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Policyholder Control of a Mutual Life Insurance Company

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FROM TIME TO TIME DURING the last hundred years or more, there have been discussions concerning the control or the lack of control by policyholders of mutual life insurance companies.[1] While this is certainly not a new issue, there have been several recent developments.

One recent development is a so-called "class action" suit brought in October 1972 against four large mutual life insurance companies in the United States District Court for the Southern District of New York.[2] This antitrust suit was brought on behalf of three policyholders as representatives of a class consisting of all mutual life insurance policyholders. The complaint alleges, among other things, a conspiracy among defendant insurance companies to use outdated and antiquated mortality tables, to charge unreasonably high and redundant premium rates, and to create self-perpetuating management.

This suit requests the court to order the defendants to refrain from violating the Federal antitrust laws, to correct their accounting procedures so that policyowners can more accurately determine the actual cost of their insurance, to refrain from using surplus funds for ventures unrelated to the insurance business, to distribute to

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[1] TEMPORARY NATIONAL ECONOMIC COMMITTEE, MONOGRAPH 28, STUDY OF LEGAL RESERVE LIFE INSURANCE COMPANIES 13-27 (G.P.O. 1941).

One method of classifying life insurance companies is according to the legal form of their ownership. In general, stock insurance companies can be defined as being that type of organization in which individuals purchase shares of stock in the company in the expectation, or at least the hope, of appreciation in the value of their shares. As such, the stockholders legally own the company and may cast votes in proportion to their shareholdings for the election of the board of directors. Further, the stockholders share in the profits and losses of the company as do the stockholders in any other corporation.

In contrast to a stock insurance company, a mutual insurance company is said to be legally "owned" by the policyholders; consequently, the policyholder in a mutual insurance company is both a customer and an owner of the company, whereas the policyholder in a stock insurance company is only a customer. Therefore, each policyowner in the mutual insurance company usually may cast one vote for the election of the board of directors, irrespective of the amouunt of insurance the policyowner may own, while the stock company policyowner, being merely a customer, except in rare instances, does not have a vote at stockholder meetings and as such does not have a voice in the election of the board of directors.

In short, stock insurance companies are organizations owned by investors who purchase shares of stock for profit while mutual insurance companies are organizations owned by policyholders themselves.

[2] Steingart v. The Equitable Life Assuru. Soc'y, Civil No. 72-4271 (S.D.N.Y., filed Oct. 6, 1972).

policyowners the excessive sums now being held as surplus, and to institute proper procedural actions to assure policyowners just participation in the management and affairs of the companies.

A second recent development is a 1972 law review article asserting that there is an emergency justifying reform.[3] The author advocates a year-long study by the National Association of Insurance Commissioners, and in the interim, "speedy" enactment by all states of a "temporary mutual insurance company control bill."[4] The proposed legislation would:

> (1) require mutual insurance companies to furnish their policyholders with annual proxy or information statements containing information similar to that supplied shareholders of stock companies and liberalize nominating procedures for the election of directors . . .
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> (2) require the return to policyholders in the form of dividends of all premiums not needed for the sound conduct of the business as determined by reserve and actuarial tables prescribed annually by the Superintendent of Insurance after public hearings; and
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> (3) prohibit the acquisition or initiation of operation by mutual insurance companies of businesses outside the immediate insurance field served by them and require divestiture within three years of such unrelated businesses now owned.[5]

The National Association of Insurance Commissioners has met in regular sessions three times since that article was published, and the author of that article may have brought his proposal to the attention of one or more commissioners of insurance. However, it was not placed on the agenda of any one of the three meetings, and there is no published evidence that this proposal was considered. If the commissioners had thought that there were any real and pressing evil to be corrected, it might reasonably be assumed that the matter would have been discussed at one of the meetings.

Another relatively recent law review article,[6] which dealt with the aspect of control in mutual life insurance companies, reached the conclusion that there is actually a conflict of interest between the policyholders and the management of a mutual life insurance com-

[3] Kreider, *Who Owns the Mutuals? Proposals For Reform of Membership Rights in Mutual Insurance and Banking Companies,* 41 U.CIN.L.REV. 275 (1972).

[4] *Id.* at 307.

[5] *Id.* at 311.

[6] Hetherington, *Fact v. Fiction: Who Owns Mutual Insurance Companies,* 1969 WIS.L.REV. 1068.

pany.[7] The author's reasoning which supported this conclusion was basically by way of a two-part analysis of the policyholder's position in mutual life insurance companies.

The first part of the article looked at the mutual policyholder as an owner. In this initial phase of analysis the author recognized that although the policyholder is legally the owner of the mutual company,[8] he is not actually the owner in the normal business sense, since he does not bear the risk of personal liability in the event of insolvency, does not have a right to profits, and does not have the ability to control the management.[9]

To support his conclusion that there is a conflict of interest between the policyholder and the management regarding the ownership aspect of mutual companies, the author stated that because the policyholder considers himself nothing more than a consumer of services offered by management, he has no interest in the management aspect of the company[10] and, consequently, the interests of the policyholder are not seriously involved in management decisions.[11]

The second part of the author's analysis considered the mutual life insurance company from the management perspective. The author reasoned that although mutual managements attempt to conserve corporate assets and promote corporate growth, these objectives are inappropriate for mutual stock companies because such goals are adverse to policyholder interests.[12] The author concluded that these management objectives were adverse to policyholder interests, due to the fact that the policyholder is principally interested in securing the maximum protection at the lowest cost.[13]

Since the stated purpose of the article was simply an analysis of the position of the policyholder in mutual insurance companies,[14] the author made no definite recommendations for improving the policyholder's position.

The facts of life are that one does not get "reform" either by the legislative or the administrative process unless the need for reform is established. The authors of the two law review articles certainly have not established this need. What they have done is to

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[7] *Id.* at 1102.

[8] *Id.* at 1070.

[9] *Id.* at 1071.

[10] *Id.* at 1086.

[11] *Id.* at 1085.

[12] *Id.* at 1102.

[13] *Id.*

[14] *Id.* at 1069.

repeat what all familiar with the situation already know, namely that the policyholders of a mutual life insurance company have little voice in the selection of management. However, it must be recognized that individual stockholders of a large stock life insurance company also have little voice in the selection of management where the stock is widely held and where there is no gross mismanagement. Both authors seem to think that the stock life insurance situation is much better than the mutual life situation from the standpoint of control by the "owners." However, both with large stock life insurance companies and with mutual life insurance companies, the boards of directors or trustees are, in fact, self-perpetuating bodies. The president usually has a major voice in the selection of new directors and these directors may feel beholden to him.

By and large, the directors of life insurance companies, mutual and stock, are dedicated persons of prominence in their communities and ofttimes of prominence nationally. They seem to know the difference between right and wrong, and there have been few instances of breach of trust or departure from high ethical standards. Where there have been such departures, remedial steps have come promptly. Within the last twenty years or so, there have been two or three instances of such departure which have occurred in large mutual life insurance companies. In these instances, the directors of such companies, perhaps prodded by regulatory authorities, promptly removed the top officers from their positions.

This matter of policyholder control of mutual life insurance companies has, over the years, received much attention from regulatory authorities, from state legislatures, and from specially appointed commissions. Variously worded state statutes attempt to give the policyholder of a mutual life insurance company a voice in the selection of management.[15] However, no mutual life insurance company has yet succeeded in persuading any considerable percentage of its policyholders to take the trouble to vote for directors.[16] Some companies do

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[15] *See e.g.* MASS. ANN. LAWS Ch. 175 §94 (1969); MINN. STAT. ANN. §61A.32 (1968); N.Y. INS. LAW §198 (McKinney 1966); OHIO REV. CODE ANN. §3913.10 (Page 1971); TENN. CODE ANN. §56-1606 (1968).

[16] The following table indicates the results of elections in 1972 in a number of important mutual life insurance companies.

Company	*No. of Individual Life Policyholders**	*Votes Cast at 1972 Election of Directors* *In Person*	*By Mail*	*By Proxy*	*Total*
Metropolitan Life Insurance Company	21,611,636**	47	669		716
Prudential Insurance Company of America	20,054,502	348			348
New York Life Insurance Company	5,484,012	219	252		471
John Hancock Mutual Life Insurance Company	8,138,692	4,082		52	4,134

(Continued on next page)

notify their policyholders of their voting rights in practically every communication to policyholders, including premium notices. While the companies which make greater efforts seem to have a larger number of votes, these sincere efforts have all resulted in failure. The simple answer seems to be that policyholders are interested in buying insurance and do not regard themselves as owners of an equity in the company as in the case of stockholders. It is probably a fact that a large percentage of policyholders do not even remember the names of the companies in which they are insured, and do not distinguish between stock and mutual companies. The policyholders seem to rely on their agents in whom they have some confidence.

Mutual life insurance companies, as well as stock life insurance companies operate in a fish bowl. They must disclose annually to regulatory authorities many details of their operations, including compensation of directors and of top officers, investments and investment results, legislative expenses, resisted claims, payments to lawyers, as well as countless other details. They are also subject to periodic examinations by insurance regulatory officials which, in the case of the larger companies, includes representatives of other states in which they do business. Usually these detailed examinations are conducted on a three year basis. Many of these regulatory requirements stem

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(Continued from preceding page)

Company	*No. of Individual Life Policyholders**	*Votes Cast at 1972 Election of Directors*			
		In Person	*By Mail*	*By Proxy*	*Total*
Equitable Life Assurance Company	3,452,744	6	129	2	137
Northwestern Mutual Life Insurance Company	1,999,360	83	32		115
Mutual Life Insurance Company of New York	1,679,183	155	37		192
Massachusetts Mutual Life Insurance Company	1,181,345	877			877
New England Mutual Life Insurance Company	1,098,830	1,291			1,291
Penn Mutual Life Insurance Company	1,060,501	700		7	707
Connecticut Mutual Life Insurance Company	1,011,917	155		525	680
Bankers Life Company	635,793			223	223
Provident Mutual Life Insurance Company	396,572	34		3,943	4,977
Union Central Life Insurance Company	355,532			61,446	61,446
Western and Southern Life Insurance Company	1,878,253			302,402	302,402

*At year end 1972, including term insurance but excluding industrial and group insursurance. All figures are from the 1972 Annual Statements.

**1971 election. The Metropolitan resumed annual elections in 1973 in lieu of elections every two years.

from the Armstrong Investigation of Life Insurance in New York in 1905,[17] and these requirements have been updated from time to time, as the need has developed.

Numerically, mutual life insurance companies represent but a small percentage of all life insurance companies. Presently there are 154 mutual life insurance companies in the United States, and the total number of life insurance companies exceeds 1800.[18] These mutual companies, however, have roughly two-thirds of the assets and slightly more than one-half of the business in force.[19] This larger size is a reflection of the fact that the average age of the mutual companies is much higher than the average age of the stock companies, a large percentage of which have been organized during the last twenty years.

The possibility of any material change in the number of mutual life insurance companies is small. Many of these companies were organized as stock companies, and later mutualized by buying out the interest of the stockholders, usually over a period of years. The possibility that many other stock life insurance companies will be mutualized is now small, primarily because the market value of life insurance stocks is, in almost every instance, substantially above the book value.[20] This situation did not exist a number of years ago when several life insurance companies were converted into mutuals. There have also been instances where mutual companies have been converted into stock companies, but this does not occur frequently. It may therefore reasonably be anticipated that the number of mutual life insurance companies will remain about the same as at present, but that their share of the total life insurance market will decrease.

The argument usually advanced for greater policyholder participation in the selection of directors of mutual life insurance companies is that these policyholders occupy positions similar to stockholders in a stock life insurance company. The statement is often made that the policyholders are the "owners" of the company.[21] This is true in the sense that there are no others who could be classed as owners of a mutual life insurance company. However, the courts have

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[17] NEW YORK STATE LEGISLATURE JOINT COMMITTEE ON INVESTIGATION OF LIFE INSURANCE (1906). *See* Anderson, *The Armstrong Investigation in Retrospect*, IX PROC. ASSN. OF LIFE INSURANCE COUNSEL 237.

[18] INSTITUTE OF LIFE INSURANCE, 1972 LIFE INSURANCE FACT BOOK 89.

[19] *Id.*

[20] This fact is apparent from a comparison of the market value of life insurance company shares as quoted in The Wall Street Journal with the book value as shown in BEST'S INSURANCE REPORTS, LIFE-HEALTH, 1972.

[21] Kreider, *supra* note 3, at 279; *but see* Hetherington, *supra* note 6, at 1070-71.

uniformly held that the relationship of a mutual life insurance company policyholder to his company is merely that of creditor and debtor.[22]

The Iowa Supreme Court in *New York Life Insurance Co. v. Burbank*[23] considered the relationship of a mutual policyholder to his company at some length, stating:

> While the plaintiff is a mutual company, and is owned by its policyholders rather than by stockholders, it is nevertheless a corporate entity as distinct from its policyholders, as is the stock company from its stockholders. The plaintiff's policyholders sustain a double relationship to it: (1) That of contractors with it; and (2) resulting therefrom that of pro tempore owners of it.
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> They are owners only in a qualified sense. They change from day to day, not by a mere transfer of interest which persists in others, but by utter cancellation of the interests of some and the acquirement by new contracts of newly created and temporary interests by others. The policyholder whose connection with the company expires by lapse, surrender or death has no interest which he may transmit in the continued existence of the company. The policyholders have no interest in the permanent surplus other than in the gains from the investment thereof and as an assurance of the safety of their contract. In the case of the stock company the stock is owned by the holders in a different capacity than as policyholders, though the same person may be interested in both capacities.[24]

When a policyholder of a mutual life insurance company takes out his policy, in the usual case he starts out as a debtor rather than as a creditor. This is because of the fact that the cost of putting his policy on the books generally exceeds the premium he pays. In fact, it may be five or six or more years before his company has recovered this acquisition cost. Thereafter, his policy may make a contribution to the suruplus of the company. However, in the beginning, he has, in effect, borrowed surplus funds created by other policyholders, past and present, which enabled the company to grant him his coverage.

Unlike the stockholder situation, the interest of a mutual policyholder ceases entirely when the policy proceeds are paid. There is nothing left which he can bequeath to someone else or that his estate

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[22] Andrews v. Equitable Life Assur. Society, 124 F.2d 788 (7th Cir. 1941), *cert. denied,* 316 U.S. 682 (1942); Brown v. Equitable Life Assur. Society, 142 F.835, 839 (C.C.S.D. N.Y. 1906), *rev'd,* 151 F.1 (2nd Cir. 1907), *aff'd* 213 U.S. 25 (1909); *see* W. VANCE HANDBOOK ON THE LAW OF INSURANCE 121 (3rd Ed. 1951).

[23] 209 Iowa 199, 216 N.W. 742, 743 (1927).

[24] *Id.* at 743.

can sell. If his policy has remained in force a sufficient length of time, he has made a contribution to the general surplus of the company which may be used for the benefit of others who follow him as policyholders. However, if he lapses his policy early, or if he dies early, he has received the benefit of surplus funds created by others. This is not an unfair situation calling for reform.

Another argument advanced for greater policyholder participation in the management of a mutual life insurance company is that this would result in increased policyholder dividends.[25] If this assumption were true, the result might be quite unfortunate. Solvency should be the prime objective in the management of any life insurance company and the dividend policy should never overlook this prime objective. Most mutual life insurance companies attempt to return to policyholders each year, in dividends, the maximum amount which can, with prudence, be returned. Pressure for large dividends comes from the agency force and from the natural desire of management to have their companies grow and their own salaries increase. If there is any fault with the level of dividends currently being paid by mutual companies, the fault is probably that the companies are paying out more of their earnings than they should. If for any period of time a company does go overboard in the payment of policy dividends, in the end the policyholders may suffer.

The argument advanced in the New York suit that the companies have used outdated and antiquated mortality tables and that they charge unusually high and redundant premium rates[26] is not a valid argument. Every large life insurance company is constantly studying its own mortality experience, its own investment experience and expenses, and its own reserve situation in order to determine the proper premium rates and the dividends which prudently can be paid. The fact that the mortality is better than anticipated, that the expenses are lower than assumed, or that the interest rate earned is higher than assumed is reflected year by year in the dividend scale. Also, it should not be forgotten that there are some state laws which limit the surplus funds which a mutual life insurance company chartered in that state may accumulate.[27] Realistically, these state laws, are not of prime importance because one life insurance company with a stated surplus of, for example, ten percent of liabilities may not be nearly as strong as another company with a stated surplus of five percent of liabilities but with a much more conservative reserve basis. These various differences are taken into account by regulatory authorities and by the companies immediately involved.

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[25] Kreider, *supra* note 3, at 294.

[26] Steingart v. The Equitable Life Assur. Soc'y, Civil No. 72-4271, (S.D.N.Y., filed Oct. 6, 1972).

[27] N.Y. INS. LAW §§207, 216 (McKinney, 1966) as amended.

Another argument sometimes advanced for greater policyholder participation in the management of mutual life insurance companies is that these companies should not be permitted to expand into other fields, whether related or unrelated.[28] From the standpoint of mutual life insuruance companies and their policyholders, it would indeed be unfortunate to place them in this sort of straitjacket. From the standpoint of their competitors in the stock life field, this would be a most favorable competitive development. It is quite true that any venture into new fields by a life insurance company will usually result in an initial loss of surplus just as any venture into a new field by any business enterprise is likely to result in an initial expenditure of capital. In the case of a mutual company, this surplus may have been created by policyholders not at all interested in the new development. If such restrictions had been applied in the past, mutual life insurance companies would now be confined to selling individual life insurance policies. The major expansion some years ago in the accident and health field and in group insurance was financed initially by accumulated surplus funds created by policyholders, past and present. These companies, from a practical standpoint, were required to enter these new fields in order to serve a real public need and, equally important, to remain competitive with stock life insurance companies. More recently, life insurance companies, stock and mutual, have expanded their businesses to include mutual funds, variable annuities, real estate, fire and casualty insurance, and other finance-related fields. This expansion was imperative because of competitive situations created by changing economic conditions. If mutual life insurance companies were hamstrung and kept out of these new fields, both related and unrelated, stock life insurance companies and other competitors for the savings dollar would benefit. The public, however, would suffer.

The New York Insurance Department has over the years devoted more attention to policyholder control of mutual life insurance companies than any other state insurance department. This is only natural because New York is the home state of mutual life insurance companies which have more business in force than companies of any other single state.[29] New York has detailed legislation and regulation relating to the election by policyholders of directors of mutual life insurance companies.[30]

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[28] Kreider, *supra* note 3, at 295, 311.

[29] Mutual life insurance companies chartered in New York include The Equitable Life Assurance Society of the United States, Guardian Life Insurance Company of America, Home Life Insurance Company, Metropolitan Life Insurance Company, Mutual Life Insurance Company of New York, and New York Life Insurance Company. The assets of these and other New York chartered mutual life insuruance companies total about one-fourth of the assets of all United States life insurance companies and approach one-half of the assets of all United States mutual life insurance companies. *See* BEST'S INSURANCE REPORTS, LIFE - HEALTH, 1972.

[30] N.Y. INS. LAW §188 (McKinney, 1966) as amended.

In 1966, the then Superintendent of Insurance of New York, Henry Root Stern, Jr., had this to say concerning those who were attacking the existing system of policyholder elections and control:

> Pious protestations have lately been heard in various quarters regarding the allegedly 'undemocratic' management of mutual life insurers. Procedures for the elections of directors of mutual companies have been brought into question. Solicitous concern has been expressed that the management of some mutuals is not responsive enough to the policyholders' wishes.
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> Considering the source of these righteous accusations, one is reminded of a passage from Shakespeare. The lines were spoken by his King Richard III. They go as follows:
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> And thus I clothe my naked villainy
> With odd old ends stolen forth of holy writ,
> And seem a saint when most I play the devil.
>
> Fortunately for the insuring public of New York State, the Insurance Law for more than a centuury has been thwarting people who have ambitions to 'play the devil' with the interests of policyholders. The Insurance Department is not greatly impressed by their 'odd old ends . . . of holy writ.' Such saintly censures are particularly unconvincing when they come from 'King Richards' notorious for manipulating corporations for optimum profit at the expense of long-term service to the community.
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> Despite their protestations, the 'King Richards' have an ugly history in the business world. The 'King Richards' tend to regard service to those who need insurance most as sentimentality, preferring their own brand of 'smart business.'[31]

The motives of some of those who seek to change the present system may be as pure as driven snow. However, Mr. Stern's criticism may well apply to others.

In conclusion, it appears that the present system of policyholder control or, if you will, lack of control, of mutual life insurance companies seems to be the best practical solution. This is not to say the system is perfect, but at least no other solution has evolved over the last one hundred years despite this matter's having received long and serious study. This is the conclusion reached by regulatory authorities who are most familiar with the situation. Theoretical con-

[31] Address, by Henry Root Stern, Jr., Institute of Life Insurance, March 11, 1966.

siderations must give way to the practical, and the system must serve the interests of the policyholders. If there is any real evil, as distinguished from theoretical evil, to be corrected, this would have been done long ago.

Those who seek to change the present system of control would seem to have the burden of proving that the change is needed for the benefit of policyholders of mutual life insurance companies. Perhaps also they should establish that King Richard's statement does not have any application to them. Theoretical suggestions not clearly demonstrated to be factually related to the welfare of the mutual policyholder, should be ignored.

We certainly do not need further regulation merely for regulation's sake. The National Association of Insurance Commissioners, the individual state regulatory officials, and the state legislators are now faced with many *real* regulatory problems and should not concern themselves with *theoretical* situations where no real need for reform has been established.