Conversion of Mutual Life Insurers into Stock Companies

Takeshi Inoue

Conversion of mutual insurers to stock companies will be one of the agenda for the 'Finance Council' to be newly set up within the Ministry of Finance. In the U.K., Canada, Australia, the U.S. and other countries of the world, many of the major mutual life insurers have already demutualized or are planning to do so. Some mutual life insurers in this country too are expected to seriously consider reorganizing into stock companies.

1. World- wide Trend of Conversion from Mutual Life Companies to Stock Companies

1) Activation of Demutualization in Many Countries

Recently, conversion of mutual life insurers into stock companies is under progress in many parts of the world. Last year, Norwich Union , the third largest life insurer in the U.K., reformed itself to a stock company. In Australia, National Mutual Life, the second largest in the country, demutualized in 1995, followed by the largest one, Australian Mutual Provident(1). In Canada, many of the major life insurers announced their intentions to demutualize, but with the announcement in April this year by Canada Life Insurance Co., all of the four major life insurers of the country have committed to demutualization(2).

In the U.S. as well, some medium-to-small sized mutual life insurers had converted to stock companies in the past several years, and Prudential Insurance Company of America, the largest in the country(3), announced its intention to demutualize in February this year. MONY(Mutual Life of New York) announced the same last year, and is expected to do so in the fourth quarter of 1998.

2) Objectives of Demutualization

i) Fund Raising from Capital Market (Building-up of Capital)

Among background for conversions from mutual insurance companies to stock companies, one thing is common for all. That is, to obtain the ability to access capital market. In the U.S., such debt

(1) Those to be listed in June 1998.

(2) Other three are Mutual Life, Manufacturers Life and Sun Life Insurance Co. of Canada.

(3) Total Asset $259.5 billion, Net Asset $19.7 billion, Statutory Surplus $12.3 billion, Number of Policyholders 11 million (As at December 31, 1997)

obligations as surplus notes(4) by mutual insurers are allowed to count as a part of capital, and in Japan fund raising by way of subordinated notes and subordinated loans is open to mutual life insurers(5). However, all of the above instruments tend to be insufficient to cover management risks, and they lack such flexibility as stocks normally offer(6). Retention of small amounts of earnings after paying out dividends to policyholders has virtually been the only way of increasing the surplus fund for mutual companies. (See Table 1)

Table 1. Means of Building Up Capital for a Mutual Company and a Stock Company

Mutual Company		Stock Company	
	(Nature)		(Nature)
*Retention of earning *Debt Obligations	*Time Consuming *Limitations on Flexibility and Effects, Expensive Costs	*Retention of earning *Debt Obligations ***Stocks Issuance**	*Time Consuming *Limitations on Flexibility and Effects, Expensive Costs ***High Degree of Flexibility**

Source: Nomura Research Institute

Life insurance companies could afford to obtain sufficient surplus funds if the insurance market was in an expansion phase, insurance assets were continuously growing and as a result the economy of the scale was working nicely. However, in Europe and in the U.S., as people's span of life gets longer, consumers' demands have shifted from 'insurance products providing benefits after death' to 'those products that provide retirement income and benefits'. Individuals' funds have shifted from conventional insurance products to more saving-oriented products like mutual funds which other financial institutions offer, leading to a stagnation of the insurance industry's growth.

Stagnation of the industry's growth, in turn, worsened the industry's outlook. Resultant devaluation of insurance companies made consumers move further away from insurance products. A vicious circle arose, that is, (1) Consumers moving away from life insurances,(2) Stagnation of the industry's growth, (3) Slow growth of surplus funds of insurers, and (4) Consumers moving even further away from life insurances.

On the other hand, many of the life insurers which demutualized in the latter half of the 1980's and the first half of the 1990's in the U.S. and Australia, did so for the purpose of making up for the reduced surplus as a result of massive losses incurred from their intensive investments in such high-risk assets as real estate related products, in an effort to secure high yields which should meet their high-yielding insurance products selling, to clients(7).

Life insurers are trying hard to overcome the difficulties posed by such measures as (1) mergers

(4) Debt securities. Categorized as surplus fund, as an authority's approval is required for paying interest and redeeming principal as well as issuing the securities. Some states set ceilings on the total amount to be issued.

(5) As a result of the amendment of the Insurance Business Law in FY 1996, Japanese life insurers were allowed to issue bonds. Also, since August last year, they have been allowed to utilize subordinated obligations (both notes and loans). However, inclusion of subordinated obligations to the surplus fund is limited in the calculation of the solvency margin ratio which is the basis for insurance supervision of the authority.(See Takeshi Inoue "*Capital Research Journal*, Spring 1998"

(6) See note 5.

(7) Equitable Life Assurance of the U.S and National Mutual Life of Australia are examples.

to pursue the economy of the scale[(8)], (2) introduction of new financial technology, (3) entry to new business fields, and(4)expansion of delivery channels.

All of those measures, however, require huge amounts of capital, and it is necessary for them to convert to stock companies in order to facilitate easy access to the equity market.

ii) Coping with Mergers & Reorganizations of Financial Institutions

It has recently been a trend in Europe and in the U.S. for financial institutions including insurance companies to grow in size by mergers & acquisitions. Recently, there has been big wave of financial institution restructuring, spreading over various sectors. Such examples include Zurich Insurance's acquisition of Scudder Stevens & Clark, and the merger of Citicorp and Traveler's group.

Under such circumstances, the unique corporate structure of mutual companies has made it difficult for them to get on the tide of financial reorganization, as they could not fall under the umbrella of a holding company. On the other hand, although they can have subsidiaries under them, the scope of subsidiaries they can hold is limited, and risks thereof tend to be over-weighted in calculation of the capital adequacy ratio[(9)]. Therefore, it requires a certain amount of surplus funds to maintain the ratio, while keeping investments in subsidiaries. Here again, limitation of the ability to raise capital poses a problem.

In case of mergers, there are also legal limitations as to qualifications of merging entities. In the U.S., a mutual company can merge with another mutual company only, and in Japan, while a merger of a mutual company and a stock company is viable, such a merger is limited between insurers only. Demutualization could be an important management objective for a mutual company in order to get on well with the financial industry restructuring.

iii) More Efficient Management

When a mutual company is reorganized to a stock company and its stocks are distributed to the public, the new company could introduce incentive schemes for management and employees utilizing its stocks, such as stock option schemes and employees stock ownership plans.

For mutual companies, the regulatory authorities have worked as the sole provider of checking functions on corporate management as a result of apathy to the management on the part of owners (who are members of the mutual company)[(10)].

However, when the stocks of the converted company are distributed among investors, market disciplines could be expected to work on the company's management.

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(8) Merger of AXA and UAP in France(Nov.'96), German Allianz's acquisition of French AGF(Feb.'96), merger of Commercial Union and General Accident in the U.K. and other mega-mergers are examples.

(9) In Japan, as well, higher risk ratios are applicable to investments in, and loans to, related companies and subsidiaries in calculation of the solvency margin (Surplus Fund/Risk) which is the basis for insurance company supervision.

(10) The relation of the policyholder(=member) and company is incidental to such infrequent events as payment of claims as a result of an insurance accident. As such, policyholders normally have little interest in the management of the company, unless they question the company's ability and intention to execute a contract. Also, as for members' claims to the company's assets, dividends are decided virtually freely by the company's executives, and residual assets, while being distributed among policyholders on the company's liquidation, normally go out of the policyholders hands on termination of insurance contracts and cannot be realized by negotiation, unlike the case of stocks. (See "Mutual and Cooperative Enterprises: an analysis of customer-owned firms in the United States / John A. C. Hetherington " translated by Takuma Ishiyama, Seibundo, 1996)

Furthermore, when the converted company gets listed on stock exchanges, we could also expect a more comprehensive disclosure of the company's details.

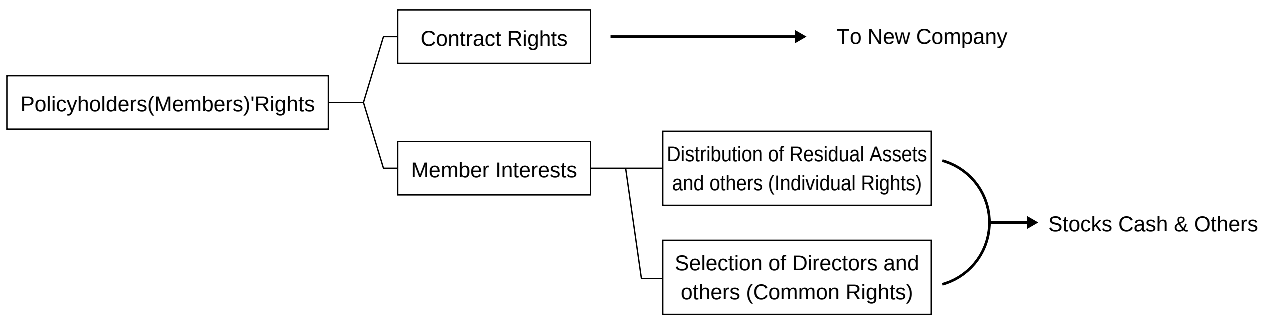
3) Forms of Demutualization

A policyholder of a mutual insurer holds the right on insurance contracts and a portion of claims to the residual value of the company (individual rights) and a right to participate in the company's management selection e.g. directors (common rights).

While policyholders' contract rights will be transferred to a new stock company as a result of a demutualization, their member interests will disappear as stockholders of the new company become the owners thereof. Usually, loss of member interests will be somehow compensated.

According to the study on the practices and the laws in Europe and the U.S., reorganization of mutual companies into stock companies takes several forms depending on how to compensate member interests.

Figure 1. Rights of Policyholders (=Members) of Mutual Companyi) Full Compensation Method



Source: Nomura Research Institute

i) Full Compensation Method

Compensation is made in the form of stocks and cash against either the company's full surplus fund or such portion of net surplus as the policyholder accumulated by contribution(11). First and second methods in the New York State Consolidated Laws(chapter 28: Insurance Law) fall in this category. This method of compensation is accommodated in many other states.

ii) Alliance Method

On or before demutualization, an insurer accepts capital from large scale investor(s). Lack of proper pricing on the acquisition value of the investor(s) could lead to serious dilution of policyholders' rights. This method is employed when the top priority is put on building-up of capital.

The cases of Equitable Life Assurnce (U.S.) and National Mutual Life (Australia) fall into this category. In either of the two cases, the provider of the capital was France's largest life insurer, AXA.

(11) The portion contributed by past members remains within the company.

iii) Warrants Method

Compensation of member interests is made by allocations of warrants to acquire stocks of the new company. By this method, the insurance company suffers no cash outflow, or rather it can raise additional funds. Unexercised warrants might be re-allocated to other investors. However, there is some criticism that this treatment represents insufficient compensation for loss of policyholders' member interests.

This type is authorized in the states of Illinois and Pennsylvania, and was adopted by the U.S. non-life insurance company, Old Guard.

iv) Mutual Insurance Holding Company Method

Under this method, contract rights, separated from member interests, are shifted to a stock insurance company set up under the mutual company. (Quite frequently an intermediary holding company is set up between the mutual company and the stock insurance company(Chart 2). As member interests remain within the mutual company, no compensation occurs. This method is relatively new, and has so far been authorized by 16 states, and is now being discussed by 8 other states(12).

Each method has respective merits and demerits for insurance companies (top management) as well as for policyholders, and top management will decide which method to employ, based on consideration of various factors. Table 2 summarizes merits and demerits of each method.

2. Procedures and Problems of Demutualization in Japan

As reorganization of mutual insurance companies to stock companies progresses in foreign countries, there have been increasing interests in the move in Japanese insurance industry. Out of 44 life insurance companies which exist in this country, including branch offices of foreign insurers, 16 are mutual companies. Total of individual insurance contracts held by mutual life insurers accounts for 92% of the industry's aggregate, and the assets held by them represents 91% of the industry. Most of the major insurers are mutual companies.

Demutualization of a mutual life company was virtually impossible in this country because of the absence of laws which accommodate the move, up until 1996 when demutualization was introduced legally with amendments of The Insurance Businesses Law(13).

However, there is strong criticism that the current laws are not accommodative enough yet to effect a demutualization, and there has been no mutual company which has reorganized to a stock company so far. We summarize the procedures and problems of the current laws.

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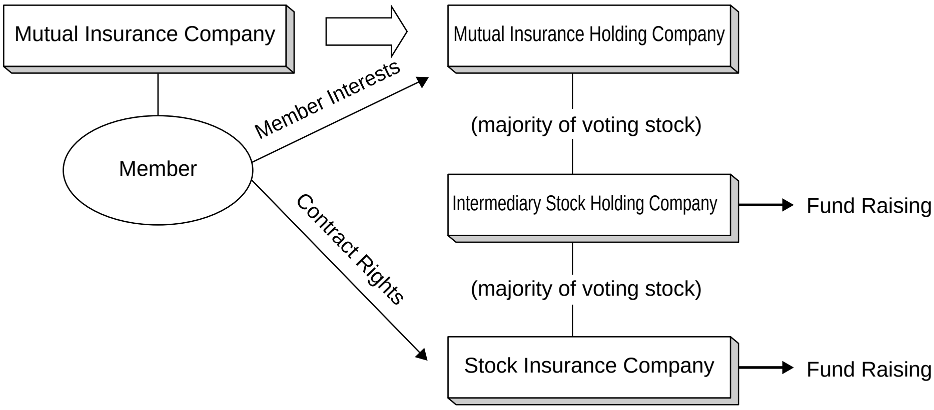
(12) National Underwriter, March 27, 1998. Also, National Association of Insurance Commissioners('NAIC') released in March this year a draft for model law. In the draft, the following states are reported to have adopted the method. They are Oregon, California, North Dakota, Nebraska, Kansas, Texas, Minnesota, Iowa, Missouri, Louisiana, Ohio, Pennsylvania, Florida, Vermont, Lord Island, and Special District of Columbia, and the method is now under discussion in the states of New York, Wisconsin, Illinois, Indiana, Massachusetts, Mississippi (only non-life insurers) and South Carolina. ("Mutual Insurance Holding Company Reorganizations" Mutual Holding Company Working Group of the Financial Condition(EX4) Subcommittee, National Association of Insurance Commissioners)

Figure 2. Structure of Mutual Holding Company



Source: Nomura Research Institute

Table 2. Merits & Demerits of Demutualization

	Policyholders		Insurers (Management)	
	(Merits)	(Demerits)	(Merits)	(Demerits)
Full Compensation Method	*Payment of Stocks & Cash *Management Disciplines by Stock Price	*Loss of Member Interests (Outflows of Future Earnings)	*Access to Equity Capital Market *Higher Flexibility of Management Like Mergers & Acquisitions *Introduction of Management Incentive Schemes Using Stocks	*Time Consuming & Costly *Right of the Management To Be Threatened (Fear of TOB) *Outflows of Cash
Alliance Method	*Payment of Stocks & Cash *Management Disciplines by Stock Price	*Loss of Member Interests (Outflows of Future Earnings) *Severe Dilution of Member's Equity Holding	*Access to Equity Capital Market *Higher Flexibility of Management Like Mergers & Acquisitions *Introduction of Management Incentive Schemes Using Stocks *Certain Degree of Management Stability	*Time Consuming & Costly *Right of the Management To Be Threatened (Relatively More Stable Than Full Compensation Method) *Outflows of Cash
Warrant Method	*Delivery of Warrants to Buy Stocks *Management Disciplines by Stock Price	*Loss of Member Interests (Outflows of Future Earnings) *No Compensation for Those Who Do Not Exercise Warrant	*Access to Equity Capital Market *Higher Flexibility of Management Like Mergers & Acquisitions *Introduction of Management Incentive Schemes Using Stocks *No Outflow of Cash *Fund Raising Possible on Demutualization	*Time Consuming & Costly *Right of the Management To Be Threatened (Relatively More Stable Than Full Compensation Method)
Mutual Holding Company Method		*Some Outflows of Future Earnings *Increase in Managerial Risk on Member Interests	*Modest Time & Cost Needed *Stability of Management Secured *Flexible on the Timing of Initial Public Offering	*Imperfect Flexibility of Management *Stock To Be Priced at Discount Because of Minority Holding by Market Investors

Source: Nomura Research Institute

(13) Insurance Business Law, Articles 85-96. Demutualization of mutual companies came to be accommodated by the new Law, following the Insurance Council's Report (1992) of 'A New Role of the Insurance Industry.' In the report, the following comments were observed. 'There is no doubt that Insurance Business in Japan will become more competitive, more diversified and more flexible in the future. Under such circumstances, there will be a strong possibility that mutual insurers in this country will follow suit of the foreign companies by seeking for reorganization of their corporate status to stock company, with the consent of members, aiming to improve their ability to raise funds and advance into new insurance business areas. In reviewing insurance businesses, it is important to provide stipulations for demutualization of mutual companies in the new law, taking lessons from the laws of foreign countries.'

1) Calculation of Allocations

The law stipulates that shares of stocks of newly set-up stock companies be allocated to members of mutual companies as compensation for loss of member interests (The Insurance Businesses Law, Article 89-1), and that calculation of allocation be made based on each member's contribution (The Insurance Businesses Law, Article 89-2). The formula employed in the calculation is as follows (The Ordinance of Ministry of Finance on the Insurance Business Law, Article 44).

<1> Calculation of Contribution by Contract Class
= (Premiums Paid by Members) + (Income from Investments of Premiums)
- (Claims Paid, Surrender Values and other Member Benefits)
- (Operational and Other Expenses)
- (Assets to be Secured to Fulfill Obligations on Insurance Contracts)

<2> Calculation of Contribution by Each Insurance Contract
= Allocate <1> above to each contract based on liability reserves, claims paid, premiums and other standards

<2> above will be the value of allocated stock for each insurance contract.

As the segregated accounting for insurance companies was introduced by the amendment of the Insurance Business Law in 1996(14), some people expect that the calculation of <1> above is arelatively easy task to do. On the other hand, considerations of differences in maturity and details of contracts are expected to incur lots of works. This could be a factor which makes a demutualization process time and cost consuming.

Furthermore, calculated contributions of some of the contracts could be negative(15). It would be hard for a policyholder to accept no allocation of stocks, as member interests include such common rights as voting rights. In the case of most of the U.S. and European countries, allocations to policyholders are the combination of the fixed portion and the variable portion based on the contribution(16). Such a treatment may be necessary in our country to facilitate a smooth demutualization process.

The Insurance Business Law(17) stipulates that net asset value per share should be more than 50,000 yen, applying articles of the Commercial Code(18). The number of contracts of Nippon Life, the largest life insurer in Japan, counts over 20 million, only for individual contracts, and even medium-sized life insurers have as many as several million contracts(Table 3). Therefore, many of the allocated stocks become odd-lots.

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(14) Profits and losses are classified into 6 groups of individual insurances (participating), individual insurances (non-participating), group insurances, group pensions, other products and overall. Assets are classified into 3 groups of general account, group insurances and pensions. Some companies set sub-divisions for single-premium endowment insurances, which are of a saving nature.

(15) For example, those saving-type insurances with high assumed rates of interest, sold in the latter half of the 1980's.

(16) For example, fixed portion was 100, 3 and 150 shares in the case of AMP, Equitable Life Assurance and Norwich Union respectively.

(17) The Insurance Business Law, Articles 89-4,5

(18) The Commercial Code, Articles 166-2, 218-2

By applying the practices of the Commercial Code and other Laws(19), those odd-lot stocks which are not registered in ledger are to be sold by auction, and the sales proceeds are to be paid to members. In this case, such problems arise as to which level the price should be set and that the procedure is very costly.

Table 3. Net Asset & Number of Contracts of IndividualInsurances For Major Mutual Life Insurers

	(1)Net Asset (in billion yen)	(2)No. of Contracts of Individual Ins. (in thousand)	(1)/(2) (in thousand yen)
Nippon	431.0	20,120	21
Daiichi	115.2	14,790	8
Sumitomo	175.7	14,450	12
Meiji	106.9	8,020	13
Asahi	52.9	6,240	8
Mitsui	39.5	4,740	8
Yasuda	43.0	4,560	9
Chiyoda	51.9	4,300	12
Taiyo	31.9	7,860	4
Toho	11.6	3,300	4
Daido	97.2	2,010	48
Hukoku	7.7	2,990	3
Daihyaku	29.9	2,640	11
Tokyo	15.7	780	20
Total	1,210.1	96,800	13

Note: Net Asset = Fund (as at end of Sep 97) + Statutory Reserves (as at end of Sep 97) + Voluntary Reserves (as at end Mar 97)
The values of (1)/(2) appear just for reference. Actual allocations to policyholders are decided according to contributions.

Source: Nomura Research Institute

2) Fixing of Net Asset

According to the Insurance Business Law, the capital amount of a new stock company cannot exceed 'actually existing surplus' of mutual company before reorganization(20). The concept of 'actually existing surplus' is also used in the Law in Connection with Mergers and Conversions of Financial Institutions(21). In the law, 'actually existing surplus' is strictly defined as the actual value of assets after marking to the market.

Therefore, the total value of stock to be allocated to members(aggregate of contributions of each contract class as calculated in <1>) cannot exceed this net asset value. Balance of surplus funds after distributing to members on conversion is required to remain in the balance sheet of the new company as either capital reserve or earned profit reserve(22).

The idea behind this treatment is that the balance which has not been paid out to members should be attributed to the past members(those who departed the insurance company on termination of their contracts) and should not be used as a source for dividends to shareholders. Even if the

(19) The Commercial Code, Article 217-1,2, etc.

(20) The Insurance Business Law, Article 90-1

(21) The Law Concerning Mergers and Conversions of Financial Institutions, Article 25-1

(22) The Insurance Business Law, Article 91

balance is put in capital or earned profit reserve, it still could be used to compensate for losses from operations. Therefore, the laws accept the option of segregating such balance as ‘reorganization reserve’ to reflect the nature of the fund clearly(23).

Some of the life insurers still hold sizeable evaluated profits on their assets, albeit the sizes thereof have been shrinking. A part of this evaluation profit is derived from ‘income from investments of premiums’(which appeared in the formula <1> to calculate the contribution to members), and the balance was considered to be contributed by past members. Net asset value of life insurers has traditionally been small. Therefore, treatment of distributions of these evaluated profits is vitally important in estimating contributions of members to decide on final allocations thereto, and it should exert a strong influence on the planning of demutualization (Table 4). In case of the U.S., this evaluation consideration matters little as securities held by life insurers, especially equity investments like stocks, have been evaluated on the mark-to-the-market basis.

3) Policyholders’ Right to Dividends on Participating Insurance

There are certain insurance products which pay dividends to policyholders among the range of products of a mutual insurer. In Japan, the majority of products mutual insurers are offering is this type of participating insurance. Normally, insurance companies allow good safety margins for assumed rates of expense on contracts, maintenance and operation, expected rate of return on premiums to be received and assumed rate of mortality in calculation of premiums. In case of mutual companies, differences between assumed rates and actual outcome represent the company’s profit, and the majority of the profit will be paid to policyholders in the form of dividends, with the small balance left being kept within the company as retention.

However, considerations have to be given as to division of the profit between stockholders and policyholders in case of a stock company where the owners of the company are stockholders. This point matters very much especially when stockholders who are not policyholders increase in number. In the U.S., in order to protect the interests of policyholders to receive dividends from participating insurance contracts before demutualization, certain portions of assets which are necessary to maintain the past dividend ratio are segregated into be a ‘closed block’, to which stockholders and new policyholders are prohibited to access.

In the case of Japan, legal treatments are different. How to treat this rights to dividends of existing policyholders is one of the biggest issues in obtaining policyholders’ consents.

In case of a mutual company, there are legal provisions which protect policyholders’ interests in the company’s profit, like the one that calls for the distribution of 80% of the surplus(24). On the other hand, in the case of a stock company, while the laws require fair treatment of dividends among policyholders(25), there is no provision for adjustment to distribution of the company’s profit between stockholders and policyholders of participating insurance(26). Some people maintain that

(23) The Insurance Business Law, Article 92

(24) The Insurance Business Law, Article 58

(25) The Insurance Business Law, Article 114

(26) There are provisions for limitation of dividends in Article 15 of the Insurance Business Law. The provisions include : (i)Capital and Capital Reserves cannot be the source of dividends, just like the stipulation of the Commercial Code, (ii) Dividends payment can be allowed only after foundation expenses and operation expenses (during the first 5 years after foundation) are amortized, and (iii) cancellation of stocks are viewed as dividends.

Figure 3. Relationship Between Net Asset of Mutual Company and Stockholders' Equity After Demutualization

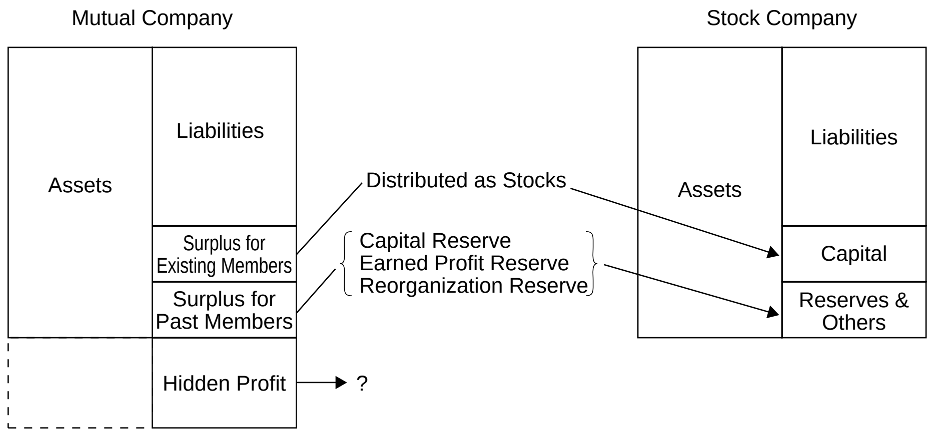

Table 4. Net Asset Value of Major Life Insurers after Mark-to-the-Market

	NAV①	NAV②	②/①	NAV③	③/①
Nippon	431.0	4,716.5	10.9	2,573.7	6.0
Daiichi	115.2	1,940.4	16.9	1,027.8	8.9
Sumitomo	175.7	522.5	3.0	349.1	2.0
Meiji	106.9	1,599.9	15.0	853.4	8.0
Asahi	52.9	149.5	2.8	101.1	1.9
Mitsui	39.5	218.3	5.5	128.9	3.3
Yasuda	43.0	210.3	4.9	126.7	2.9
Chiyoda	51.9	55.9	1.1	53.5	1.0
Taiyo	31.9	609.5	19.1	320.6	10.1
Toho	11.6	18.5	1.6	14.8	1.3
Daido	97.2	303.7	3.1	200.5	2.1
Hukoku	7.7	153.0	19.8	80.4	10.4
Daihyaku	29.9	-6.7	-0.2	11.5	0.4
Tokyo	15.7	12.0	0.8	13.8	0.9
Total	1,210.0	10,503.4	8.7	5,855.7	4.8

Note: Net Asset Value (1) = Fund(as at end of Sep 97)
+ Statutory Reserves(as at end of Sep 97)
+ Voluntary Reserves (as at end Mar 97)
Net Asset Value (2) = (1) + Evaluated Profits on Securities Held (as at end Sep 97) — Amounts Necessary of depreciations for Bad Loans (as at end Sep 97;NRI Estimate)
Net Asset Value (3) = (1) + Evaluated Profits on Securities Held (as at end Sep 97)/2 — Amounts Necessary of depreciations for Bad Loans (as at end Sep 97;NRI Estimate)

Source: Nomura Research Institute

profit of an insurance company has an element of reimbursement of premiums, and as such, full distribution of profit by way of dividends to stockholders is questionable.

Currently, the above point has caused little trouble, as stock life insurance companies are handling few participating insurance products, and the number of investors in life insurers as stockholders is negligible. However, the problem will become acute when more and more mutual companies get demutualized. In many of the major countries of the world, some kinds of adjustments between stockholders' and policyholders' dividends are observed(27).

(27) In case of the State of New York, it is stipulated that more than 10% of the surplus fund should not be paid out as dividends to stockholders (the New York State Consolidated Laws(chapter 28: Insurance Law) Article 4207-b-1).

4) Fund Raising after Demutualization

One of the primary objectives of demutualization is fund raising from the capital market. When making a public offering of new shares after the reorganization, market-price-based offering can be achieved by a resolution of the board of directors. Before trading of the stock in the market, the issue of setting the proper offering price, like in the case of auctions of odd-lots stock, arises. Improper pricing may lead to a dilution of existing stockholders (stockholders at the time of demutualization=policyholders)' equity in the company.

It could be another of the possible serious managerial concerns that a third party may easily obtain the control of the company because of the small number of shares each stockholder has on average. In some of the foreign countries, an offering of new shares is prohibited for a certain period after a demutualization(28). This prohibition, however, impairs one of the most attractive features of demutualization, agile fund raising. By guiding sales of odd-lot stocks to center on a small number of large scale investors, stable stockholders might be secured. In this case, the issue of setting proper prices comes in again.

5) Tax Matters

Problem of taxation on stocks which policyholders receive is one of the important considerations in connection with mutual insurers' demutualization. Stocks received are considered to be something similar to dividends of insurance by nature. Normally, dividends of insurance are treated as temporary income, while taxation thereon is deferred to maturity or until payment of claims. Furthermore, taxation is made only on the excess of maturity value (or claims paid) plus dividends over premiums paid, and there is special tax exemption for temporary income of up to ¥500,000.

Also, when a policyholder would like to withdraw an accumulated dividend from an insurance product before maturity like whole life insurance, tax is levied only on the excess over the accumulated premiums paid. Proper taxation is difficult because each policyholder has a different kind of insurance contract, accumulated premiums and amounts of dividends received in the past, and also because it is difficult to identify the proper value of the stock received.

In the U.S. and U.K., no tax is levied when stocks are received, the same taxation as dividends when cash is received, and the acquisition cost of stock is assumed to be nil in case of sales. The same treatment might be possible in Japan. However, some issues have to be settled. In which income category should cash receipts be classified? Whether it is proper or not to consider the whole of sales proceeds of stocks as capital gain in view of the fact that the allocated value includes an element of reimbursement of premiums.

(28) In the first method of the State of New York, offering of new shares is prohibited at the time of demutualization and during two years after demutualization. (Article 7312-d-1)

3. Concluding Remarks

As discussed above, there are several points to be clarified as to the legal provisions for demutualization of mutual companies in Japan. Some of the insurance companies insist that it is difficult to virtually reorganize to a stock company because of cumbersome and costly procedures which the current regulations require.

The Report of June last year by the Insurance Council on the Big Bang in the life insurance industry(29) depicted, in its part of introduction of holding company to life insurance industry that "While provisions for reorganization of a mutual company to a stock company were introduced in the new Insurance Business Law, details of procedures should be discussed in the future." Following that, the Council's General Committee meeting also touched on the importance of simplification of demutualization procedures. While some people are of the opinion that reorganization to a mutual holding company is legally difficult to introduce because of the problem of mutual insurer's performing holding company business, and because of the issue of separation between contract rights and member interests, there is also a school of people who strongly ask for the introduction of holding companies(30).

The Ministry of Finance is said to be tackling this issue seriously in the Finance Council to be newly set up, and are trying to aim at a necessary amendment of laws in FY 1999(31).

In Japan as well, the growth of the life insurance industry has become stagnant, and the lowering of capital adequacy ratio has caused the credit rating of life insurers to lower, which in turn has made clients stay away from it. Furthermore, a big wave of the Financial Big Bang is surging to result in overall restructuring of the whole financial world. Building-up of surplus is one of the top priorities for management of life insurance companies in Japan, and demutualization will no doubt be one of the options for expansion of instruments to raise equity capital.

(29) "Regarding the Review of Insurance Business - In Line With Reforms of Financial System" June 13, '97

(30) Professor Tomonobu Yamashita at the University of Tokyo (Faculty of Law) pointed out some problems of mutual holding companies in the 3rd Meeting of Insurance Council's General Committee on March 10, '97.

(31) Nihon Keizai Shimbun, April 5, '98