



## HOW CONVERSION OF LIFE INSURANCE COMPANIES COULD AFFECT YOU

Many mutual life insurance companies are going through a major conversion in how they operate—called demutualization—that could significantly affect current and future policyholders. Here are some questions and answers that explain how a conversion could affect you.

### **What is demutualization?**

Life insurance companies traditionally started out as mutual life insurance companies. They were made up not of shareholders but “members,” who are the policyholders who buy life insurance or annuity policies. Members are entitled to certain rights, such as voting for management, the expectation that the company will be run for the members’ benefit, and a share of the profits in the form of dividends. When an insurance company “demutualizes,” it converts to a stock company in which anyone, policyholders and non-policyholders, can own the stock.

### **Why are mutual life insurance companies converting to stock companies?**

Mutual life insurance companies say they are better able to raise capital as a public stock company, are more flexible, are financially stronger, and are in a better position to compete against other stock life insurance companies and large financial services firms. They note that 14 out of 15 insurance companies today are stock companies, though mutual life companies still own a third of the industry’s assets and policies. However, critics contend that the drive is primarily by management wanting higher pay and stock options.

### **I’ve heard there are basically two forms of demutualization.**

That’s correct. Full demutualization occurs when the company converts entirely to a stock company. The policyholders typically trade their membership for shares of stocks, cash or policy enhancements, though their insurance contracts remain in force.

The other form is a partial demutualization, in which the company forms a holding company, similar to what some banks converted to in the 1980s. The mutual life company is converted to a stock company which in turn is owned and run by the holding company, which typically owns at least 51 percent of the shares. The policyholders thus become owners of the holding company while remaining as contract holders in the stock company.

### **Which type of conversion is best for policyholders?**

Proponents of the full demutualization argue that policyholders usually receive some conversion benefits, such as stock or cash. They say mutual company policyholders don't receive any benefits for converting to a holding company unless the holding company eventually fully demutualizes. And they say that there is an inherent conflict of interest between the stockholders and the policyholders: stockholders want lower dividend and claims payouts, while policyholders want higher dividends and payouts.

Proponents of holding companies contend that full demutualization is a much more costly and time consuming process than converting to a holding company. They point out that demutualized companies tend to come on the market at a discounted book value and thus policyholders who sell their shares fairly soon after conversion—which is common—don't get as good a price. They also argue that a holding company allows a gradual conversion into a full demutualization, allowing management to adjust to the more competitive nature of being a stock company.

### **What should I do?**

First, pay attention to your insurance carrier. If it is a mutual life insurance company and is thinking of, or planning to, reorganize, find out how it plans to reorganize. Be aware of the risks and rewards of conversion. As a policyholder, you have the right to vote for or against conversion. While full demutualization can often be good for policyholders, the company management may in fact not be up to the task of competing as a stock company. Also assess how financially strong the carrier is.

Some insurance experts suggest that you may not want to replace a policy you already have with a mutual life company that's considering converting, since you could reduce or eliminate potential benefits from a conversion. Deciding whether to buy a policy with a mutual company that may convert also requires careful analysis. As this is a complicated issue, you'll want to talk to your Certified Financial Planner practitioner about the pros and cons.

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