The world's most dangerous insurance publication℠

SCHIFF'S

November 22, 2002
Volume 14 • Number 17

INSURANCE OBSERVER

The Reinsurance Company No One Wants

GE's Employers Re

In early 1999 we placed a call to General Electric Capital—the parent of Employers Re (ERC), one of the world's largest reinsurance organizations. We wanted to discuss a series of ERC ads that carried the famous GE logo and that stated, in a variety of ways, that ERC's policies were "backed by" GE's "resources" and "capital reserves."

ERC's ads were misleading and deceptive because they gave the false impression that GE—as opposed to ERC—had financial responsibility for ERC's obligations. On the surface, this issue might appear so subtle as to be a non-issue, but history has shown that large companies will not maintain their subsidiaries' financial health at any cost. Those who choose to believe otherwise do so at their own risk.

When we told GE Capital's spokesman, Neil McGarity, that we thought his company's ads were misleading and asked what the "backed by" claims meant, he was reluctant to spend much time explaining the unexplainable. "'Backed by' means that [ERC is] a member of the GE family and we stand behind them," he said.

But what does *that* mean, we persisted. Is GE *guaranteeing* ERC's obligations?

McGarity dismissed our comments as "overblown speculation" and said he didn't want to talk further.

Yesterday, General Electric announced that it would take a $2.5 billion pretax charge for ERC's prior-years' losses (mostly 1997 to 2000). This charge is in addition to the $2 billion of reserve charges the company had taken in the previous three years.

In order to shore up ERC's diminished capital, GE plans to inject $1.8 billion into the company. (In the past five years ERC has upstreamed $2 billion in dividends to its parent company.) GE also announced a $4.5 billion infusion into GE Capital, whose balance sheet is stretched a bit thin. (GE Capital has $260 billion of debt outstanding.)

Until 2000, ERC had been reporting profits that did not upset Jack Welch's gut. Now it's clear that ERC's recent earnings were an illusion resulting from—we say this with all due respect—honest mistakes made by GE stock-option holders trying to set reserves accurately. (A question: If GE could be so wrong at ERC, is it not plausible that it may be equally wrong at other divisions?)

Jeffrey Immelt, GE's CEO, would love to wash his hands of the reinsurance business. "ERC does not fit GE's business model," the company said yesterday. Indeed, losing a few billion dollars doesn't fit *any* company's business model. GE plans to sell ERC's life reinsurance business soon. If it could find a buyer, it would probably sell the rest of ERC. "About the only thing they can do is pare back and, perhaps, spin off what's left with a clean slate," says our old friend Chris Winans, senior equity analyst at Williams Capital in New York.

An untethered ERC is not good news for insureds who relied on the financial backing of GE to keep ERC in the pantheon of triple-A credits. (To count on such, one had to ignore financial history—at least the financial history reprinted on pages 3-16.)

Years ago, junk-bond impresario Mike Milken noted, quite correctly, that triple-A credits have nowhere to go but down. It's easy to forget the importance of such a banal observation. When *Schiff's* looked at ERC in 1999, the company sported top ratings from Best, S&P, and Moody's. Those ratings are now history. As recently as July 10, Best affirmed ERC's "A++" rating, commenting on the company's "excellent stand-alone capitalization; leading global market position, and prospective long-term earnings capability." On October 14, in light of the company's problems, Best revised its rating to "A+", expressing its "concerns regarding GE's long-term commitment to GE Global [ERC's direct parent] due to its bias against earnings volatility inherent in GE Global's non-life businesses." Yesterday, Best placed the "A+" rating under review with negative implications.

Standard & Poor's "AA+" rating is also under review with negative implications. S&P "will reevaluate the stand-alone ratings on the ERC companies and ERC's strategic role within GE." By year-end it will review "ERC's loss-reserve studies and plans for capital replenishment" and hold discussions with GE regarding its long-term commitment to ERC. "*Upon completion of the review, it is likely that the ratings will be lowered by as much as a full category.*" [Emphasis added.]

Fitch, which is striving to make a name for itself in the insurance-rating business—it can best distinguish itself by being tougher than the others—isn't waiting until year-end. It lowered GE Global Insurance from "A+" to "A" yesterday.

Moody's lowered ERC from "Aaa" to "Aa2" on Tuesday. Some of its commentary was noteworthy: "The continued poor performance of Employers Re appears to be stressing [GE's] long-term commitment to the reinsurance business...[The lower rating] reflects the expectation that *while* [emphasis added] General Electric Company owns ERC, it will continue to provide financial support as needed to maintain the reinsurance group's capitalization at appropriate levels."

After yesterday's announcement of GE's intended capital infusion into GE Capital, Moody's affirmed GE Capital's "Aaa" rating, noting that "a more appropriately capitalized GE Capital would provide multiple benefits for bondholders." It is paradoxical that an "Aaa"-rated company can be inadequately capitalized, yet such is the way of the world. Discussing GE's plans to inject and keep more capital in GE Capital, Moody's had this to say: "The latest series of initiatives directly addresses a concern that Moody's has had for some time—*that GE Capital is undercapitalized on a stand-alone basis…GE's support for GE Capital will continue to be a very important rating factor for Moody's*." [Emphasis added.]

Those concerned with financial strength may choose to remember the Milken dictum and ask the following: If a company doesn't qualify as triple-A on a stand-alone basis, should it qualify as triple-A based on *implicit* parent-company support (as opposed to *explicit* parent-company support)?

ERC policyholders and creditors who placed their faith in GE's logo and implicit guarantees might answer "no."

The following pages, which contain an article about financial strength, misleading advertising, insurance-company failures, and deceptive practices, originally appeared in the March 1999 issue of Schiff's. *Although we thought it was one of the best articles we've ever written, it didn't go over well when it was published. We usually receive a considerable amount of feedback, especially on lengthy articles. But this one got* nothing. *It was as if every issue had been lost in the mail. Perhaps the problem was that the article was buried in a 32-page issue. Perhaps our message—a concern about financial strength and deceptive marketing—wasn't what people wanted to read during the biggest financial boom in modern times. Maybe it was our dud of a title: "How to Influence People and Sell Insurance." Or maybe it was something else.*

In any case, we're giving the article another life, and hope you find it intriguing this time around. (Several companies discussed in the article no longer exist in a solvent state. Amwest, Condor, Frontier, and Reliance—all of which we expressed skepticism about—have failed. Travelers is no longer "a member" of the Citigroup family, and ERC is not really "backed by the prodigious resources" and "capital reserves" of its "parent company, GE.")

Please go to the next page...

The world's most dangerous insurance publication℠

SCHIFF'S

INSURANCE OBSERVER

Editor and Writer . . . . David Schiff
Production Editor . . . . Bill Lauck
Foreign Correspondent . . Isaac Schwartz
Copy Editor . . . . John Cauman
Publisher . . . . Alan Zimmerman
Subscription Manager . . . . . . Pat LaBua

Editorial Office
Schiff's Insurance Observer
300 Central Park West, Suite 4H
New York, NY 10024
Phone: (212) 724-2000
Fax: (212) 712-1999
E-mail: David@InsuranceObserver.com

Publishing Headquarters
Schiff's Insurance Observer
SNL c/o Insurance Communications Co.
321 East Main Street
P.O. Box 2056
Charlottesville, VA 22902
Phone: (434) 977-5877
Fax: (434) 984-8020
E-mail: Subscriptions@InsuranceObserver.com

Annual subscriptions are $149.
For questions regarding subscriptions please call (434) 977-5877.

Reprints and additional issues are available from our publishing headquarters.
Insurance Communications Co. (ICC) is controlled by Schiff Publishing. SNL Financial LC is a research and publishing company that focuses on banks, thrifts, real estate investment companies, insurance companies, energy and specialized financial-services companies. SNL is a nonvoting stockholder in ICC and provides publishing services to it.

continued

How to Influence People and Sell Insurance

Awful Disclosure: The Annals of Misleading Advertising

Although we've long been interested in how insurance is distributed, until now we haven't written much on the subject. This article should begin to remedy that. At this moment our concern is not how insurance is sold, but how it is *mis*-sold through advertising and promotional materials.

When people in the insurance industry think of insurance fraud, they tend to think of fraud perpetrated upon insurance companies. A growing problem, we believe, is fraud perpetrated upon buyers of insurance; we define "fraud" as any "perversion of the truth in order to induce one to part with money."

Conduct that fits our definition is widespread; it encompasses property-casualty insurance as well as life and annuities. It is employed by small insurance companies as well as by many of the biggest and supposedly best. The targets are individuals, small businesses, big businesses, and other insurance companies.

Because objectionable marketing techniques are often artfully employed, they can be hard to detect, especially by the unknowing. We've all grown accustomed to these "hidden persuaders" because they work so subtly that we're generally unaware of them. But the pervasiveness of these methods of deceptive persuasion does not justify their use. Puffery and braggadocio might be tolerable in the sale of breakfast cereals and laundry detergents but are often unacceptable in the sale of insurance.

The misleading marketing practices we intend to cover do not, for the most part, involve specific misrepresentations about insurance coverage or pricing. In general, they deal with the means by which insurance companies instill a false sense of security about their financial strength.

In this age of convergence of giant financial institutions and the spread of co-branding, misleading advertising and marketing pose a threat not only to consumers, policyholders, and insurance companies, but to financial institutions including banks, investment firms, and holding companies.

❖

The insurance industry is in the business of selling security. People aren't likely to shell out good money for a piece of paper known as an insurance policy unless they believe that the issuer of that policy is prosperous, strong, and solvent.

Insurance companies sell their soundness in several ways. For starters, their names tend to convey the impression of stability and credibility. Joseph Belth's fine book, *Life Insurance: A Consumer's Guide*, notes that companies often choose

The real signature and the logo.

names that suggest such desirable traits as "financial strength (Guaranty, Protective, Reserve, Security), financial sophistication (Bankers, Commercial, Financial, Investors), maturity (Colonial, First, Old, Pioneer), dependability (Assurance, Great, Reliable, Trust), fair treatment (Beneficial, Equitable, Golden Rule, Progressive), intimacy or friendliness (Citizens, Family, Home, Peoples), breadth of operation (Continental, National, International, Universal), and government (American, Republic, State, United States)."

Some companies have associated themselves with famous Americans, even when such an association is dubious. Lincoln National Life, Franklin National Life, Washington National Insurance Company, and John Alden Life were formed 50 years, 94 years, 123 years, and 281 years, respectively, after their namesakes' deaths. (There's no Benedict Arnold Insurance Company.) The award for chutzpah, however, goes to John Hancock Mutual Life, which was started 69 years after John Hancock's demise: not only did John Hancock (the insurance company) appropriate Mr. Hancock's fancy signature as its logo, it actually registered that signature as a trademark.

An insurer doesn't need to trade off the goodwill of famous Americans if it has an honest folksiness about it—the kind of good old reliability that's been around for as long as anyone can remember. Take Old Reliable Casualty Company. It's been old and reliable ever since it was formed way back in 1978.

Names are important. When Lloyd's of London—which had a reputation for transacting its affairs on a higher plane—one of "utmost good faith"—dumped its pre-1993 liabilities into a questionably capitalized run-off company, it gave that company a magnificent moniker that bespeaks fairness as it rolls off the tip of the tongue: Equitas.

Good names are merely a beginning. Insurance companies burnish their images through the use of branding and advertising, both of which have become increasingly sophisticated. It has been our observation that advertisements (which generally emphasize protection, security, and prudence), have shown a growing tendency to tout insurers' size and financial strength, as well. Many insurance companies, however, have gone far beyond selling the sizzle and are making misleading claims about their financial resources. Such practices are likely to haunt them someday.

The New York State Department of Insurance has rules governing insurance-company advertising. Regulation 34A, for example, which deals with life insurance and annuity contracts, sets forth certain commandments so eminently fair that it's hard to imagine that anyone, in any state, in any line, could disagree with them:

Advertisements shall be truthful and not misleading in fact or in implication.

The format of an advertisement…shall be sufficiently complete and clear so that it is neither misleading nor deceptive *nor has the capacity to mislead or deceive.* [Emphasis added.]

An advertisement shall not use logos…in a context which might imply that the policy is being sponsored or endorsed by an organization, if such is not the case.

An advertisement shall not use a trade name, an insurance group designation, name of the parent company or affiliate of the insurer…service mark, slogan, symbol, or other device or reference if such use would have the tendency to mislead or deceive as to the true identity of the insurer, *or create the impression that someone other than the insurer would have any responsibility for the financial obligation under the policy.* [Emphasis added]

Condor Insurance Company, which specializes in auto liability for local trucking operators in California, recently ran an ad that creates the impression that someone other than Condor has responsibility for Condor's financial obligations under a policy. Condor has $10 million of surplus and carries a "B (Vulnerable)" rating from A. M. Best, but its full-page ad touts its affiliation with its parent company: "*We're backed by the financial strength and stability of Amwest Insurance Group* (rated A- 'Excellent' by A.M. Best)." [Emphasis added.]

Amwest is indeed rated A-, but that rating doesn't extend to Condor. If Condor fails, Amwest isn't obligated to make good on Condor's liabilities. Shirley Burch, assistant to Amwest's president, explained Condor's ad, saying, "We try to put our best foot forward."

But isn't that misleading?

John Savage, Amwest's president, said that Amwest had put money into Condor and that Condor is backed by Amwest.

But doesn't "backed by the financial strength and stability of Amwest" imply that Amwest is providing Condor with some sort of explicit guarantee or obligation?

Savage, expressing concern, acknowledged that Amwest provides no guarantees to Condor, nor does it have any financial obligation to the company or its policyholders. (Indeed, if Amwest were to guarantee Condor, Condor's ratings would probably rise and Amwest's would probably fall.)

Although we've singled out Condor, it is not unique. A list of other companies whose ads give the impression of greater financial resources than are actually committed includes such companies as AIG, Colonial Penn, Employers Reinsurance, MassMutual, Motors Insurance Company (a subsidiary of General Motors), PXRE Reinsurance Company, Travelers, Winterthur Swiss Insurance Group, and Zurich. These companies' ads are of concern for an obvious reason (it's wrong to mislead), and for a not-so-obvious reason (insurance companies may be exposing their parent corporations and affiliates to liability). In the event that Condor were to fail, policyholders who relied upon statements made in Condor's ad would probably discuss the matter with Amwest—in court.

At issue in such situations is the following: if a holding company's insurance-company subsidiary becomes insolvent, can an insured pierce the corporate veil and attach the assets of the holding company? (Most insurance companies are owned by holding companies or by insurance companies that are owned by holding companies, e.g., National Union is a subsidiary of American International Group, Inc., and Travelers Indemnity is a subsidiary of Travelers Property Casualty Corp., which is 82% owned by Citigroup.) Given many of the practices employed by insurance companies, piercing the corporate veil doesn't seem all that far-fetched. (In Japan, where failure is in abundance, *The Nihon Keizai Shimbun* reported that companies affiliated with insolvent Japanese life insurers may have to pay some of the losses of their insolvent insurance affiliates.)

Where does promotion end and deception begin?

Owens Financial Group (represented by Anderson, Kill & Olick), sued AIG, accusing it of, among other things, false advertising. As part of a well-known advertising series, AIG had run a full-page ad with a large photograph of a mountain of old tires. The caption read: "Dump Them, You Break the Law. Recycle Improperly, You Break the Law. Meanwhile, More Tires Just Came In." The ad's text mentioned "environmental controls" and "environmental standards," and said "fortunately, AIG specializes in designing the kind of custom coverages you need…" Owens' complaint, filed in October, alleges that AIG insured a used-tire recycling facility (including some of the tires featured in the ad) under a Pollution Legal Liability Policy, then denied coverage on the grounds that tires are not "pollutants." (AIG declined to comment; its denial of coverage is based on policy terms and conditions.)

While the issues in Owens v. AIG deal with coverage rather than financial strength, the lawsuit raises a question worth some reflection: how often do insurers' advertising departments talk to their legal departments?

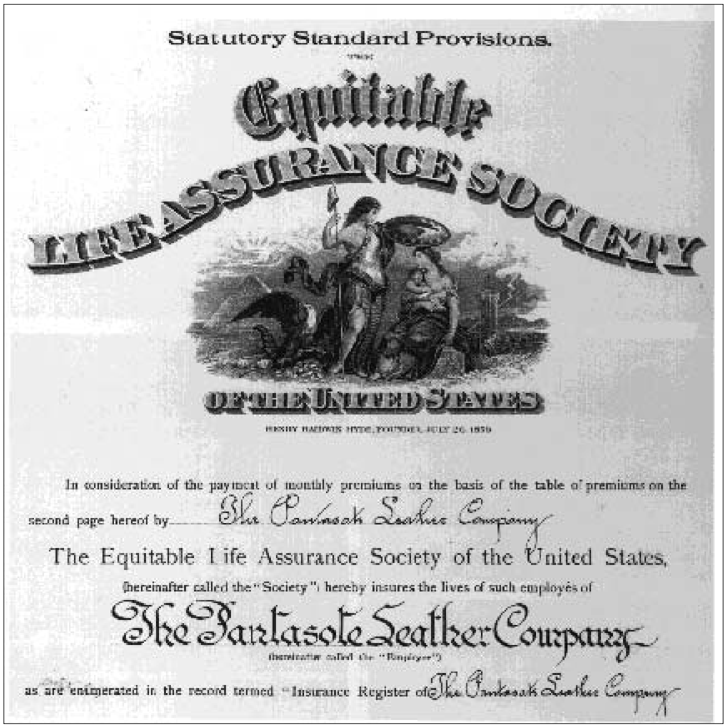
Later in this article we'll delve into some of the incredible claims being made in insurance-company ads. We shall examine the dubious, review the spurious, and fathom the depths of the fallacious. Before doing that, however, we'll journey into the past—when a dollar was worth its weight in gold, financial crises were known as "panics," and Alan Greenspan was yet unborn. We'll visit an era in which inflated trusts imploded, monopoly trusts were busted, and dicey sovereign debtors did what they tend to do—default. In short, our tour will take us through times that, on the one hand, bear little resemblance to the world of today, and, on the other hand, are strikingly similar. Then, as now, financial decisions were made by Homo sapiens (who tend to react emotionally), rather than by Vulcans (who tend to act logically).

As part of our trip, we'll take a gander at a number of notable failures (insurance and otherwise) and examine some of the means that insurers have used to convey the look and feel of financial strength.

Although insurance policies now look as if they have come out of a laser printer, such wasn't always the case. In the good old days, policies often had an official appearance that included indicia, engravings, flowing longhand script, and *real* signatures.

An Equitable policy from 1911, for example, bears a greater resemblance to paper money or to a corporate security than it does to a modern policy. Equitable's name, "Equitable Life Assurance Society of the United States," is set in engraved, shaded typeface, and is placed above Equitable's corporate emblem, an allegorical neoclassical image called the Protection Group.

The Protection Group, first used in 1860, is a depiction of a bare-breasted female warrior (reminiscent of Delacroix's "Liberty") holding a shield over a bare-breasted young mother cradling an infant. To the Protector's right is that great American symbol, the bald eagle. In the distance is an image familiar to anyone who has looked at the back of a one-dollar bill: the Great Pyramid. Adding extra drama is a jagged bolt of lightning shooting down from the heavens. (Over the years, Equitable became a tad prudish, and the risqué Protection Group image was redesigned. Now, the breasts of the Protector and the mother are cloaked.)



Statutory Standard Provisions.

Equitable Life Assurance Society of the United States

HENRY BALDWIN HYDE, FOUNDER, JULY 26, 1859

In consideration of the payment of monthly premiums on the basis of the table of premiums on the second page hereof by The Pantasote Leather Company

The Equitable Life Assurance Society of the United States,

(hereinafter called the "Society") hereby insures the lives of such employés of

The Pantasote Leather Company

(hereinafter called the "Employer")

as are enumerated in the record termed "Insurance Register of The Pantasote Leather Company

A fancy-looking Equitable Life policy from 1911.

Although property and casualty policies may not have looked as currency-like as Equitable's policy, property and casualty insurance companies have long used familiar images to connote solvency and security. Failing to heed Samuel Johnson's admonition that "patriotism is the last refuge of a scoundrel," they often wrapped themselves in the flag.

A National Union Fire Insurance Company sign from the early 20th Century incorporates both the American flag and the Capitol building. (What do you expect from a company called "National Union"?) A Great American Insurance Company sign from the same era shows Uncle Sam against a backdrop of the American flag. (The FDIC wouldn't come into existence for another 15 years, and there are still no Federal guarantees for insurance policies.) Great American also advertised its surplus—$10,759,422—and declared itself to be a "Solid thoroughly American Institution," boasting "Losses Paid Since Organization over $90,000,000."

The Continental Insurance Company (founded 70 years after the end of the American Revolution), used a Revolutionary War soldier as its corporate symbol. United States Fidelity & Guaranty's insurance companies' symbol included a bald eagle holding a shield with stars and stripes. The American Fire Insurance Company of Philadelphia used a bald eagle carrying an American flag. Aetna's signs contained an American flag and a shield with stars and stripes.

While waving the American flag won't actually sell insurance, it probably reduces resistance to the sales process. Another way to reduce resistance is for insurance companies to convey the image of great financial strength, regardless of whether they are in possession of such.

On November 21, 1929—twenty-three days after the stock market crash—Hugh Hart, vice president of The Penn Mutual Life Insurance Company, spoke before the Boston Life Underwriters Association, emphasizing the "stabilizing factors" present in the U.S. economy. "We," he said, referring to American insurance companies, "are carrying a financial reserve of $100 billion of non-shrinkable, non-declinable, non-panicable life insurance." The effect of this was comparable to what might happen if Abby Joseph Cohen were to tell a meeting of The Beardstown Ladies' investment club that the Dow was going straight to 15,000—the audience broke into applause. That Hart's words were a pile of bushwa was, apparently, beside the point. Although he continued to refer to a "vast reservoir" of "$100 billion," no such reservoir existed. In actuality, the $100 billion was the *face* amount of life insurance in force. The life-insurance industry's total assets were less than $20 billion, and, contrary to Hart's assertion, these assets were shrinkable, declinable, and panicable.

By 1933, insurance-company balance sheets were laden with defaulted mortgages, non-performing loans, and illiquid bonds, and a national life-insurance moratorium (similar to the Bank Holiday) was instituted. Assets were frozen, and policyholders were prohibited from cashing in their policies or taking out policy loans. (Death benefits continued to be paid.) The life-insurance industry decided to put its best foot forward by publishing a pamphlet absolving itself of blame. "Following the suspension of banking activities, the brunt of the crisis fell heavily upon the life insurance companies," explained the pamphlet. "They became the victims of a financial situation *in which they had no part*." [Emphasis added.]

But life-insurance companies *did* have a part in the crisis. They had been swept up in the euphoria of the 1920's, making speculative loans and recklessly concentrating their assets in real-estate mortgages. Around the time the industry's pamphlet was published, 25% of Equitable's residential mortgages were in default, and the Metropolitan Life Insurance Company was the owner of a busted mortgage on the Empire State Building and in the process of becoming the owner (through foreclosure) of 2,000,000 acres of farmland.

Fifty-eight years after the life-insurance industry had published its pamphlet, Mutual Benefit sent its agents an important letter along with a pamphlet entitled "Facts & Fiction." The letter, dated June 27, 1991—a mere 18 days before Mutual Benefit would be taken over by its regulators—stated that concerns about Mutual Benefit's financial stability were the result of "a series of rumors and misinformation." The pamphlet claimed that Mutual Benefit was in "strong financial position," was "a solid 'investment grade' company," had "limited exposure to 'high risk' investments," and "continues to be an extremely profitable insurance company." *continued*

These statements were false. An affidavit filed in the Superior Court of New Jersey subsequently revealed that two months earlier, Mutual Benefit had met with the New Jersey Insurance Commissioner "to advise him of its increasingly precarious financial condition." At that meeting, Mutual Benefit disclosed that it wouldn't make a profit in 1991 and that it had grave concerns that, as a result of anticipated asset writedowns, its ratings would be downgraded by Standard & Poor's and Moody's.

How is it that Mutual Benefit, which had been around since 1845, could tell the public that it was strong when it had told the commissioner it was weak? Part of the answer has to do with the nature of insurance regulation. Although no honest company in Mutual Benefit's financial condition could have issued securities without first disclosing its distressed condition, Mutual Benefit's products (whole life, fixed annuities) are not considered securities. Even though these products are generally considered "investments" by those who purchase them, they are exempt from SEC regulation. As a result, an insurance company isn't required to issue a prospectus and disclose material information when it sells these "investments."

The McCarran-Ferguson Act, passed in 1945, delegates the regulation of insurance to the states rather than to the federal government. Unfortunately, the states haven't always provided adequate regulation. In a "race to the bottom," state legislators have often undermined good regulations to please powerful insurance-company constituents, and have used *lack of regulation* as a means of economic development. (The theory behind this practice is that insurers will relocate to the state with the easiest regulation.)

Mutual-insurance-holding-company legislation, which, fortunately, has *not* been passed in 30 states (among them New York and New Jersey), is just one example of terrible state regulation.

What does it say about state regulation if an insurance company like Mutual Benefit—one in dangerously weak financial condition—is not required to disclose its "precarious financial condition" to prospects prior to selling them a policy? It says that regulation is often ludicrous. While there are many good people in state insurance departments, the combination of inadequate insurance-department budgets, revolving-door commissioners, and a regulatory process heavily influenced by big money tends to produce unsatisfactory results.

There is perhaps no better example of the inadequacy of state regulation than Iowa, which takes in $140 million a year in premium taxes, but spends just $6 million on regulation. Iowa's insurance industry is large, and its insurance department is woefully understaffed. Letters go unanswered, complaints are ignored or misunderstood, and complex financial shenanigans are overlooked, because there's no one there who has the time to understand them. Worst of all, the Iowa Insurance Department is run by Terri Vaughan, who doesn't seem at all perturbed by this.

Vaughan's role as commissioner has been catastrophic for policyholders: she was personally responsible for permitting three large mutuals, Allied, AmerUs, and Principal, to engage in transactions in which policyholders were skewered.

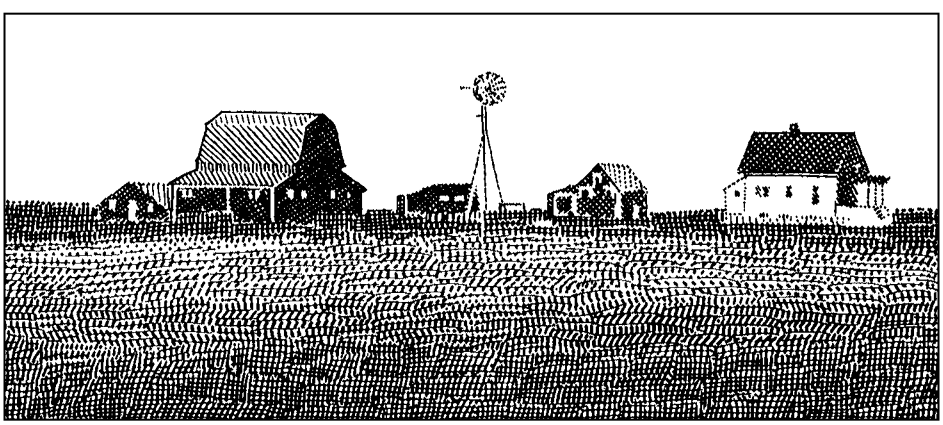
Tom Vilsack, Iowa's new governor, surprised many people by *reappointing* Vaughan, whose term was to expire on March 31. She "exhibits a growing sensitivity" to policyholders, his spokesman claimed.

Life insurers haven't cornered the market on financial instability. During the more-than-250-year history of American property insurance, failures have been common. America's first property insurer, the Friendly Society for the Mutual Insurance of House Against Fire, in Charleston, South Carolina, was wiped out in 1740, a mere four years after its formation. The Great New York Fire of 1835 bankrupted all but three of New York's insurance companies, and the Great Chicago Fire of 1871 burned up 68 insurance companies. Between 1969 and 1994, 591 property-casualty companies failed.

The Home Insurance Company, once the largest fire-insurance company in America, approached the abyss a number of times before ultimately falling in. (Its surplus was wiped out by the Chicago Fire in 1871, and had it been forced to mark its investments to market in 1932, it would have been undercapitalized.) Despite such setbacks, The Home grew larger. In 1968, during an era of great consolidation in the insurance industry, it was taken over by a conglomerate, City Investing. (Great American, The Hartford, Reliance, and many others were taken over around the same time.)

Under City Investing's management—rather, *mis*management—the seeds for The Home's eventual demise were sown. When City Investing was liquidating in 1985, it couldn't find a buyer for The Home, so it spun it off as an independent company. The Home Group, as it was now called, then did what numerous insurance companies have done in the past, are doing at the present, and will do in the future: it became a financial-services supermarket. It acquired a securities brokerage (Gruntal), a savings & loan (Carteret), and grew its assets rapidly and imprudently.

Then, in 1989, The Home Group changed its name to the patriotic sound-



Metropolitan Life Insurance Company's investment portfolio, 1935.

ing "AmBase." (An American flag adorned the front and back cover of AmBase's annual report.) A 1990 ad for The Home Insurance Company carried the tag line, "A subsidiary of AmBase Corporation." It seems that The Home was trying to improve its appearance of financial strength by showing that it was part of AmBase, and that AmBase, which was overleveraged, was trying to improve its stock price by showing that it owned The Home.)

If that was the strategy, it failed. The Home deteriorated, and AmBase's stock collapsed. Miraculously, a buyer from Stockholm, Trygg-Hansa SPP, shelled out about $800 million for The Home, apparently on the theory that nice Swedish fellows could do a better job with the company than could AmBase's chief honcho, the avaricious George T. Scharffenberger. The Swedes must have had one too many Aquavits to think such thoughts, and would soon rue their investment.

In December 1993, Lehman Brothers, Donaldson Lufkin & Jenrette, Salomon Brothers, and Gruntal—all of which, apparently, were not under the influence of Aquavit—underwrote public offerings in which $128 million of stock and $280 million of debt were issued by what was now called Home Holdings. That well-known Wall Street houses would underwrite the toxic securities of a nebulously capitalized insurance sinkhole isn't surprising; underwriting fees are so high that it's difficult for firms to say "no." (A note for the historical minded: Lehman was once owned by American Express, Salomon became part of Travelers Group, which, in turn, became part of Citigroup, and Donaldson Lufkin & Jenrette is a subsidiary of Equitable.)

Although the prospectuses for Home Holdings' rotten securities contained 14 "Risk Factors," one essential risk factor (that The Home was particularly vulnerable to adverse effects in the event of a rating downgrade by A. M. Best) was, incredibly, omitted. When Reliance Group had issued $650 million of debt a month *prior* to Home Holdings' offering, its prospectus included the following: "A downgrade in the Best rating below A- could adversely affect the competitive position of the Reliance Property and Casualty Companies." One would have thought that Donaldson Lufkin & *Jenrette*, a lead underwriter in both deals, might have learned from Reliance's prospectus and insisted upon a similar risk factor in the Home deal. (Richard Jenrette, who, in 1990, became CEO of DLJ's parent, Equitable Life, when it was in deep financial trouble, is a man well aware of risk.)

On November 7, 1994, after *Schiff's Insurance Observer* had published six articles criticizing Best's rating practices during the previous year (see "The Will Rogers of Insurance Rating Agencies," "An Unreasonable Risk of Insolvency," "Let's Face the Music and Dance," "Does Continental Deserve a B+ Rating Instead of an A-?", "Clear and Present Danger: How 'Managed' Ratings Inflate the Ratings of Weaker Companies," and "The Harder They Fall: Why Best's Ratings Portend a Rash of Downgradings"), A. M. Best downgraded The Home from A- to B+, hastening The Home's demise into runoff, where the ultimate payment of its liabilities remains uncertain. Amazingly, Best did not consider The Home to be "Vulnerable" until March 4, 1996, at which time it assigned it a B- rating. (At that time, B- was defined as "adequate." These days B- is defined as "fair.") On March 4, 1997, The New Hampshire Insurance Department issued an order placing The Home under formal state supervision. Six days later Best assigned The Home a rating of "E (Under Regulatory Supervision)."

While Best did not distinguish itself in the early 1990's, it has made significant strides in the last few years. Although its rating system could be improved—for example, it should use a scale similar to that used by Standard & Poor's and Moody's (AAA, AA+, AA, AA-, and so on)—its hardcover *Insurance Reports* is an indispensable source of information that we use daily. (For an excellent recap of the complex mess that is now The Home, we refer readers to the 1998 edition of *Best's Insurance Reports*, pp. 2332–2339.)

The Home is just one of many once-great insurance companies to have gone awry. Financial institutions, by their very nature, are prone to all sorts of problems, particularly during the busts that tend to follow booms. Whether one chooses to call the current U.S. economic environment a boom, bubble, bull market, or new era, it will, in all likelihood, be followed by what will be known as a bust, bear market, recession, or depression. (If Beardstown lingo is employed, it may simply be referred to as a "correction.")

Although the Internet-stock mania is a good example of a current speculative bubble, we'll cite instances of financial hysteria and speculation that are more pertinent to the insurance business. We'll show that prestigious institutions don't necessarily guarantee their subsidiaries or the products they sell, and that a respected name doesn't necessarily provide any value for policyholders or creditors.

Near the height of the mid-1998 financial frenzy, Goldman, Sachs & Company tried—but failed—to fob off its stock upon the public at a $30-billion market valuation, more than four times book value. Goldman's failure was the public's good fortune, for Goldman and its rapacious partners don't knowingly sell anything—including so-called "fairness opinions"—at bargain prices.

Those versed in financial history may recall Goldman Sachs Trading Corporation, a giant investment trust formed by Goldman, Sachs in 1928. Investment trusts were the rage back then, and Goldman Sachs Trading, essentially a blind pool, raised hundreds of millions of dollars very quickly. Using a leveraged pyramid structure, it acquired other investment trusts which had, in turn, previously acquired other investment trusts. (Through a merger with Financial and Industrial Corporation, Goldman Sachs Trading ended up with control of the Manufacturers Trust Company, later known as Manufacturers Hanover.) These financial machinations propelled Goldman Sachs Trading's stock from $50 to over $113, far above the underlying value of its inflated assets. Investors undoubtedly assumed that Goldman, Sachs, by sponsoring Goldman Sachs Trading and providing it with several directors, was, in some way, guaranteeing Trading's success. Such was not the case. Goldman Sachs Trading soon turned into a debacle, and by 1932, when its shares were priced at 3½, the concept of investment trusts had been in disrepute for a couple of years.

"Economic, like alcoholic, excess has its inescapable aftermath," wrote John Kenneth Galbraith in the introduction to the 1988 edition of his book *The Great Crash, 1929*.

Another example of a financial mania partially sponsored by a reputable company was the debacle in Latin American bonds. National City Bank, the forerunner to First National City Bank (which subsequently became Citibank, now part of Citigroup), was a major underwriter of Peruvian bonds in the 1920's, when the City Bank imprimatur was viewed as a seal of approval; that seal ultimately meant nothing. Peruvian government bonds, issued at par in the 1920's, traded down to $3 in 1932, as Peru, like virtually all South American countries except Argentina, defaulted on its U.S. debts. (The phrase "Peruvian bond" subsequently became a pejorative term, a synonym for a worthless debt.) In 1933, the Glass-Steagall Act separated commercial banking and securities underwriting.

Financial institutions are like candles: they can give off light right up to the moment that they suddenly flicker out. Kidder Peabody, which cost General Electric dearly as a result of a 1994 bond-trading scandal, had a history of being solvent most of the time; 1930, however, was not one of those times. Kidder had to be bailed out by J. P. Morgan and Chase National Bank. (Chase was the Rockefeller bank, and John D. Rockefeller was its largest shareholder.)

In 1955 Chase merged with the Bank of Manhattan to form Chase Manhattan Corporation. In 1970, when David Rockefeller became chairman and CEO, Chase Manhattan created and sponsored Chase Manhattan Mortgage & Realty Trust. (Much as the 1920's had seen a boom in leveraged investment trusts, the early 1970's was the heyday of a new type of leveraged trust, the Real Estate Investment Trust (REIT). Between 1970 and mid-1974, REITs grew from $2.5 billion in assets and $1.6 billion in equity to $21 billion in assets and $6.6 billion in equity.) The illustrious Chase Manhattan name—not to mention the Rockefeller connection—made Chase's "trust" all the more appealing to investors. Indeed, many believed that Chase Manhattan wouldn't let Chase Manhattan Mortgage & Realty fail, thereby sullying the illustrious Chase Manhattan moniker; they were dead wrong.

Although Chase Manhattan served as Chase Manhattan Mortgage & Realty's management advisor, it didn't guarantee or assume financial responsibility for Chase Manhattan Mortgage & Realty's obligations. After several rounds of restructuring beginning in the mid-1970's, Chase Manhattan Mortgage & Realty filed for bankruptcy in February 1979. (Many other REITs collapsed, as well.)

Six years later, the failure of Chase Manhattan Mortgage & Realty was ancient history. The stock market had turned, and New York was on the upswing. Thus in 1985 the Rockefeller family was able to cash out of Rockefeller Center through a mortgage REIT, Rockefeller Center Properties.

The original $44.9-million mortgage on Rockefeller Center, made by Metropolitan Life during the Depression years 1931–1935, had carried a 5% interest rate. In bullish 1985 the Rockefellers were able to take out a $1.3-billion mortgage on Rockefeller Center. The money came from a public offering of shares underwritten by Goldman, Sachs and Shearson Lehman. The shares in Rockefeller Center Properties, priced at $20, were not an equity interest in Rockefeller Center; rather, they were an equity interest in the mortgage on the property. The Rockefellers did not provide any guarantees, although many shareholders were undoubtedly drawn to the deal by the luminous Rockefeller name. (Surely the Rockefellers wouldn't let Rockefeller Center fail!) Another attraction: the prospectus for Rockefeller Center Properties implied that shareholders could earn a 13% annual return (rents were supposed to keep rising). Investors would have been wise to ask, "If the Rockefellers are borrowing from me, what do they know that I don't?"

In 1989, in a splendid stroke of timing, the Rockefellers sold 80% of their *equity* in Rockefeller Center to Mitsubishi for $1.4 billion. Soon after, rental rates in Manhattan started to fall, and vacancy rates soared. In May 1995, Rockefeller Center's owner filed for Chapter 11 bankruptcy protection. Shareholders of Rockefeller Center Properties ultimately received $8 per share—a loss of 60% on their investment.

We mention some of these long-ago events because, in the age of consolidation, convergence, co-branding, global marketing, financial-services supermarkets, and Citigroup, it's worth remembering that a good name does not connote solvency, and that risk, without the commensurate potential for reward, is not worth taking—either for an insurer or an insured.

Many insurance companies would have people believe that because they're part of larger organizations, people should have greater confidence in doing business with them. While that might be the case, it also might not. Many large companies don't provide guarantees that enhance the financial strength of their insurance subsidiaries. "Multi-line writers may establish an affiliate to write casualty lines of coverage *in order to isolate the parent from the potential loss exposure* of these more volatile lines," notes A. M. Best. [Emphasis added.]

Writes Moody's: "Because rated companies can issue very long-dated contracts it is important to determine the parent's long-term support and ownership commitment towards its subsidiaries."

Rating agencies, like everyone else, can only make informed guesses about what's going to happen over the long term. While their opinions are worth paying attention to, one must recognize their limitations; most of the major insurance-company failures caught the rating agencies by surprise. Furthermore, insurance companies—like everything else in the world—are often up for grabs if the price is right. Thus, while Colonial Penn might now fly the General Electric flag, there's no guarantee that it won't be sold in the future. Similarly, there's no guarantee that Travelers Property Casualty won't be set adrift by Travelers Group.

In a moment we'll examine a variety of ads that are misleading in some form or other. Before we do that, however, let's review two recent examples of insurance-company debacles that illustrate our point—that an insurer's good name and prestigious parent company may be of little use to an insured when the chips are down.

Example one: from 1980 until 1987, First Capital Life was called E.F. Hutton Life Insurance Company. Policyholders probably felt a sense of comfort knowing that they were with an insurance company bearing such a distinguished name—that E.F. Hutton wouldn't let anything bad happen to its insurance company because that would besmirch the name made famous by the advertising campaign, "When E.F. Hutton talks, people listen." In 1987, E.F. Hutton was taken over by Shearson Lehman, a subsidiary of American Express, and E.F. Hutton Insurance Group, which included E.F. Hutton Life, was sold to First Capital Holdings. When First Capital Life (aka E.F. Hutton Life) failed in 1991, E.F. Hutton didn't step in to pick up the pieces or make good on the liabilities, even though Shearson Lehman Hutton Holdings was still the largest shareholder in First Capital Holdings. Policyholders of E.F. Hutton Life learned the hard way that E.F. Hutton's talk was cheap.

Example two: in 1992, Prudential Property and Casualty Insurance Company (PRUPAC) was wiped out by Hurricane Andrew. (PRUPAC's capital was subsequently replenished by its parent, Prudential Insurance Company.) In 1993, when the Florida Insurance Department wouldn't permit PRUPAC to non-renew policies in areas where it had a high catastrophe exposure, PRUPAC brought suit, claiming that it faced "an unreasonable risk of insolvency" as a result of the Insurance Department's actions. So that there were no doubts that the "risks" were faced by PRUPAC (as opposed to Prudential Insurance Company), Prudential said that it would not necessarily bail out PRUPAC if it became insolvent again, and emphasized that it was providing "no guarantees" to PRUPAC.

That was then; this is now. "In 1996, we launched a corporate-wide initiative called 'One Prudential,'" writes Prudential's chairman and CEO, Art Ryan, in the company's most recent annual report (available on Prudential's website). "In simple terms, One Prudential means…Prudential will look and act like one company…By coordinating our marketing efforts, we're bringing a wider, more accessible menu of services to our retail clients…[and] by unifying our communication and graphic standards across all of our businesses, we're helping to strengthen our brand."

A homeowner who isn't knowledgeable about insurance, corporate law, finance, insurance regulation, and Prudential might accept at face value what Ryan says in the annual report: "Prudential is a trusted name in quality insurance products. As a top issuer of life, personal lines, property & casualty insurance, as well as annuities, we have distinguished ourselves as an industry leader. *Our strength lies in our commitment to our customers*." [Emphasis added.]

That "commitment" doesn't extend to guaranteeing PRUPAC's policyholders in the event that PRUPAC should fail.

To win a prize for being misleading, an insurance company's ad, brochure, or letter should do the following: make a ludicrous, beguiling statement; imply things that aren't true; use a well-known name and logo to lull the reader into complacency; create the impression that the owner of that name and logo is guaranteeing its insurance company's obligations to policyholders (even though it really isn't); and, finally, prey on someone who won't understand any of the above.

By these criteria, Colonial Penn is a prize-winning insurance company.

A New York State resident, John Q. Public (not his real name), recently received a nine-by-twelve-inch manila envelope that carries a provocative question in bold type: "Want to save $337 a year on your auto insurance?" The envelope's large white label reveals that it was mailed from the "Executive Offices" of "Colonial Penn Insurance, *A GE Financial Assurance Company*." The label prominently displays the General Electric logo.

Colonial Penn Insurance
A GE Financial Assurance Company

Inside the envelope are four pages, printed front and back. The first page is a letter on stationery which displays the General Electric logo and, like the mailing label, is from the "Executive Offices" of "Colonial Penn Insurance, *A GE Financial Assurance Company*." (The letter also includes the slogan, "We bring good things to life.")

Attached to the letter is a yellow Post-it® note with the GE logo and the Colonial Penn and GE names. Although the letter is addressed formally, ("Dear Mr. Public"), the Post-it®, which was printed to look handwritten, reads, "John, Call now for a free price comparison. See how much you may save. – Chris."

The letter and the three following pages are all part of Colonial Penn's clever—but misleading—marketing effort to sell personal auto insurance directly. Although the insurance being pitched is from Colonial Penn, the words "General Electric" or "GE" appear 13 times, General Electric's logo appears eight times, and the slogan "We bring good things to life" appears three times. (The Colonial Penn name appears many times, too.)

What the mailing *does not include*, however, is anything making it clear that General Electric is not responsible for Colonial Penn's policyholder obligations. Indeed, the use of General Electric's name, logo, and slogan seems *designed* to make Mr. Public believe that General Electric is responsible for Colonial Penn's policyholder obligations. (The closest the mailer comes to having a disclaimer is some small print on the back of the enclosed application, which reads: "Colonial Penn's automobile policies are issued by either Colonial Penn Insurance Company, Colonial Penn Franklin Insurance Company, or Colonial Penn Madison Insurance Com-pany of Valley Forge, PA.")

One page of Colonial Penn's mailer extols six "ABSOLUTE GUARANTEES" in big, bold capital letters. Underneath is an official guarantee entitled "GUARANTEE OF BETTER SERVICE & BENEFITS." This guarantee raises an obvious question: how can Colonial Penn (and General Electric) "guarantee" better service and benefits unless they know what service and benefits Mr. Public is already receiving?

Some of the "benefits" in the guarantee appear particularly attractive. For example: "We *guarantee* you will never be 'dropped' because of an accident…

When you qualify for our guaranteed policy renewal you'll never lose your coverage because of your age or driving record."

That sounded great, so we called Colonial Penn and asked a customer-service representative what it meant. "After one year," she replied, "as long as you've had no accidents or tickets, you're put into our 'guaranteed' program."

When we pressed for more information, it became clear that Colonial Penn was providing a guarantee that meant little, if anything. Yes, the company guarantees that it will renew your policy, but it doesn't guarantee the rate it will charge you. The customer-service rep admitted that if you had a bad driving record, Colonial Penn—which tends to write insurance for preferred risks—might charge rates as high as those in the assigned-risk pool.

Another one of Colonial Penn's "guarantees" turned out to be illusory: "We *guarantee* responsive customer service 24 hours a day! Call us anytime of the day or night, seven days a week. You shouldn't have to schedule your day around your insurance company's hours. Our friendly customer service representatives are always willing to answer any questions you have."

We took Colonial Penn (or was it General Electric?) up on its offer, and called its customer-service line one Sunday after midnight and said we wanted to ask some questions about a policy's terms and conditions. We were informed that for questions of this sort we'd have to call back between 7:00 a.m. and 11:00 p.m.

On the last page of its mailer, Colonial Penn makes misleading statements about its financial strength and ratings:

RATED "EXCELLENT (A-)"

You can feel secure knowing that you are dealing with a company rated "Excellent (A-)" by the A.M. Best Company. This rating, from the most respected rating company in the insurance industry, attests to Colonial Penn's financial stability, soundness and operating performance. Colonial Penn is a member of the General Electric family of companies dedicated to the highest quality products and services. GE tied for the #1 ranking in 1995 and 1996 in the Forbes Super 100, which measures sales, profits, assets and market value.

We will now examine, and respond to, Colonial Penn's words:

COLONIAL PENN: "You can feel secure knowing that you are dealing with a company rated 'Excellent (A-)' by the A.M. Best Company."

RESPONSE: Notice how Colonial Penn has inverted its Best rating: Best always shows its ratings as a *letter* followed by a *description*, e.g. "A- (Excellent)." By inverting the order—"Excellent (A-)"— Colonial Penn has put its best foot forward and altered the meaning of the rating, since "Excellent" sounds better than "A-."

Furthermore, although an A- rating is in Best's "secure" category, it's debatable just how secure you can feel about a company with an A- rating. (A "B+"rating is also "secure.") Fifty-two percent of the property-casualty "rating units" that have a letter rating are rated "A-" or higher, and 36% are rated "A" or higher. "A-" is Best's fourth highest rating category; it is three notches above the "Vulnerable" category.

When we called the Colonial Penn toll-free hotline and asked a representative to explain the significance of Best's "A-" rating, we got the following response: "That means we take care of our customers and we take care of our claims." That is erroneous. Best's ratings refer to an insurer's financial strength, not to its customer service.

COLONIAL PENN: "This rating, from the most respected rating company in the insurance industry, attests to Colonial Penn's financial stability, soundness and operating performance."

RESPONSE: A.M. Best's ratings don't "attest" to anything. (Webster's defines *attest* as "to affirm to be true or genuine" and "to authenticate officially.") Best says its ratings "reflect our independent opinion of the financial strength, operating performance and market profile of an insurer relative to standards established by the A.M. Best Company. Best's ratings are not a warranty…"

COLONIAL PENN: "Colonial Penn is a member of the General Electric family of companies dedicated to the highest quality products and services."

RESPONSE: Although Mr. Public might have been reassured by this and by the repeated use of the GE logo, Colonial Penn's policyholder obligations aren't guaranteed by General Electric.

COLONIAL PENN: "GE tied for the #1 ranking in 1995 and 1996 in the Forbes Super 100, which measures sales, profits, assets and market value."

RESPONSE: A red herring. While it's wonderful that GE is so successful and large, size doesn't guarantee financial strength, and GE doesn't guarantee Colonial Penn's obligations. Amica Mutual, Cincinnati Insurance, Erie Insurance, and USAA, to name several companies that are minuscule compared to GE, all carry A++ ratings.

General Electric doesn't just tout itself to unsophisticated folks looking to save a few bucks. Employers Reinsurance Corporation (aka ERC), which is owned by GE, has been running a series of full-page ads in insurance publications. You've probably seen them: they contain a catchy quote (e.g., "'It's not whether you get knocked down. It's whether you get up again.' –Vince Lombardi"), in white lettering on a red background. The ads contain a few lines of text ending with the slogan, "It's a world of risks. Be prepared." Underneath the text, the famous GE logo is featured as prominently as "ERC."

And what is it that GE—we mean ERC—is telling readers? Here's a sampling from several ads (we've added the italics for emphasis): "At ERC our risk experts have over a century of reinsurance expertise behind them. *Not to mention the vast resources of GE.*" "With reinsurance experts in more than 40 countries and *GE capital reserves*, we can help manage all kinds of risk." "ERC's customized Casualty Facultative programs…*backed by the interminable* [sic] *resources of GE*." "Put the *combined strength of GE & ERC* to work for you." "…*backed by the prodigious resources of our parent company, GE*."

So, the vast—rather, interminable—resources and capital reserves of GE are supposedly backing ERC, and this combined strength will work for you. But does that mean what it sounds like it means—that GE provides guarantees or sets up reserves for the benefit of ERC policyholders?

We phoned ERC and were told to call Neil McGarity of GE Capital, who's in charge of answering pesky questions from people who believe that words mean something.

"Does General Electric explicitly guarantee ERC?" we asked McGarity.

"It's simply saying that if you want

security…" his voice trailed off.

We asked about the "backed by" claims and expressed the opinion that the ads were misleading.

McGarity didn't seem to share our concerns: "'Backed by' means that they are a member of the GE family and we stand behind them."

What does *that* mean? Is GE guaranteeing ERC's obligations?

McGarity characterized our comments as "overblown speculation," and said he didn't want to talk further.

We weren't surprised. After all, what was he to say? That ERC's ads are misleading hokum? That GE *isn't* guaranteeing anything when it put its logo on ERC's ads?

Other ERC ads are misleading in a different way: "Pad yourself with ERC's innovative Casualty Treaty services. Backed by a network of deep GE capital reserves, *it's the highest rated service in the industry*."

We'll skip a discussion about whether GE—or rather, ERC—offers fine Casualty Treaty services. But is it really the "highest rated service"? (A footnote in the ad explains that by "service" ERC is referring to its ratings of A++ from Best's, Aaa from Moody's, and AAA from S&P.)

Is it proper for ERC to say that it is the "highest rated [insurance company] in the industry"? Doesn't that mean that no other insurance company is rated as highly (which, of course, isn't true)? Interestingly, in a press release to the investment community, GE and ERC are more careful about what they say: "ERC holds *top* financial strength ratings from Standard & Poor's…"

Another five-star General whose advertisements have caught our eye is General Motors. MIC Re, rated A+ by Best, is a subsidiary of Motors Insurance Company, a subsidiary of GMAC Insurance Group, which is owned by General Motors. MIC Re's two-page ad features a Chevrolet truck above the following: "As a member of the General Motors family, MIC Re engages significant resources to ensure the success of our Treaty and Facultative customers…" The ad features a big "GM" logo at the bottom right. General Motors, of course, is not responsible for MIC Re's liabilities.

For that matter, Citigroup isn't going to be on the hook (absent a lawsuit) if Gulf Insurance Group runs into trouble, even though Gulf's ads display the Travelers' umbrella and say that Gulf is "a member of Citigroup." (Gulf is owned by Travelers Property Casualty Corp., which is 82% owned by Travelers Group, a subsidiary of Citigroup.) Unless financial regulations are changed in the next five years, Gulf will no longer be a "member" of Citigroup.

Frontier Insurance Company isn't located on the frontier—unless one considers the Catskills to be the frontier. Yet the company's logo is a Davy-Crocketesque figure in a coonskin cap with a rifle—an ironic touch, considering that Frontier has shot itself in the foot by growing too rapidly. One of its recent ads was, mostly, typical trade-publication fare in which a company uses a silly sports metaphor to link an image with words. Frontier pictures a high jumper bent backwards as he clears the bar, with the caption, "Frontier's market flexibility gets you over the top when you compete for excess workers comp business."

The ad goes on to say that Frontier Insurance Company is "a member of Frontier Insurance Group (NYSE: FTR)—which is nearing Two Billion Dollars in assets." Frontier's use of its New York Stock Exchange listing is, we suppose, meant to impress people, implying that the company is strong. (Frontier Insurance *Company*, by the way, does not have Two Billion Dollars in assets; it has $1 billion, and is not listed on the NYSE.)

Frontier is one of the few companies that advertises its Demotech ratings. (We pay no attention to Demotech's ridiculous ratings and don't think anyone else should, either.) Frontier, for example, is rated A- by Best, A+ by S&P and—get this—"A Prime (Unsurpassed Financial Stability)" by Demotech. If Frontier's financial stability is "unsurpassed," then we're all in trouble. (For a good article on Demotech's ratings, see the January 1998 edition of *The Insurance Forum*, [812] 876-6502.)

United Capitol Insurance Company, which writes environmental liability and is owned by the folks who "get you over the top," has been running an ad that demonstrates how creative typography can be used to give an impression of greater financial strength than actually exists: "A member of the Frontier Insurance Group, Inc. (NYSE-FTR), United Capitol combines the flexibility of a surplus lines carrier with the strength and stability of an A-*rated* parent company." [The italics are ours.] Since the words "A" and "rated" are being used as an adjective that modifies "parent company," it is proper to insert a hyphen between "A" and "rated," producing the phrase "A-rated parent company." Here's the problem: United Capitol is rated "A-". By eliminating the space between "A-" and "rated," United Capitol boosts its rating a notch and misleads readers. United Capitol's ad should read, "an 'A-' rated parent company."

Unionamerica Insurance Company runs an ad that says in big letters, "Meet the 'A Team,'" then goes on to say, in smaller lettering, "With the 'A Team' you get more than just ratings." We suppose the "more" refers to the five Unionamerica executives pictured in the ad. What you don't get from the "A Team," however, is an "A" rating from Best. (The ad notes that Unionamerica is rated "A-" by Best and "A" by Standard & Poor's.) The ad continues: "The 'A Team' also scores straight 'A's in flexibility, innovation, and service." Not to mention an A+ for creative advertising.

More insidious is Winterthur Swiss Insurance Group, which knows how to make beautiful music with its misleading advertising. One ad shows a photograph of hands playing a piano keyboard, along with the header, "We write insurance in concert with you." The ad includes a chart of "key figures"—$72.4 billion in assets, $19.4 billion in premiums, and 27,797 employees—and lists the name and address of six Winterthur insurance-company groups. The text says that each company in the Winterthur network in North America is "independent…Yet we are part of a well-orchestrated, worldwide effort to provide our policyholders the strength, stability, and security of one of the world's largest, most successful insurance groups."

Winterthur's $72.4 billion in assets

are not allocated to pay the claims of each insurance group or company; these assets are held in numerous entities. Also, as we have noted before, size does not equate with financial strength.

Although Winterthur's ad doesn't show ratings, its insurance companies have varying degrees of financial strength. Blue Ridge and Republic Underwriters both are rated "A-"; Southern Guaranty and Unigard are rated "A"; and General Casualty is rated A++.

In a recent ad, PXRE Insurance Company, which underwrites catastrophe reinsurance, declares that it provides "continuity of coverage for the next time all hell breaks loose." (We wonder about PXRE's continuity; with its stock trading below book value, it's a dirt-cheap asset play. We'll bet that it's taken over within five years. Who knows, it could be taken over between the time we go to press and you receive this issue.)

What intrigues us about PXRE's ad is the following statement: "We write business worldwide, supported by over $475 million of our own surplus, *and almost $4 billion in capital made available to us by trading partners* who share our underwriting philosophy." [Emphasis added.]

What is this "$4 billion in capital" and why doesn't it show up on PXRE's balance sheet? And what are "trading partners'?

PXRE didn't return our calls (maybe all hell had broken loose that day). But we assume that the "$4 billion in capital" from "trading partners" is just a highfalutin way of describing the company's retrocessions (the ceding of some of the risk that it has assumed through reinsurance). If our assumption is wrong and PXRE has, say, a $4-billion line of credit that it can call upon to pay insurance claims, we'll be glad to provide a free subscription to every PXRE employee.

While PXRE is proud to lay claim to its trading partners' capital, MassMutual, "The Blue Chip Company," proudly lays claim to money that it manages for others, advertising the following: "For more than 145 years, people across America have relied on us to insure their lives and financial future. With over $160 billion under management and excellent ratings, MassMutual and its subsidiaries have the financial strength to help families and businesses keep their promises."

According to A.M. Best, about $100 billion of MassMutual's $160 billion are assets managed by MassMutual's subsidiaries: Oppenheimer Funds, David L. Babson & Company, and Cornerstone Real Estate Advisors. These assets no more belong to MassMutual than the assets in Smith Barney's money-market funds belong to Sandy Weill. Furthermore, MassMutual's $100 billion in non-insurance assets are not what give the company the financial strength to keep its promises (nor are its $60 billion of insurance assets on its balance sheet). MassMutual is a well-capitalized insurer with top ratings, and it shouldn't have to resort to the use of misleading statistics to imply that it is strong.

One of the great ironies of the insurance industry in recent years is that supposedly high-quality mutual life insurers like MassMutual—companies allegedly run for the benefit of their policyholders—have been staunch proponents of the Mutual Insurance Holding Company concept, a neutron-bomb form of corporate organization that levels policyholders but leaves mutual-insurance-company executives standing.

AIG is a fine organization filled with innovative folks. Surely it doesn't need to mislead the public about its financial strength. And yet, it is not above artful guile. The following is from the folder that AIG uses to deliver personal auto-insurance quotes directly to prospects. (In personal lines, AIG is a direct writer, eschewing brokers and agents.)

> AIG—WORLD LEADERS IN INSURANCE AND FINANCIAL SERVICES
>
> In reviewing your rate quotation, please keep in mind that this automobile insurance is offered by member companies of American International Group, Inc. (AIG), one of the largest and most respected insurance organizations in the world.
>
> In April 1998, Fortune Magazine *ranked AIG #1 in the insurance industry among publicly-traded Property & Casualty stock companies based on revenue.* And in its March 30, 1998 issue, Business Week reported that *AIG has the highest profitability and highest market value* among companies rated in the nonbank financial category. *That puts it above such industry giants as Travelers, Allstate, Fannie Mae and Morgan Stanley.* [Emphasis added.]

While AIG's statements may be true, they are irrelevant, and it's hard to see how they could do anything other than confuse an AIG Auto Insurance Program prospect.

So what if AIG is the largest publicly traded property-casualty insurance company based upon revenue? In personal auto (the coverage in question), AIG's insurance companies are relatively small—about 5% the size of State Farm.

And so what if AIG has a higher "market value" than Travelers, Allstate, Fannie Mae, and Morgan Stanley? Travelers and Allstate write much more personal auto than AIG. (AIG writes much more personal auto than Fannie Mae and Morgan Stanley, but then, these two aren't in the insurance business.)

Why would AIG compare itself to Fannie Mae and Morgan Stanley in a direct-mail piece to consumers? Has it gone daft?

We called the toll-free number provided by AIG and asked the fellow who picked up the phone if he could tell us what AIG was talking about in the folder it sends to prospects. His response was that it meant that AIG was a well-run company that would be around, and that it had the revenues behind it to pay any claims.

We professed confusion. Is there some significance to AIG's having the highest profitability and highest market value?

Well, explained our man, "We make money for our stockholders—we're just telling you that we're solid." He also told us that AIG's stock had gone way up in the past year.

But we're interested in buying a policy, we said, not stock. Our man then told us that all of this stuff had something to do with AIG paying its claims in a timely manner.

AIG's profitability and market value have nothing to do with paying its personal-lines claims in a timely manner. We know this, and Hank Greenberg knows this—but individuals who buy insurance directly from AIG may not know this.

Given that Mr. Greenberg's temper is reputed to be a tad combustible, we hope that he doesn't get mad at the customer-service man who spoke with us—after all, the poor fellow didn't write the twaddle in AIG's direct-mail piece.

In our February 1998 issue, we wrote about Reliance*Direct*, the direct-selling auto insurance subsidiary of Reliance Insurance Company, whose marketing pitch boasted that it would reduce policyholders' premiums by "eliminat[ing] the middleman so your rates are never inflated by agents' commissions and sales fees." Reliance's agents and brokers, not surprisingly, didn't take kindly to eliminating middlemen, and RelianceDirect changed its name to InsureDirect. "We're saying 'good-bye' to middlemen and high overhead," said its website.

Insure*Direct* didn't catch on, and the company went back to its old appellation, Reliance*Direct*. "Only our name has changed—we're still the best choice for auto insurance!" exclaims its website. "We still offer the same great coverage, low rates, attentive customer service, and responsive claims handling. So why the change? We've decided to return to the proud heritage of our parent company—Reliance Insurance Company. Reliance's roots go back to 1817."

Reliance*Direct* has been around since mid-1997; last year it wrote about $5 million in premium. It's rated A- by Best. "We like to consider our company the very bright child (if we do say so ourselves) of a well-established parent," says the website. "You see, we're a part of Reliance Group Holdings, a company with over $11.3 billion in assets, as well as a long, colorful history of its own."

Moody's gives Reliance Group Holdings' senior debt a "junk" rating—Ba1. "Bonds which are rated ['Ba1'] are judged to have speculative elements," says Moody's. "Their future cannot be considered well assured." The rating of Reliance Group Holdings' senior debt is far more relevant to Reliance*Direct*'s policyholders or prospects than is the fact that Reliance Group Holdings has $11.3 billion in assets.

Reliance*Direct* is nothing if not brash. "Something is definitely wrong with car insurance today. You pay and you pay and you pay. And when something unfortunate happens—when you finally need them to hold up their end of the bargain—it's as if they don't know you anymore. For this, middlemen pocket roughly $11 billion a year in commissions. And insurance companies wind up with lots of extra profits. Something's gotta give."

Reliance*Direct*'s website doesn't actually *name* any of the insurance companies that are violating the law by not "hold[ing] up their end of the bargain" and thereby making "lots of extra profits." (By the way, Reliance, was once a big writer of personal lines—until it pulled out of the market earlier in the decade.)

The website also claims that "some other low-priced insurers are giving 'direct' a bad name." Really? When we think of "direct," GEICO Direct's name comes to mind. While we're aware that it

can be difficult to get through to the company at times, its website is remarkably understated: no mention of billions in assets; no wild claims. While the Berkshire Hathaway connection is mentioned, it is done so in the middle of text: "GEICO Direct is a wholly owned independent subsidiary of Berkshire Hathaway."

Reliance*Direct* has more to say: "We cut out literally [sic] tons of overhead. You don't pay for agent commissions, huge corporate travel accounts or layers upon layers of bureaucracy. But the insurance you get is just as complete as any of the companies who hide those expenses in your final costs."

Last year Reliance*Direct* sent out a junk-mail solicitation in which it claimed: "We…provide you with excellent service and promptly paid claims. Which is why A.M. Best rates us 'A- (Excellent)' for paying claims." Reliance's "A-" rating is not a measurement of service and promptly paid claims, it is a measurement of financial strength.

Reliance*Direct* doesn't give "direct" a bad name. It merely gives "Reliance" and "insurance" a bad name.

Like many other mutuals, Mutual of Omaha is pondering some form of demutualization. Last year it asked Nebraska's insurance department whether it could keep its well-known name if it demutualized and became a stock company. Commissioner Timothy Hall told Mutual of Omaha that it could continue to use "Mutual" in its name—provided that it included some sort of disclaimer that it wasn't a mutual.

The word "mutual" has positive connotations, particularly in insurance. The applicable definition in Webster's is the following: "of or relating to a plan whereby the members of an organization share in the profits and expenses; specifically: an insurance method in which the policyholders constitute the members of the insurance company." It is no more appropriate for a stock insurance company to use "mutual" in its name than it would be for Colonial Penn to tell policyholders it's a charitable organization.

In January, we called Commissioner Hall to ask about his decision. So far, neither he nor his office has returned our call. On February 19, we wrote the following letter:

Dear Commissioner Hall:

We are giving consideration to forming a Nebraska-domiciled insurance company called Mutual of Nebraska Insurance Company. Although it will not be a mutual, we believe that using "mutual" in the company's name will help us sell insurance, as many prospects are likely to mistake the company for a mutual and think that it will be run for their benefit rather than for ours.

We are not averse to using some sort of disclaimer to the effect that Mutual of Nebraska is not a mutual. Perhaps the company's logo will carry the following tagline in small print: "a stock company."

We trust that you will approve the name proposed above (or some variation of it, if the name is already taken). We would appreciate it if you would provide guidelines for using the word "Mutual" in a stock company.

We look forward to your response.

The Zurich organization, a financial-services conglomerate, engages in promotion that is as full of holes as Swiss cheese. For example, a 1995 Zurich-American Insurance Group ad in *Business Insurance* said, "We're willing to take risks other companies won't. And we'll service our policies in a way other companies can't. Because we're backed *by the financial strength, stability and the power of partnership only* The Worldwide Zurich Insurance Group can provide." [Emphasis added.] The worldwide Zurich Insurance Group does not *guarantee* the obligations of Zurich's U.S. insurance companies.

ZURICH

Zurich also hits individuals directly. A New York resident recently received a mailing from Zurich advising him of the "opportunity to invest in one of the highest yielding general money-market funds in America"—the Zurich YieldWise Money Fund. The mailing, which included a letter, brochure and other material, cited three reasons why

Zurich could offer such attractive yields. The first reason: the fund is "100% No Load—so every investment dollar works hard for you." That claim is meaningless: to our knowledge, *all* money-market funds are no-load. (Zurich also explained that its yields were high because its expenses were low and that you pay only for the services you use.) After a little salesmanship, the letter launched into familiar language: "And behind your investment stand the resources of a global financial leader with more than $200 billion in assets under management."

The amount of money that Zurich manages worldwide, is irrelevant to the yield and safety of the Zurich YieldWise Money Market Fund, and telling prospects about the "$200 billion" seems calculated to instill in them a false confidence. Neither the Zurich YieldWise Money Market Fund nor the worldwide Zurich organization guarantees the yield investors will receive or the return of their principal.

Zurich's letter states that its fund is not guaranteed by the FDIC and that "it is possible to lose money by investing in this and all money-market funds." That essential fact could easily be overlooked amidst the attractive brochures.

The expense rate for Zurich's money market fund is low—0.44%—but not so low as that of Vanguard Prime Money Market Portfolio, which is 0.32%.

What makes Zurich's solicitation ironic, however, is that last November, Zurich-American Insurance Group unveiled a new type of coverage—a Money Market Net Asset Value Protection policy, which "protects investors when the assets that underlie money market funds default and jeopardize the $1.00 Net Asset Value of the fund." Notes Zurich's press release: "We think this will help the average person who invests in money-market funds feel more comfortable when they turn to these important savings vehicles." (The policy is sold to *managers* of money-market funds.) The press release also notes that the policy is issued by member companies of the Zurich Financial Services Group, which has "gross premiums of more than $44 billion" and "$375 billion of pro-forma assets under management."

We wondered whether Zurich YieldWise Money Market Fund bought the new Money Market Net Asset Value Protection policy, which Zurich-American says is "beneficial to both money market shareholders and investment advisors." When we called Zurich YieldWise Money Market Fund's toll-free hotline and asked about the insurance policy, the man who answered the phone said yes, the fund carries the insurance.

We were surprised, and suspected that his answer was wrong, so we asked again, in greater detail. "We're backing our funds with $367 billion in assets," he responded, spouting some irrelevant information that we suspect he'd been told to say.

When we asked once more whether the Zurich YieldWise Money Market Fund actually had the Zurich insurance policy, we got a different answer: "No."

Perhaps the most egregious recent example of a parent company's involvement in its insurance subsidiary is the case of Florida Progress, a large public company that owns Florida Power Corporation, an electric utility, and Mid-Continent Life Insurance Company, the oldest insurance company in Oklahoma.

In 1986 Florida Progress purchased Mid-Continent as part of a diversification effort. Mid-Continent's primary business was the sale of a two-part policy called "Extra-Life," consisting of a small amount of participating whole life and a large decreasing term-insurance rider. The policy was sold as a "level-premium" policy with a guaranteed death benefit. (The concept behind the policy was that dividends on the whole-life portion would be used to pay the premium on the decreasing term-insurance portion.)

Mid-Continent isn't a large company. According to Best, which gave it an A+ rating for many years, at year-end 1996 it had $281 million in assets and $64 million of surplus.

Mid-Continent became a debacle—an actuarial nightmare that led to its own ruin, financial problems for policyholders, and significant potential liabilities for Florida Progress. Unlike most failed life-insurance companies (which ran into trouble as a result of investments that went sour), Mid-Continent ran into trouble as a consequence of inaccurate actuarial assumptions.

Our December 1991 issue included a piece on Peter Hutchings, executive vice president and chief financial officer of Guardian Life Insurance Company, and an actuary by training. In the wake of the Executive Life and Mutual Benefit fiascoes, Hutchings surmised that in the future the industry might well see *liability-side* problems (as opposed to asset problems) due to actuaries' aggressive behavior. (Insurance companies' liabilities are primarily *reserves*; these liabilities are offset, in theory, by assets.)

Mid-Continent's complicated "level-premium" policy was mispriced, apparently due to at least two mistakes: 1) Assumptions about lapse rates were wrong; lapse rates turned out to be much *lower* than expected. That was a problem because the policy was constructed so that it would be very profitable in its early years, but not in its later years. This is reminiscent of a "tontine," a financial arrangement in which the surviving participants profit at the expense of participants who drop out or don't survive. 2) Assumptions about future investment yields were overly optimistic.

As a result, Mid-Continent's reserves were understated. Once the company became aware of this, it was faced with several alternatives, including the following: it could try to raise the premium on its "level-premium" policies, which could provoke outrage and lawsuits; it could successfully raise the premium on it "level-premium" policies (but still suffer from adverse selection); or premiums could be kept level and, to maintain solvency, Florida Progress could pump in a plenty of new capital, or find someone who would.

Mid-Continent decided to raise the premiums on its "level-premium" policies.

In "The Disaster at Mid-Continent Life" (*The Insurance Forum*, August 1997), Joseph Belth quotes liberally from the Extra-Life sales literature. Here is just a small sample: "Guaranteed Level Protection at the Lowest Level Premium Outlay"; "Guaranteed Death Benefit… Level Premium!"; "Both your premium and your coverage are designed to remain level"; "The premium starts at $641 per year. In the 21st year it's still $641. Ditto in the 31st year and every year"; "*Frog Insurance* is life insurance that jumps up in price every year…At Mid-Continent we sell *People Insurance*…The scheduled premium does not jump."

Belth writes that a *footnote* in a sales illustration for a Mid-Continent policy says that "dividends and insurance premiums based on the current scale are not guaranteed." Belth also quotes obfuscatory policy language that apparently says something to similar effect, although, as Belth notes, this is contradictory to the impression created by the sales literature. (Belth has graciously provided us with copies of certain court documents he obtained regarding *State of Oklahoma v. Mid-Continent Life*. The opinions expressed here, however, are our own.)

The premium increases on Mid-Continent's "level-premium" policies led to complaints, ultimately leading to the company's seizure by Oklahoma regulators on April 14, 1997, on the grounds that it was massively underreserved. Since then, the regulators have been involved in a legal battle with Florida Progress, seeking $300 million to bolster Mid-Continent's reserves. At year-end 1997, Mid-Continent's assets totaled $314 million, but its surplus was *negative* $348 million.

Florida Progress doesn't see eye-to-eye with Oklahoma's regulators. It denies that it owes $300 million, and it denies that it guaranteed that the premiums on its "level-premium" policies would actually remain level.

For now, the issue of whether Mid-Continent can raise the premiums on policies it hawked as being "level premium," is murky. In 1997, an Oklahoma judge ruled that Mid-Continent *could* raise premiums, but at the same time the judge appointed the Oklahoma Commissioner as Mid-Continent's receiver and directed him to submit a plan of rehabilitation. The matter has not yet been settled.

What distinguishes the Mid-Continent mess is the role that Florida Progress played. Of the 150,000 Extra-Life policies sold, "more than 100 were sold to current and former employees of Florida Progress itself," writes Ameet Sachdev in *Knight-Ridder Tribune Business News*. "They had been assured by no less a figure than the chairman of Florida Progress that the rates would stay the same 'as long as you keep the policy.'"

Over the years, Mid-Continent and Florida Progress played up the link between the two companies. At a Florida Progress meeting for financial analysts on October 16, 1987, in a presentation by a Mid-Continent executive, the following statement was made: "Agents…like the Florida Progress ownership, and they know that it adds financial clout to their own sales presentations." The full text of the presentation was sent to Mid-Continent's "Associates."

On October 4, 1991, Riley Simon (chairman and CEO of Mid-Continent until March 1995) sent the following letter to Mid-Continent's regional directors:

> The enclosed September 1991 Report to Shareholders of Florida Progress is an outstanding sales piece. Many of our Regional Offices have received calls from stockholders wanting to buy from Mid-Continent Life as a result of this piece.
>
> These reports will be put in the November 5th commission statements and each Regional Office will be receiving 200 of them.
>
> I highly recommend you put one of them in each of your broker kits; it shows the strong relationship between Florida Progress and Mid-Continent Life, and their commitment to us.

On November 8, 1994, Mid-Continent and Florida Progress met with A.M. Best. A formal presentation from that day, entitled "Corporate Overview," is printed over Florida Progress's name and logo. Among the points that Florida Progress made to Best in that presentation is the following: "We are here today to express our commitment to Mid-Continent and to support our plan to maintain the A+ (Superior) rating."

To what extent Best relied on Florida Progress's assurances remains proprietary, but the record shows that Best maintained Mid-Continent's A+ rating for two more years, at which time it downgraded the company to "A." It did not downgrade its rating further until after its seizure by Oklahoma regulators.

This incident with Best only serves to highlight the problems that can arise from rating agencies' reliance on an insurer's parent-company support—whether that support is explicit, implicit, or assumed—as a justification for providing a higher rating to an individual insurance company.

Another piece of material apparently distributed by Mid-Continent shows the company's name and logo, and, in smaller letters: "A Florida Progress Company." Beneath that are the words, "$5 Billion. Rated A+ (Superior) by A.M. Best Company." The $5 billion, presumably, refers to *Florida Progress's assets*.

About 40% of Mid-Continent's Extra-Life policies were sold in Texas. In April 1998 Paul Hendrix, a Texas insurance agent, wrote to the John Crawford, Oklahoma's insurance commissioner:

> In formal training sessions and in individual meetings with District Managers of Mid-Continent, agents were assured many times that Mid-Continent Life had always made dividends since its founding in 1909, would continue to do so, and if needed, the parent company, Florida Progress Corp., was there to back up any losses.
>
> So agents sold policies with the confidence that these terms would be met because they had the history, the knowledge, and the backing of Florida Progress to make sure policyholders were taken care of…

Florida Progress's "commitment" to Mid-Continent—which was expressed to the company's sales force, to policyholders, and to Best—only applied during good times; in hard times it meant nothing. That's worth remembering.

Chase Manhattan is in the insurance business, and it has been engaging in curious behavior. A brochure for Chase Insurance Agency, which we picked up at a Chase bank, displays the Chase logo and states, "Remember, when you need to find the right insurance, you've got CHASE." The brochure tells readers that they "can count on Chase," and urges them to call "1-800-CHASE24."

Reading this brochure you could easily think that Chase Manhattan Bank is the insurer, or that it's guaranteeing the insurer. You would have to read the brochure's fine-print disclaimer to understand that, contrary to Chase's assetions, you can't count on Chase for much: "Insurance products are not…[the] obligations of or guaranteed by the [Chase Manhattan Bank or its affiliates]."

But perhaps the disclaimer is wrong. Maybe Chase Manhattan Bank *does* guarantee—albeit inadvertently—the insurance sold by its insurance agency. Perhaps the fine print won't be enough to overcome lawsuits, should they arise. After all, can Chase use its name and logo to tell customers (in large print) that they can "count on Chase," while disclaiming responsibility in small print?

We recently examined a 120-page life-insurance proposal from Chase Manhattan Bank—or was it from Chase Insurance Agency? It's hard to tell. The proposal, made last year, was bound in a dark, heavy-duty cover on which Chase's logo and "The Chase Manhattan Private Bank" were embossed in gold. (Inside, a plain sheet of paper stated that the contents were "presented by" Chase Insurance Agency.) Chase Manhattan Private Bank is not an insurance agency, nor is it licensed to sell insurance. The proposal did not carry a disclaimer that the insurance being proposed was not an obligation of or guaranteed by Chase Manhattan Private Bank.

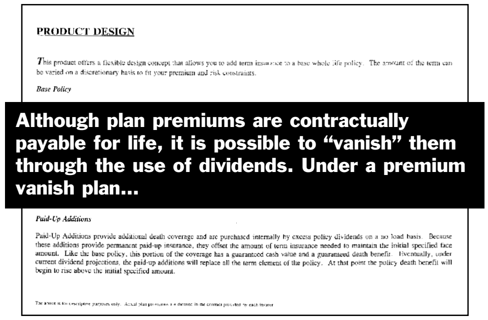
That's the *good news* about Chase's proposal.

A New York insurance regulation (53, Section 3.2b, number 8), prohibits an insurer, its producers, and other authorized representatives from using the words "vanish," "vanishing premium," or similar terms when using an illustration in the sale of a life-insurance policy. This regulation was enacted January 1, 1998, in response to the scandals and lawsuits caused by vanishing-premium sales illustrations. Unfortunately, the proposal in the Chase Manhattan Private Bank binder, which included a sales illustration from MassMutual, ignored the regulations. It said:

> Although plan premiums are contractually payable for life, it is possible to "*vanish*" them through the use of dividends. Under a *premium vanish* plan, both past and current dividends are used to offset your annual premium." [Emphasis added.]

Chase had no formal response to our questions about these documents, but that's not surprising. We'd hardly expect it to admit violating New York State regulations, engaging in misleading and deceptive behavior, and selling insurance through a bank rather than through an insurance agency. (We have sent a copy of this article to the New York Insurance Department and look forward to its response.)

MassMutual didn't have much to say, either. On January 15, 1999, we wrote to the company asking whether it considered any of Chase's material misleading or in violation of insurance regulations.



PRODUCT DESIGN

This product offers a flexible design concept that allows you to add term insurance to a base whole life policy. The amount of the term can be varied on a discretionary basis to fit your premium and risk constraints.

Base Policy

Although plan premiums are contractually payable for life, it is possible to "vanish" them through the use of dividends. Under a premium vanish plan...

Paid-Up Additions

Paid-Up Additions provide additional death coverage and are purchased internally by excess policy dividends on a no load basis. Because these additions provide permanent paid-up insurance, they offset the amount of term insurance needed to maintain the initial specified face amount. Like the base policy, this portion of the coverage has a guaranteed cash value and a guaranteed death benefit. Eventually, under current dividend projections, the paid-up additions will replace all the term element of the policy. At that point the policy death benefit will begin to rise above the initial specified amount.

Chase Manhattan's life-insurance illustration

Callow readers may find this hard to believe, but MassMutual—a certified member of the Insurance Marketplace Standards Association (IMSA), which is dedicated to ethical market conduct in the advertising, sale, and service of individual life insurance and annuities—did not respond to our letter. MassMutual, whose website proudly bears the IMSA logo and carries the solemn pledge to uphold IMSA's "Principles and Code" and meet its "rigorous standards," apparently sees no incongruity with the rules of ethical conduct in ignoring valid questions about its conduct and that of its representatives.

MassMutual's failure to respond doesn't exactly surprise us: the company has been a vocal omnipresence in the national debate about mutual-insurance-holding companies, using its political and financial muscle to influence and eventually help pass anti-policyholder mutual-insurance-holding-company legislation in Massachusetts.

We have written to the Massachusetts Insurance Department and to IMSA about MassMutual's advertising and its relationship with Chase. (Our bet is that we'll never get a satisfactory response from the Massachusetts Insurance Department, and that after receiving a letter from IMSA saying that it takes such matters seriously, we'll never hear from it again.)

Today the distinctions between a bank, insurer, mutual fund, money manager, securities firm, investment bank, and other financial services have blurred. Unless economic cycles have been repealed—and in the future, financial-services conglomerates can sidestep problems they haven't been able to sidestep in the past—harsh failures are not to be ruled out.

At the dawn of this decade, the "Citicorp" name had little value. Yes, Citibank was "too big to fail," but Citicorp's bonds traded at levels that implied insolvency, and an auction for the company's resettable auction-rate preferred stock failed—a blow to the perceived integrity of the rest of the organization. In 1973, for reasons that have more to do with psychology than securities analysis, Citicorp's stock traded at four times the company's book value of $7.45 per share. In 1991, it sold for about one-third of its reported book value of $21.22 per share. (The common dividend was omitted that year and wasn't resumed until the second quarter of 1994.)

Today Citigroup is back in favor. Through Primerica it hawks overpriced term insurance to underpaid patsies. Through Travelers it sells life insurance, annuities, and property-casualty insurance. Through Salomon Smith Barney it transacts securities, investment banking, and asset-management businesses. Through Commercial Credit it operates a consumer-finance business. Through Citibank it runs a commercial and consumer banking business.

Citigroup is on the cutting edge of convergence. *Bank Investment Marketing* reported that the cross-marketing arrangements between Citigroup's subsidiaries will soon include the following: brokers at Citicorp Securities selling Travelers' annuities, salesmen at Salomon Smith Barney offering Citibank mortgages, Citibank loan officers offering Commercial Credit's appraisal services, Travelers' insurance being pitched to Citibank's credit-card customers, Commercial Credit's debt consolidation loans being offered to Citibank customers, and employees of both companies being offered *everything*. And this is just the beginning.

Citigroup is not alone in this game. Everyone wants to play. The players, larger than ever, are creating the kind of financial sprawl typically seen during extended booms. Don't be surprised to see more companies advertising their huge asset bases and claiming that they are "backed by" something or other.

Mergers and acquisitions have been justified by the theory that "size matters." While that may be true, it's wise to remember the words of that bare-knuckled master of the sweet science, John L. Sullivan, who noted: "The bigger they come, the harder they fall."