, 1995–99, as getting our act together. After being a public company for eight years, this period was characterized by high growth and high return. By the time we hit 1997, our earnings multiple was 21 times and our multiple-to-book value was over three times, and our market value was approaching \$9 billion. This was up from roughly \$600 million when we started as a public company, so we had learned to put it all together. Just to give you a little bit of a track record, I'll demonstrate how UNUM's stock has performed. If you invested \$100 when we went public, it would be worth \$1,062 today. If you put it in the S&P 500, it would be worth \$710, and if you put it in a more relative peer group index like the Dow Jones Life Index, it would be worth \$839. The stock has performed well, despite having had some ups and downs. Certainly as a management team, we've learned that being a public company requires a strategy that's focused and understood, including active management of capital, predictable earnings growth, and a story that hangs together with your investors.

Life at a public company is not getting any easier as capital markets are really great regulators and motivators of behavior. Our top 10 shareholders own over a third of the company and when they call, we respond rather quickly. Some of my shareholders call at 6:30 or 7:00 at night, and interestingly enough, we're always there to respond to them. That's what it's about. Those are the capital providers.

The board of directors has a whole new fiduciary obligation. It was very interesting to watch this in the merger we just went through with Provident. The fiduciary obligation no longer pertains to just the policyholders. Really, the first and foremost responsibility is to the shareholders. That doesn't mean policyholders aren't thought of; clearly they are, but the dynamics and attention in the equation changes a little bit. We have the same regulator, states, and rating agencies. That's no different whether you're a mutual or a stock company. But as a stock company, you also have the SEC and you have the New York Stock Exchange. With this merger, it took us five months to clear the SEC to do our proxy. That's because the SEC does not like pooling of interest, and it doesn't like reserve charges. In addition, you've got the dynamic of being a stock company. Everyone talks about short-term versus long-term trade-offs between earnings growth and long-term investment in the company. But you've also got the issue of becoming a takeover risk if your company is not performing. Every day, your job is evaluated by what the market thinks of you, and the ultimate vote will cause your company to no longer exist.

The merger between UNUM and Provident was announced November of 1998. We hope all the regulatory approvals will come in in May 1999, and that we'll close this June 30, 1999. It has taken us three months to clear the Federal Trade Commission (FTC), and as I mentioned, it took five months to clear the SEC. In addition, there were half a dozen states we had to clear. It's a difficult process but it looks like we're in the home stretch. One analyst viewed this transaction with the quote, "I don't remember a time when we've had a merger that was strategic yet financially positive from day one." The transaction is completed without a nickel based on the cost savings. Not only is it strategic, but the shareholders get a kick in earnings per share right off the bat. The rationale is it gives you the ability to protect your future and to stay a winner. I think this is one of the advantages of being a stock company. This thing is about scale and financial flexibility, but first and foremost it's about growth. UNUM itself is growing top line year after year these days at about 17%. We're both leaders in our markets: Provident is on the individual disability side; UNUM is on the group disability side. This merger will take our market cap from roughly \$8 billion up to close to \$15 billion. In today's world of consolidation, you need to be a winner, you need to have scale, you need to have size, and you need to have distribution; you also need to have product innovation, and you need to be number one or two in your markets. This transaction brought us to what a stock company should be by setting the foundation for the future.

Here's what it leaves us with. We are number one in disability, including long-term disability, short-term disability, and individual disability. It brings us to number four in group life, where we weren't even on the charts five years ago. It brings us to number two in payroll deductions. I think having stock as a currency and the ability to pull a company together helps assure you of being a competitive force going forward. Mutual insurance companies have several options when it comes to organizational structure. They can stay a mutual, they can become a stock company, or they can become a hybrid, which is something in-between.

I'm a strong advocate of full demutualization. In support of that, let me add a few comments. First, Standard of Oregon announced recently they would demutualize and their prospectus had the following quote: "In 1997, Standard's management and its board of directors concluded that Standard's future growth and financial flexibility might be constrained by its mutual company form." I feel this is an understatement. Second, since I spend a fair amount of my time these days with rating agencies, a relevant quote from *Standard & Poor's*, related to their opinion of the mutual insurance industry is: "Mutuals are at a distinct disadvantage when participating in consolidations." A final quote comes from *Moody's*: "The benefits of demutualization include improved access to capital markets and heightened market discipline." Obviously I'm biased because I live in that world, but I see the excitement and challenge of a very dynamic world. As a stock company, you have the flexibility to survive in it.

Mr. Campbell: Our next speaker is Steve Sperka from Northwestern Mutual Life. Steve has been with Northwest Mutual for eight years. He is currently responsible

for pricing and product development of long-term-care insurance, and is a graduate of the University of Wisconsin-Madison.

Mr. Steve P. Sperka: What I wanted to talk about today is the mutual company concept and what does it mean, because I feel it's as valuable in today's marketplace as it has ever been. Part of what drove me to this approach was something that happened about a week ago. I was talking with my brother who is an astute member of the banking world, who also happens to be a Northwestern Mutual policyholder. He asked me, "How is your stock price doing?" I said, "We're a mutual company. We don't have a share price." The point is, even though he's a policyholder and familiar with financial markets, he's not aware of what it means for a company to be a mutual company. In fact, I think the concept of what a mutual company stands for is misunderstood by a lot of people. What I want to do today is to highlight some of those mutual concepts.

To do that, let's start by talking about mutual company history. There are several books written that chronicle the history of Northwestern Mutual. One such book was written in 1908, by William Franklin Terrell, who wrote this great history of mutual insurance. I'd like to share some of the stories related here because it will put into context where the mutual idea originated. The idea of insuring your life took a while to catch on. If you look through this history, you'll see evidence of fire and rain insurance being around for a long time, but the concept of insuring your life didn't appear until the late 17th century. The foundations of it were built on organizations whose members contributed money together for the mutual benefit of all the members. The first of these organizations was founded by groups of clergymen who contributed money so that, when a clergyman died, his widow would receive payments. Unfortunately, since these groups didn't have the benefit of actuarial advice, most of them failed fairly quickly.

A few years after that, in 1706, we recognize what you'd call the first life insurance office ever being formed in London. I found this interesting because these may have been early actuaries. The founders reasoned that in London, on average, one in 20 people died each year. They figured they would charge everyone \$5 for a \$100 death benefit. That would have been reasonable if they could have insured the entire city of London. Unfortunately, they limited their membership to 2,000 people and had no form of selection. Therefore, I offer that the very first life insurance company had the first evidence of antiselection, making the concept of antiselection as old as insurance itself.

In 1762, a company called Old Equitable was founded in London, and it is significant for two reasons. First, it sold whole life policies for which you could pay a single premium or annual premiums, and they offered annuities to survivors. These were significant since we'd recognize these features today. What I found more interesting was, shortly after their formation, the British government decided to tax their assets. Therefore, the first evidence of taxation of a life insurance company is almost as old as the industry itself.

Moving forward, in 1772, a gentleman named William Gordon wrote a very prophetic paper because he listed the very concepts we use in the mutual company

today. These concepts included a society where all members are joint proprietors, all members have equal rights, and the society was large enough so as to not be influenced by a powerful few. Unfortunately, this concept did not catch on until the mid 1800s, when we saw the formation of some of the big U.S. mutuals. These companies would play a big part in the life insurance arena for quite some time. A second wave of mutual company formations came shortly after entering the 20th century as a result of the Armstrong investigation. The Armstrong investigation was conducted by the New York Insurance Department; it probed into insurance practices. When the findings of its report proved damning, a lot of companies felt it would be a good idea to mutualize. As a result, four recognizable mutual companies formed about that time.

Next I want to talk about what it means to be a mutual company. Now all of these are basic concepts, but I want to review them because I don't think we hear about them any more. What does it mean when you purchase your policy from a mutual company? It means you are now an owner, since the policyholders own the company. You can certainly debate whether policyholders really own the company. Arguably membership would be a better word, but it's still a unique type of ownership since you can't separate the ownership rights from the policy rights, and you have the legal right to receive a fair share of the surplus or the profits. The general idea of a mutual company is that every year you've got premium and investment cash flow coming into the company. You've got benefits, expenses, and reserve increases going out and you're left with earnings. Now what is done with those earnings? Either they are added to surplus to provide safety to the policyholders, or they are used to finance company growth. What's left over is our profit. Now a stock company pays that profit to the people who are at risk—the shareholders. In a mutual company, the people at risk are the policyholders, so those profits flow back to the policyholders. Therefore, that's the way mutual policyholders are able to purchase their insurance at cost. Any profits generated are given back to the owners of the company. I'd like to drill down on the concepts of mutuality, at least in the context of how Northwestern Mutual has defined mutuality. The first concept I want to talk about is equity. As I mentioned before, we generate profits which are given back to the policyholders, but how do you determine what to give them back? We give back to them in dividends determined proportionately to the way policyholders contributed to those profit. We have blocks of business that contribute a lot to profit, so they will get higher dividends. The blocks that don't do as well receive lower dividends. To do that, we reflect actual mortality, expense, and investment experience each year. This is a very detailed process, but the idea is to treat each policyholder fairly.

Our second concept of mutuality is we try not to have loss leaders. In that, we try not to subsidize new lines of business by taking profits from in-force business. Since new business often requires a lot of surplus, we accomplish this goal by requiring new business to pay a reasonable rate of return. That way no one policyholder is getting a better deal than anyone else.

Another concept we try to apply is that of retroactivity, and what we mean by that is we want to be as proud to face a policyholder today as a policyholder who bought their policy 10 years ago. To accomplish this, as new features become available,

we try to make them available to our current policyholders. The retroactivity concept is also supported by the update programs we run periodically. For example, in 1980, the company became eligible for certain tax advantages if policyholders agreed to amend their life insurance policies to a different guaranteed interest rate. In order to encourage policyholders to do that, the company had the idea to give the benefits back to the policyholders who generated them. This was done by increasing the death benefit for the policyholders who agreed to this, while leaving the required premium the same. Another update program occurred in 1983 when we introduced a direct recognition program for policy loans, which caused the level of a policyholder's dividend to be reflective of their level of borrowing. This was established to prevent policyholders who were doing a lot of borrowing from being subsidized by the policyholders who didn't borrow.

In general, when you say you're buying a policy from Northwestern Mutual Life, these are the general concepts that you're getting when you buy that policy. Now I think our agents love to go out and tell that story because it sells a lot of insurance. I think we'd all agree that, when it comes to insurance, we would like to be treated fairly and I think that works in the marketplace.

In summary, we at Northwestern Mutual feel that we'll never come out and say we'll always be a mutual, but we certainly feel today that the mutual concept is as appealing today to policyholders as it has been in the past. Obviously though mutual companies are facing issues related to limited capital. There's really nothing wrong with those principles. The issues are more structural in nature and as we go forward, we certainly see a lot of opportunity in remaining a mutual.

From the Floor: It seems to me a great deal of that surplus was contributed by past policyholders who are no longer around.

Mr. Campbell: I've thought about that issue quite a bit, and your point is a very valid one. I think that if you look back to how that surplus was generated for a lot of the big companies, especially the very big mutuals, you'd see that a large portion of the current surplus could be deemed orphan surplus. It's hard to say who should get that. It's obvious that in going to a public structure, somebody has to get that surplus, but from a theoretical standpoint, the big question is who should get that benefit?

Mr. Sperka: I guess I would argue that although some of that old surplus came from policyholders who no longer are around, part of the deal when you buy into a mutual company is contributing to the future economic growth of the mutual company. You've got to pay in to become part of the company, and you have an interest in it being a viable economic organization in the future.

Mr. Richard S. Robertson: I came to this session with three questions. The first one is the title of the session, "Is the Mutual Company an Endangered Species?," and although the panel didn't specifically address that, I got the sense from the material presented that the answer was probably yes, or at least likely to be so. My second question is, is this a good or a bad thing? I sense that we've gotten two answers to that depending on which side one sits. In spite of being an actuary

for a stock company, I guess I've got enough of a commitment to firm diversity that I think there is a reason to see the mutual company still remain in existence. What can a mutual company do today to increase the likelihood that the institution of the mutual company will survive?

Mr. Sperka: First, I think it's healthy to have both mutual companies and stock companies because the competition between the two makes both forms stronger. To just have one form would likely lead to inefficiencies. Second, to address what mutual companies can do to survive, I can speak to what Northwestern Mutual has done. We've taken a very cautious approach to branching into other financial services areas. I think one of the issues here is whether our field force has access to enough products so that they can support themselves? We have a captive agency and a big issue of ours is whether our agents can make a living just selling life insurance. The options are to branch into other areas of business or expand through a merger. In more general terms, we're taking a very close look at what our core values. These have made us exist for 150 years, and we want to continue to do the things that have made us successful. We're trying to keep our focus on life insurance and areas where we feel our agents need to get into other areas to be viable. We try to either accommodate them with other products or with acquisitions.

Mr. John C. Kelly: My question deals with how an individual policyholder might value a policy held with a company that's in the process of demutualizing. Is there any way you could generalize from the company's income statement, balance sheet, or insurance in force as to what their policy might be worth?

Mr. Campbell: I doubt that there's any easy way of doing that. One concept of demutualization that is discussed is that you try to split the payment of the equity shares between a fixed portion and a variable portion. In theory, the fixed portion relates loosely to the amount of orphaned surplus whereas the variable portion would be related to the non-orphaned surplus because that's the actual capital that those existing policyholders contributed to the existing surplus of the company. But beyond that concept, it's not easy to estimate what a company's orphaned surplus would be. Furthermore, I guess because the whole idea behind the variable calculation is to give shares to policyholders based on a complex assessment of an individual policyholder's contribution to surplus, there would appear to be too many variables to come up with a simple relationship to use.