Mutual Respect

The sharpshooters at publicly owned insurers used to scoff at their stodgy competitors, the mutual insurers. Not anymore.

By Bernard Condon and Daniel Fisher

MUTUAL LIFE INSURERS ARE STUCK IN THE MUD. IF you've pizzazz, you work for a stockholder-owned insurer. That was the refrain from stock insurers a few decades ago.

Without the shareholders' lash to whip them into shape and stock with which to buy rivals, policyholder-owned insurers were sure to get crushed by publicly traded rivals. So went the argument, and so began a flight from mutual ownership that included such stalwarts as Equitable, Prudential and Metropolitan.

Who's sneering now? The mutuals that refused to switch over. The stocks of publicly held life insurers have fallen 63% this year. They had a little too much pizzazz, in the form of corporate bonds, mortgage securities and risky bets on annuities.

With their survival on the line, publicly traded insurers are scrambling for cash by cutting dividends and issuing new shares (diluting existing investors), begging regulators for a relaxation of capital requirements and lobbying Washington for a cut of the $700 billion Wall Street bailout.

Their mutually owned rivals haven't asked for a dime. Their statutory surpluses (the regulatory counterpart to book value) have held steady or even increased. Some are announcing plans to pay out near-record dividends to policyholders.

"We're Main Street. Not Wall Street," brags an ad from mutually owned New York Life. Translation: We're better off than swashbucklers like American International Group.

"We're not seen as stodgy and slow anymore," says Dennis Manning, chief executive of mutually owned Guardian Life.

Moody's life insurance analyst Arthur Fliegelman says mutuals have done plenty of stupid things over time. But he reserves his 2008 booby prize for their public rivals, several of which he has downgraded this year. He puts the blame for their missteps squarely on the need to satisfy Wall Street and its lust for quarterly profit gains. Public companies felt they had to report a return on equity of at least 15%. "You just can't do that in a mature business without taking too much risk," Fliegelman says.

Two years ago mutually owned New York Life began fearing that the thin premiums corporate bonds were paying over Treasurys didn't justify the added risk and began shifting assets into government bonds. The $20 million a year in income it lost as a result would have left shareholders howling at publicly held insurers, says Solomon Goldfinger, a New York Life senior vice president.

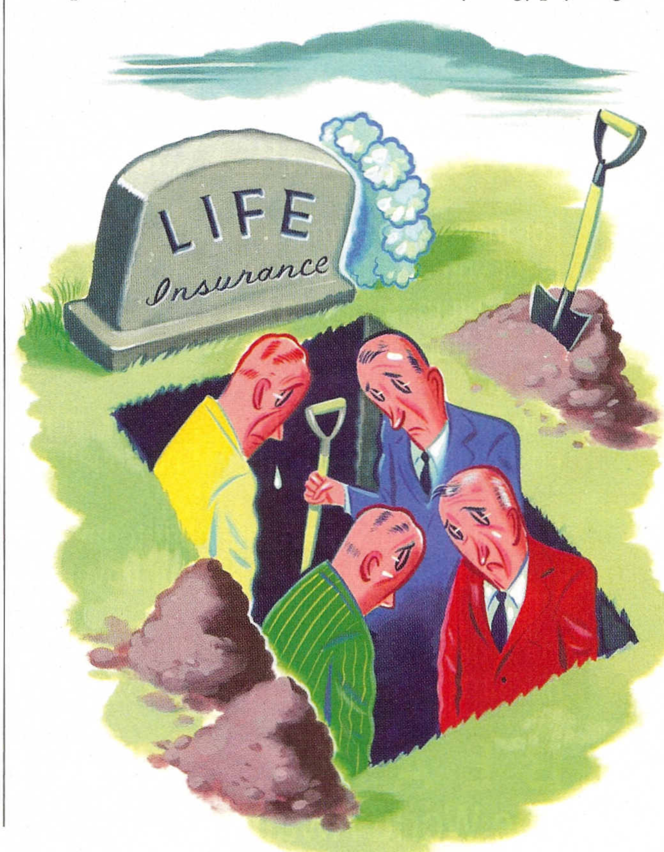
Publicly held firms like MetLife, Prudential Financial and Hartford Financial have been forced to recognize billions of dollars in losses this year on mortgage securities, corporate bonds and real estate. They've also been clobbered by promises they made to pay variable annuity holders minimum returns in the event that stocks fared badly.

Variable annuities are mutual funds (often stock funds) wrapped inside life insurance policies that endow them with a tax deferral. As competition heated up for this lucrative, fee-driven business, publicly listed insurers began making brash guarantees of minimum returns to backstop the stock funds in which the customers' money was invested. Following October's stock market shellacking, more than half of Hartford's U.S. variable annuity clients are sitting on portfolios worth less than the company has guaranteed to pay them. That has caused its potential annuity-linked liabilities to balloon to $3.9 billion from $184 million at the beginning of the year.

Hartford noted in a November securities filing that an S&P 500 decline to 900 would cause its capital to fall by another $1.5 billion; the index recently closed at 816. Hartford's shares are off 90% since the beginning of September and now trade for 18% of book value.

Soon after going public in 2001, Prudential Financial bought Skandia, the largest variable annuity distributor. It then acquired similar units from Cigna and Allstate. Pru Chief Executive Arthur Ryan assured shareholders of "double-digit returns." Instead, they got triple-digit losses. As stocks have fallen, and Pru's guarantees kicked in, its annuities unit swung to a $307 million operating loss in the third quarter from a $205 million profit a year earlier.

The mutuals, meanwhile, are sticking largely to sales of whole life—policies with a death benefit and relatively stingy payout guar-



RYAN HESHKA FOR FORBES

antees. Guardian Life says its individual life insurance sales rose 14% in October from a year earlier. New York Life says its individual life sales are growing at double-digit annual rates, too.

David Schiff, an industry gadfly and publisher of *Schiff's Insurance Observer*, has been warning since the late 1990s that earnings-per-share pressures would drive insurers to do dumb things. He was right. Since going public Prudential has spent $11 billion buying back shares at an average cost of $63, Schiff estimates. Those shares are now worth $19. Hartford spent $2 billion the past two years buying back stock. That's as much as the entire company is now worth.

The mutuals aren't geniuses at investing—proportionally they own more mortgage securities than do public insurers, according to Etti Baranoff, a professor of insurance at Virginia Commonwealth University and former Texas insurance regulator. It's just that mutuals don't have the same incentives to boost net income.

Baranoff also notes that mutuals don't have to file financials under Generally Accepted Accounting Principles. Those principles require public companies to mark down investment securities, some of them distressed and thinly traded, to current market values. The rule has given rise to $40 billion in unrealized losses as of Sept. 30.

Policy Differences

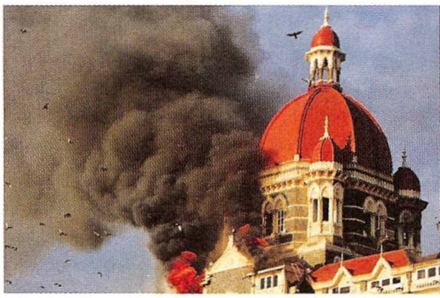
Economic tumult aside, top mutually owned insurers have increased book values this year. Not so their public rivals.

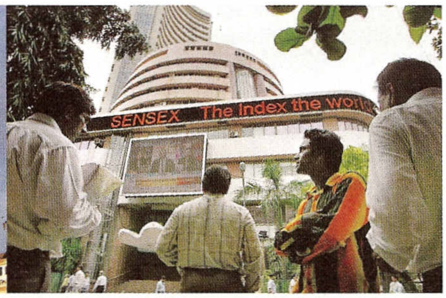
COMPANY	BOOK VALUE ($BIL)[1]	% CHANGE THIS YEAR	A.M. BEST RATING
MUTUALS			
Mass Mutual	$8.4	5%	A++
New York Life	12.0	0	A++
Northwestern Mutual	12.4	2	A++
PUBLICS[2]			
Hartford Life	4.7	–19	A+
Metropolitan Life	12.0	–9	A+
Prudential Life	3.8	–46	A+

[1]Statutory surplus and capital as of Sept. 30. [2]Surplus and capital at each insurer's biggest operating subsidiary. *Source: SNL Financial.*

Perhaps the market has overcorrected, and shares of Hartford and Prudential are a bargain. But their mutual rivals will be snickering for quite a while. **F**

FINANCIAL TERRORISM





Mumbai Will Rise Again

The carnage is horrible. But India is already staging a comeback | By Naazneen Karmali

AMONG THE INTENDED VICTIMS WERE Americans and Britons, Jews, ordinary Mumbaikars—and the $626 billion Indian economy. Like massacres in Luxor, Egypt, Bali and, recently, Islamabad's Marriott Hotel, the attacks were aimed at tourists—and the heart of India's financial capital.

India had already been rocked by aftershocks of the global financial earthquake. Its growth slowed to 7.6% in the quarter ended Sept. 30. The stock market has suffered most: The Bombay Sensex is down 56% this year. India's 40 richest are poorer by $212 billion.

Already lacerated by several attacks since 1993, Mumbai has always recovered quickly—and will likely do so again. Akhil Gupta, chairman of the private equity firm Blackstone India (with $800 million in investments), left a meeting at the Oberoi Hotel less than an hour before the shooting started. He notes that 90% of the 10,000 people employed at the outsourcing firm Intelenet, a Blackstone investment, were back at work the morning after the attacks began. "There's no question about Mumbai's ability to make a fast comeback," he says. All but 2 of 40 branches of Kotak Mahindra Bank in Mumbai stayed open. Remarkably, the Sensex, while dipping, was holding above its October low.

The broader economy should hold its own, too. "The intrinsic India story of fantastic demographics and a growing economy remains intact," says Malvinder Singh, chairman of Ranbaxy Laboratories, the giant pharmaceutical firm, who argues that the domestic market is big enough to support growth. India's savings rate of 35% of GDP remains among the highest in the world. It is unlikely that there will be a large-scale flight of capital, since foreign investors with a long-term horizon seem bullish. Says New Zealand billionaire Richard Chandler of Orient Global, who has $1 billion-plus invested in India, mainly in the financial sector: "I have every confidence that the Indian economy will continue to grow."

Tourism will certainly take a big hit in the short term. A far greater worry is the impact on India's export-led outsourcing firms, a $52-billion-a-year business already wounded by weaker demand. "Some clients have expressed concerns about a likely disruption," says Ganesh Natarajan, chairman of Nasscom, the software industry association group. "There is nothing to suggest [customers] are extremely worried or rethinking—at least at this point," says Girish Paranjpe, joint chief executive of Wipro Technologies. The challenge, he says, is keeping investors upbeat. Genpact, one of India's largest outsourcers, with 25,000 employees, has tightened security at offices in six cities, including one in midtown Mumbai. "We can be vigilant within our offices," says Chief Executive Pramod Bhasin. "But the real situation is out there, which is not in our control." **F**

With reporting by Vidya Ram in London.