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Why We Need Mutual Life Insurers

by James H. Hunt, F.S.A.

For the last 15 years I have worked as an actuary for Massachusetts Savings Bank Life Insurance, which was conceived as a means of selling low-cost life insurance through mutual savings banks. I bank at a 135-year old mutual savings bank, buy auto and homeowners insurance from AMICA Mutual, and have a life insurance policy with Northwestern Mutual Life. Most of my assets are looked after by Vanguard mutual funds, the only *mutual* mutual fund organization, widely recognized for its very low costs.

On the other hand, I am comfortable buying gasoline from Exxon and hamburgers from McDonald's, shareholder-owned enterprises in intensely competitive businesses. The point is that where markets are truly competitive, one need not worry about the organizational form of the supplier. Term life insurance is sold in a competitive market today; consumers can shop for term life insurance by price, with the lowest premiums usually offered by shareholder-owned insurers.

Cash value policies are a different matter; consumers are unable to shop by price, as evidenced by the hundreds of companies that clog the market, not having been driven out of business by more efficient companies, and by the wide range of results in historical performance studies.

For many years I have evaluated cash value life insurance policies for consumers, most recently in association with the Consumer Federation of America. In the last three years, I have reviewed nearly 2,000 illustrations, the vast majority of them in-force policies, and it is evident that the gap in performance between mutual and stock companies is large and widening in favor of the mutuals. I can't escape the conclusion that, especially in the last year or so, shareholder-owned companies have taken advantage of the inability of policyholders to measure how well or poorly their universal life policies are doing by lowering their current interest rates faster than market changes and by not decreasing mortality charges to reflect mortality improvements. Consider the extremes in today's market: Northwestern Mutual currently credits 8.8 percent on non-borrowed policy values while many universal life insurers credit 5.5 percent. The dividend interest rates of most other mutuals exceed 7 percent. If the public understood such disparities, universal life insurers would be driven from the market.

(An interesting question: Will the next targets of major litigation in life insurance be universal life insurers that credit, say, 5.5 percent to existing policies while illustrating, say, 6.25 percent on new policies, despite the illogic of doing so at a time of falling interest rates? I hope so.)

Securities markets have responded to this favorable climate by bidding up the valuations of shareholder-owned life insurers. Recently, the Dutch insurer ING bought Equitable of Iowa at about three times book value. Equitable of Iowa has a substantial block of participating whole life policies, and its nonparticipating universal life business is effectively participating. Is it not likely that the impressive premium paid for the company reflects the ability of Equitable of Iowa to extract its 15 percent return on equity off the top before making decisions about dividend interest rates for whole life policies and current interest rates and mortality charges for universal life policies? And will ING add its need for the same return to the premium it paid for Equitable of Iowa, thereby further depressing future policyholder returns? Who knowingly would want to be a part of this?

Readers should reflect on whether they know how well their own policies are performing, as compared with their bank accounts and mutual funds, and the comfort level they would have in owning a policy in a shareholder-owned company that can take its profits off the top without the discipline of competitive markets.

Mutual banks have pretty much disappeared throughout the United States in recent years, thanks to legislation that appealed to the greed of managements to convert to stock form. But at least bank customers have a chance to understand bank pricing; for example, they can compare annual percentage rates and annual percentage yields. (Perhaps not a good chance, as suggested by the swollen profits in the banking industry.) Not so with cash value life insurance policies, whose interest-adjusted indexes are meaningless to consumers and an embarrassment to the actuarial profession, which has done precious little to expose their flaws.

Unless sales of cash value life insurance policies in the United States, down 30 percent in the last ten years in real dollars, are to be relegated to oblivion, it is vital to preserve mutuality in the life insurance business. As consumers need a Vanguard in the mutual fund business to keep downward pressure on mutual fund charges, so the life insurance business needs a substantial mutual component to give consumers a chance at receiving low-cost life insurance (other than term). In the coming years, the Consumer Federation of America will advise financial writers to warn consumers to avoid buying cash value life insurance in shareholder-owned companies.

Mutual holding company legislation that fully preserves mutuality would get my support. While demutualization arguably preserves mutual policyholder rights, the windfalls conferred on present policyholders in companies more than a century old are at least partly undeserved. Far more important, mutuality is lost. Regrettably, in the lobbying for the legislation that has been enacted so far, the best talents of the proponents of mutual holding companies have been devoted to preserving opportunities for profiteering by insiders.