Demutualization in the insurance industry

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While sections 268 to 279 of the Amended Insurance Code provide for the rules on the mutualization of stock life-insurance companies, Section 280 pertains to the demutualization of mutual life-insurance companies by complying with the requirements of Title 17 of the Amended Insurance Code. The insurance commissioner is authorized to issue such rules to carry out the provisions on demutualization. While the Insurance Code does not mention the possible motivations for mutualization, one interesting reason behind mutualizations is simply to fend off takeovers. With the ownership in the hands of policyholders, it cannot be easily acquired.

Demutualization is the “process of converting a mutual life-insurance company, which is owned by its policyholders, into a publicly traded stock company owned by the shareholders, who may or may not be policyholders.”

To distinguish a mutual company from a stock company, the “mutual traditionally raises capital from its customer members in order to provide services to them (for example building societies, where members’ savings enable the provision of mortgages to members). It redistributes some profits to its members. By contrast, a joint stock company raises capital from its shareholders and other financial sources in order to provide services to its customers, with profits or assets distributed to equity or debt investors.”

It should be pointed out, however, that mutual companies may own a stock corporation. Thus, a mutual company may own a subsidiary, which is a stock company. An example is New York Life Insurance Co., which wholly owns a subsidiary, the New York Life Insurance and Annuity Co. Mutual companies may also own stock companies listed in the stock exchange. An example is the Nationwide Mutual Insurance Co. owning stock companies listed in the stock exchange.

As a result of demutualization, eligible policyholders become shareholders in the stock company. They receive newly issued stocks or cash. In return, the rights and interest of all members are extinguished. They, however, retain their interests as policyholders. Their rights as customers, with respect to their insurance coverage, policy values, premiums and policy dividends, remain unchanged. The insurance policy is modified only as to the name of the issuing company and the elimination of the voting and liquidation rights.

What is the driving force toward demutualization? As a stock company, it will be easier to raise capital and to be more competitive. It can effect mergers and acquisitions, or be acquired. It can attract and retain employees through the use of stock options. In other jurisdictions, it has been observed that the tax advantages of a mutual insurer have been eliminated, thus triggering interest in demutualization.

In the process of demutualization, we see all the accumulated profits of the mutual company returned to the policy owners. They are returned in the form of cash, stocks or as policy credits. There are cases when some policy owners are unresponsive and, thus, the existence of unclaimed demutualization compensation. Metropolitan Life accumulated unclaimed demutualization compensation of 60 million shares worth about $2 billion.

Prudential Life was unable to locate 1.2 million policyholders entitled to receive 110 million shares worth over $3.025 billion. Not every policyholder is entitled to receive compensation, only those who are eligible. Eligible policy owners are generally those paid-up and in force on or before the date of demutualization, including their heirs. And they must be participating policies.

There have been several demutualizations around the world. The biggest among them took place in the United States, Canada and Japan. In the US more than 200 mutual life-insurance companies have demutualized since the 1930s. Among these are Prudential Life, John Hancock Mutual Life Insurance Co., Mutual of New York and Phoenix Mutual. Metropolitan Life Insurance Co. of America (MetLife) demutualized in 2000. By 2006, there were less than 80 mutual life insurers in the US. New York state passed a demutualization law in 1988. Other states adopted varying demutualization laws. Illinois, Pennsylvania and Iowa passed different methods.

In Canada, with the passage of legislation in March 1999 allowing demutualization, four life-insurance companies have recently demutualized. These are Canada Life Insurance Co., Manufacturers Life Insurance Co. (Manulife), Sun Life Assurance Co. of Canada, Clarica Life Insurance Co. (formerly the Mutual Life Assurance Co. of Canada). Manulife's initial public offering (IPO), following its demutualization, of C$2.5 billion broke all previous all-time record.

In Japan the biggest was the demutualization of Dai-ichi Mutual Life Insurance Co. on April 1, 2010. Dai-ichi is the third-largest insurer in Japan, after Postal Life, which is government-owned, and Nippon Life. Today it is known as Dai-ichi Life Insurance Co. It was the largest demutualization since demutualization was allowed in 1996. Dai-ichi had total assets of $366 billion as of March 31, 2010. It subsequently undertook an IPO. Dai-ichi was established in 1902 as Japan's first mutual insurance company. For its demutualization, Dai-ichi issued

10 million shares. Allocation was done “in proportion to their contribution.” Eligible policy was defined as participating policies in force on March 31, 2009. Accordingly, “of the 8.2 million members with eligible policies, 7.4 million, or 90 percent, were allocated shares. Of those, 3.1 million received one or more shares, and others received less than one share.” Allocation of fixed number of shares per member or policy is not allowed in Japan.

There are generally three recognized methods to demutualization: 1) Full demutualization (also known as New York method); 2) Sponsored demutualization; and 3) through a mutual holding company (also known as the Iowa method or partial demutualization).

In a full demutualization, the mutual company converts to a stock company under a regulator-supervised process pursuant to a conversion plan. The stock company then transfers its own stock or cash or policy credits to the members, thus converting the members to stockholders. No mutuality is preserved in any form. In effect, the entire company’s value, including all accumulated profits, are distributed to all eligible policyholders. The demutualized company is then usually publicly listed in the stock exchange to raise new equity capital. One reason for the IPO is the realization of its true economic value.

Demutualization unlocks the economic value of the company. “First, the policyholders’ surplus (largely retained earnings) under mutual is transformed into marketable shares through creation and distribution of stock to existing policyholders, as well as an IPO; this, stockization liquefies what has been illiquid. Also, stockization of mutual life-insurance companies broadens the set of available securities for investors and this it ‘completes the market’”.

In a sponsored demutualization, “mutuality is essentially bought by a stock corporation. Instead of receiving stock in the formerly mutual company, stock in the parent company is granted instead.”

Demutualization through mutual holding company is where membership rights are transferred to mutual holding company, which owns a newly formed subsidiary stock life-insurance company. It is also known as the Iowa method because in 1995 Iowa, passed legislation authorizing the formation of mutual insurance-holding companies.

Under the Iowa mutual insurance-holding company law, the mutual insurance company is reorganized so that the policyowners’ membership interests are automatically converted into membership interests of a mutual insurance-holding company and the mutual insurance company is reorganized into a stock subsidiary, which is 100-percent owned by the mutual insurance company or an intermediate stockholding company. Under Iowa law, the mutual holding company must own at 0.51 percent of the newly formed subsidiary stock-insurance company.

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