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How John Hancock Overpays Its CEO

Demutualization Connection

Recent articles in *The New York Times* and *The Wall Street Journal* focused on the remarkable amount of money—$21.7 million not including stock options—that David D'Alessandro, chairman, CEO, and president of John Hancock, received in 2002. Hancock's compensation committee and board of directors believes that D'Alessandro's compensation is justified because John Hancock's stock has increased significantly from its IPO price of $17. (Its current price is $27.33.)

John Hancock was a mutual until it demutualized in January 2000. Although most demutualizations are somewhat unfair, Hancock's was by far the most egregious of any large demutualization. Not only did it sell $1.7 billion of stock at $17 per share—about half the company's private-market value—but it had no need for the capital. It used most of the proceeds from its IPO to cash out approximately 2,000,000 policyholders—about 75% of the total—*without getting their informed consent.*

These policyholders would have gotten about $1,700 of stock or less, and were unable to give their informed consent because the Policyholder Information Statement they received from John Hancock in connection with the demutualization was deceptive, misleading, and coercive. Policyholders were cashed out by a *default-to-cash* provision in Hancock's plan. That is, unless they specifically *requested* stock, they got cash instead. (As former Vermont insurance commissioner, Jim Hunt, testified at Hancock's demutualization hearing, "The default to cash is a form of negative sign-up, and in my regulatory experience, negative sign-ups for insurance have always been frowned upon, if not prohibited.")

In order to avoid being cashed out, a policyholder had to first make sense of the voluminous misleading documents he received, then complete and return a complicated "ballot," "taxpayer identification information," and "cash/stock compensation election."

There were good reasons why policyholders would have preferred to receive stock rather than cash: 1) the stock was severely undervalued, and 2) receipt of cash is a taxable event, whereas receipt of stock is not.

Many people who don't work for mutuals, or for their investment bankers, believe that increased compensation was the real reason so many mutual CEOs favored demutualizations. In the December 1997 issue of *The Insurance Forum*, editor Joseph Belth wrote the following: "In discussions of mutual holding companies, the two motivations usually mentioned are the need for more flexibility in making acquisitions and the need for an expanded ability to raise external capital. The desire to facilitate the enrichment of officers and directors is rarely mentioned. Stock grants, stock options, and other such devices are available to stock insurance companies and not to mutual insurance companies."

In a 1999 speech, Belth referred to corporate officers and directors, investment bankers, consulting actuaries, and lawyers: "The apparent consensus that financial-services integration is in the best interests of consumers may exist only among people with a powerful financial interest in the integration process."

So far, the warnings of the demutualization opponents have been borne out. The insiders have been enriched and the converted mutuals have often wasted the money they received from issuing stock. Many policyholders are no better off.

For several years in the late 1990s, Jason Adkins, the consumer advocate, pol-

David D'Alessandro's Compensation Soars after Demutualization

John Hancock demutualized in January 2000 in a particularly egregious transaction, cashing out unwitting policyholders at a low price and issuing shares to institutional investors at bargain-basement prices.

David D'Alessandro became CEO of John Hancock in May 2000. Since then, his compensation has soared, especially compared to that of CEOs at other mutuals, or recently demutualized insurers.

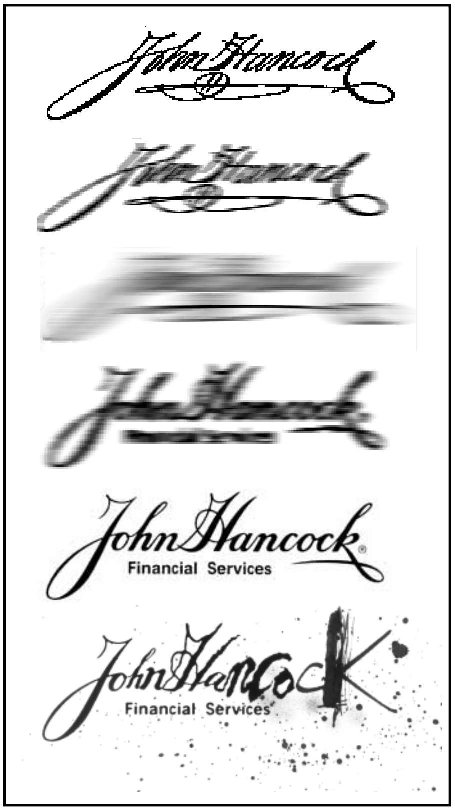
	1998	1999	2000[1]	2001	2002
John Hancock			*$ millions*		
Stephen Brown[2]	$4.1	$2.8	$4.2	$8.1	$6.7
David D'Alessandro	***$1.8***	***$1.7***	***$3.1***	***$8.1***	***$21.7***
MetLife					
Harry Kamen	$6.5				
Robert Benmosche	$2.7	$7.4	$9.3	$9.1	$8.6
Northwestern Mutual					
James Ericson	$2.7	$4.1	$5.1	$6.8	$4.2
Edward Zore					$3.6
New York Life					
Sy Sternberg	$3.6	$4.1	$5.3	$6.8	$6.2

Source: *The Insurance Forum* [1]John Hancock demutualizes [2]CEO until May 2001 icyholder activist, and lawyer, actively opposed mutual executives' attempts to enrich themselves through the demutualization process. For example, he represented John Hancock policyholders, and requested permission to intervene at John Hancock's November 1999 demutualization hearing, but was denied the right to cross-examine the company's witnesses. He was allowed to present witnesses and question them, however. (David Schiff, who spent several years opposing unfair demutualizations, was one of the witnesses.) John Hancock's lawyers, Debevoise & Plimpton, were permitted to cross-examine Adkins' witnesses.

Morgan Stanley acted as John Hancock's financial advisor for Hancock's demutualization plan and also served as the lead underwriter for its IPO. Although serving in both capacities is a conflict of interest, Morgan Stanley had no problem opining that Hancock's demutualization plan was "fair."

Those who have followed the recent Wall Street scandals and paid attention to the large sums that the big firms, including Morgan Stanley, have paid as settlements, will find the following of special interest. Morgan Stanley's fairness opinion was signed by Derek Kirkland, then managing director and co-head of Morgan's global insurance group. Kirkland's opinion was not really much of an opinion. It didn't say that the deal was fair, that the pricing (right around book value) was fair, or that the cash-out provision was fair. Nor did it opine that policyholders would receive greater consideration in a demutualization than in a sale of the company. Finally, it didn't offer any opinion—even a rough estimate—as to what John Hancock was worth. In short, it was the typical opinion rendered in connection with demutualizations: an opinion that blesses whatever the company's board of directors decides to do—regardless of whether it is best for policyholders.

Morgan Stanley seemed more concerned about being fair to Hancock's officers than to its policyholders. In a letter dated May 26, 1999, Kirkland advised against giving Hancock's policyholders the right to purchase stock in Hancock's IPO and therefore avoid having their ownership diluted. If policyholders bought shares, Kirkland stated, "*these shares will not be available for sale...to institutional investors*." [Emphasis added.]



Morgan Stanley, of course, stood to make a lot of money selling those shares to institutional investors. So much for the supposed separation of Morgan Stanley's investment-banking and brokerage businesses.

Kirkland also implied that if institutions didn't get in on the ground floor that "coverage of Hancock by research analysts also will be limited, because analysts historically are reluctant to cover companies with limited institutional ownership." John Hancock, one of the largest life-insurance companies in America, didn't need to do an IPO to be covered by analysts. In fact, the dearth of large, public life-insurance companies made analyst coverage a given.

Remarkably, Kirkland also posited that if Hancock didn't let institutional investors buy Hancock stock in a cheap IPO, then Hancock's stock might not be liquid, and this could ultimately hurt the value of the stock held by policyholders.

In Kirkland and Morgan Stanley's upside-down world, *unless* Hancock issued stock to institutional investors at a bargain price—something that no company should knowingly do—then Hancock's stock would supposedly suffer.

Kirkland and Morgan Stanley did not opine on the fact that if Hancock gave its stock to institutions at a bargain price, those institutions might not mind if Hancock's honchos subsequently received exorbitant compensation packages.

Predictably, Hancock's stock rose significantly from the deliberately depressed IPO price, and Hancock's 2000 annual report included a chart showing how the company's stock far outperformed the S&P 500. Naturally, CEO D'Alessandro didn't explain that the primary reason for the stock's outperformance and appreciation was the fact that the stock was significantly underpriced to begin with.

John Hancock's demutualization plan, the Massachusetts' commissioner's rubber-stamp approval, and the company's subsequent IPO set the stage for D'Alessandro to receive extravagant compensation.

In 1999, John Hancock mailed policyholders a glossy brochure soliciting their approval for the company's demutualization. Chairman Stephen Brown and president David D'Alessandro wrote that "we are pleased to inform you" that John Hancock's board had unanimously voted to approve a demutualization. Brown and D'Alessandro told policyholders that the company was proposing the demutualization "for the purpose of gaining access to capital to invest in the growth of our business...With sufficient capital we can take advantage of opportunities through strategic acquisitions and investments in *new technology and customer-service improvements*." [Emphasis added.] They said the demutualization would make Hancock "even stronger and better equipped to support your policies and benefits."

The glossy brochure would have been an ideal place to tell policyholders that a primary reason John Hancock planned to demutualize was to give its employees greater compensation. But such an admission would have shocked policyholders, and was not included in the hundreds of pages of documents they received. It was included, however, in SEC documents that most Hancock policyholders never saw: "Our primary reason for converting to a stock company through demutualization is to improve our access to the capital markets in order to expand our business in a changing marketplace," stated the prospectus for Hancock's IPO. "Access to the capital markets will allow us to...*better attract, retain, and provide incentives to management in a fashion consistent with other stock life insurance companies*." [Emphasis added.]

D'Alessandro's $21.7 million pay package raises an intriguing question: If John Hancock needs to pay its CEO $21.7 million to "retain" him, how do Northwestern and New York Life manage to retain their CEOs when they pay so much less?

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