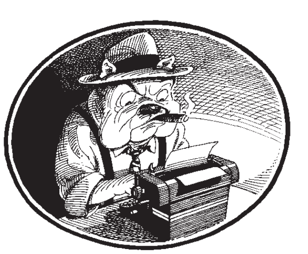

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INSURANCE OBSERVER

Revisiting 'The Company You Keep'

A Conversion, of Sorts?

In terms of money, the biggest issue in the insurance business in recent years was the highly contentious topic of mutual holding companies (MHCs). For those who may have forgotten, the now-discredited MHC structure works like this: a mutual insurance company is converted into a stock insurance company controlled by a shell mutual entity. It then conducts an IPO and shares are issued to investors and insurance-company employees—but not to policyholders.

In 1997 and 1998, a battle raged between the nation's largest life insurers (who favored MHCs) and a handful of activists and writers who opposed MHCs. The battle pretty much ended when—in what will go down in the annals of financial history as one of the most remarkable upset victories of all time—the small group of MHC opponents beat the giant mutuals. (For much more on this see every issue of *Schiff's* published between October 1997 and December 1999.) The *Christian Science Monitor* called the defeat of the mutuals' MHC plans "one of the greatest triumphs ever for consumers." As a result of the mutuals' defeat, policyholders have now received $75 billion or so.

In the last couple of years, many of the largest mutual life insurers have opted to do full demutualizations, giving most of their value to policyholders. Among those that have gone this route are the four largest Canadian mutuals, MetLife, Prudential, Principal, John Hancock, and MONY.

One company that has not only *not* demutualized, but says that it's strongly committed to remaining a mutual insurance company, is New York Life, which, on the surface, seems odd. In 1997 and 1998, New York Life was the most rabid proponent of MHCs, spending more money than any other insurance company lobbying for MHC legislation. (Despite its tremendous efforts, New York Life failed to get the legislation enacted in New York.)

Sy Sternberg, chairman, president, and CEO of New York Life, has been getting raves in insurance-industry publications recently. *National Underwriter* columnist Thomas J. Slattery wrote that he'd spent an hour "mining nuggets of insight" from the "dynamic" Sternberg who is "Mr. Everything" at New York Life. An article by Ron Panko in *Best's Review* said this of Sternberg: "At ease in his animated style of articulation, he is unabashed in his enthusiasm, secure in his convictions, *dedicated to his mission to serve policyholders without the distraction of shareholders* [emphasis added]."

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Sternberg fervently believes in mutuality, and has said that New York Life should remain a mutual insurance company "for the foreseeable future." (Strunk & White's *The Elements of Style* has this to say about "the foreseeable future": "A cliché, and a fuzzy one. How much of the future is foreseeable? Ten minutes? Ten years? Any of it? By whom is it foreseeable? Seers? Experts? Everybody?)

These days, Sternberg extols the virtues of mutuality and criticizes the drawbacks (from the policyholders' perspective) of demutualizations and stock insurance companies.

Since even contentious issues are rarely black and white, and even strongly held beliefs are subject to change, we thought it would be worthwhile to compare Sternberg's comments about MHCs (made at the November 13, 1997 public hearing on proposed MHC legislation held by the New York State Assembly's Standing Committee on Insurance) with comments that Sternberg made more recently. The difference between what he said when he was lobbying to get MHC legislation passed and what he is saying now is striking.

At the 1997 hearing, Sternberg asserted that if New York Life converted to an MHC and issued stock to investors and management (but not to policyholders), there would be no conflict of interest between policyholders and shareholders: "In the real world, and the real world is 99% of the time—there is an absolute alignment between what the mutual [holding] company policyholders want and what the outside shareholders would want. If the company grows and prospers, the shareholder value increases, policyholder dividends increase…"

Today, Sternberg sounds quite different. "Think about how many shareholders of insurance companies like John Hancock or MetLife—most of which are institutional holders like Fidelity or pension funds—really care what will happen 30 years from now," he told *Best's Review*. "They care what will happen next year or the following year...To me, that creates a *fundamental conflict* [emphasis added] that I can only resolve by remaining a mutual."

In 1997, Sternberg asserted that New York Life needed to issue stock and make acquisitions. "It's simply economies of scale," he said, cautioning that without an MHC through which New York Life could do an IPO, the company "may not have a competitive level of expenses" to "maintain those [policyholder] dividends that we've talked about."

The recent *Best's Review* article contained a different opinion: "Participating whole-life policies are where mutual companies can beat the performance of a stock-company product, Steinberg said. Most stock companies try to achieve a return of 15% or so in each new product, while mutuals might accept a lower return…'That's why participating policies can't be supported in a stock company.'"

In 1997, Sternberg was adamant that an MHC was the magic bullet for New York Life's capital needs. "I am convinced," he said, "that witnesses at the prior hearing who questioned our need for capital do not appreciate today's market dynamics." (The witnesses Sternberg was referring to were New York City's public advocate Mark Green, Jason Adkins of the Center for Insurance Research, Ralph Nader, James Hunt of the Consumer Federation of America, David Schiff, and Herbert Kurz, chairman of Presidential Life. In fact, these witnesses didn't question the possible need for capital; they criticized the MHC concept and the specifics of the proposed bill.) Sternberg continued: "We need capital to develop our insurance operations domestically and internationally, to build new technologies and to engage in other business initiatives. Lack of enabling mutual-holding-company legislation is an unacceptable situation for my policyholders…it may very well be a long-term survival issue."

Now, Sternberg says that New York Life's capital position "is such that we don't require additional capital."

In 1997, Sternberg said that going public via the MHC route (in which policyholders would receive nothing) was best for policyholders: "If we sell more business and take market share away from other companies, we grow. And if we grow, the price of our stock grows. And if the price of our stock grows, everyone becomes rich. Our policyholders [who would receive no shares] become rich and the shareholders become rich."

In response, Assemblyman Pete Grannis, who chaired the 1997 hearing, asked, "How do the policyholders benefit from the enhanced value of this expanded company?"

The gist of Sternberg's answer was that New York Life would be stronger, expenses would be lower, and, as a result, policyholders would get higher dividends and greater security.

Last week's *National Underwriter* carried a different opinion from Sternberg: "Since the equity market fell and the bull market collapsed, our sales in traditional whole life—dividend-paying policies—are up more than at any time since I've been with the company… [Traditional whole life] *can't be supported by a demutualized company* [emphasis added]." (In an MHC, the mutual life insurer is demutualized—it becomes a stock insurance company.)

How does one reconcile the Sternberg of 1997 with the Sternberg of today? Although we strongly disagreed with his concepts about mutuality four years ago, we find ourselves in agreement with much of what he says now. We wondered therefore, did he experience some sort of epiphany, or did his opinions gradually evolve to where they are now?

When we told him that we might want to call this article *Sy Sternberg's Change of Heart*, he said—with some annoyance—that he hasn't had a change of heart; he believes what he said four years ago, and he believes what he's saying now, too.

"My endgame was to remain a mutual," he says, equating an MHC with a mutual insurance company. Whereas "MetLife viewed an MHC as an interim step on the way to full demutualization," Sternberg says that New York Life "didn't want to use this as a stepping stone."

continued

Let the record show that Sternberg wasn't trying to curry favor with us or get on our good side. Since an MHC followed by an IPO—but no demutualization—leaves the policyholders with no compensation, it is, in our opinion, much worse that an MHC that's a stepping stone to a full demutualization (where policyholders receive compensation).

In fact, we're puzzled by Sternberg. Didn't he realize that an MHC that has public shareholders creates conflicts of interests for the policyholders: their company's directors would have a fiduciary responsibility to the shareholders rather than to the policyholders, and the policyholders would receive nothing from the process in which that change of fiduciary responsibility occurred?

"We always considered that the primary owner [of the MHC's public company] would be a mutual," Sternberg says. "That's the fundamental point. I'm a firm believer that the controlling interest of New York Life should always be in the hands of our policyholders. We believed that we could protect the interest of the policyholders."

In response, we pointed out that state laws are designed to make it virtually impossible for policyholders to have any say in the governance of a mutual insurance company—that the policyholders have no control. Control resides with management and the board of directors. Once an MHC sells stock in its insurance company to the public, the directors of the public company have a fiduciary responsibility to the shareholders. And, even if the MHC votes the "control" block of stock, all it can do is elect directors; it can't obligate them to run the company in the interest of policyholders instead of the shareholders. Indeed, as Sternberg had pointed out, mutual insurance companies have an edge over stock companies in traditional whole life *because they don't have shareholders* who need a return on their investment.

Although Sternberg wouldn't renounce his past positions (which are in opposition to his current positions), he made one begrudging admission: "We probably didn't give as much weight as we should have to the product issues. The particular issue of traditional whole life was not really vetted thoroughly enough."

That was as far as he would go, and perhaps that's far enough. "I'm not in support of MHCs," Sternberg said. New York Life has no interest in moving forward with an MHC. We would not exercise the option if it were available."

Although Sternberg claims to have had no change of heart, he and New York Life are no longer on the dark side of the mutual-insurance-company reorganization debate. Skeptics will point out that this only came about after MHC legislation was defeated in New York and was thus no longer an option for New York Life.

While that's true, we're glad to welcome Sy to our side. ■

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