opinion

NRMA INSURANCE DEMUTUALISATION

Race Mathews

It is vital for the future of mutualism that the proposed demutualisation of the insurance arm of the National Roads and Motorists' Association (NRMA) should not escape informed scrutiny.[1] The rush to demutualisation of the insurance mutuals is the thin edge of the wedge. Failing proper vigilance and timely action, demutualisation will before long engulf all Australia's mutuals including - along with the insurance mutuals - our building societies, friendly societies, farm co-operatives and credit unions.[2] The writing is on the wall. It will be too late for regrets and recriminations when the last mutual has been privatised as a shareholder company. Where then will those Australians who are less well off - and their number is increasing daily - look for the key role in enabling them to make ends meet and enriching the quality of their lives which our mutuals have so long, effectively and honourably discharged? Where then will the community turn for the capital to fund new mutuals in response to new needs consequent on rapid economic, social and technological change?

1 That the word "demutualisation" has so rapidly passed into the language and become common usage recalls the sequence, in Johnny Woo's 1996 film "Broken Arrow", where the Chairman of the US Joint Chiefs of Staff telephones the president's senior aide to report "Sir, we have a Broken Arrow". Asked by the aide "What's that?", he explains that a nuclear weapon has been hijacked. Replies the aide: "I don't know what's more worrying: that its happened or that you've got a name for it".

2 The Reserve Bank believes that the net worth, or equity, of demutualised companies, as at January, 1999, amounted to about $21 billion, with assets under their control of about $180 billion. See Anon., (1999), pp. 1-6.

Performance of the NRMA as a Mutual

The proposed NRMA Insurance demutualisation is in no sense indicative of a failure of mutualism. As a mutual, NRMA Insurance has not, like the demutualised National Mutual Society (NM), performed so miserably as to have allowed itself to be taken over by the French insurance giant AXA[3]. It has not, like the demutualised Australian Mutual Provident Society (AMP), lost hundreds of millions of dollars in a botched take-over bid for the privatised NSW Government Insurance Office (GIO).[4] It has not, like the GIO, so misconducted its response to that take-over as to now be on the receiving end of a $500 million class action by its aggrieved shareholders. It has not, like the GIO, incurred losses totalling some $900 million in the reinsurance market.[5]

On the contrary, NRMA Insurance has, by its own account, achieved spectacular successes as a mutual. In the most recent financial year, the operating profit for the insurance business rose to $329 million from $116 million. The chief executive officer, Mr Eric Dodd, states that the group's ability to achieve strong profit growth in a year that included the single biggest insurance catastrophe in Australia's history was a measure of the company's strength. According to Mr Dodd, "This year's strong result, in the face of such high claim activity, vindicates - in part - the decision to diversify the business of NRMA Insurance".[6]

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3 AXA now holds a 51 per cent share in National Mutual. See, for example, the Age, 3 August, 1999.

4 For a significant warning that a greater risk of such debacles is intrinsic to demutualisation, see Fliegelman, Maloney and Riegel (1998), p. 7. The authors note in a prescient passage that: "One almost universal reason that mutual insurers provide for conversion is to facilitate acquisitions of other companies. ... However, any transaction is a relatively high risk affair; unwise transactions have often been known to inflict unexpected (and even serious) harm on the unprepared acquirer".

5 *Australian Financial Review*, 12 November, 1999.

6 *Australian Financial Review*, 3 September, 1999.

The Marsden-Copernican Report

Nor can NRMA Insurance be claimed to have problems which are insuperable for it as a mutual. The Marsden-Copernican report - the report of a consultancy commissioned by the NRMA board and paid for by NRMA members but not so far made public - concludes categorically that the contrary is the case. As the *Australian Financial Review* has reported - and the NRMA Board has not denied - the Marsden-Copernican report states that the case for demutualising NRMA Insurance is essentially philosophical, with the challenges confronting the motoring and financial services group solvable within its existing mutual structure. The report concludes that:

- NRMA's governance problems are not exclusive to mutuals and are not insoluble.
- The case for retention of the mutual structure rests largely on whether the board and members see value in retaining the objectives of mutuality.
- If mutuality is valued, then there is no cogent reason to demutualise.
- There are no tax disadvantages to NRMA's acquisition aspirations from its mutual status.
- NRMA is not short of capital.[7]

The report highlights the outstanding success stories of such thriving mutually owned financial intermediaries as Holland's Rabobank and Canada's Desjardins credit unions.[8]

The Credit Suisse First Boston (CSFB) Report

The *Australian Financial Review* also reports - and the NRMA board has not denied - that the Marsden-Copernican report repudiates key findings by earlier consultants, Credit Suisse First Boston (CSFB), on which the

7 *Australian Financial Review*, 12 July, 1999.
8 *Australian Financial Review*, 10-11 July, 1999.

board has relied in pressing ahead with the option of demutualising its insurance business. According to the *Australian Financial Review*, "In the report, Marsden Jacob Associates and Copernican Securities conclude that there are negative benefits from a re-structure and attack a key premise of CSFB's work, which asserted that, as a mutual, NRMA required 20 percent more capital than other insurance companies".

Significantly, the *Australian Financial Review* discloses - and the NRMA board has not denied - that CSFB "no longer holds modelling work undertaken for NRMA in relation to the proposed float of the group's $5 billion insurance arm, even though the board of the NRMA has yet to finalise its restructuring options. CSFB appears to have destroyed models, data and related records following completion of a study into NRMA's options on future structure and capital requirements".[9] In particular, CSFB's models and data were not available to Marsden Jacob and Copernican when they required the material as a benchmark for their joint study.

The question for NRMA members is what credence can be given to conclusions for which the basic working documentation purportedly no longer exists and is therefore no longer available for critical scrutiny or independent verification? What are members to think of the disclosure by the Tokyo correspondent of the *Australian Financial Review*, Andrew Cornell, in his "Tokyo Observed" column in August 1999 that "Credit Suisse, the Swiss investment banking group, will have the licence of one of its Japanese subsidiaries revoked while several other group operations in Japan will suffer suspensions and other sanctions".

According to Mr Cornell, "Credit Suisse's sins were of two categories: selling products to help other corporations hide losses and window-dress accounts; and obstructing the investigation by Japanese authorities, including shredding and hiding documents".[10] May not NRMA members find Mr Cornell's disclosures disturbingly reminiscent of events closer to home? The *Australian Financial Review* quotes "the principal of another leading investment bank, who cannot be named", as stating:

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9 *Australian Financial Review*, 12 July, 1999.
10 *Australian Financial Review*, 2 August, 1999.

> The one thing you do not do is to destroy that work. Its part of your intellectual capital. It can be important to you to understand the whole sector. The practices are that you keep your files. You may destroy them at some stage, but not soon after you do your report.[11]

The Marsden-Copernican report is clearly a document of international public significance, with major implications not only locally but in other countries where demutualisation is occurring on the basis of incomplete, misleading or tendentious information.

Meanwhile, it is important to establish conclusively whether the modelling work on the proposed demutualisation has been destroyed, as CSFB has so conveniently felt itself able to claim. If so, further questions arise as to on whose instructions the loss of such key intellectual property occurred, and whether, as is also claimed, destruction of modelling work is regarded by CSFB as a standard operating procedure or policy. Is CSFB able to demonstrate conclusively that such a procedure has been followed consistently in other instances? Has the NRMA board required CSFB do so, and, if so, will the response be made public prior to any poll of members on the demutualisation issue?

Members of the NRMA may also wish to know whether their board had advance notice that the work carried out by CSFB at the NRMA's expense was to be destroyed, in circumstances where its availability for scrutiny and verification was so clearly crucial to debate on the demutualisation issue. If so, why were measures to protect the modelling not taken? If not, has legal advice about a possible action for recovery of damages from CSFB been obtained, and will it be made public? The apparent failure of the board to satisfy itself of the security of the material or insist on its retention is open to the interpretation that the board's intention is less to facilitate a genuinely informed consideration by members of the future status of their insurance business than to trigger

11 *Australian Financial Review*, 12 July, 1999.

a rush for short-term gains - a dash for cash - at the expense of either their own or the community's long-term interest.[12]

Stifling of Debate

Faced with so profoundly embarrassing a collapse in the credibility of its case for demutualisation, the board's strategy has been to stifle debate and fudge the facts and issues. This is nowhere more apparent than in efforts by the board to gag those of its members who oppose demutualisation. It is evident in particular in the legal extremes to which the board has resorted to silence criticism of demutualisation by one of its more prominent dissidents, Ian Yates. The board's determination to frustrate informed discussion of the demutualisation of its insurance business has become so blatant as to cause the *Sydney Morning Herald* to condemn it as "unconscionable". An *SMH* editorial has warned that:

> It is not open to the directors who favour corporatisation, even if they are in a majority on the board, to use their power to install devices to silence those with different views. ... At no time has it been more important for the members to have the fullest information and the freest debate about the great change that some continue to urge.[13]

What is remarkable against the background of so magisterial a remonstration from so august a media source is the total absence of any acknowledgement by media financial commentators of the avoidance by the NRMA in its capacity as a mutual of the pitfalls and pratfalls which have so sorely and spectacularly embarrassed its demutualised or

12 The board has a further credibility problem in that current arguments for a demutualisation of NRMA Insurance alone contradict statements in the 1994 prospectus for demutualising the insurance and road service businesses together. The 1994 prospectus reads: "Selling off NRMA Insurance would effectively split the NRMA apart. The NRMA's strength lies in the value of both road service and insurance, with each benefiting the other. If they were to be separated, each would be weakened. The value of the combination is greater than its parts. Separating the two would mean splitting the staff of the NRMA, thereby destroying the very culture which has made the NRMA a success". Anon. (1994), p. 11.

13 *Sydney Morning Herald*, 21 August, 1999.

privatised competitors. Likewise there has been no acknowledgement by the same commentators of the success of NRMA in its capacity as a mutual to achieve the earnings its competitors must with good cause so greatly envy.

Can anyone doubt that, if, as a mutual, NRMA had suffered comparable setbacks, the same media commentators would have been vehement in attributing its misfortunes to mutualism? Is it other than obvious that in such circumstances the commentators would have been falling over themselves to condemn mutualism and dance on its grave? What is being witnessed in current financial media cover of the proposed demutualisation of NRMA Insurance is a double standard of truly monumental proportions.

Meaning and Benefits of Mutualism

In general, the hard questions about demutualisation are not being asked. In the first instance, where in the current controversy has attention been paid to the meaning and benefits of mutualism? Mutualist bodies such as insurance societies, credit unions, friendly societies, building societies and co-operatives reflect the principle that our key needs can often be satisfied more effectively by acting together than alone. Mutuals are usually formed so members can obtain goods and services which would otherwise be unavailable or higher priced. As Mark Sibree of the leading friendly society, Australian Unity, sees the society's relationship with its members: "we are not in a position to rip them off: there's no purpose. The same people who are our customers can turn up at the annual meeting and vote".

A case in point is Australia's credit unions. While Australia has had financial co-operatives for more than a century, credit unions in their modern form date from the 1950s. Australians who married in those years could obtain 30-year home loans at fixed rates of about 3 per cent. However, buying furniture or a car required borrowing from hire purchase companies - often subsidiaries of the trading banks - at interest rates which were flagrantly exorbitant.

As a consequence, families in outer suburban Catholic parishes got together after mass, pooled their savings and queued for loans at affordable rates. In time, their neighbours of other faiths or none at all joined in, giving rise to community credit unions and, a little later, industrial credit unions. The benefits of credit unions are so obvious that they now number some 3 million members, with assets totalling more than $20 billion.[14] Every member is an equal co-owner of the business, with an equal say in its affairs and equal access to its services. [15]

Mutual insurance is no different. NRMA Insurance is simply a body of people who have come together to provide themselves with insurance services and other financial products for lower prices than conventional commercial providers. Like other mutuals, NRMA Insurance is assisted in offering a better service at a lower cost by the capital which earlier generations have contributed in the expectation that it will be passed on for the benefit of generations still to come.

NRMA members may well ask themselves whether they can in good conscience abdicate their responsibilities as, in effect, trustees for the dead and the inheritance of the unborn. What are decent, long-term NRMA members who believe in a fair go to make of finding themselves in the company of the blow-ins and johnny-come-latelies - the so-called "carpet-baggers"[16] - who have qualified for membership of NRMA

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14 Figures made available to the author by Credit Union Services Corporation of Australia (CUSCAL)

15 For a useful account of the development of credit unionism in Australia, see Lewis (1996).

16 The term "carpet-bagger" is widely used in Britain in the context of large numbers of people joining permanent building societies in order to vote for their demutualisation and share in the distribution of their assets. "Serial carpet-baggers" are those who do so repeatedly. There are also "carpet-bagger" clubs which organise external bids to demutualise mutuals, and "carpet-bagger" vulture funds which invest in bringing about demutualisations. It is estimated that, in the case of a recent failed attempt to demutualise the giant Nationwide Building Society, 600,000 of the 4.6 million members qualified to vote had joined the Society immediately prior to the poll for the express purpose of supporting a demutualisation. Building societies are in some instances responding to the threat to their mutualist status by rule changes requiring new members to enter into an undertaking that any windfall gains accruing to them from a demutualisation will be paid directly to a nominated charity. See Mathews (1999), pp 168-173.

Insurance exclusively in order to bring about and benefit from a carve-up of the assets which others before them have created and conserved?

Insurance Costs

A second key issue for NRMA Insurance members is what real value they are likely to receive in return for surrendering their membership entitlements. Economic fundamentalist commentators such as the Melbourne *Age's* Stephen Bartholomeuz like to vilify the savings a mutualist insurance body delivers as "corrupting the market in which it operates".[17] What they mean is that the price of insurance would be much higher if the mutuals were no longer around to keep it down. Just as credit unions played a key role in stamping out the worst excesses of the hire purchase racket, so the presence of the insurance mutuals is a major factor in keeping the insurance market honest.

Significantly, since the Housing Loan Insurance Corporation became a proprietary limited company, housing loan insurance costs have risen by 30 per cent. NRMA members should ask themselves how long it will be before the value of the "fistful of dollars" currently on offer for their rights will be eroded by premium increases and a less sympathetic response in the face of hail storms, floods, fires and other natural disasters. The *Australian Financial Review* has disclosed - and the NRMA board has not denied - that, in the view of the Marsden-Copernican report, a demutualisation of NRMA Insurance "would increase the cost of insurance to all insurance policy-holders in the key NSW market".[18]

Retargeting and Reinventing Mutuals

A third key issue for NRMA members is what wider benefits will be foregone in the event that NRMA Insurance is demutualised. Modern

17 *The Age*, 10 July, 1999.
18 *Australian Financial Review*, 10-11 July, 1999.

mutualism rejects the view that mutuals are necessarily restricted to their original services. It sees them instead as pools of community wealth which periodically require re-inventing and re-targeting in response to changing needs, or where commercial providers deliver comparable services at competitive prices.

For example, a major US mutual, Co-operative Services Inc of Detroit, was formed in the 1930s in response to the need for affordable, hygienic home milk deliveries. When the corporate dairies moved in with comparable services at a comparable price, the co-operative re-invented itself so that the community capital it had accumulated was applied to meeting the need for affordable optometrical testing and the supply of spectacles. When that function in turn was taken up by the optometrical corporations, a further re-invention of the co-operative took place. The co-operative then re-tasked itself to meet the need for affordable accommodation and support services for older people. It now operates apartment complexes for older people - all self-governing entities within the over-arching parent body - in several states.[19]

A second compelling case in point is the great Desjardins credit union federation in Canada. The Desjardins credit unions were established around the turn of the century, in response to a pressing community need for affordable loans to tide over working-class households in the face of emergencies from one pay-day to another, and so eliminate the need for them to borrow from factory-gate loan-sharks at usurious rates. In the 1950s and 1960s, the credit unions reinvented themselves as a source of affordable personal loans for major consumer durables such as cars, furniture and household appliances. They are now undergoing a second re-invention, in order to respond to the most pressing current need: namely, for local and regional economic development which will provide members and their children with jobs.[20]

The NRMA president, Nicholas Whitlam, has been reported as saying that a demutualisation of the NRMA would mean an immediate boost to the Hunter region economy of $438 million.[21] Might not NRMA

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19 Anon. (1993).
20 See, for example, Poulin (1990) and Birchall (1997), p. 209.
21 *Newcastle Herald*, 16 August, 1999.

members be prudent to ask whether their long-term interest could be better served by the spinning-off of a new NRMA Insurance subsidiary as a source of patient capital for new regional enterprises and jobs than by a one-off payment with a necessarily short-lived economic impact?

Are not compelling models for such a subsidiary readily available in the Desjardins credit unions or the Caja Laboral Popular - the Mondragon credit union - in the Basque region of Spain?[22] The authoritative Moody's credit rating service reports that "Mutuals, and even stock companies, have used downstream holding companies to support the growth of specific lines of business. This alternative can in many cases be easier and less costly to implement than a demutualisation".[23]

Safeguards Against Conflict of Interest

A fourth and final question NRMA Insurance members may wish to ask is whether the demutualisation issue is being considered with sufficient regard for safe-guards against conflicts of interest. A prominent New York insurance industry lawyer has warned that stock options are the real motivation for all insurance demutualisations. What he means is not the relatively minor parcels of shares which are passed out to policy-holders in return for their membership entitlements, but the mammoth allocations of share options to favoured individuals such as the AMP's now departed CEO, George Trumbull. It is the lawyer's strong view that, without the inducement of stock options, the current rush to demutualisation of insurance mutuals would not have occurred.

Amendments to Canada's Insurance Companies Act in 1999 disqualify directors or officers and employees in demutualising insurance societies from benefits other than their entitlements as eligible policy-holders. Given Australia's lack of comparable statutory safeguards, might it not be prudent and proper for NRMA members to require of their board members, officers and staff clear evidence that advice and decisions

22 For Mondragon, see Whyte (1991); MacLeod (1997); and Mathews, (1999), pp. 179-247.

23 Fliegelman Maloney and Riegel, (1998) p. 10.

supportive of demutualisation have not been tainted by the expectation of benefits which the Canadian legislation would disallow?

Accordingly, might it not be reasonable for NRMA members to require from members of the current board legally-binding undertakings that, in the event that the insurance business is demutualised and they retain their present positions or are otherwise employed in a demutualised entity, they will not for a period of, say, five years accept overall remuneration for their services in excess of that to which they are currently entitled?

Might it not be appropriate for similar undertakings to be required from officers and staff whose advice to the board has favoured demutualisation? Is it likely that any board member, officer or employee who has in good faith voted for the proposed demutualisation or advised in favour of it would do other than welcome so clear-cut an opportunity to demonstrate that their deliberations and decisions have been disinterested?[24]

Insurance Mutualism Subverted

The problems with the NRMA result directly from its having been dominated for too long by narrowly commercial interests which have not only neither understood nor supported mutualism but actively opposed the election to the board of candidates favourable to mutualism. For example, as long ago as 1970, a group of candidates standing on a platform of vigorous adherence to mutualism was rejected by the board of the day on the grounds that the candidates were insufficiently qualified.

The candidates the board thought were not good enough for it included Paul Landa, later an outstanding Attorney-General of NSW; the current

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24 That disinterested advice and decisions cannot be taken for granted is evident from the example of Australia's first credit union demutualisation. When the Sunstate Credit Union demutualised in 1997, fewer than 14% of its members received anything whatsoever in return their interests in its assets, and the most conspicuous beneficiaries were a tiny minority made up largely of its directors and staff. See Mathews (1998).

Chief Justice of NSW, Jim Spigelman; and John Menadue, who became the head of several key commonwealth departments, ambassador to Japan and CEO of QANTAS.[25] It may well be asked how many NRMA board members either then or since have had more to offer, much less achieved comparable distinction. What the then board members objected to about the Landa/Spigelman/Menadue ticket was precisely its commitment to making mutualism work. In the absence of a board majority with a clear commitment to giving mutualism a go, NRMA Insurance has become a Clayton's mutual - the mutual you have when you are not having a mutual.

A Moratorium and an Inquiry.

Following the clean sweep of NRMA board positions by pro-demutualisation candidates at the 1999 elections, the dilemma for NRMA Insurance members is whether, like Esau, to sell their birthright for the biblical mess of pottage. Will NRMA members now allow themselves to be seduced into surrendering their membership entitlements by a lavishly-funded, ideologically-driven drive for demutualisation with no more substantial a basis than the contested conclusions of a consultancy which has been fatally flawed by the purported destruction of its working documentation? Or will they rather adhere to the mutualist principles so far-sightedly entrenched by the founders of NRMA Insurance in its memorandum and articles of association? And might not the public interest be better served by a moratorium on further demutualisations, including the demutualisation of NRMA Insurance, pending an independent, open and expert inquiry where mutualism can be assessed on its merits?

25 Menadue (1999) p. 105.

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Cartoon. Bruce Petty.