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AN ANALYSIS OF A DECADE OF PROPERTY AND LIABILITY INSURANCE COMPANY MERGERS, 1950-1959

Dissertation

Presented in Partial Fulfillment of the Requirements for the Degree Doctor of Philosophy in the Graduate School of The Ohio State University

By

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* * * * * *

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Any defects in the study are my responsibility.
VITA

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CHAPTER I

INTRODUCTION

The recent merger movement within property and liability insurance companies has received a considerable amount of attention from both insurance companies and regulatory authorities on both state and federal level.\(^1\) It might be considered one of the major factors in the question of state versus federal regulation of the insurance business.

Insurance company mergers are not a new phenomenon in the insurance business. They have been constantly taking place in the various lines of the insurance business. However, the first real wave of them among non-life insurance companies took place by the end of the nineteenth century.\(^2\)

There are different reasons for combinations, such as:

1. Financial instability of the company acquired.
2. A desire of a company to establish or strengthen and enlarge its business in a particular territory.
3. To enable a company to acquire a good share of the insurance market in a line it had not previously transacted.

\(^1\)Property and liability insurance is currently used to indicate the various lines of fire and casualty insurance. Property-liability is used interchangeably with fire and casualty in this study to indicate the non-life insurance field.

4. To enable a company to complement its personnel through the acquisition of a staff having the technical knowledge and experience for handling the business.

Prompted by one reason or another, there have been literally hundreds of mergers in the decade of the 1950's. The reasons which brought them about may have differed from those which led to the early groupings. However, in either case, the outcome may have been the same, namely, the change of the insurance business.

A study made in 1960 indicated that 187 cases of merger took place in the five years from 1953 through 1957 with the exclusion of acquisition of stock of companies within the same group.³ It was further stated that "in not one case did the State insurance departments refuse permission to merge or institute proceedings to prohibit a merger. Also, several States indicated that the merger question was not considered at all by the department, either with respect to approval or denial of permission to merge."⁴

According to Best's Insurance Reports, 135 stock companies, 90 mutual companies, and 14 Lloyd's and reciprocals, a total of 239 property and liability insurance companies retired from the insurance business through merger and acquisition during the decade of the 1950's.⁵ According to records kept by the American Mutual Insurance Alliance,

⁴ Ibid.
⁵ Best's Insurance Reports, op. cit., pp. 715-26B.
9,051 property-liability insurers have been organized in the history of the United States. Some 5,762 of these have retired from business for reasons which include mergers, reinsurance, conversions, failures, receivership, or voluntary retirement, leaving 3,289 in operation as of August 1, 1962. Furthermore, it indicated that during the period 1930 to August 1, 1962, some 2,220 property-liability insurance carriers retired from business out of which 643 carriers (341 mutuals, 281 stock, 19 reciprocals, and 2 Lloyd's) retired through mergers.

Purpose of the Study

The purpose of this study was as follows:

1. To trace the origin and development of insurance company mergers to the present time, giving due consideration to the underlying factors and forces.

2. To analyze the present laws that have been specifically designed to control insurance company mergers with due emphasis on the impact of such legislations on the companies' attitude toward mergers.

3. To analyze the types and methods of insurance company mergers, including in the process a brief review of the other means of retirement beside merger as used by the insurance companies.

4. To summarize, analyze, and evaluate the problems which arise following mergers and show how these problems are actually treated. The effects of mergers on the companies' competitive environment, concentration of economic power, and efficiency of operation would be included.

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7 Ibid.
Limitations of the Study

Of necessity, several limitations must be placed on a study of this type:

1. This study, based partially upon personal interviews with acquiring insurers, was limited to merger cases which occurred during the period from January, 1950 through December, 1959.

2. That part of the study regarding actual practices of insurance companies and the effect of mergers was, of necessity, restricted to case studies.

3. This study was confined to non-life stock insurance companies in the United States, since all merger cases among mutual companies involve small companies most of which are county mutuals where their size was too small to permit a thorough analysis.

Basic Issues

Preliminary analysis of available data revealed certain issues which might be clarified by this study. These may be stated in the two basic issues of cause and effect.

1. Why has the trend occurred, and what are the factors and forces underlying the merger movements?

2. What problems are involved in completing a merger and how are these problems analyzed? What are the effects of mergers on the insurance company's competitive environment, concentration of economic power, growth of companies' assets, and efficiency of operation?
Definition of Concepts

The general term "merger" has been used in the insurance literature in various ways. It has been employed to refer broadly to the specific ways in which two or more operating companies unite. It has stood for "consolidation," "absorption," "purchase," as well as merger. The meaning of the term may also incorporate other general expressions such as acquisition, combination, and amalgamation, although there are technical differences among the latter terms. 8

Most writers on corporate finance distinguish merger from consolidation by the fact of continued existence, in the former, of one of the constituent companies involved in the transaction. Merger, then, is a method of uniting in which "an existing company acquires all the assets and liabilities of another company, and the latter company passes out of existence." 9

A consolidation, on the other hand, is a method of combination in which a new company is formed for the particular purpose of taking over the assets and liabilities of two or more other companies, and the latter pass out of existence as separate entities. 10 The new company issues new capital stock and operates under a new charter.

Purchase of Assets is still another device whereby two or more companies may be combined through the cash purchase by one company of

8 Cf. the various terms subsumed under the definition of merger by J. Fred Weston; The Role of Mergers in the Growth of Large Firms (Berkeley and Los Angeles: University of California Press, 1953).


10 Ibid., p. 689.
all -- or a substantial part of -- the assets of another company with a sum sufficient to offset the liabilities assumed from the latter company. The selling company distributes among its stockholders the cash from the sale transaction and any remaining assets after instituting liquidation proceedings.

When the purchasing company has acquired all of the assets and assumed all the liabilities of the selling company, the purchase price is, sometimes, based on so many dollars per share of the sellers capital stock. However, in both types of sales transactions the corporate existence of the selling company is terminated.

Section 480 of the New York insurance law defines the term merger as "the union of two or more companies in a single company which is deemed a continuation of the corporate existence of one of such companies."\(^{11}\) It also defines the term consolidation as "the joining of two or more companies by merger or otherwise, so that a single consolidated company results there from."\(^{12}\) Hence, this differs from the already stated terms.

**Selected definition of merger.**--For the purposes of this study, the term merger is used to include all of the various specific methods of combining two or more insurance companies, that is to include merger, consolidation, absorption, and purchase of assets. Thus, a merger is defined in this study as any form of combination whereby two or more


\(^{12}\)Ibid.
operating insurance companies are brought together under a single charter and a single management.

Although there are technical and legal differences among the various methods of combination, the ultimate economic result is the same: the combined insurance companies are joined together under the stipulations of one charter and of one management. This selected definition of a merger will enable a more extensive use of statistical data compiled by insurance literatures such as Best's Insurance Reports and the Spectator.

The broad definition, however, is also justified by the economic consideration that the various types of combination do effectuate a centralized control over two or more insurance companies.

Methodology

In order to obtain the objectives set forth for this study, the following reference sources and research methods were used:

1. Literature in the field of corporate mergers. This included both current and older classic text books, professional journals, and government publications.

2. State laws and Court case citations.

3. Income statements and balance sheets of the companies involved in the merger process.

4. Personal interviews with fourteen property and liability
insurers who were involved in one or more merger transactions. These insurers were selected mainly in New York state (eleven of the fourteen interviewed insurers) because it was the scene of approximately thirty-six percent of all merger transactions taking place in the nation during the time covered by this study as shown in Chapter II. Furthermore, the interviewed insurers acquired thirty-six property and liability companies in the decade of the 1950's by themselves or with other members of the same group.

The purpose of these interviews was to elicit information concerning problems which arose as a result of merger transactions (post-merger problems) and the manner in which these problems were handled. It was planned that such a procedure would shed some light on such areas as underwriting, marketing, personnel, loss adjustment, and accounting and finance which are now only spottily covered by the current literature.

5. Research design: In discussing the effects of insurance company mergers, it was necessary to determine the possibility of attributing the outcomes to the merger transaction itself. Merger is only one of several factors which may affect insurance company statistics. Other factors -- stock-market, catastrophies, floods, fires, earthquakes, 

13Part of these insurers are heads of groups representing more than one company under the same management. These groups were as follows: American Insurance, Continental Insurance, Commercial Union-North British, Crum and Forster, Great American, Hanover, Phoenix of Hartford, Royal-Globe and Travelers Group. The other insurance companies included in the personal interviews were as follows: American Equitable Assurance Company of New York, North American Reinsurance Corporation, Phoenix Assurance Company of New York, Provident Insurance Company of New York, and Republic-Franklin Insurance Company.
changes in management, et al. -- may affect the acquiring company to the extent of accelerating or compensating for merger effects. Hence, the problem was one of isolating these latter variables, so that any residual differences could be attributed to the merger transaction itself.

As the study was projected as a case study of the effects of mergers, professional statistical advice was solicited about this problem, with the result that it was believed impossible to identify the effect of these other variables and to eliminate them from the total effect. Even a high rank-order correlation among these variables in merger cases would only give an indication of the result subject to certain degrees of error.

By taking comparable periods, it was assumed that these other factors have the same effect on all stock companies and any difference was attributable to the merger transaction. The most appropriate procedure which was followed is known as before-after with control group research design. This type of design has been explained as follows:

the difference between the "after" and "before" measurement of the control group . . . is the result of uncontrolled variables. The difference between the "after" and "before" measurements in the experimental group . . . is the result of the experimental variable plus the same uncontrolled events affecting the control group. The effect of the experimental variable alone can be determined by subtracting the difference in the two measurements of the experimental group.  

Such research design is "frequently considered the ideal model that must always be attempted, if not achieved."  

---

15 Ibid., p. 85.
Because some companies acquired more than one company during the period of study, the dollar value changed during this period, and the time required for the effects of merger to appear, it was found that, rather than using a deflator, it would be better to take the three years before and three years after the period of study. In this case, in order to investigate the period 1950-1959, the time span from 1947 to 1949 was compared with that from 1960 to 1962.

All merging companies "acquiring only" which existed in both the periods "before" and "after" were included in the case study. These companies were classified according to the relationships, which existed before the consummation of the merger, with the acquired company into two groups -- "experimental groups" (see Appendix B):

a) Merger with independent company -- merger with a company where no relationship existed before the merger took place -- thirty-two acquiring companies.

b) Merger within group -- merger with a company where both the acquiring and the acquired company were members of the same group -- thirty-one acquiring companies.

For purposes of comparability, both groups were grouped into three categories on the basis of size, "net premium written": less than $5 millions -- "small"; $5 to $50 millions -- "medium"; and $50 millions and over -- "large."

After ranking all non-merging stock companies listed in Best's Insurance Reports, Fire and Casualty, 1963, according to these criteria of size, a random sample was taken from each group: a sample equal in number to the acquiring companies in that group, e.g., twelve large
companies acquiring independent companies were matched by twelve large non-merging companies chosen at random — "control group."

Eight ratios were calculated for each of the experimental and control groups in the periods 1947-1949 "before" and 1960-1962 "after" on the basis of the average results of each of the three-year periods. The differences between "before" and "after" for each of the experimental groups were compared with differences between "before" and "after" for the control group.

The hypothesis in this study was that merger resulted in better results for the acquiring companies as measured by these ratios. This hypothesis was tested by setting the null hypothesis at the 10 per cent level of significance. The analysis of variance was used to test the change in "before" and "after" in the experimental groups with the change in "before" and "after" in the control group.

Table of F ratio was used to see whether the difference was significant or not. If the difference was significant it indicated that the merger had an effect for the measurement used. To see the direction of the effect, whether favorable or unfavorable, both the arithmetic means of the experimental and control group should be compared.

---

16 The ratios are: loss ratio, expense ratio, loss and expense ratio combined, underwriting profit to earned premiums ratio, policyholders' surplus to total "true" liabilities ratio, ratio of common stock to total assets, investment efficiency ratio, and profitability to owners ratio before and after federal taxes.

Organizational Plan of the Study

In the analysis of mergers of property and liability insurance companies a definite organizational pattern is followed. The present chapter explains the purpose and limitations of the study, basic issues, definition of concepts, and methodology used in the study. The subsequent chapter contains the history and motivations for mergers. Chapter III presents the federal and state regulations which pertain to the merger of insurance companies. Types and methods of insurance company mergers are covered in Chapter IV. The methods of valuation of the acquired company and other ways of retirement other than merger are also covered in this chapter.

The post-merger problems and the manner in which these problems were handled are presented in Chapter V. Chapter VI appraises the impact of the merger movement upon concentration of economic power, competitive environment, growth of assets, and operational results of property and liability insurance companies. The final chapter, Chapter VII, summarizes the principal findings and conclusions of this study.
CHAPTER II

HISTORY AND MOTIVATIONS OF MERGER TRENDS

Background of Merger Trends

Mergers of insurance companies have been an important trend in recent years. Because of the high interest in current mergers by governmental agencies, both state and federal, it is worth while to examine present merger activity in the light of historical trends. This provides a basis for judging the extent and character of the current merger movement. It also helps to see its significance to the insurance business and how the present position involving its acceleration was reached.

Mergers of insurance companies could be traced back to the middle of the nineteenth century. In 1954, Great Barrington Mutual Fire Insurance Company merged with Honsatonic Insurance Company. Two merger cases were also reported in 1878, when Gebhard of New York merged with Star of New York, and Resolute--N.Y. merged with New York Insurance Co. In 1881, Home, Shenandoah merged with Cedar Rapids and Hope in Sterling.

The merger cases reported starting from 1890 to 1907 ranged from one to four cases per year, with the exception of 1899, when eight merger cases were recorded. Not a single case of merger was reported

in the years 1891 and 1895. Starting in 1908 the merger cases fluctuated through the years, to reach a high of ten cases in 1911, eighteen in 1921, twenty in 1930, thirty-three in 1931, twenty-eight in 1932, and twenty in 1948, as indicated in Table 1.

**TABLE 1**

NUMBER OF MERGER TRANSACTIONS CONSUMMATED WITHIN PROPERTY AND CASUALTY INSURANCE COMPANIES

1899-1949

<table>
<thead>
<tr>
<th>Year</th>
<th>Fire</th>
<th>Casualty</th>
<th>Total</th>
<th>Year</th>
<th>Fire</th>
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<td>8</td>
<td>1925</td>
<td>4</td>
<td>7</td>
<td>11</td>
</tr>
<tr>
<td>1900</td>
<td>3</td>
<td>--</td>
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</tbody>
</table>


2Ibid., pp. 1222-1243.
The long-run trend in merger activity of property and casualty companies in the years 1910 to 1949, is indicated in Chart 1. This chart shows that four distinct waves of mergers have occurred over the 40-year period, 1910-1949.

The first real wave of mergers took place before the end of the nineteenth century. The second period of merger activity followed World War I, between the years 1918-1922. The third intensive period of merger activity took place in the period 1929-1933. From 1925 there was increasing activity of mergers of insurance companies until the peak year was reached in 1931, when thirty-three mergers were listed.

Finally, the present merger movement which began following World War II, continued through the 1950's and up to the present time had scored a new peak in 1957 when thirty-nine mergers took place, as indicated in Table 2.

Unique Forces Behind Early Merger Movements

The roots of the present situation could be traced back to the time before the first merger movement began. Up to the late 1800's, most early American insurance companies were confined voluntarily to one line or very closely related lines of insurance. This was largely due to public opinion and company desire for specialization. As a result of the early abuses of insurance companies, which affected not only the

---


TABLE 2
MERGER TRANSACTIONS CONSUMMATED WITHIN PROPERTY AND LIABILITY INSURANCE COMPANIES, IN THE UNITED STATES, 1950-1959

<table>
<thead>
<tr>
<th>Year</th>
<th>Stock</th>
<th>Mutual</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>16</td>
<td>3</td>
<td>19</td>
</tr>
<tr>
<td>1951</td>
<td>5</td>
<td>9</td>
<td>14</td>
</tr>
<tr>
<td>1952</td>
<td>12</td>
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<td>1953</td>
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<tr>
<td>1956</td>
<td>17</td>
<td>9</td>
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<tr>
<td>1957</td>
<td>16</td>
<td>23</td>
<td>39</td>
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<tr>
<td>1958</td>
<td>25</td>
<td>11</td>
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<td>1959</td>
<td>9</td>
<td>9</td>
<td>18</td>
</tr>
<tr>
<td>Total</td>
<td>135</td>
<td>90</td>
<td>225</td>
</tr>
</tbody>
</table>

Source: Best's Insurance Reports, Fire and Casualty, 1960, pp. 716B-726B.

Consuming public but also the insurers alike, the need for regulation of this important segment of the U. S. economy became apparent.

In 1849, New York state enacted the first general insurance law which separated the insurer's powers among four classes of insurance, namely, marine, fire, inland marine and life insurance.  

The first real supervision of insurance transactions came later  

Ibid.
with the organization of the first state insurance department by Massachusetts in 1855, followed by New York in 1859. 6

In 1871, three years after the Paul v. Virginia decision, New York's Superintendent of Insurance strongly advised that life insurance companies should not be allowed to do any accident or casualty business. 7 This pattern of regulation was followed by insurance departments of many other states, since New York was the leading insurance state and one of the first to have effective legislation.

The separation of insuring powers by classes continued on the basis of classifying all insurance by most states into three major classes or lines. These were fire, marine and life. By the end of the nineteenth century, casualty insurance was started and it became a fourth major class of insurance in this century.

This separation of insuring powers was considered to be a protection to the insuring public by preventing a company which wrote a certain class of insurance from risking its assets in unfamiliar kinds of insurance. As a result, insurance agents were forced in those days to represent many different companies in order to offer a well-rounded program of coverage for their clients. This included contracts covering fire, casualty, surety and other lines of insurance.

In 1910, a prominent surety company began writing casualty policies. 8 This provoked some fire insurance companies into organizing

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7 Ibid.
casualty companies as subsidiaries under common management. As this trend continued, separately chartered companies began to offer a wide variety of insurance coverage from the fire and casualty lines, all of which were under some centralized company control.

An insurance company group or "fleet" consists of two or more companies under joint ownership or management. In many instances, company groups include different types of companies, such as casualty companies and fire companies. Other groups include a number of companies conducting identical forms of insurance.

The formation of insurance company groups or "fleets" goes back to the end of the nineteenth century. In June, 1898, National Fire of Hartford purchased the control of Mechanics and Traders of New Orleans, and early in 1899 Hartford Fire purchased Citizens of Missouri. The group or "fleet" of operation plan was adopted for the purpose of securing more agency representation in a particular territory than was permitted under rules in existence at this time. These rules limited the number of agents to represent a single company, but not the number of companies which would be formed to increase the number of agents.

The Home Insurance Company set a record in 1948 by the acquisition of ten companies. These companies were merely members of the Home "fleet" and created largely to circumvent the "rules" of restrictive agency representation. This merger transaction and similar activities could be considered a reversal of the group or "fleet" operation trend.

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9Best's Insurance Reports, op. cit., p. vii.

10Best's Insurance Reports, Fire and Casualty (1952), pp. 660B-662B.
The beginning of the early merger movement might be placed at the point where the insurance companies started combining a number of independent companies. Where this was not the case, many companies belonged to the affiliated groups or "fleets." These groups are in effect mergers since they provide certain joint management and joint facilities among their agencies, supervision of their funds and similar management items.

Strict enforcement of the mono-line principle was also a reason for the development of the group plan of operation as a method of merger. Table 3 shows the number of groups and their member companies during the period 1900-1962. It can be inferred that the group plan of operation which started about 1900 reached a peak in 1929 when some 90 separate groups included 287 fire companies and 68 casualty companies for a total of 355 individual companies as members.

In the 1930's, during the depression years, the number of groups was reduced to 74 in 1935, with 232 fire companies and 51 casualty companies -- a total of 283 individual fire and casualty companies as members. This reduction came about as a result of retirement, mergers and acquisitions. The total number of company members in group operations continued very close to the 1935 figure of 283 companies, up to 1945 when it reached the 1929 record of 355 company members.

Mergers and acquisitions reduced the number to 318 in 1950, but in succeeding years there was a net increase to new highs, with 435 fire and casualty companies in 149 groups in 1962. In addition to that, 109 life companies are members of these groups which are not included, as
TABLE 3
NUMBER OF STOCK FIRE AND CASUALTY COMPANIES AND STOCK COMPANY GROUPS, IN THE UNITED STATES, 1929-1962

<table>
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<th>Year</th>
<th>Company Groups</th>
<th>Fire</th>
<th>Casualty</th>
<th>Total</th>
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<td>1950</td>
<td>104</td>
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<td>1960</td>
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<td>397</td>
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<td>62</td>
<td>149</td>
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compared to 35 life companies in 1957. Because of this method of merger, larger and more financially powerful organizations controlled smaller and younger companies. These young companies enjoyed, through this arrangement, the benefit of economical operation, and management

of the executives of the larger companies with their greater experience, talent and ability. In spite of this, many fire companies still prefer to confine their business strictly as fire companies, without casualty subsidiaries, while other companies continued as casualty companies without fire insurance subsidiaries.

From this may be concluded that the major force behind the first merger wave was competition between insurance companies. It was also stated in the history of a dominant insurance company that, "a particularly significant era . . . began in 1890, the era of absorbing competitors. The preceding years of storms, floods and fires had been a discouraging period for insurance companies. Absorption of other insurance companies meant further expansion and an enlarged horizon . . . ."\(^{12}\)

**Economic conditions and mergers.**--Another major force behind the recurrent merger waves is the economic conditions of the U. S. as a whole. Chart 1 (page 16) indicates that there might be a relationship between business cycles and the merger activities among insurance companies. However, it is hard to correlate the number of mergers with other indices of business behavior or economic changes partly because of the variety of economic and institutional factors influencing mergers, and partly because the indices of merger activity do not necessarily reflect changes in the inducement to expand through acquisition.\(^{13}\)

\(^{12}\) *Fireman's Fund Record -- Seventy-Five Eventful Years -- 1863-1938* (May, 1938), LX, p. 37.

Although "merger" is one possible use of funds (beside internal expansion), from the point of view of the individual company, it does not absorb real savings from the point of view of the economy as a whole. The fact that an increase of real investment is a characteristic of prosperity for the economy, while depression is a deficiency of real investment, merger or acquisition could be the dominant form of expansion in the latter.\textsuperscript{14}

The impact of the Depression on larger companies was lighter since they have competitive advantages over smaller companies, greater financial strength, and often plan farther ahead because they can afford it. In contrast to smaller companies, depression is sometimes looked upon by medium- or large-sized companies as a good time for expansion since the costs are low.

"Depressed economic conditions unquestionably favor large firms as a group in comparison with small firms, and often permit individual, large firms to consolidate their position and further improve their competitive strength."\textsuperscript{15} High security prices in relation to asset values of the 1920's encouraged merger activity because they made outside capital relatively cheap.\textsuperscript{16} The 1920's (particularly 1921) were hard years in the insurance business due to a combination of factors. These were "a decreasing income, stationary or increasing expenses, and a very largely increased burning ratio. On top of this . . . the

\textsuperscript{14}\textit{Ibid.}, p. 241.

\textsuperscript{15}\textit{Ibid.}, p. 244.

so-called 'side lines,' notable marine insurance, have had a bad year."\(^{17}\) The economic recession of 1921 was a sharp one. Index figures of wholesale prices fell from 231 in 1920 to 125 in 1921.\(^ {18}\)

On the other hand, measured by generally accepted economic indices, the great Depression which burst upon the world in 1929 continued for six uninterrupted years. Richard M. Bissel, president of the Hartford of Hartford Insurance Company, wrote in January 1930, "When all industries and business are seriously depressed and many become inoperative, unproductive or unprofitable, it is inevitable that the business of insurance should share in the misfortunes."\(^ {19}\) Stock fire and casualty insurance companies were greatly affected in these years, particularly in 1930 when they suffered investment losses of $147,831,000, and underwriting losses of $22,601,000.\(^ {20}\) In 1931 they lost $11,200,000 in underwriting and gained $59,969,000 from investment, but in 1932 they lost $8,629,000 in investment and $3,455,000 in underwriting.\(^ {21}\)

The major economic factor contributing to insurance company mergers in these years was the prevention of insurance company failures. Liquidation, receivership, or reinsurance were the alternatives to

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\(^{19}\) *Op. cit.*, p. 228


\(^{21}\) *Ibid.*
merger. These merger cases may be identified as protective types of merger in contrast to the motives underlying the fourth wave of merger.

Development of the insurance business.—As the insurance business in the U. S. prospered and gave evidence of financial stability, the fourth wave of merger took place around 1950. At this time the multiple-line laws were enacted by most of the states. These laws extend the underwriting powers of the insurance companies and enable them to write fire and casualty and surety lines across the board without the need for the establishment of subsidiary companies for the given lines of insurance. In contrast to the mono-line laws, multiple line laws enabled fire companies to write casualty, and casualty companies to write fire. The same powers were granted to insurance company subsidiaries and "fleets."

Due to the anticipated advantage of multiple line underwriting such as "bringing increased stability to a company's status through the wider spread of risk among the various lines of protection," obtaining actuarial strength through the diversification among lines of insurance and other advantages, insurance companies were encouraged to do business in multiple lines.

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22 In 1946, 21 states had by then granted "full" multiple-line powers. In 1949, 6 states including New York State adopted a "full" multiple-line bill. Only 4 states by early 1950 did not allow multiple-line company formation. Ohio was the last state of these to pass a multiple-line bill, on Sept. 5, 1955. See David L. Bickelhaupt, op. cit. for a complete coverage of the multiple-line development.

23 David L. Bickelhaupt, op. cit., p. 61.

24 Ibid., p. 67.

To change to multiple line operations, three methods of transition were followed by these insurers. First, some mono-line insurers amended their charters and licenses to permit them to write additional underwriting powers by entering new lines of insurance. For example, the United States Fidelity and Guaranty Company (which is a casualty company) amended its charter to write fire and allied lines in 1949. The Hanover Fire Insurance Company also amended its charter in 1950 to permit the company to write casualty insurance.

The second method of changing to multiple line operations is through company affiliates, a continuous practice of the company groups or "fleets" which was already in existence. Some companies have extended their multiple line operations by purchase of a company in the opposite field. Other insurers set up a new company with either fire, casualty, or full multiple line underwriting powers.

Although the major reason for group operations no longer exists, that is multiple line operation, Table 3, p. 11, indicates an increase in both the number of groups and the number of members.

Finally, the third method of conversion of a company to multiple line operations was through merger or consolidation of two or more companies. This method of changing to broader underwriting powers was sought by existing companies as superior to the two other methods. "Mergers and consolidations have been a major source of multiple line insurance companies since 1949." According to Tables 1 and 2 the

26 Ibid., p. 87.
27 Ibid.
28 Ibid., p. 88.
number of insurance company mergers increased from 38 in 1940-45 to 106 in 1950-55 -- an increase of 68 merger transactions.

"Although a number of these mergers involve company combinations for objectives other than multiple-line operations, the increase is large enough to indicate the significance of the merger movement during the full multiple-line era from 1949 to date."\(^{29}\)

**The Recent Merger Wave**

There is considerable debate about the number of merger waves which took place in the insurance industry up to the present time.

One writer stated that there have been three major waves, those of the late 1800's, the late 1920's and just before World War II. This latter one has continued into the postwar period.\(^{30}\) Another stated that "Although the roots of the present situation go back about 50 years . . . perhaps we could place the beginning of a merger trend at this point" where the so-called multiple-line laws were passed by states\(^{31}\) throughout the country. Finally, a third writer stated that there have been only two broad waves of mergers, one during 1926-1929, which was motivated by profits, and the second which is the current one, started after the close of World War II. The latter could be called the era of management mergers.\(^{32}\)

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\(^{29}\)Ibid., p. 89.


Although there is a clear difference in the number of merger waves, it is a fact that all three of these writers do agree that there was a merger wave during the decade of the 1950's, and it is not yet over.

During the period 1950-1959, 225 merger transactions took place among fire and casualty insurance companies of which there were 135 cases among stock companies and 90 among mutual companies. The number of merger cases was inconsistent over the years. It fluctuated within a range between a low of 12 merger cases in 1954 to 39 cases -- the peak -- in 1957.

Stock company merger transactions reached their peak, however, in 1958, with 25 merger cases. The largest number of merger transactions took place in New York State with 38 stock and 21 mutual, a total of 59 merger cases -- about 26 per cent of total company mergers, as indicated in Table 4. Pennsylvania ranked second with 13 stock and 12 mutual company mergers -- a total of 25 merger cases.

However, the number of merger cases taking place is only a factor in analyzing the merger trend which has to be considered along with other factors such as the size and numbers of companies involved. The merger of two small companies, for example county mutuals, is not of equal importance with the merger of two giant or even medium sized companies despite the fact that each is counted a merger transaction.

Table 5 shows the number of merger transactions consummated by the acquiring stock companies in the 1950's. It indicates that two companies acquired five companies each during this period.

Six companies each consummated three acquisitions, nineteen
### Table 4: Number of Merger Transactions Consummated Within Property and Liability Insurance Companies in the United States, 1950-1959

<table>
<thead>
<tr>
<th>State</th>
<th>Stock</th>
<th>Mutual</th>
<th>Total</th>
<th>State</th>
<th>Stock</th>
<th>Mutual</th>
<th>Total</th>
</tr>
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<td>--</td>
<td>4</td>
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</tr>
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<td>Oklahoma</td>
<td>--</td>
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Total: 135 (Stock) 90 (Mutual) 225 (Total)

Source: Best's Insurance Reports, Fire and Casualty (1960), pp. 716-26B.
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<td><strong>Total</strong></td>
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Source: Best's Insurance Reports, Fire and Casualty (1960), pp. 716-21B.

Companies acquired two companies each, and sixty-nine companies completed only one acquisition during the period of study. In computing the number of acquisitions, companies which had already been acquired by another company were not included, if acquired later by another company. For example, Columbia Insurance Company of New York acquired Imperial Assurance Company in 1952 and Phoenix Indemnity Company acquired Phoenix Assurance Company, Ltd. in 1955.

Both of these companies were acquired by Phoenix Assurance Company of New York, the first in 1956, the latter in 1955. The acquiring company also acquired United Firemen's Insurance Company in 1956.
Although the surviving company has technically acquired five companies, it has really only consummated three merger transactions. Columbia Insurance Company and Phoenix Indemnity Company, although they no longer exist, it is considered a consummated merger transaction by each company.

The total number of the acquiring companies on this basis was 96; during the 1950's they acquired 135 stock insurance companies.

Not all of the acquiring companies are stock companies, but five companies were mutual acquiring stock companies. On the other hand, five stock companies acquired mutual companies. This will raise the question of the feasibility of acquiring a stock company by a mutual, or vice versa. This is covered in Chapter III.

Furthermore, five of the acquiring companies were life insurance companies, which will also raise the question of the legality of the formation of all-lines companies. This also will be covered in Chapter IV.

Finally, not all of the acquiring companies existed until the end of the 1950 decade, seven companies having retired through merger; five through receivership; two withdrew; and one reinsured its insurance portfolio.

The motivations underlying the number of mergers and acquisitions completed in the past decade vary over a wide range. An examination of mergers which have been consummated in recent years within the insurance industry would show every conceivable purpose behind them. It is likely that no two of these mergers were formed with the same objectives. Furthermore, every acquiring company hoped to accomplish
something to enable it to increase its volume of business, boost its underwriting profits, reduce its expenses of doing business, or merely maintain a competitive position with other companies.

One writer has summarized the reasons for mergers as follows:

1. To secure additional production facilities
2. To secure additional distribution facilities
3. To secure diversification through new products and additional lines
4. To secure additional capital or profit potential.

He stated further that "the first merger objective does not apply to the insurance industry" and "the other three reasons, however, are pertinent."

Dynamic Demands Upon Insurance Companies

Due to the fact that insurance companies are highly service-oriented, new insurance protection is constantly being demanded by individuals. Insurance companies do not operate in a vacuum, but in competition with one another for the insuring public.

Only those companies which are responsive to their insureds' demands will maintain and solidify their position in the insurance business. For many small companies the only recourse for meeting the pressure of keen competition has been through the device of the merger.

Many economists hold that the major motive for merger is to achieve a near-monopoly in some field, so that prices to consumers

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could be raised ever higher, with wages depressed to lower levels. With regard to the early groupings of the nineteenth century there might be an element of truth in this, although it was never proved in regard to the insurance business.

Monopoly, however, has never been an objective of present-day mergers, but there are other sound reasons to bring about mergers among insurance companies. One or more reasons may contribute to any one merger transaction. Each insurance company presents its own specific, contributory elements.

This study examines the principal motivations operative in the overall merger movement. These could be summarized under management, investment, marketing, financial, and tax considerations.

No attempt is made to investigate every cause or motivation for mergers among insurance companies, or to present the relative importance of each cause discussed as a motive for recent merger transactions.

Management Considerations

There is an increasing pressure upon insurance companies to find adequately trained personnel to keep pace with our rapidly-growing economy. Merger often proved attractive to both companies involved in such a combination.

It yields advantages for the absorbing company through the immediate acquisition of personnel, departments or experience already set up. On the other hand, many absorbed companies (mostly small or medium size) often have problems of superannuation and inadequately-trained replacement of personnel. Management in large companies is
better able to carry out an adequate, attractive personnel policy.

An expert in the insurance business stated that in the many years he has been in insurance it has never met its need for trained personnel. He explained his reasons as follows:

"In the early 1930's the watchword was 'cut back,' and after that the trend was to unrealistic salary scales . . . . 'There is a lost generation' made up of the very men who should now be at the senior level or ready to move into it."

In explaining why mergers of insurance companies are taking place he said, "Many mergers are motivated by the desire to acquire staff needed for expansion, particularly into new territories. It is a slow, laborious process to steal men and impossible to train them fast enough to take advantage of a current market opportunity. Finding a company in the area with staff is the easy, and often the only practical solution."

One of the principal managerial motives for mergers was the integrating of the many functions and operations of an insurance company. In the merger transaction involving American Insurance and American Automobile Insurance companies it was announced that "the integration of the two field organizations which is contemplated, will bring to producers and policy-holders strong country-wide facilities in all aspects of multiple-line insurance operations."

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35 Ibid.

"By becoming a single multiple-line company, a former company group with affiliates in the various lines can achieve substantial corporate simplification and an opportunity to improve operations economically."\(^{37}\)

The most common underlying reason in the majority of merger cases is probably that of gaining time. This is true, based on the assumption that the management of a particular insurance company has the ability to reach its goals through internal expansion. Some managements would never achieve their objectives without bringing in personnel, facilities for operation or cultivated markets.

These are the ones that would be buying time. For example, in an insurance company with growth as one of its objectives, merger or acquisition will help in accomplishment of this aim.

The Republic Indemnity Company of Columbus, Ohio, increased its assets from $2,433,000 to $4,388,000, and its policyholder surplus from $530,000 to $1,610,000 by acquiring Franklin Fire and Casualty Company, January 21, 1960.\(^{38}\) Added to this growth, which is about 100 percent in assets and 200 percent in policyholders' surplus, Republic acquired the services of approximately 160 new agents. This alone resulted in an increase in the direct premiums written from $1.555 million in 1959 to $2.473 million in 1960 for the surviving corporation, or about 60 percent of growth.

Therefore, merger often enables a company to achieve its


objectives of growth much more rapidly than do other methods. Sometimes, however, merger demands a long period of assimilation and incurs greater problems than would a different method of achieving the same objective.

Acquiring other firms raises the rate of expansion enormously because it reduces substantially the managerial services required per unit of expansion. It is noted that the majority of the acquired companies during the period 1950-1959 are medium or small-sized companies. Some of the medium or small-sized acquiring companies may be able to double their size every year or so for several years through merger or acquisition -- a prospect that is not open to the giant companies. This is, in part, because of the increasing scarcity of large companies which can be acquired and the administrative problems of efficiently absorbing a sufficient number of suitable small firms at a rapid rate. This does not mean, however, that merger is unimportant to the very large firms as a means of securing additional distribution facilities, diversification through writing new lines, or securing additional capital or profit potential.

Acquisition may be essential if the company is to avoid a sharp decline in its rate of growth rather than a gradual one. Thus it may be concluded that the prospects of expansion through merger and acquisition are less significant for very large companies, but may help small and medium-sized companies to attain their goals with regard to the rate of growth.
In the final analysis, the future success of a potential merger and acquisition depends, to a great degree, upon the ability of the management which will take over after the acquisition.

Marketing Considerations

The insurance market in the United States is composed of all strata of society and of firms. Low price of protection may attract a part of this market, but some people are looking for services such as prompt claim adjustment and convenience. It is not easy to put together an insurance company that can satisfy all classes.

Insurance is an intangible service, a product which needs to be sold the same as a tangible product. The type of channel of distribution used by any insurance company is determined by whatever method is most efficient and least costly. Generally speaking, the distribution channel in the field of life insurance is usually direct, while property and liability insurance normally utilizes an indirect one, with one or more independent middlemen involved. The latter has been termed the "independent" system. 39

The general and the local agent in the property insurance business are independent middlemen. They own the business they write and usually represent more than one company. Some companies write their insurance business through the general agent who deals as a wholesaler, since he acquires this business through local agents who act as

39 For an intensive coverage of the marketing of property and liability insurance see John S. Bickley, Trends and Problems in the Distribution of Property-Liability Insurance (Columbus: Bureau of Business Research, The Ohio State University).
retailers. Some insurers will not use a general agent, but will work directly through local agents or build up a branch office to deal with local agents.

In this case, the branch office takes the functions of the general agent with only one difference, namely, only one company is represented in a branch office instead of several. Finally, a few insurers solicit their business, or at least part of it, directly by mail without employing any kind of agent. Such insurers, who should be considered as direct writers, have their greatest volume in the field of automobile insurance.

In recent years an unprecedented demand for personal lines of coverage have been produced by the rise in property values; increasing injury awards; increasing automobile registrations; and the compulsory and quasi-compulsory coverages. This, added to the fact that the agency system has been unable to exploit the whole market, has led certain insurers to recognize the need for improving their selling techniques.

As a result, some insurers are changing their internal structure in order to meet the increasing demand for protection. Many companies, however, were forced to limit their writings in order to prevent deterioration of the policyholders' surplus according to the established rule which requires a certain amount to be added to surplus for each increase in premium writings.

To maintain the capacity to handle new business, many insurers

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expanded their business through the method of reinsurance agreements. Insurers, searching to increase their capacity to serve the market, have combined in groups. New companies are licensed to aid in the expansion of the sales forces. In addition to these and other devices, mergers have been used as means of increasing sales organizations, of acquiring a ready-made volume of business, and of increasing the importance of certain lines of business in the acquiring company's portfolio.

As a consequence, the over-all merger movement in recent years is due to the attempts of many insurance companies to enhance and augment their market position. Like banks, industrial and commercial firms, insurance companies must keep pace with the economic growth of the country by maintaining a relatively strong and viable market position.

Such a position is dependent, at least in part, upon the flexible response of the insurance company to the growing demands for protection.

Financial Considerations

There are also financial reasons behind the mergers which took place between non-life insurance companies. If an insurance company wished to develop its business along new lines or establish its business in a territory where it had no representatives, it had to build up personnel with the facilities needed for its operation.

To do this, it had to raise an amount of money which varies with the degree of intended expansion. It is often found that smaller
companies are less able to command financial resources needed for such expansion or modernization. 41 This is a factor that causes the selling company to take the initiative in certain cases to sell or merge with another company.

Mr. J. Victor Herd, President and Chairman of two merged companies (Fidelity Phoenix Fire, and Continental) 42 explained the underlying reasons for this merger transaction as follows:

... today's expanding economy and rapidly growing insurable values but emphasize the need for insurance risk capital to meet greater responsibilities both here and abroad. Indeed the tremendous concentration of insurable values represented by modern bridges, tunnels, ocean vessels, jet airlines, shopping and cultural centers, industrial plants and equipment, mercantile, habitational and recreational enterprises, and experimental installations, such as nuclear power plants, are striking evidence of the increasingly important role that insurance risk capital now is being called upon to perform.

Another financial reason behind insurance company mergers, besides the inability to raise money, is the financial difficulties or instability of the acquired company. Insurance companies are subject to a mandatory examination by the Insurance Department mainly to assure the solvency of the companies. Superintendent Pink commented on the subject of company examinations as follows:

If we had to eliminate all phases of insurance supervision except one, the examination of companies would be retained. It is the most important thing we do. The solvency of companies, their honest and intelligent management, and ability and inclination to meet their obligations as they occur is of primary importance to the public.

Since fire insurance companies are examined at least once every five years and casualty companies once every three years, insurers tend to remedy the situation immediately if they get into financial trouble. The merger will be one alternative other than liquidation, receivership, or reinsurance. Merger in this case may be looked upon as a protective type of merger.

An insurance company which is facing financial difficulties may have to choose between three alternatives to protect the investment of its stockholders. These alternatives are (1) continuation of its operations under new management, (2) liquidation of the company after reinsuring all of its insurance portfolio, or (3) merger with, or sale to, another company.

The first alternative is unfeasible since it will be hard to get any new management to reorganize or rebuild an insurance company which is suffering from financial difficulties. This is because of the keen competition prevailing within the insurance business. Liquidation of the company is always mandatory if the company is insolvent, since the Insurance Department will interfere and may put it under receivership or give an order for liquidation.

For a solvent company which is facing financial difficulties due to insufficient liquid funds, liquidation is not considered the best course of action, for a solution. Stockholders will not get much out of their equity in the company, plus the fact that it will require a long period of time to liquidate an insurance company (due to the complexities of the business and the numerous interests involved).

Finally, merger or sale of the company is the only alternative
that will preserve the stockholders' investment in the company. If the company is sold for cash, its price is always reached after valuation of the company's assets and liabilities. This price may be in line with the stockholders' equity in the business as will be discussed fully in Chapter IV.

In the case of merger, stockholders will exchange their shares with the acquiring company's shares, with an amount equal to their equity in the business, as fixed by the valuation committee. In either the merger or sale transactions, stockholders of the acquired company do not lose, since their equity is determined by a valuation process which is based on the assumption that the acquired business will not be terminated.

All of this will explain why a company facing financial difficulties always initiates the merger or the sale transaction.

Inflation and steadily rising costs are partially responsible for the merger trend between property-liability insurance companies. They are the major causes of the underwriting deficits, particularly in the casualty fields. The dearth of underwriting profits caused stockholders of small and medium-sized insurance companies to be restive.

Shares of their companies are selling in the open market at discounts of 40 to 60 percent below the net assets or liquidity value without assigning any value for agency plant or goodwill built up over the years. The existence of some interests seeking to capitalize on the mentioned unsatisfactory situation will work to accelerate the problem.

The temptation of higher prices may prove to be too great for even the old stockholders who may really prefer to remain loyal. As a result, the companies would have to choose whether to merge or liquidate and probably they would choose the former.

Merger of two companies results in the simplification of the corporate structure because there will be only one company under one charter instead of two or more different companies. This simplification is expected to result in several advantages for the surviving company. In the merger plans for Commerce Insurance Company with the Glens Falls Indemnity it was stated that:

This simplification of the corporate structure is expected to develop important reductions in operating expenses and eliminate certain charges assessed by the states against each company doing business within their borders. It will also make it possible to simplify materially and make more understandable the financial structure and the financial reporting to government, stockholders, agents and employees. The merger raises the capital of the Glens Falls Insurance Company from $3.250 million to $6.5 million.45

Investment Considerations

Another factor that should be considered as a motive for insurance companies to acquire another company in the light of strengthening their market positions is the fact that certain economies can be derived from the acquisition of "ready made" insurance companies' agencies. Merger transactions will help to meet the problem of the high cost of establishing new agencies or offices.

The influence of rising costs.--The squeeze between rising costs and the more or less fixed rates has served to reinforce the trend to economize through large units. In the case of the merger of American Insurance Company with American Automobile Insurance Company it was stated that the "increased size will enable integrated organizations to take full advantage of costly high-speed electronic machinery and other labor and cost-saving devices."46

Wage and salary payments of insurance companies are now 2-1/2 times their 1945 level. Part of this reflects larger employment, while an advance of 2/3 in the salaries of company employees represents the other main cause. Because of these increases, insurance companies are seeking to secure a satisfactory return on every dollar spent to stand competition and remain in business.

One of the characteristics of insurance is a tendency for the operating expense ratio to fall as the size of the company increases. Several examples could be cited to show this tendency, such as Aetna Casualty and Surety with an expense ratio of 37.2 percent in 1956 for a volume of direct premium written of $246.374 millions was reduced to 33.9 percent in 1960, when the volume of business rose to $374.327 millions.47 Also, Insurance Company of North America reduced its expense ratio from 38.5 percent in 1956 to 36.6 percent in 1960 by increasing the volume of direct premium written from $263.412 to $349.686 millions in the same years.48

48Ibid., p. 119.
A study was made on 34 non-life insurance firms (with 135 affiliates) for the period 1950-1954 indicated that "the trend of expense ratios for the firms . . . is steadily downward as firm size increases."^49

Although some companies may deviate from this rule because of other factors such as bad management, etc., hundreds of examples which would coincide with it could be cited. This saving in expenses by larger companies is realized in a number of ways. It can be accomplished by spreading overhead cost on a larger volume of business; in other words, more widely. Also the ability to use mechanical and electronic equipment more effectively is another factor contributing to savings in expense. Large companies have an urgent need for such equipment to handle thousands of policies and policyholders' accounts, as well as the huge volume of transactions arising from the services they perform for their policyholders.

Diversification of operations.—Any examination of the reaction on the part of merging companies toward the enhancement of their market positions will uncover their desire to write or transact more balanced or complementary types of business. This could be achieved by diversification of operations with either geographically or by the line of business written, or both together.

Many insurance company mergers took place as an answer to the

growing need for diversification. As already noted, the enactment of the multiple-line laws have enforced the merger trend in 1948-50 and continued through the 1950's up to the present time.

In the American Insurance Company merger with the American Automobile it was stated, "It is felt that the interchange of the successful fire insurance underwriting techniques of American Insurance and the profitable casualty underwriting operations of American Automobile will provide these companies with a complete multiple-line operation which should be able to compete on an equal footing with the best companies in the industry." 50

It was also stated that "This merger will produce a multiple-line operation of desired balance and diversification, both as to classes of insurance risks and as to territorial distributions." 51

Another way in which certain insurance companies have diversified their operations was through merger with foreign companies. This is known as geographical diversification and will help to distribute the business written on a wider area so as to avoid catastrophic or heavy concentration of losses. An example of this type of diversification is the acquisition of Anchor Casualty Company (Minnesota) by Agricultural Insurance Company of New York in 1961. Another is Birmingham Fire and Casualty Company (Alabama) acquired by St. Paul Fire and Marine Insurance Company (Minnesota) at the end of 1961. 52

50 "Two Leading Carriers Propose to Merge," op. cit., p. 265.
51 Ibid.
52 Best's Insurance Reports (1962), p. 715B.
Tax Considerations

Another element must be added to the motivations for company mergers, and that is the very high income tax rates. A brief summarization of the Internal Revenue Code with regard to the tax aspects of the fire and casualty insurance company will help to clarify why federal income taxes are given consideration during the establishment of a merger transaction.

The taxation of non-life insurance companies varies with the type of organization. The Revenue Act of 1921, which is the present basis for taxation of stock property-liability insurance companies, provided that taxable income be "computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners." 54

Section 101(11) of the Code granted exemption to "farmers or other mutual, hail, cyclone, casualty, or fire insurance companies or associations (including inter insurers and reciprocal underwriters), the income of which is used or held for the purpose of paying losses and expenses." Therefore, this Act made no change in the basis for taxation of mutual organizations which claimed exemption as non-profit organizations under Section 101(11) before mentioned. Many mutual companies paid no Federal Income Tax prior to 1942 for this reason.

53 The analysis covers only changes in the Internal Revenue Code with regard to property-liability insurance companies during the decade of 1950. Further amendments -- such as the 1964 amendment -- in the IRC following this period are not included in the study.

54 Revenue Act of 1921, c. 136, Title II, sec. 246, 42 Stat. 262-263.
In 1942, the Treasury Department, in order to raise more revenue, proposed to Congress that mutual property-liability insurance companies be taxed in the same way as stock property-liability insurance companies.

The result of this proposal was the amendment of Section 101(11) of the Code, which placed a ceiling of $75,000 on tax exemption of mutual companies.

Another Act which affected some property-liability insurance companies was the Excess Profits Act of 1950. This levied an excess profits tax of 30 percent on "excess" profits earned by corporations after the beginning of the Korean War. 55

Some property-liability insurance companies also felt the effect of the Revenue Act of 1951. This Act provided for ceiling tax rates on excess profits of 17-1/4 percent of excess profits net income for the 1951 calendar year and 18 percent of excess profits net income for the years beginning after March 31, 1951. 56

The Act also provided for an alternative "Excess Profits Credit Based on Invested Capital," using either the "Historical" method or the "Asset" method. By the end of 1953 the Excess Profits Tax Act expired.

Section 831 of the 1954 Internal Revenue Code provided for the taxation of stock property-liability insurance companies, mutual marine insurance companies, and mutual fire insurance companies using perpetual policies. These companies pay the regular tax rates of 30 percent on

55 Excess Profits Tax Act of 1950, c. 1199, sec. 430, 64 Stat. 1137
56 Revenue Act of 1951, c. 521; Title I, sec. 121, 65 Stat. 466.
the first $25,000 plus 22 percent on all over $25,000 of underwriting and investment income, plus capital gains rates on realized capital gains.  

A special rule applying to both stock and mutual property-liability insurance companies with regard to capital gains and losses has been enacted by the federal government. This rule modifies the tax laws pertaining to capital gains and losses suffered by an insurance company which is forced to sell or dispose of part of its assets to meet the required contingencies of the business.  

Without this rule abnormal losses might require an insurance company to sell or dispose of assets at a loss. 

A complete revision of the insurance section of the Internal Revenue Code of 1954 took place in 1962. However, the principal provisions which were subject to change affected only mutuals and reciprocals and have nothing to do with the subject of this study.  

Tax savings are possible under various provisions of the Internal Revenue Act. These may be summarized as (1) the more favorable rates on capital gains as compared with rates applicable to ordinary income of corporations or individuals; (2) the provisions related to the method of merger and covering tax-free exchanges of stock; and (3) the provisions governing the carrying forward of past operating losses as tax credits against future earnings.

All of these stimulate mergers, as does the high level of estate taxes.

In a letter directed to the shareholders of the Republic Indemnity Company in relation to the proposal of merger of the Republic with Franklin Fire and Casualty Company, it was stated that Republic stockholders will benefit from the merger, in addition to other things:

"4-The surviving corporation will have a substantial tax-loss carry forward with the result that earnings of the next several years will directly increase the equity of the shareholders without deduction for Federal Income taxes."

Consequently, it is clear that it is feasible for a company with a tax-loss carry-over dating back several years, to merge with a profitable company so that its tax credits can be utilized.

These are some of the motivations and advantages claimed by the acquiring companies which underly the merger movement in the insurance industry.

Whether merger is good or bad is an individual case which may vary from one company to another. The success of business as a result of merger is not a general rule which will stand for all other companies.

However, an attempt will be made in Chapter VI to compare some companies which have merged during the decades of the 1950's with others which were not involved in a merger transaction, to test the effect of merger on the acquiring companies.
CHAPTER III

LEGAL ASPECTS OF INSURANCE COMPANY Mergers

All insurance company merger transactions are enacted within a definite framework formed by the laws and regulations of the various insurance supervising agencies. The purpose of this chapter is to discuss the various laws, federal and state, related to this type of insurance company's activities. A study of the principal legal stipulations governing insurance company mergers affords information on how the merger transactions are initiated and established. This, however, would not alter the fact that the plan of merger originates within the insurance companies themselves. Generally speaking, the terms of the merger plan have to be settled and approved by the boards of directors of the participating companies through internal negotiations before it comes under the perview of the supervising authorities.

Once the legal and regulatory requirements are met and get a notice of "no objection" from the Superintendent of Insurance, the proposal is presented to the stockholders of both companies to obtain their approval. The terms of the merger could be executed after approval of stockholders, which could be obtained by formal voting at a stockholder's meeting. Acceptance by stockholders owning not less than 80 percent of
the insurance company's outstanding shares is required to make the proposal effective.¹

Section 485 of New York Insurance Law provides that "votes representing two-thirds of all the stock in the case of purely stock companies, or two-thirds of all the stock (if any), and of two-thirds of all the votes cast by members represented at the meeting (in person or by proxy in the case of other companies), shall be necessary for the adoption of such proposed agreement."² Despite this minimum statutory requirement, insurance companies always seek the acceptance of at least 80 percent of the stockholders to be considered a reorganization from the Internal Revenue point of view, for tax purposes.

The Legal Background

As is well known, for a period of 75 years prior to 1944, the federal antitrust laws were not considered applicable to the insurance business. The Supreme Court had consistently held that state regulation of the insurance business did not violate the commerce clause of the Constitution. Early in 1869, the Supreme Court had decided in the case of Paul vs. Virginia that "issuing a policy of insurance is not a transaction of commerce . . . . These contracts . . . are local transactions, and are governed by the local law."³ This ruling gained support and was reaffirmed in subsequent cases. In the case of Hooper vs. California,


³Paul vs. Virginia, 8 Wall. 168, 183 (1869).
in 1895, the Court made the statement, "the business of insurance is not commerce."\(^4\) In 1913, when the New York Life Insurance Company protested against a Montana tax on the ground that its business was not conducted so as to be considered in interstate commerce, the Court declared that "contracts of insurance are not commerce at all, neither state nor interstate."\(^5\)

This was the legal environment which surrounded the insurance business for a period of 75 years despite the nationwide character of the operations of most insurance companies, and the communication of information and the movement of persons, money and papers across state boundaries in the negotiation and execution of an insurance policy. The Federal Government had never asserted any control on this type of business and the states were upheld in their individual efforts to enforce satisfactory business conduct.

In 1944, in the famous case of United States v. South-Eastern Underwriters Association (SEUA), this past precedent was set aside by the Supreme Court in favor of the view that insurance is commerce, and, when crossing state lines, \textit{interstate} commerce.\(^6\) For the first time, the Supreme Court had before it the question of whether or not the Sherman Act, a Federal statute, could be applied to insurance transactions which stretch across state lines. The SEUA, an organization with a membership of 198 private stock fire insurance companies

\(^4\)Hooper Vs. California, 155 U. S. 648, 654-655 (1895).


\(^6\)U. S. v. SEUA, 322 U. S. 533 (1944).
operating in Georgia and surrounding states, was charged with conspiracies in violation of the Sherman Act. 7

About 90 percent of the fire insurance and allied lines sold by all stock fire insurance companies in the six states were controlled by the member companies. In soliciting this share, they not only fixed and maintained arbitrary and non-competitive premium rates and agents' commissions but employed boycotts, coercion and intimidation to force non-members into the conspiracies by cutting off their valuable opportunity to reinsure their larger risk. They also compelled persons who needed insurance to buy from them on their terms by refusing to deal with persons who patronized non-members of the organization.

These practices were spotted effectively by state inspection, rating bureaus and local boards of insurance agents in certain cities. In August, 1943, the U. S. District Court sustained a demurrer to the indictment in the SEUA case. On appeal, the Supreme Court reversed the District Court by a 4 to 3 decision. The Court's majority sustained the indictment on the ground that the nationwide insurance business, involving the transmission of papers, communications and money across state lines, was "commerce among the several states." The fact that "it is built upon sales contracts which are local in nature" would not deprive it of its interstate character. 8

Owing to the fact that many similar transactions had been considered within the Commerce power by the Court, it was inconsistent and

7Alabama, Florida, Georgia, North Carolina, South Carolina and Virginia.

8U. S. v. SEUA, 322 U. S. 533, 547 (1944).
unrealistic that the insurance business as now conducted did not constitute interstate commerce. It was also held that the Sherman Act was intended to prohibit practices which restrain or monopolize the interstate fire insurance business. No evidence either in the legislative history or the wording of the Act was found to support the contention that Congress intended to exempt insurance companies.

Finally, the Court expressed the view that the argument that considering the application of the Sherman Act made many state laws regulating insurance invalid, was exaggerated. The Court stated, "No states authorize combinations of insurance companies to coerce, intimidate, and boycott competitors and consumers in the manner where alleged, and it cannot be that any companies have acquired a vested right to engage in such destructive business practices."

This extension of the scope of the Commerce Clause upset the long insulation of the insurance business from the numerous federal statutes resting on this Clause. It also created confusion and aroused fears in the insurance field of federal prosecutions, federal regulation of insurance, and destruction of state authority and taxing systems on the ground of unwarranted restraints of interstate commerce.

There was great argument against federal control of the insurance business and a move to maintain and strengthen state regulation. Under considerable pressure from the insurance industry, the 78th Congress considered legislation to exempt insurance from federal regulation. Although a bill exempting the insurance business from the

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9Ibid., 322 U. S. 522, 562 (1944).
application of the Sherman and Clayton Acts favored by the House Com-
mmittee, this bill died on the Senate floor.\textsuperscript{10} Considerable opposition
developed during and after the course of the hearings on this exemption
issue "based on the belief that government's prosecution of the SEUA
has been based on real abuses, which previously existing state regula-
tion had not prevented."\textsuperscript{11} Early in 1945, Congress enacted compromise
legislation which provided for a qualified withdrawal of federal control
on the insurance business. The McCarran Act (Public Law 15) which be-
came law on March 9, 1945, created a so-called "moratorium period" for
three years extending to June 30, 1948 during which the insurance busi-
ness was to be exempt from the operation of the federal anti-trust
laws.\textsuperscript{12} This period was granted in order to give the states an oppor-
tunity to revise their laws and to assure control of the states over
the regulation of competition in the insurance industry. However, under
the provisions of Public Law 15, the federal anti-trust laws, at the end
of this period, are to be again "applicable to the business of insurance
to the extent that such business is not regulated by state law."\textsuperscript{13}

The main question, from the viewpoint of this study, is "How do
the federal anti-trust laws which regulate merger transactions, and

\textsuperscript{10} This bill was H.R. 3270 (H. Rpt. No. 873, 78th Cong. 1st ses-
tion) - passed the House (90 Cong. Rec. 6565) - died without debate on
the Senate floor (90 Cong. Rec. 8054).

\textsuperscript{11} Federal Trade Commission, Docket No. 6238 (April 25, 1955),
p. 12.

\textsuperscript{12} Public Law No. 15, 79th Congress, 1st session, amended by
Public Law No. 238, 80th Congress, 1st session, approved July 25, 1947.

\textsuperscript{13} Ibid.
referred to in Public Law 15, "affect the insurance industry?" To understand the impact of Public Law 15 upon the insurance business, it is important that the anti-trust laws mentioned in this law be understood.

The area of anti-trust laws is a broad one including federal laws such as Sherman Act, Clayton Act, the Federal Trade Commission Act, and Robinson-Patman Act, as well as many state laws enacted by the individual states. Although all the anti-trust laws are of major importance to the insurance business, the Sherman, Clayton, and Federal Trade Commission Acts are of major importance to this study with regard to merger, and deserve explanation.

The Sherman Act -- 1890

Mergers and acquisitions were historically the nation's first monopoly problem. Prior to the enactment of the Sherman Act in 1890, there was no federal legislation to regulate or control monopolies, contracts and combinations in restraint of trade. The individual states were unable to suppress these practices because these monopolistic aggregations crossed state lines. The enactment of the Sherman

14"Before 1890, in the United States the right of contract had been restricted more extensively than in England, especially through limitations imposed by public policy. Both loose agreements to fix prices and combinations of various forms were generally held illegal at common law. The trust form of organization was an attempt to get around these legal restrictions. But this, also, was held to be contrary to law and against public policy." For further discussion about the "application of common law to mergers and acquisitions" see David Dale Martin, Mergers and the Clayton Act (Berkeley and Los Angeles: University of California Press, 1959), pp. 8-11.
Act represented the first attempt to combat the threat to free enterprise presented by the first wave of mergers which had arisen in America in the last half of the nineteenth century. The first anti-trust case to reach the Supreme Court, United States v. E. C. Knight Co., involved a series of mergers by which the American Sugar Refining Co. achieved a virtual monopoly.

Failure in this case was due to the Court's narrow interpretation of the scope of Congressional power under the Sherman Act. However, in subsequent anti-trust cases such as Northern Securities Co. v. United States; Standard Oil of New Jersey v. United States; and several others, the government was more successful. The enforcement of the Sherman Act established the key role of mergers and acquisitions when the result was the restraint of trade or the achievement of monopoly.

The application of the Sherman Act by the courts proved to be inadequate to prevent or to correct mergers which took place at this time and caused a few changes in the competitive characteristics of many major industries. In 1911, the United States Supreme Court ordered a dissolution of the Standard Oil and American Tobacco Companies.

15 156 U. S. 1, 39 L. Ed. 325 (1895).


17 Ibid.
owing to the adoption of the "rule of reason" as the standard to be applied in deciding cases under the Sherman Act.\(^{18}\)

A widespread disapproval and unsatisfactory results from the actual dissolution of these two companies' "trusts" were blamed on the weakness of the Sherman Act. A revision of the Sherman Act was made to fill its gaps and resulted in the enactment of the Clayton Act.

### The Clayton Act

The Congress enacted the Clayton Act on October 15, 1914, which embodied the experience of nearly 25 years under the Sherman Act of 1890. The Clayton Act was avowedly an amendment of the Sherman Act and is entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes."\(^{19}\) It deals with a wide range of subjects including certain provisions relating to the permissibility of business merger.

The most important section of the Act bearing upon the legality of corporate merger and acquisition is Section VII. Under that Section it is prohibited for any corporation engaged in interstate commerce to acquire the securities of a competing corporation in the same line of business, "when the effect of such acquisition may be to substantially lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition, or to restrain such commerce

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in any section or community, or tend to create a monopoly in any line of commerce." 20

The underlying purpose of the original Section VII was to fore­stall the development of restraints and monopolistic tendencies by acquisition of corporate stocks by companies engaged in the same line of commerce. This Section proved ineffective because it deals only with acquisitions of a horizontal and not vertical and/or conglomerate character. 21 Also, it only mentioned the acquisition of corporate stock and not the acquisition of assets. In addition to both shortcomings, the courts were applying the same tests used with the Sherman Act.

The ultimate effect of the original Section VII was to encourage acquiring corporations to purchase the assets rather than the capital stock of other companies. It proved to be ineffective in coping with successive merger movements, particularly in the 1920's and after 1945. 22 For this reason, the Celler Act of 1950 was passed, amending Section VII and bringing its ineffectiveness to an end.

The Amended Section VII

With the amendment of Section VII of the Clayton Act in 1950, Congress closed the loopholes of asset acquisitions and devised a new test of illegality. Section VII, as amended, provides that "no corpora­tion engaged in commerce shall acquire . . . the whole or any part of the assets of another corporation engaged also in commerce, where in any

20Ibid., Sec. VII.
21Irston R. Barnes, op. cit., p. 281.
22Ibid.
line of commerce in any section of the country, the effect of such an acquisition may be substantially to lessen competition, or to tend to create a monopoly."

Congressional committees had been concerned with the ineffectiveness of Section VII of the Clayton Act and the Sherman Act to halt the merger waves which may end with increases in the level of economic concentration in some sectors of the nation's economy. The Senate Judiciary Committee made the flat statement in its report that the purpose of the amendment "is to limit future increases in the level of economic concentration resulting from corporate mergers and acquisitions." This Committee also stated explicitly its purpose "to make this legislation extend to acquisitions which are not forbidden by the Sherman Act."24

Under the amended Section VII, the lessening of competition between the corporate parties to the merger or acquisition is no longer the test of illegality. The new test of substantially lessening competition or of a tendency toward monopoly is not limited to those situations which are of nation-wide or industry-wide significance. The intent was to deal with monopolies before they become a problem serious enough to warrant the use of the Sherman Act.

The Federal Trade Commission Act

Administrative responsibilities under Section VII.--The Federal Trade Commission Act was adopted in 1914 to supplement and strengthen


24Ibid. at 4.
the Sherman Act. This Act established an administrative tribunal to which businessmen could resort for guidance and advice. The Commission is given broad powers by the Act over businesses engaged in interstate commerce such as issuing and serving a complaint, holding a hearing, and issuing a "cease and desist" order against the offender. Also, it is granted the power to investigate the "organization, business, conduct, practices, and management of any corporation engaged in commerce."25

With the amendment of Section VII of the Clayton Act, both the Anti-trust Division of the Department of Justice and the Federal Trade Commission share the responsibility for the enforcement of this Section. The Federal Trade Commission is charged with the responsibility for dissolving mergers or acquisitions which may substantially lessen competition or have a tendency toward monopoly. This broad authority is not confined to a specific segment of the economy but holds in all regional and national markets, in specific lines of commerce as well as major industries.26

Owing to the fact that the business of insurance was not considered to be interstate commerce prior to 1944 within the provisions of the Sherman Act, little thought was given to the merger activity in the insurance field. In 1944, insurance was held to be commerce and therefore subject to federal regulation. The McCarran Act (Public Law 15) provided a moratorium period for the insurance business from the operation of the federal anti-trust laws, after which the Sherman Act,


26Ibid., Sec. 11.
Section VII of the Clayton Act and other anti-trust laws became applicable to the insurance business "to the extent that such business is not regulated by state laws." Following the passage of this law, almost all the states enacted new provisions regulating the business of insurance. Thus, it might seem that the effectiveness of the anti-trust laws in general and Section VII of the Clayton Act in particular was impaired by the passage of Public Law 15. The applicability of Section VII to a merger or acquisition of an insurance company depends upon the following two factors:

a. The nature of the merger or acquisition which is being consummated. Since the McCarran Act exemption covers only the insurance business, if an insurance company were to acquire the assets or stock of another organization other than an insurance company, it would be subject to Section VII of the Clayton Act.

b. The enactment of insurance laws covering merger or acquisition cases by the state when this transaction took place. Section VII applies fully to mergers or acquisitions in those states where there are no regulations governing them. The absence of such regulations may indicate that the particular state had not intended to deal with the merger activity of its insurance companies and put it in the hands of the federal anti-trust authorities.

27 Public Law 15, opct.

Generally speaking, all mergers and acquisitions subject to the amended Section VII could be evaluated according to their market effects. These are classified into three types of mergers: horizontal, vertical and conglomerate.

1. Horizontal mergers are those made up from competitors through the acquisition or getting together of the stock or assets of a similar business in the same market. Merger with a direct competitor may have a substantial effect upon the whole market since it may reduce competition between the firms or tend toward monopoly, thus violating Section VII. In testing the legality of this type of merger, consideration must be given to whether the competition lost by the merger transaction constitutes a substantial loss to the market as a whole.

2. Vertical mergers take place when the acquired or merged company is producing and distributing its product at a different level than the acquiring company. This type of merger always involves the acquisition of a customer or supplier. This could hamper competition if the integrated concern was able to influence prices — both final and at the various levels of production. It could limit the market for a product and restrict needed supplies by this price control. Thus in testing the legality of this type of merger, there is the question of whether the integrated concern has substantially lessened competition through the restriction of access to needed supplies, or limitation of the market for any product.

3. Conglomerate mergers, sometimes referred to as a circular merger, involve the merger between two or more companies whose business has no real relationship to the business of the surviving or acquiring
company, i.e. neither horizontally nor vertically related to each other. Because of the different nature of the merged companies, this type of merger seldom lessens competition. However, Section VII may be violated if the acquiring company possesses a volume of resources large enough to put the acquired company in a competitive advantage (over its competitors).

The inclusion of conglomerate with vertical and horizontal mergers in the list of acquisitions to be subject to Section VII is not intended to form a third category but only to protect competition between traditional sources of supply, product, or customer identities. However, there are certain exceptions to the application of Section VII, of which two are of major importance to the insurance business. The first reads as follows: "This section shall not apply to corporations purchasing such stock solely for investment and not using the same by voting or otherwise to bring about, or in attempting to bring about, the substantial lessening of competition." The importance of this provision lies in the fact that many acquisitions in the insurance field are made for investment purposes.

In the Hamilton Watch Company v. Benrus Watch Company, it was ruled that 24 percent stock acquisition was too much for investment purposes because of the poor financial condition of the acquired company, the large amount of money spent for the stock, and the acquiring company's "investment" activities in other watch manufacturers. In

29 Ibid., p. 787.
American Crystal Sugar Company v. Cuban-American Sugar Company, the latter company was defeated with a similar ruling. Furthermore, it was stressed in the DuPont case that even though the acquisition is only for investment purposes, Section VII applies when the action is used to lessen competition.

It appears from the above cases that a strict standard to which all companies have to adhere has been set. Although the investment motive is often found in an acquisition, any indication that competitive considerations were involved will rule out the investment exception. However, in the insurance business, stock purchase for investment is almost the sole reason for acquisition.

The second exception to the prohibitions of Section VII is concerned with companies that are in poor financial condition, and has been termed the "failing corporation exemption." A company may purchase the stock of a competitor if (1) there is no other prospective purchaser and (2) the company's failure would mean a loss to the community in which it was located and to the stockholders. This exemption was set forth in the Supreme Court's holding in the International Shoe case which was quoted with approval in the House and Senate reports on the amendment to Section VII. The problem with this exception is where to

33 Victor R. Hansen, op. cit., p. 788.
draw the line in situations where the firm is not bankrupt but is obviously failing.

Reviewing the legislative history of the McCarran Act supports the view that Congress did not intend to exempt the insurance business from the anti-trust laws in those states which fail to enforce its regulations adequately. 34 Thus, Section VII would apply to insurance company mergers when the insurance department failed to enforce its merger statutes. However, this view was not confirmed and was questioned in the FTC v. National Casualty Company case, where misleading advertising practices of a certain company were in question. 35 The Supreme Court rejected the FTC's argument that it had authority to issue cease-and-desist orders because the state had appropriate legislation. The Supreme Court said, "However, assuming there is some difference in the McCarran-Ferguson Act between 'legislation' and 'regulation,' nothing in the language of that Act or its legislative history supports the distinctions drawn by petitioner." 36

The most recent case in which no decision has been yet issued is the acquisition of the Kansas City Title Insurance Company by the Chicago Title and Trust Company. The Department of Justice has brought a civil anti-trust complaint in the United States District Court for the Western District of Missouri against the latter company charging that the acquisition of the Kansas City Title Insurance Company violates

34 Ibid., p. 786.


36 Ibid.
the provisions of the Clayton Act because it tends to lessen competition and creates a monopoly. The bringing of this complaint is perhaps a result of the criticism contained in the Senate Subcommittee's Report alleging that the states failed to deal effectively with insurance company mergers.\textsuperscript{37}

It is believed that "the application of the McCarran Act may be an issue in this litigation. The Government may contend that this Act does not apply to companies operating interstate because their activities in the merger field cannot be regulated by one state. The Government may also contend that if the McCarran Act does apply then the states must show that all states in which the company does business have regulated the merger."\textsuperscript{38} In view of these contentions, the NAIC Committee concluded that this organization has to consider whether recommendations should be made regarding the handling of mergers particularly with reference to the responsibility of the home states of the companies involved to put all states in which the companies are doing business on notice of the merger proceedings.

The Role of the Security Exchange Commissioner

Under Sec. 2 (b) of the Public Law 15 which provides that "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business


\textsuperscript{38}\textit{Ibid.}
of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance . . ." the SEC has no jurisdiction over the business of insurance. The insurance business is exempt from the provisions of the Securities Act of 1933 and the Investment Company Act of 1940. Most insurance companies' securities are traded over-the-counter. In case of merger, the merging companies file a registration statement which includes all the information about the securities to be exchanged to the SEC. The role of the SEC in this case is to make it known to the people involved but it has no right to disapprove the merger transaction.

Due to doubts concerning the ability of the state insurance departments to deal with the problems arising out of mergers, the SEC is currently seeking through Senate Bill 1642 to force insurance companies and other businesses whose stocks are traded over-the-counter market to make full disclosure of their financial standing and also to follow SEC rules with regard to solicitation of proxies and trading in stock by company "insiders." 39

State Regulation

The degree and amount of regulation of the insurance business by the various states varied widely at the time of the passage of Public Law 15 in March, 1945. State regulation ranged from strict supervision of all aspects of insurance in some states to little or no regulation in others. Several factors contributed to this such as

differences in population between states, as well as economically and socially, insurance needs of the community, location of insurance companies and others. This created a problem to each state which had to evaluate its existing insurance laws to determine whether its laws constituted "regulation" within the meaning of Public Law 15 so that it continues state regulation and avoids the application of the Federal Anti-Trust Laws. Some states passed new insurance laws while other states added only such laws as they felt were needed to supplement their then existing laws. The result was the enactment by almost all of the states of new provisions regulating the insurance business.

After the enactment of Public Law 15, two organizations representing all segments of the insurance industry, the National Association of Insurance Commissioners and the All-Industry Committee, cooperated to set a program of legislation which will regulate the insurance industry effectively according to the intention of the Congress. The word "regulated" included in the wording of Public Law 15 which provides, in part, that the Sherman, Clayton and Federal Trade Commission Acts shall be applicable to the business of insurance only "to the extent that such business is not regulated by state law" was an important problem facing the NAIC and the AIC. There is no yardstick which could be used to determine whether a particular legislation constitutes "regulation" within the meaning of Public Law 15. Some eminent authority believes that the term "regulate" as used in the wording of Public Law 15 requires "both positive and effective regulation of all

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40 Cited at footnote.
phases of the insurance business." On the other hand, other prominent insurance executives and attorneys assert that the intention of Congress in this Act "will be fully satisfied by the adoption of state legislation setting up merely a standard or rule as a guide for regulation."  

State regulation of the insurance business is a device designed to protect the interests of both the insurers and the insureds. Since some activities of the insurers will be beneficial to them but may be injurious to the insured public, the State regulatory authority should be alert to such activities. For example, some types of agreements between insurance companies may help to increase their volume of business at higher rates but this section is illegal since it is harmful to the insured's interests.

Section 3. (b) of the McCarran Act provides that nothing therein "shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation." This Section has successfully proceeded against local insurance boards which have sought to place competitive handicaps in the way of mutual insurance companies, or to limit the freedom of individual insurance brokers to do business on such terms and with such companies as they choose.

The McCarran Act, however, imposes limitations as already

42 Ibid.
indicated upon the jurisdiction of the Federal Anti-trust Division in dealing with insurance company activities which are subject to State regulation regardless of how effective such regulation may be. The mere enactment of State laws dealing with insurance company mergers renders the Clayton Act inapplicable to this important activity of insurance companies. The mere existence of Little Clayton Acts or similar Acts which regulate the merger activity does not warrant an effective enforcement of the State laws pertaining to mergers.

Effectiveness of State Regulation

The fact that all merger transactions between fire and casualty companies which were reported to the insurance departments of the various states were approved raises an issue about the extent of inquiry into such mergers conducted by State officials. What statutory criteria do they apply in passing on insurance mergers? There have been merger cases which the Department of Justice has examined and felt that they may have anticompetitive implications.

However, due to the limitations imposed by the McCarran Act upon its jurisdiction to deal with insurance company activities which are subject to State regulation, the Department of Justice was precluded by State laws and was powerless to act. The whole decision on the question of insurance company mergers is left in the hands of the insurance departments in the States which have laws regulating this phase of the insurance business. The insurance commissioner is granted broad

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authority over the mergers of domestic companies, and is obliged by statute to evaluate their effect upon competition.

Many states apply their general corporation laws, particularly the part dealing with mergers and acquisitions, to insurance. This is hardly the kind of "regulation" referred to by the Congress in Public Law 15. However, New York State, where 26 percent of all merger cases took place in 1950-59, has a "Little Clayton Act" which deals with mergers and acquisitions of insurance companies. This Act provides that as a result of the investment, retention or acquisition of capital stock or common management "the business of such insurers with the public shall not be conducted in a manner which substantially lessens competition generally in the business of insurance or creates a monopoly therein."45 Furthermore, advance approval of the insurance commissioner is required in certain insurance mergers or consolidations. Section 486 states that "the adoption of the agreement of merger or consolidation . . . shall be submitted to the superintendent for his approval."46

The State insurance commissioner is given the authority over mergers and acquisitions of domestic insurers. Section 486 of New York Insurance Law, for example, reads as follows: "The superintendent shall thereupon consider such agreement, and if satisfied that the same is in accordance with the provisions of this article, is fair and equitable, and is not inconsistent with the laws and the constitution of this state and of the United States and that no reasonable objection exists thereto, he shall approve such agreement as submitted."

45 New York Insurance Law, sec. 67 (1958). See Appendix A.
46 Ibid., sec. 486 (1949).
Foreign companies have to seek the approval of the state of incorporation if they are involved in a merger transaction. For example, New York Insurance Law provides in Section 488 that "In case of a merger or consolidation between a domestic and a foreign company, the agreement of merger or consolidation shall be executed by the proper officers of said foreign company . . . and if required by such laws, said agreement of merger or consolidation shall be submitted to the superintendent or other insurance supervisor official of the state in which such foreign company is incorporated and no such merger or consolidation shall take effect until it shall have been approved by the superintendent of this state."

The New York Insurance Department employs a certain procedure when scrutinizing merger transactions to determine whether the statutory criteria "fair and equitable" are met. The Office of General Counsel gathers specific factual and statistical data as to the nature and extent of the merging companies' business. Also, these companies have to submit a memorandum proving that the proposed merger or acquisition would not tend to lessen competition substantially or create a monopoly within the insurance business.

To determine the impact of the proposed transaction on competition, three areas are examined, namely, lines of commerce affected, geographical areas involved, and competitive impact. Consideration is also given to the percentage of business done by the constituent companies "in relation to the volume done by the entire industry, their relative size and position, evidence of a trend towards consolidation by the companies and by the industry, the case with which new competitors
may enter the field and the competitive nature and degree of concentration prevailing in the industry."\(^{47}\)

The Office of General Counsel reports its findings and conclusions to the Superintendent. If the Superintendent concludes that the transaction is barred by Section 67, which is cited before, a notice of hearing is sent to the insurers involved.

In the case of the acquisition of a domestic company by a foreign company, most states provide that the latter company has to comply with the part of the law dealing with the admission of foreign companies.

Although five stock companies were acquired during the decade of the 1950's by mutual companies, and eight mutual companies were acquired by stock companies, most state laws do not permit stock companies to merge with mutual companies.\(^{48}\) Section 494 of New York Insurance Law provides, for example, that "a stock company may merge or consolidate with another stock company, but shall not merge or consolidate with a mutual company."

The reason behind this statutory prohibition is obvious -- namely to protect the policyholders' interests. Due to the different nature of ownership in both types of incorporation most State laws prohibit their merger. There is no stock ownership in a mutual insurance company -- all the funds belong to the policyholders. A stock insurance company, on the other hand, is owned by its stockholders who furnished


its capital and surplus. The policyholders' surplus "capital plus surplus" is used for the protection but not owned by the policyholders. The question is how the acquiring company could manage to bring both interests together.

If a stock company acquires a mutual company -- who is going to get the policyholders' surplus of the acquired company? A similar problem exists if a mutual company acquires a stock company since the merger is going to result in two different types of ownership -- policyholders of the acquiring company and stockholders of the acquired company. Furthermore the policyholders of the stock company will have no rights in the acquiring company's surplus more than statutory protection, thus will not be in equal footing with the acquiring company policyholders who own this surplus.

According to the study conducted by the Committee on the Judiciary -- Subcommittee on Antitrust and Monopoly the fact was revealed that there were 187 mergers of insurance companies in the last five years from 1953 through 1957. This figure does not include acquisition of stock companies within the same group. The study raises the doubt with regard to the quality and the ability of the State insurance departments in regulating this important aspect of insurance company activity. It indicated that "in not one case did the State insurance departments refuse permission to merge or institute proceedings to prohibit a merger. Also, several states indicated that the merger question

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49 The Insurance Industry, op. cit., p. 216.
was not considered at all by the department, either with respect to approval or denial of permission to merge. 50

The extent to which the merger activity is permitted or denied may have a major effect on the competitive environment within which the insurance business operates.

Most State laws encourage competition by including provisions permitting insurers to adopt their own systems of expense loadings, and for insurers not belonging to rating bureaus to file their own rates. Consequently, there existed some companies writing at less than full bureau rates. These companies may be favored by some of our insuring public that is considering cost more important than any other factor. If one of these companies merge with or is acquired by a bureau company this means the elimination of a competitor and could be harmful to competition. These companies writing at less than full bureau represent a major segment in the insurance business. According to the NAIC report, more than one-third of the total fire insurance is written off the full bureau rates, and the volume is constantly rising. 51

It is now settled that the business of insurance is considered interstate commerce when conducted across state lines. This characteristic poses a major problem for the state authorities with regard to controlling and regulating the merger activities. An insurance company is considered a domestic company in its state of incorporation, and a

50 Ibid.

51 "Insurance Hearings," Statement by the Committee on Preservation of State Regulation, National Association of Insurance Commissioners, Part 8, p. 4975.
foreign company in other states. For a merger transaction to be consummated the merging companies have to seek the approval for merger from the insurance departments in the States which consider them as domestic companies.

The States where they are considered foreign companies have no authority in any merger transaction. That is the basic root of the problem. A merger transaction may look ideal, from the point of view of the States where the merging parties are considered domestic companies, and may not substantially affect the competitive market of their domestic States and therefore are granted the approval. On the other hand, the competitive situation in the States which consider them foreign companies may be seriously affected, but the local insurance department would have no jurisdiction or power to prevent the merger. Thus, a serious problem exists when considering state jurisdiction over merger activities.

Assuming that anti-trust laws had been enacted by all the States, many questions still remained unanswered concerning the actual administration and enforcement of these laws. Taking the Chicago Title and Trust case as a basis for our analysis (since it was the first merger case in the insurance field attacked by the Department of Justice), Chicago Title was charged of protecting its monopoly of the title insurance business in Illinois through the control of all of the title business in Cook County and ninety-five percent of the State of Illinois. It has also secured control over the business in Missouri and Wisconsin

through the recent acquisition of major title insurance companies doing twenty percent of the title business of the first state and fifty percent of the latter.\textsuperscript{53} The complaint shows that both St. Louis Title and Kansas City Title companies, which were acquired by Chicago Title, had over seventy percent of the title insurance business in Missouri.\textsuperscript{54} Furthermore, Chicago Title had over seventy percent of this business in Wisconsin as a result of its acquisition of Kansas City Title Insurance Company.\textsuperscript{55}

In this case, there is a merger of a Missouri insurance company into an Illinois company. However, the principal impact of this merger is alleged to be in Wisconsin which has no jurisdiction over this acquisition since both companies are incorporated outside this State. Furthermore, no approval was sought by the constituent companies since some states, including Illinois, do not subject title insurance to regulation under the insurance laws.

Based on these facts, certain questions were raised with regard to the quality and enforcement of state laws in the matter of merger and acquisition transactions.\textsuperscript{56} "To what extent is this business entitled to the protection of the McCarran Act? Were the mergers in question required by law to be approved by state officials, and were the mergers, in fact, reviewed by Insurance Departments and approved? Do the

\begin{itemize}
\item \textsuperscript{53} Ibid., at par. 13-14.
\item \textsuperscript{54} Ibid., at par. 18.
\item \textsuperscript{55} Ibid., at par. 19.
\item \textsuperscript{56} Donald P. McHugh, "An Industry Outlook -- Casualty Insurance," \textit{The Insurance Law Journal} (September, 1963), p. 552.
\end{itemize}
approval requirements involve the application of competitive criteria? The Judiciary Committee questions whether state officials ever examine mergers in terms of competitive effect. If not, is this regulation which bars the Clayton Act? Is it possible for states to regulate effectively in this area with a welter of different and, in some cases, conflicting laws? Can one state properly judge the legality of a merger whose principal impact may be in some other state?

However, the Chicago Title and Trust Company case differs from the fire and casualty merger transactions in two respects. First, Chicago Title and Trust Company controlled a greater portion of the market in Illinois, as given in the Justice Department release, than would be the case for any company in the fire and casualty business in any area. Second, the title insurance business has a unique nature which makes it profitable only when it has a large file of searches for a given geographical area and does not have to start most new searches from scratch.

The principal responsibility of the Anti-trust Division of the Department of Justice is to check the substantial lessening of competition resulting from mergers and acquisitions in its incipience. The evidence reveals that the States have not dealt effectively with mergers which have occurred in the insurance business either because of the lack

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58 Ibid.
of adequate State legislation or lack of concern with this problem.\(^{59}\)

Despite the fact that Public Law 15 delegates to the states the power to tax and regulate the business of insurance, there has been no demand from the insurance men that the federal government revoke this delegation of power.

However, it should be noted that with regard to certain areas (the Federal Trade Commission Act, the Clayton Act, and the Sherman Act) Public Law 15 reserves regulatory powers for the federal government in the absence of effective state regulation. Owing to the fact that States have devoted little time to the merger activities and in many cases they are not technically equipped to handle the problem, serious questions exist as to their power under State regulation to deal with the myriad complexities of large mergers.\(^{60}\)

Against this background, the responsibility of the Federal Government is to protect the competitive economy and the free market (in insurance) from the inroads of concentration of economic power by filling the vacuum resulting from defects in State supervision.

The NAIC recognized this problem and attempted to adopt a solution presented by the Preservation of State Regulation Committee. The Committee report suggested that "it might be well for the NAIC to consider whether recommendations should be made as to the handlings of mergers, particularly with reference to the responsibility of the home


\(^{60}\)Ibid.
states of the companies involved, to put all states in which the com-
panies are doing business on notice of the proceedings." 61

The understanding of the anti-trust laws is of major importance
to insurance companies which are intending to expand through acquisition
or merger with others. The acquiring company must develop adequate data
on companies considered for acquisition. Such data should show the line
of business, the areas where the company to be acquired competes with
the acquiring company, and the states of incorporation for both the
acquired and the acquiring company. The laws of these states pertaining
to the merger and acquisition transaction should be consulted and if not
enacted due care should be given to Section VII of the Clayton Act. Top
management should make sure of the availability of this data before any
steps are taken for the completion of any combination. This will help
to avoid actions which might bring a company into trouble under anti-
trust laws either federal or state, and thus save time and the high
cost of legal expenses.

Because of the fact that there are many legal as well as financial
problems in any merger transaction, it is advisable that both the
legal and financial department of a company work together when conceiv-
ing a merger. In some cases a merger may be financially sound but legal
counsel may anticipate anti-trust problems and conclude that it should
not be consummated.

Owing to the fact that the merger movement in the insurance
business is active and there is no evidence of an end in the near future,

61 Committee Report, Proceedings of the National Association of
Insurance Commissioners (1963), I, p. 58.
state regulatory authorities must be aware of its impact on the insurance companies' competitive environment. They should investigate the effect of a single merger or a series of mergers on the structure of the market which the merging companies serve.

A continuous and unrestrained trend towards merger would eliminate a large number of small and medium sized companies and must inevitably lead towards monopoly. The only antidote to monopoly is effective regulation and enforcement of the law. The mere fact that a few states have strict regulation of the merger transaction does not guarantee that the other states will follow. These latter states represent a threat to the whole insurance industry and may finally end with federal regulation of this business.

The question of whether this merger movement will bring Federal regulation of the insurance business is somewhat overwhelming. It is obvious that added efforts are being extended to place insurance mergers under Federal supervision. In his address at Arizona University, Mr. Donald McHugh, counsel to the Senate Sub-Committee, said that the federal government should have a "preferred position" in the supervision of insurance company mergers.62

House Bill No. 9896 which was introduced into the 86th Congress represents another attempt by the federal government to assume some control over mergers. The purpose of this bill was to "amend the Clayton Act and make it mandatory for any corporation with capital funds

in excess of $10,000,000 to give thirty days advance notice to the
Attorney General of the United States and to the Federal Trade Commis-
sion before engaging in a merger, acquisition or consolidation." 63

Recently Senator Dodd has introduced a bill to put the federal
government into the regulation of the insurance business, under the
Secretary of Commerce. He declared that the federal government is con-
sidering such fields as mergers, rates and forms, etc., where presently
"there are serious questions concerning the adequacy of state regula-
tion." 64 He adds, "It is entirely reasonable to expect federal action
in any area of the insurance industry where the public interest requires
action but the states are either unwilling or unable to do the regula-
tory job adequately." 65

Consequently, as the merger movement continues to include a
large number of insurance companies, the proponents of federal control
will act more forcefully toward federal supervision of this type of
activity.

This raises the issue of State vs. Federal regulation which is
out of the scope of this study. However, all the senior executives of
the insurance companies interviewed for this study unanimously were
opposed to federal interference and preferred continued regulation by
the state insurance department. The major shortcoming most of them
see in these departments is the need for more personnel. This is a

63 K. R. Rathert, "Insurance Mergers -- What Next?" The C.P.C.U.
64 Editorial Comment, "At Last, The Proposal For Federal Rule,"
65 Ibid.
result of the low budgets of the insurance departments which need a substantial increase. By adding qualified employees to the staffs of these departments they can investigate and examine thoroughly all the merger proposals, as well as other things, thus barring federal intervention.

In summary, insurance companies are subject to federal antitrust laws in two cases: (1) when an insurance company acquires the assets or stock of another organization other than an insurance company, and (2) when regulation covering merger or acquisition cases does not exist in the state where this transaction took place.

Many states apply their general corporation laws, particularly the part dealing with mergers and acquisitions, to insurance. Advance approval of the insurance commissioner is required in mergers and acquisitions of domestic insurers. Foreign companies have to seek the approval of the state of incorporation if they are involved in a merger transaction. In the case of the acquisition of a domestic company by a foreign company, most states provide that the latter company has to comply with the part of the law dealing with the admission of foreign companies.
CHAPTER IV

TYPES AND METHODS OF INSURANCE COMPANY MERGERS

Merger of an insurance company, like managerial decisions of any other financial institution, has to be planned before its execution. It represents methods of management that can be used to achieve the different interests' objectives. It could be used by any size of company -- by small as well as large ones -- to achieve goals which may take a company many years, if using internal methods. In planning a merger transaction, management must decide what it hopes to achieve.

Advanced planning helps management in deciding the type and method of merger. It also helps to locate the merger prospects and alleviate, if not avoid, some of the post-merger problems. The purpose of this chapter is to present the types and methods of insurance company mergers. Methods of valuation and other ways of retirement beside mergers are also presented.

Types of Insurance Company Mergers

There are several ways of classifying merger transactions. They may be classified as follows:

A. From the tax point of view
   1. Taxable acquisitions
   2. Non-taxable acquisitions

B. From the accounting point of view
1. Purchase
2. Pooling of interest

C. According to the motives or objectives behind the merger transaction
   1. Defensive merger
   2. Aggressive merger

D. According to the type of companies involved
   1. Mono-line
   2. Multiple-line
   3. All-lines

E. According to the ownership or company management
   1. Merger of companies already under the same ownership and management
   2. Merger of separately-owned fire company by a casualty company and vice versa
   3. Assembly of two or more fleets of property-liability companies under one management
   4. Entering into the life insurance field through the merger or acquisition of the stock of an existing life company

The tax view

From a tax viewpoint, mergers and acquisitions of an insurance company fall into two principal categories: (1) "Tax free" and (2) taxable acquisition.

1. "Tax free" acquisitions are set forth by the Internal Revenue Code. Section 368 of the IRC describes three types of
acquisitions which are considered non-taxable at the time of the transaction: (a) a statutory merger or consolidation, (b) an exchange of stock for stock, and (c) an exchange of stock for assets.

a. Statutory Merger or Consolidation: Statutory merger is the execution of a merger agreement between two or more companies which entitles one to the direct acquisition of the net assets of the other or others in accordance to the statutory requirements of the state or state governments concerned, with the acquiring company surviving. Consolidation, on the other hand, is the same as merger except that all the consolidating companies dissolve and a new company is organized to acquire the net assets of the combining companies.

This type of combination is considered non-taxable under Section 368 (9)(1)(A) of the IRC and court decisions have provided that the stockholders of the acquired corporation must receive "a continuing proprietary interest in the surviving corporation, which interest must be substantial in relation to the assets transferred."^1

b. Exchange of Stock for Stock: According to Section 368 (a) (1)(B) of the IRC, an acquisition transaction or a series of transactions taking place in a short period of time are considered tax-free when eighty percent or more of the stock of a corporation is acquired solely in exchange for voting stock of the acquiring

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^2 Ibid., p. 104.
corporation. The Supreme Court has ruled that the transaction is taxable "if any cash or property other than voting stock is given, even for less than twenty percent in value of the acquired corporation."³

c. Exchange of Stock for Assets: Section 368(a)(1)(C) of the IRC provides that a tax-free reorganization takes place when a corporation acquires "substantially all the properties" of another corporation in exchange solely for its voting stock or its parent's voting stock.

Failure to qualify for a tax-free acquisition can result in losing some anticipated tax benefits such as carryover of predecessor's tax basis and non-recognition of gain on the exchange. Thus, it is desirable for the acquiring company to obtain in advance the Treasury's ruling with regard to the tax consequences of a proposed merger transaction.

2. Taxable acquisitions. Following the acquisition of a sufficient portion of a company's stock, the acquiring company may elect either to liquidate the acquired company or allow it to continue as a separate entity. The taxability of the purchaser of at least eighty percent of the stock depends upon when the plan of liquidation is adopted. If the liquidation takes place within two years of the purchase, the cost of the acquired stock is allocated to the assets acquired in the liquidation, with certain adjustments.⁴

³Ibid., p. 105.
⁴Ibid., p. 110.
If the acquired corporation continues as a separate entity, it retains its existing tax basis and methods. When the parent owns eighty percent or more of its stock, the acquired corporation can be liquidated tax free into the parent company. On the other hand, the acquired company's tax basis is carried over to its parent if the liquidation is not prosecuted until after the two years have elapsed.

The sale of stock results in capital gain or loss, from the standpoint of the seller, provided, in the case of gain, that the corporation is not collapsible under Section 341 of the IRC. Gain, sale or redemption of stock of a collapsible corporation, such as corporations formed or availed of with a view to their liquidation, is ordinary income.

The accounting view

The accounting treatment of the financial structures of the merged companies has a significant effect on their assets and capital structure. There are two concepts which determine the particular type of accounting treatment based on the motivation behind the merger transaction.

1. A combination is viewed as a purchase of one corporation by another, for accounting purposes, when the ownership interest in the acquired business is acquired by the acquiring company. The surviving interests carries on the activities of both companies and the former interests in the acquired company are either eliminated or substantially altered. In this case, the acquired assets are treated on a new basis of cost accountability based upon the value of consideration paid.

\[^{5}\text{Ibid.}, p. 118.\]
Since the consideration is determined by current values at the time of the transaction, book values of the acquired company's assets are of no importance although they may coincide with current values. Also, the existence of a goodwill or going concern value is recognized in many instances in the purchase price, thus representing an additional cost.

Since a part of the company's assets is subject to depreciation or amortization which constitutes a cost charged against the income, the introduction of a new cost basis results in depreciation or amortization cost differing from the previous amounts which were based on the book values of the acquired company. Thus the future earning's contribution of the acquired company will differ from its previous earnings because of the accounting procedure.

2. A combination is viewed as a "pooling-of-interests," for accounting purposes, when the ownership interests in two or more companies decide to combine their business efforts and activities into a combined enterprise. Both groups retain their interests in the new enterprise that carries on the business which they previously conducted separately. Since this case is deemed to represent a continuation of existing ownership, it does not call for a new basis of asset accountability.

Further, since no change of ownership is deemed to have taken place, there will be no need to recognize and create a goodwill factor. Consequently, the accounting treatment of such a combination has no influence on the earning results of the combined companies. Due to the concept of

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6Ibid.
continuity, the earned surpluses of the combined companies are carried forward into the combined company.

The motivation view

Mergers of insurance companies could be classified according to the motives underlying the transaction into two classes: (a) aggressive, and (b) protective or defensive.

a. An "aggressive merger" is an acquisition of an insurance company undertaken by an expanding company and/or by a relatively profitable and financially strong one for the purpose of securing a larger share of the market which it serves, or to secure diversification through new products and additional lines. The recent merger agreement between Firemen's Fund (which mainly serves the West Coast), and the American Insurance Company of New Jersey (which serves the East Coast and had already acquired the American Automobile Insurance Company of Montana), is an example of this kind of merger since each of the companies involved has a good, financially strong record.

b. A "defensive merger" is a merger transaction designed primarily to protect the various groups' interests of the company which initiates the merger idea against financial difficulties experienced or anticipated in the near future. The merger of Franklin Insurance Company into Republic Insurance Company is an example of this kind of merger. Franklin was failing and its management and sales agency were deteriorating. The only way to save it from involuntary liquidation was to merge with a relatively strong company.
Both terms "aggressive" and "defensive" refer to the real motives of the constituent companies that led to the consummation of the merger transaction. To decide whether a merger transaction is aggressive or defensive one has to study the predominant forces and motives behind it. A combination of both motives, "aggressiveness and defensiveness" is often found in a merger transaction. That is, aggressiveness on the part of the acquiring company and defensiveness by the acquired company which conceived and initiated the merger transaction.

However, in any merger transaction, it is the job of the management to determine the reason for the particular kind of acquisition. This is important because it helps in determining how to get the acquired company into operation. For example, if the predominant reason for acquiring a casualty company by a fire company is defensive, then casualty business will only be an accommodation line and will be pushed only when it is necessary for a direct and immediate benefit to the acquiring company. On the other hand, if it is acquired as a profitable investment venture then all segments of management are aware that the casualty line will be aggressively marketed regardless of the need of the acquiring company.

**Types of companies involved**

According to the line of business conducted by the constituent companies, merger could result in a mono-line, multiple-line, or all-line insurance company.

A mono-line insurance company writes only one line of insurance.
As already mentioned in Chapter II, insurers and insurance have been traditionally classified into either life, fire and marine, or casualty. Until 1946 when the National Association of Insurance Commissioners approved full multiple-line underwriting powers, insurance supervision relied upon mono-line insurance. Insurance companies operated on mono-line principles for many years as a matter of performance and it was considered a protection to the public, that did not object to it since it prevented insurers from risking their companies' solvency by venturing into unfamiliar lines of insurance. The existence of the Appleton Rule also discouraged any approach other than mono-line since it prohibited domestic companies in the State of New York from writing any lines they would not write in the State.

Multiple-line insurance is "insurance against loss caused by any one of several perils traditionally insured separately. In its current application it has come to mean insurance combining coverage by either a casualty or a fire-and-marine insurer of perils that were formerly covered by only one of these types." This type of merger is covered later in this chapter.

All-lines insurance is insurance which combines fire and marine, casualty, and life. An all-line insurer refers to the insurer who may write literally "all-lines" of insurance under one administrative charter. In 1960 all-lines insurance was statutorily permitted in

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thirteen states. However, through the organization of company groups or "fleets," some insurers operated fire and casualty companies, as well as life companies as members of the fleet, thus enjoying the same advantages as all-lines insurers.

Two major problems affect full all-line underwriting, namely, the lack of trained agents who can handle all types of insurance and the considerable amount of money needed for a property company to enter the life insurance business. However, this trend is gaining favor among insurers for reasons discussed later in this chapter.

The management view

The final classification of the types of merger is looked at from the ownership and company management point of view. In this regard there are four types of merger:

1. Intra-company mergers: The acquisition of companies already operated under common ownership and management may be called intra-company merger. The acquired companies are always member companies of a group or "fleet" while the acquiring company may be the parent or head of the fleet or a companion carrier.

The major reason behind this type of merger is to reduce costs through savings which accrue by combining several companies into one. Due to the fact that the need for a multiplicity of subsidiaries because of limitations on the number of agent appointments per company no longer exist following the decision in the South Eastern Underwriters

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Association case and the passage of the McCarran Act, insurance company groups looked for economy and convenience. Economy could be achieved by eliminating this multiplicity of companies, thus reducing costs of licensing and fees, preparation of annual statements, tax reports, filing, bookkeeping, stationery, records, policy forms, deposit in various states, etc. These mergers resulted in the simplification of the structure of the group, and thus more convenience for the management. In some cases the policyholders' surplus of the affiliate was not too large while its companion has a relatively large one which will permit more growth and a larger volume, thus dictating the merger.

There are several groups which have followed this type of merger, such as Great American, Corroon & Reynolds, Travelers, Phoenix of Hartford, and Sun Insurance Office, Ltd.

2. Inter-company mergers: This type of merger which is merely the merger of a separately owned fire company into a casualty company and vice versa to form a multiple-line company became possible following the passage of multiple-line laws. A multiple-line insurance company is a company which has the powers to sell insurance coverage in both the fire and casualty fields. Multiple-line insurance is the combination

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9 Attention is invited to the fact that "ocean marine insurance, both cargo and hull, is basically international commerce and under the U. S. Constitution is subject to regulation by the Congress of the United States . . . the ocean marine market does not consider itself regulated by the States." For a complete coverage of the "nature and scope of the marine insurance exemption from the anti-trust laws" see The Insurance Industry, op. cit., pp. 61-69.
of the basic types of coverages known as fire and casualty insurance.\textsuperscript{10}

Multiple-line development, as indicated in Chapter II, took a long time (a century or more) to reach its present status. It was not considered complete till the passage of legislation granting a single insurance company the legal power to write all forms of fire and casualty insurance following the Diemand Committee Report to the National Association of Insurance Commissioners in 1944. However, the passage of multiple-line laws by the State of New York in 1949 is considered the major landmark in this development.\textsuperscript{11}

Multiple-line companies claimed advantages achieved through the writing of multiple line insurance, such as broader coverage, less cost, more convenience, less adverse selection, better insurance to value, etc.\textsuperscript{12} These features plus the lifting of restrictions on one company writing both fire and casualty lines attracted many mono-line companies to enter into the multiple-line era to protect their market position. Two major techniques of change took place to create multiple line companies, namely, charter amendments permitting the extension of the company's licensing power and insurance activities to include other lines of protection, and mergers and acquisitions of a fire insurance company by a casualty company or vice versa.\textsuperscript{13}


\textsuperscript{11}Ibid., p. 867.

\textsuperscript{12}For a comprehensive coverage of the transition to multiple-line insurance, see David L. Bickelhaupt, \textit{op. cit.}

\textsuperscript{13}John H. Magee, \textit{op. cit.}, p. 867.
3. The assembly of two or more groups of companies into a larger fleet represents another type of merger. The reasons behind this type of merger may be as follows:

   a. Competition in the property insurance business is such that the control of the company's expense ratio is much more important and at the same time difficult. Therefore, increasing the size of the merged companies is desirable to control expenses through economies of large scale.

   b. In the past few years, insurance companies experienced a drastic drop in the underwriting profit margin due to high injury awards, inflationary prices of damaged property, and increased claim frequency. To cope with these problems, many companies combined in order to be large enough to afford spending in fields of market research, production research, data processing, better programs of employee training and systems analysis, etc. It also resulted in putting the combined companies under skilled and persuasive managements assisted by an extensive staff of specialists who would render better service for the insuring public, the companies' owners and the producers and employees who will be able to stand the weathering competition.

   c. Living in the atomic age, the size of an insurance company group is desirable to furnish the protection needed by individuals and organizations. The combining companies will be big enough to retain most of the insurance written and would not be forced to reject part of the coverage because of lack of capacity.

   d. Diversification by class of business and by territories
may be another reason. The Continental Group acquired about twenty two percent of the total capital stock of the Phoenix Assurance of London through the investment of $37.5 million in November, 1963 in order to be able to use its facilities abroad.

Several other examples could be cited for such type of merger. In 1956, the American Insurance Company of New Jersey acquired the American Automobile of Missouri and its subsidiaries. In the early part of 1963, Fireman's Fund Insurance Company of San Francisco acquired all the American Insurance Company Group.

Also the Commercial Union Group (composed of nine companies) acquired the North British Group (six companies) to form the Commercial Union-North British Group in 1960. Also the American Fire took over the Loyalty Group late in 1957; this combination involved two of the largest fire and casualty company groups.

4. The fourth type of merger is the acquisition of the stock of an existing life company by a property-liability company. By this transaction the acquiring company will put itself in a position to offer through one agent all lines of insurance which include, fire, casualty, and life.

Affiliation of life insurance companies with property and casualty has existed for years in the United States through insurance groups such as Travelers and Aetna. By the end of 1962 there were 149 property and liability groups which have 109 life companies affiliated, compared with 128 groups with 35 life companies in 1957. Also during the decade

of the 1950's, six stock fire and casualty insurance companies were merged into life companies.\textsuperscript{15}

There are several reasons behind this trend of all-lines insurance;

a. It will permit further diversification of risks which will act as a stabilizing factor in the underwriting area by combining the volatility of property and casualty operations with the stability of life operations.

b. It will be possible to achieve substantial economies by spreading the expenses over more lines of insurance. Also economies could be gained through the consolidation of some functions such as accounting, statistics, advertising, printing, purchasing, investments, and selling.

c. It appeals to the consumer who likes to buy all the protection he needs through one agent and if possible in one folio-type policy.

d. The fact that property companies suffered underwriting losses in the last decade: their stocks were sold in the market at lower prices while life companies' stocks moved ahead. Therefore, in the search for greater profit or at least to reduce losses, plus the attractiveness of price movement of the life company stock led property companies either to organize or acquire a life company as an affiliate.

Viewed from a property company, there are several advantages which accrue following the affiliation of a life company.

\textsuperscript{15}Best's Insurance Reports, 1960, pp. 716B-726B.
Springfield Fire and Marine Insurance Company bought the capital stock of the Monarch Life Insurance Company and claimed in the prospectus dated April 25, 1958:

The affiliation will permit them to provide the entire insurance needs of a policyholder through their combined underwriting facilities, thereby lending convenience to the policyholder and improving customer relations and the production of both companies. The affiliation will provide wider diversification of risk and type of insurance, as well as increased diversification of investments. In certain areas of research such as investments, economics, marketing methods and personnel, the combined activities of both companies will increase the effectiveness of the current separate efforts. More effective use of modern electronic data processing equipment is possible as the volume of data handled increases. Moreover, through the collaboration of the technical staffs of both companies, advantages can be gained by each company from the experience the other has acquired in this comparatively new field. Some functions can immediately be consolidated, such as purchasing and printing with advantages accruing from the larger volume handled and increased facilities available to both companies. By advertising both companies through the same media, more effective use can be made of the money allocated by each company for advertising and publicity purposes. The extensive program for the education and training of employees and agents which each company maintains can be made available to the other with mutual advantages. Claim Personnel and other field representatives who service policies will be able to use joint office facilities with resulting economies through reduced overhead costs to each company. The home offices of both companies are situated in Springfield, Massachusetts on valuable and well located sites in close proximity. Monarch's is nearer the business center of the city. Springfield's larger floor area and acreage will provide adequate room for expansion of both companies.

This summarizes the advantages which are claimed by the acquiring company. However, despite this ambitious program, the Springfield-Monarch Group decided to discontinue this combination between the life and property business through reinsurance of practically the entire
underwriting portfolio of the old Springfield Fire and Marine, which may be an evidence of the impracticability of the plan.  

According to Best's Reports, relatively few life insurance companies own fire and casualty subsidiaries. However, the Court of Appeals decision in Connecticut General Life Insurance Company appears to have opened the door to life companies to acquire fire and casualty subsidiaries and still be permitted to do business under New York State laws.

The merger movement not only brought changes such as multiple-line and all-lines insurance but also it moved a further step, through the advent of investment trusts, into the insurance field and the sale of mutual funds by insurance companies. An insurance group (Nationwide) for example entered into the investment trust field, and an investment trust (Channing Group) made its advent into the insurance field (Wolverine Group). These groups are now able to offer all financial services which include all lines of insurance, mortgage and real estate services, as well as automobile financing through the agency's several separate departments.

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17 Best's Insurance Reports, F & C (1962), p. IX.


Methods of Insurance Company Mergers

Merger and acquisition of insurance companies could be accomplished by several methods. The use of one method or another depends upon the motives underlying the transaction; whether the acquired company's stock is closely held or widely distributed among a large number of stockholders; the interest of the acquiring company in the acquired company; the bargaining power and the financial position of both companies.

From interviewing fourteen acquiring insurance companies it appears that the most important company mergers and acquisitions are effected by acquiring a company's stock through exchange or purchase. Another method of merger is the purchase of the acquired company's net assets.

**Exchange of acquirer's stock for acquired company's stock**

The exchange of stock method is widely used by insurance companies in merger transactions. Exchange of stock is based on the process of ascertaining the value of the acquired company's stock and giving its stockholders an amount of the acquiring company's stock equal in value in exchange for his holdings. Different methods of valuation of an insurance company are discussed later in this chapter. This method results in all equity owners of both companies who are party to the merger winding up as equity owners of the surviving company. Owing to the fact that some differences exist in state laws, the actual mechanics may differ from state to state. The new owners are assimilated in accordance with plans previously determined at the time of
negotiation. This is because most insurance companies stock is owned by individuals, bankers, other insurance companies or commercial or industrial firms which are not interested in realizing an immediate profit through the sale of their holdings. The fact that these stock owners are investors and in a higher income bracket for tax purposes makes them reluctant to sell their stock holdings outright unless the future of their investments is threatened. Since there is no capital profit recognized in an exchange of stock process, it is a tax exempt operation which appeals to many investors.

This method is looked upon as a tradition by the insurance company which intends to merge or acquire other companies. It is used under two different circumstances. The first case is where two separately owned and managed insurance companies merge together. An example is the exchange of the stock of the American Insurance Company of Newark, N.J. for the stock of the American Automobile Insurance Company of St. Louis, Missouri on the basis of one share of American Insurance for one share of American Automobile Insurance Company.

The second case takes place when a head of group or "fleet" or a member company of the group acquires the affiliated company. Great American Insurance Company for example, in 1958 exchanged its stock in a merger transaction for the stock of two of its subsidiary corporations: Great American Indemnity Company and Rochester-American Insurance Company on the basis of each share of Indemnity for 0.44 of a share of Great American and each share of Rochester for 1.28 shares.
Acquisitions effected through purchase of stock

An acquiring company may complete a merger through the purchase of the stock of the prospective company from individual persons or firms at private sale, or it may be bought in the open market, and sometimes both methods are used.

a. Purchase of stock at private sale: The private sale method was used by the United States Fidelity and Guaranty Company when it purchased the stock of Dallas Insurance Company late in 1957. However, some companies use this method to acquire control of an insurance company before they go in a merger process. The Hanover Insurance Company for example, acquired control through the purchase of thirty percent of the stock of Massachusetts Bonding and Insurance Company from State Mutual Life during 1960 because of illegal holding of the latter company of this stock. In 1961, the Hanover acquired Massachusetts Bonding in a merger transaction on the basis of converting each share of Massachusetts to one share of Hanover, the continuing corporation.

Private sale of the capital stock of an insurance company is always possible where the stock of the acquired company is closely held. It is easy to deal with a small number of stockholders directly or through an investment banker.

b. Purchase of stock in the open market: Insurance companies'  


stocks are traded in over-the-counter market. Some companies' stocks are widely distributed; others are closely held by large investors. The acquisition of a company with a widely distributed stock requires the services of an investment banker to buy in the open market the number of shares of stock large enough to gain its control. In most cases, a tender of capital stock of the acquired company for sale is made, and by this means those who want to dispose of their stock holdings will sell at the offered price.

**Purchase of assets from the acquired company**

Some insurance companies acquired other insurance companies through the purchase of their assets. It is known that the assets of a fire and casualty insurance company consist of cash, securities (bonds and stocks), real estate, premiums in course of collection and other assets. These assets are to meet the liabilities which include all the reserves set aside (unearned premiums, losses, taxes, dividends, market fluctuation and contingency reserve), reinsurance fund, capital and surplus. Therefore it is impossible for a company to purchase the assets of another company unless it assumes all the liabilities. The selling party receives an amount which may vary according to the method of valuation used. This is discussed later in this chapter.

These are the methods by which the merger or acquisition is consummated. However, some other method is used in the case of the acquisition of a subsidiary corporation, namely the cancellation of its stock which is wholly owned by the acquiring company. Great American Insurance Company acquired four subsidiaries out of which two were wholly
owned (Massachusetts Fire and Marine and Detroit Fire and Marine Insurance Company) in 1958. Although there was a conversion ratio set for the shares of both acquired corporations, their shares, being then owned by the acquiring company, were cancelled on the merger. Travelers Indemnity Company also eliminated the stock of Travelers Fire Insurance Company in 1956, which was already owned by Travelers Indemnity stockholders.

Methods of Valuation

Following the determination of the feasibility and legality of the proposed merger, the basis upon which the merger is to be made has to be settled. That is, the price or consideration to be paid to the owners of the acquired company by the surviving corporation, and whether such consideration is to be paid in cash or in stock or other securities, or a combination of these. When cash or face value securities or a combination of both is used as the consideration to be paid, only the acquired company must be valued. On the other hand, when the stock of the surviving company is used as the consideration to be paid for the whole or part of the value of the acquired company, both companies must be valued.

Valuation of insurance companies represents the major bargaining stage between the interested parties of the merger transaction. Due to the fact that insurance companies usually keep good financial records, most of the items on the balance sheet are not hard to evaluate. All admitted assets, for example, are checked for actual existence and value, reserves are checked to make sure that they are not understated,
and the fair value of non-admitted assets is arrived at. The valuation of insurance business in force, however, may represent the only difficult step in this process since it often provides the widest range for opinion, thus representing the major bargaining point in the merger deal. The purpose of this valuation is to reflect the owner's equity in unearned premium and loss reserves.

Many intangibles must be considered in the valuation of an insurance company, such as the caliber of management personnel to be acquired; the caliber, stability, and productiveness of agency organization; and other "going concern" aspects. No independent value is usually given for these intangibles, but are included in the dollar value arrived at for business in force.

The valuation process is sometimes made by the parties of a merger themselves. Often it is made by independent insurance accountants, using yardsticks of value as agreed upon by the parties involved. There are some agencies or professional counselors who have specialized in this job and many companies depend heavily on their services of setting the value of a prospective company for acquisition. Alfred M. Best Company, for example, was consulted in determining the rate of exchange between Aetna Casualty and Surety and Automobile Insurance Company shares in 1955. Some insurance companies, such as the

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23Ibid., p. 22.

Hanover Insurance Company of New York used three independent appraisals when it acquired Massachusetts Bonding and Insurance Company in 1961. These were the Alfred M. Best Company, Hanover's investment banker, and Massachusetts Bonding investment banker.

There are several methods of valuation of property and liability insurance companies. The use of one method or other depends primarily upon the bargaining power of both the constituent companies, the existence of more than one prospective buyer or prospective seller, the past record of the acquired company, the urgent needs of the acquiring company, and prevailing economic conditions at that time. The following are methods of valuation which might be used when purchasing a non-life insurance company.

**Book value**

Book value is seldom used alone as a determinant of how much a company is worth. This is because the book value, or net worth of the business as shown by the balance sheet, is probably the least reliable measure of a company's value. In many cases, the values of some assets have increased without any corresponding increase in book value. The basic function of the book value is to provide a means of establishing asset values for accounting purposes. These values are basically the original cost of the assets which may bear small relation to the present cost. However, this does not mean that book value is useless or that no consideration should be given to it. Book value, when properly

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analyzed, could be used as a basis for adjustments and serves as a starting point for comparative analysis.

Book value may be used to measure the reasonableness of exchange of stock. By comparing the pre-merger book value of a share against the post-merger book value, stockholders could measure dilution in their relative participation in the net worth of the company. Although it would appear that earnings per share should be the true measure, many corporate managements are concerned with dilution and many merger plans were rejected because of a decrease of per share in book value resulting from combining the two companies.\(^\text{26}\)

**Market value**

An insurance company stock is measured by the current quotation of that stock on an exchange if the company's stock is being quoted on that exchange. On the other hand, if the company's stock is not quoted, a realistic value may be determined only if there is a continuing active private exchange of stock which may suggest a proper level of current values. In the absence of both, market value could not be determined and the constituent parties have to use some other value.

The market value of a successful company usually exceeds its book value and in nearly all instances portrays the "going-concern" value.\(^\text{27}\) This is because market value reflects many factors which are difficult to assign a value for each individually, but contribute to

\(^{26}\text{Ibid.}\)

public confidence. These factors would include past performance, efficient management, reputation in the industry, and experience record with respect to underwriting efficiency, investment earnings, expense efficiency, and persistency of business -- in short -- the growth trend of the company. 28

Liquidating value

Liquidating value is the value which theoretically would accrue to the owners of an insurance company should liquidation be resorted to. 29 This value is based upon the balance sheet of the liquidated company alone. It is arrived at by adding the owner's equity in the unearned premiums reserve to the capital and surplus and all other funds which are set aside voluntarily and termed as "free funds" such as general and voluntary reserves. Intangibles such as the value of goodwill and the various agencies which may represent considerable investment by the company through the years are not included.

The liquidating value of a fire insurance company would be capital plus surplus, plus voluntary reserves, plus forty percent of the unearned reserve. In the case of a casualty company and a multiple-line company, it would be capital plus surplus, plus voluntary reserves, plus thirty-five percent of the unearned premium reserve. 30 The total of these items represent the aggregate liquidating value of the company.

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28 Ibid.
29 Roger Kenney, "This Question of What a Fire or Casualty Company 'is Worth'," United States Investor (August 1, 1959), p. 20 (2192).
30 Ibid.
under valuation. The "liquidating value" per share could be finally determined by dividing the aggregate liquidating value arrived at by the number of shares outstanding.

The owners' equity in the unearned reserves exists because insurance companies are required by laws of the various states to set up as a liability the unearned part of the full premium on every policy in force, without any allowance for operating expenses, most of which are incurred at the inception of the policy. This equity is confirmed by the fact that if an insurance company reinsures its insurance portfolio, the reinsurer accepts the assumption of the liability and pays an amount less than the full unearned premium. This price is estimated to be adequate to meet losses, loss adjustment expenses and other expenses on the business assumed until expiration, with a margin for profit. It is the practice of insurance companies to use the average ratio of losses and loss expenses incurred to premium earned over a span of time (five years of operation or more) in determining the amount of commission retained by the ceding company. The reinsurer agrees to deduct such commission from the unearned premium reserves since it recognizes that to write a similar volume of business through its own agents would entail a total expense roughly comparable to the commission.

"Going concern" or "current actual" value

This value differs from book or market values and also in excess of the values which could be realized in liquidation. It entails a complete investigation of the company's records to ascertain both tangible and intangible values. It is based on the assumption that the
business in force will be carried to expiration. It necessitates adjustments in the following items:

a. Equity in unearned premium -- calculated the same as in liquidating value and credited to the assigned value of the stock.

b. Reinsurance in unauthorized companies -- credit unearned premiums and reserves for outstanding losses arising from certain reinsurance cessions which are fully recoverable, but which are disallowed under Insurance Department's rulings.

c. Funds with ceding reinsurers -- considered as non-admitted asset although it is fully recoverable.

d. Agents' and premium balances past due -- Agents' balances, representing business written more than three months before the statement date are deducted in full from the assets reported under the rules of the Insurance Departments. Owing to the fact that virtually all such past due balances are subsequently collected, at least ninety percent of its face value has to be included.

e. Automobiles, furniture and equipment -- This asset is not reflected in the annual statements of the insurance companies since the cost of these items is charged directly to the annual expenses, i.e. not considered a capital expense. Thus, it will be appropriate to include its depreciated value for valuation purposes.

f. Bills Receivable -- reported as non-admitted assets while it is usually fully recoverable. Therefore, at least ninety percent has to be credited to the company's assets.

g. Additional audit premiums earned but not entered -- In the
case of insurance companies writing Workmen's Compensation and certain types of liability insurance, audit of the policyholders' books takes place periodically to ascertain whether an additional premium should be charged. After collecting these premiums, additional expenses are incurred including commissions to agents on the additional premiums and taxes to the Insurance Department. Therefore these additional premiums have to be credited after giving allowance for a reasonable amount to cover the expenses.

h. Additional equity in stocks of other insurance companies--Insurance companies holding the stocks of affiliated or subsidiary companies carry such stocks on their books by a figure equal to the capital and surplus only. Since the value of stock holdings is in excess of this which appears on the company's statement, the company's assets must be credited with the difference.

i. Surplus adjusted to market values -- The company's surplus should reflect the actual market value for all the securities "bonds and stocks" owned and not the book value.

j. Value of agency force -- The fact that it takes time and money to develop a good and productive agency force calls for assigning a value to the agency force of the acquired company to be included in its price. This value depends upon how long agents have been in the insurance business, their experience, reputation, quality of business written, etc.

k. Goodwill -- a company with a good earning record usually sells at a higher price than one with a bad one. The company's goodwill is directly connected with a good management and a
productive agency force. In the case of assigning a value for the agency force no value is assigned for goodwill since the agency force is the major factor in building the goodwill.

Despite the fact that a myriad of valuation methods exists, the value of the acquired company lies in its future contribution to the over-all results of the acquiring company. Thus, it is vital for the acquiring company to have projections of the future potential business, not as a separate entity but as a part of its own organization. The value of a merger or acquisition is not so much what the acquired company is now but rather what the acquiring company can make of it. There may be opportunities for combining underwriting facilities, increasing sales outlets, cutting overhead costs, or a myriad of other cost-economizing or revenue-building actions. Such projection should be completed before the merger is consummated in order to foresee and provide for them or avoid all possible future pitfalls.

In the final analysis, merger is a matter of give-and-take, not of exact mathematics. Mathematics can offer only the basis for negotiations of the merger and represents the opinion of the appraiser or the person in charge of valuation as a suggested basis for arriving at a final arrangement equitable to all parties concerned.

Other Ways of Retirement

Historically, merger and acquisition of insurance companies have been the instruments by which unprofitable insurance companies or those in financial difficulties were eliminated from doing business by

31Stanley W. Dale, op. cit., p. 50.
being acquired by stronger companies. 32 There are several reasons to explain why an insurance company might speculate and take over an insolvent company with the knowledge that they may sustain a loss in such a venture. These include benefits to the acquiring company, such as increase in the volume of business; tax advantages; acquisition of some trained personnel; acquisition of a developed agency organization; and the chance to do business in new areas. They may also include an unselfish motive on the part of the acquiring company and a desire to perform a social service by protecting the policyholders of the acquired company.

Mergers and acquisitions, however, are not the only actions taken in the case of an insolvent or near insolvent insurance company. Certain alternative approaches to the problem of insolvency may be taken. These include reinsurance, liquidation, rehabilitation, and receivership. It should be noted that according to New York Insurance laws, liquidation and rehabilitation proceedings may be applied to domestic insurers and to United States branches of alien insurers. 33 With regard to foreign insurers, the insurance commissioner has only the power to suspend or revoke their licenses.

Reinsurance

Portfolio reinsurance represents another way of retirement from the insurance business beside merger. The major purpose of this device


is to shift the liability from one insurer to another through the reinsurer's assumption of each outstanding risk written by the ceding insurer. The significance of portfolio reinsurance stems from the fact that certain lines of business or the entire operation of the ceding company can be absorbed with the same result as if a merger had been consummated. This calls for a careful study of such reinsurance arrangements by the insurance departments to measure its effect on competition.

There are several reasons which may lead an insurer to reinsure all or part of his business. These reasons include the desire of a management to retire, lack of prudent management, or lack of production. In some cases two insurers, both top-heavy with liability in different classes or different localities, may agree to exchange business resulting in diversification and improvement in the distribution of their respective portfolio. 34 Another reason is when an insurer has been forced to draw upon its surplus to finance necessary increases in the unearned-premium reserve resulting from building its business too rapidly. Reinsurance of part of its portfolio may permit a further expansion of its business.

It was noticed following the enactment of the multiple-line laws that many fire companies reinsured the business of casualty companies to help them build the casualty portion of their multiple-line portfolio. During the 1950's decade ninety-two fire and casualty insurance companies retired from the insurance business by reinsuring

34 G. F. Michelbacher, op. cit., p. 209.
their portfolios out of which thirty-three stock companies and fifty-nine mutual companies as indicated in Table 6.

TABLE 6

NUMBER OF FIRE AND CASUALTY COMPANIES REINSURED IN THE UNITED STATES 1950-1959

<table>
<thead>
<tr>
<th>Year</th>
<th>Stock</th>
<th>Mutual</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>2</td>
<td>8</td>
<td>10</td>
</tr>
<tr>
<td>1951</td>
<td>2</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>1952</td>
<td>2</td>
<td>4</td>
<td>6</td>
</tr>
<tr>
<td>1953</td>
<td>2</td>
<td>3</td>
<td>5</td>
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<tr>
<td>1954</td>
<td>3</td>
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</tr>
<tr>
<td>1955</td>
<td>1</td>
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<td>1956</td>
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<td>1957</td>
<td>3</td>
<td>9</td>
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<tr>
<td>1958</td>
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</tr>
<tr>
<td>1959</td>
<td>3</td>
<td>9</td>
<td>12</td>
</tr>
<tr>
<td>Total</td>
<td>33</td>
<td>59</td>
<td>92</td>
</tr>
</tbody>
</table>

Source: Best's Insurance Reports - Fire and Casualty, 1960, pp. 716B-726B.

Portfolio reinsurance may involve some of the headaches found when negotiating a merger transaction, namely in the process of valuation. In portfolio reinsurance, the reinsurer usually receives the unearned premium and loss reserves of the ceding insurer. Owing to the fact that most of the acquisition expenses of writing the business have
already been paid on the acquired business, the ceding insurer receives a commission from the reinsurer which roughly should be equivalent to his equity in the unearned premium reserve. The volume of this commission depends upon many factors such as the quality and the profit potential of the reinsured business, the reasons for reinsurance, the need of the reinsurer for such volume of business, and the ceding company loss experience in the past years, etc.

Portfolio reinsurance is subject to the approval of the insurance commissioner. This is due to the fact that a large proportion of the ceding company's assets is transferred as premiums for the reinsurance. In this case there is a large opportunity for a failing company to defraud its policyholders unless this process is supervised and safeguarded to protect their interests.

Liquidation

Liquidation of fire and casualty insurance companies represents another way of retirement from the insurance business. The reasons leading to such a process may differ from one company to another. It may be the outcome of improper management or lack of prudent management, doing no business, or not enough business to warrant the company's existence, insolvency and inadequate finances. The keen competition which prevails in the insurance industry may force marginal companies out of business because of their high expense factors or generally poor

underwriting experience. Furthermore, due to the variations in financial requirements with regard to capital and surplus, there have been situations where a company was declared insolvent in one state and solvent in another.

There are two types of insurance company liquidation: voluntary and involuntary. Although both types are subject to the insurance department's supervision to assure the equity to policyholders, they differ in the procedure by which the liquidation process is executed and the liquidator in charge of it.

Voluntary liquidation results from a decision of the company's management to discontinue its operation and retire from the insurance business for whatever reasons it offers to secure the owners' approval. With regard to the insurance policies in force, the insurance company may choose to cancel these policies or reinsure them with another company. The national Reinsurance Corporation of New York, for example, voluntarily liquidated in 1956 after reinsuring all policies by the Reinsurance Corporation of New York. Banker Hill Insurance Company of Philadelphia, on the other hand, voluntarily dissolved and all policies were cancelled as of August 22, 1957. However, in either


38 Ibid.

39 Best's Insurance Reports, 1960, p. 719B.

40 Ibid., p.
case, the insurance company has to seek the approval of the insurance commissioner whose job is the protection of the policyholders' interests.

Involuntary liquidation takes place when it is unadvisable for an insurance company to continue doing business while it is considered delinquent or insolvent by the insurance commissioner. Insurance laws of the various states usually set forth the grounds for liquidation. Section 511 of New York Insurance Law lists, for example, fourteen grounds for liquidation of domestic insurers, including insolvency, refusal to submit books and accounts for inspection, failure to comply with an order to make good impairments of capital or surplus, etc.

Liquidation proceedings are carried out under the statute and start with a hearing before the court based on a petition from the insurance commissioner. If the application for a liquidation is granted, the insurance commissioner is appointed liquidator and title to the company's assets is vested in him.

It was the practice in the State of New York before 1909 to liquidate insolvent insurers in ordinary receivership proceedings similar to all other businesses except banks. By appointing the insurance commissioner as liquidator it proved to be beneficial in the sense that the process of liquidation has been speeded up, with a marked reduction in the costs of liquidation and an increase in the amount recovered by the policyholders.

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42 Ibid., pp. 611-12.
The duties of the insurance commissioner as liquidator are generally divided into two parts: ⁴³

1. To protect and marshal the assets of the company subject to liquidation.

2. To apply these assets to payment of the insurer's liabilities.

Table 7 indicates that eighty-eight fire and casualty insurance companies were liquidated in the decades of the 1950's out of which twenty-seven stock companies and twenty-eight mutual companies (a total of fifty-five companies) voluntarily liquidated and ten stock companies and twenty-three mutual companies (a total of thirty-three companies), involuntarily liquidated.

Rehabilitation

The term rehabilitation refers to the action of the insurance commissioner when he takes possession of an insolvent or near insolvent insurance company. As a rehabilitator, the commissioner is responsible for running the insurer's business until the conditions which called for its rehabilitation are removed, thus making it possible to return it to its former management or dispose of it to a successor corporation.

The insurance commissioner may apply for an order of rehabilitation of an insurance company if he expects that the company's conditions could be restored on a sound basis through its rehabilitation. This might be a better solution for the stockholders, policyholders and

TABLE 7
NUMBER OF FIRE AND CASUALTY COMPANIES LIQUIDATED IN THE UNITED STATES, 1950-1959

<table>
<thead>
<tr>
<th>Year</th>
<th>VOLUNTARY Stock</th>
<th>Voluntary Mutual</th>
<th>Total</th>
<th>IN Peoples Stock</th>
<th>peoples Mutual</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>2</td>
<td>3</td>
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<td>--</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>1951</td>
<td>2</td>
<td>1</td>
<td>3</td>
<td>1</td>
<td>3</td>
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<tr>
<td>1952</td>
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<td>4</td>
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<td>--</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>1953</td>
<td>1</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td>3</td>
<td>7</td>
</tr>
<tr>
<td>1954</td>
<td>3</td>
<td>5</td>
<td>8</td>
<td>--</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>1955</td>
<td>5</td>
<td>3</td>
<td>8</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>1956</td>
<td>3</td>
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<td>6</td>
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<td>3</td>
<td>7</td>
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<tr>
<td>1957</td>
<td>8</td>
<td>1</td>
<td>9</td>
<td>1</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>1958</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>--</td>
<td>--</td>
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</tr>
<tr>
<td>1959</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
</tbody>
</table>

Total | 27 | 28 | 55 | 10 | 23 | 33 |

Source: Best's Insurance Reports, Fire and Casualty, 1960, pp. 716B-726B.

creditors of an insolvent company than its liquidation. Sometimes, however, the commissioner may find it futile to continue an attempt at such rehabilitation so he may apply for a liquidation order. 44

Rehabilitation of a fire and casualty insurance company and restoration of its affairs to the former or a new management has not

44 New York Insurance Law, Section 512.
worked out successfully to any large degree during the decade of the 1950's. Only two companies were rehabilitated, Rhode Island Insurance Company of Providence, Rhode Island and Mid-Union Indemnity Company of Illinois. The first company was placed under the Director of Insurance Regulation for rehabilitation, July 20, 1950. This attempt was unsuccessful so it was placed in liquidation by court order, December, 1952. The latter company was placed in rehabilitation under the direction of the Illinois Insurance Department as of August 31, 1959.

Receivership and conservation

The insurance commissioner may file a suit against an insurer to obtain the appointment of a receiver and an injunction against the further continuance of business. Provisions are made in all state laws for the appointment of a receiver for a domestic company at the instance of the insurance commissioner or of the attorney general. Due to the fact that many states narrow the grounds for revocation of a domestic company's license, compared with those applied to foreign companies, receivership is considered a solution in situations where the commissioner has no power of revoking a domestic company's license.

Receivership is usually applied for when an insurance company is in financial difficulties. During the 1950's receivership

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45 *Best's Insurance Reports* (1960), p. 719B.
46 Ibid.
47 Ibid.
48 Edwin Wilhite Patterson, *op. cit.*, p. 95.
49 Ibid., p. 94.
proceedings were taken against twenty-two stock and twenty-eight mutual fire and casualty insurance companies (a total of fifty receiverships) as indicated in Table 8. A remarkable number of these actions were taken in the State of Texas where six stock companies and eighteen mutual companies were put under receivership.

**TABLE 8**

NUMBER OF FIRE AND CASUALTY COMPANIES PUT UNDER RECEIVERSHIP IN THE UNITED STATES, 1950-1959

<table>
<thead>
<tr>
<th>Year</th>
<th>Stock</th>
<th>Mutual</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>--</td>
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<td>4</td>
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<td>1951</td>
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<tr>
<td>1953</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>1954</td>
<td>3</td>
<td>4</td>
<td>7</td>
</tr>
<tr>
<td>1955</td>
<td>6</td>
<td>5</td>
<td>11</td>
</tr>
<tr>
<td>1956</td>
<td>4</td>
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<td>1957</td>
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<td>1</td>
<td>3</td>
</tr>
<tr>
<td>1959</td>
<td>3</td>
<td>2</td>
<td>5</td>
</tr>
</tbody>
</table>

**Total** 22 28 50

*Source: Best's Insurance Reports, Fire and Casualty, 1960, pp. 716B-726B.*
With regard to foreign and alien insurers the commissioner is given authority to institute conservation proceedings. He is directed by a court order to take into his possession the assets of a foreign or alien insurer which are located in the State of New York, for example, and to conserve the same until further order. In the conservation proceeding the conservator has no statutory authority either to adjudicate or pay claims. However, an agreement may be reached between the conservator and domiciliary receiver which will be subject to approval by the court in both the domiciliary receivership and in the conservation proceeding. This agreement gives the conservator the authority to adjudicate claims filed in the conservation proceeding and pay allowed claims if there are sufficient funds.

There were three cases of conservation proceedings during the 1950's out of which one involved a non-licensed insurer with assets in New York. The New York Superintendent of Insurance was appointed conservator April 7, 1952 for the Eastern Insurance Company of Wilmington, Delaware of which nearly all policyholders and creditors were located in New York. By special court order, the New York Conservator made distribution directly to the creditors.

In summary, there are several ways of classifying merger transactions. Such classification could be identified according to the tax point of view, the accounting point of view, the motives or objectives

50 New Insurance Laws, Sects. 515 and 516.

51 Best's Insurance Reports (1960), pp. 717-18B.
behind the merger transaction, type of companies involved, and the ownership or company management.

Merger of insurance companies could be accomplished by several methods. The most important company mergers are effected by acquiring a company's stock through exchange or purchase. Another method of merger is the purchase of the acquired company's net assets.

Valuation of insurance companies represents the major bargaining stage between the interested parties of the merger transaction. There are several methods of valuation of property and liability insurance companies. These include book value, market value, liquidating value, and going concern or current actual value.

Merger or acquisition is not the only instrument by which unprofitable insurance companies or those in financial difficulties were eliminated from the insurance business. Certain alternative approaches may be taken subject to approval by the insurance commissioner. These include reinsurance, liquidation, rehabilitation, and receivership.
CHAPTER V

EFFECTS OF Mergers ON THE INDIVIDUAL COMPANY

The purpose of this chapter is to present the planning process of merger and to point out some of the problems which might be faced by the merged company following such process. It can not be said that any two mergers consummated between insurance companies are ever the same. These might be very similar but they can never be the same since the human element is involved. This fact makes it difficult to set guide lines or benchmarks against which a merger transaction has to be checked to assure its success.

To be successful, a merger plan should be tailored to the desires of those whose approval is most important in making the merger transaction effective. Many selling companies insist on a tax-free exchange of stock by which they receive the acquiring company's stock in exchange for their equity in the acquired company. This is a common stipulation of company owners who have built up their business over a period of years and who fear they would pay substantial capital gain taxes on taxable acquisitions.

Merger or acquisition should be a part of a company's long-range planning. It is one means of implementing the company's plans and achieving its objectives. The long-range plan which indicates how a company will act to reach its objectives should clearly specify the
contribution of merger or acquisition to the over-all plan. Establish­
ing company objectives, evaluating resources, and setting a long-range plan are fundamental to the consideration of merger by both the acquir­ing and the acquired company. ¹

Planning a merger in advance can help the acquiring company to find the right company and evaluate it after it has been found. The planning function consists of three phases as follows: ²

1. Stating objectives
2. Setting criteria; and
3. Organizing to achieve the objectives.

**Stating Objectives**

An insurer willing to adopt a merger program should define care­fully the underlying objectives behind this type of acquisition before a search for a particular company is initiated. The absence of defined objectives will only lead to haphazard search for a type of company nobody knows. It will be a fortuitous circumstance if any sensible merger transactions are consummated.

There always exists the danger that some of the goals and objec­tives of the acquiring company go astray in some merger transactions if these objectives are not clearly defined in advance. The mere fact that some merger transactions have been successfully consummated should not induce other companies to follow suit unless their conditions require

¹Clarence I. Drayton, *op. cit.*, p. 43.

such action. This requires careful analysis of the company's strengths and weaknesses in areas such as underwriting, marketing, personnel, and finance. Such analysis will serve as a background of experience and basis for determining what action has to be taken to strengthen the company's competitive position.

Establishing the company's objectives requires the cooperation of its top management since it represents an important phase of the planning process. The top executives have to think in terms of the goals and objectives to be achieved when setting the broad lines of the merger plan. Merger or acquisition of an insurance company without clear objectives as to the reasons for such action can lead to substantial loss of profits except under accidental circumstances.

Criteria

Once the company's objectives have been defined, creating criteria and implementing the program is relatively simple. Establishing a set of criteria which describe specifically the type of company to be considered for merger or acquisition represents the second step in the planning process.

There are several reasons for establishing a set of criteria:3

a. They help as guidelines for those company personnel who are responsible for carrying out the merger process. The established criteria will describe the elements which are essential in a company to qualify for merger. Such elements as size, growth potential of the prospect, underwriting experience, underwriting results, lines of

3Ibid., pp. 66-69.
insurance written, management compatibility, agency representation, geographical coverages, price, method of financing and anti-trust considerations, will help to locate the right company.

b. They help in screening candidates for merger or acquisition by the company's personnel and by outside agencies. By eliminating those companies which are not acceptable according to the company's criteria, the search for the right company will be narrowed down thus helping to save time, effort, and aimless study.

c. Such criteria could be used by investment bankers and outside agencies which have a fair knowledge about companies interested in selling. Without a fairly clearly described set of criteria, their proposals will waste the time of the company's executives on nonuseful and diversionary discussions.

The statements of criteria must be constructed "to give detailed meaning to the individual company objectives and to reflect realistically what is practicable in view of the company's conditions."\(^4\) Owing to the fact that growth, financial strength, and operating conditions vary among insurance companies, statements of criteria must be tailored to each company's objectives and circumstances.

Statements of criteria should be checked from time to time to assure their validity. In case of identifying a prospect for merger, top management should conduct a preliminary examination. Acceptance or rejection recommendations by the examiners should be studied closely.

If the criteria are correct and accurate, management should

\(^{4}\)Ibid., p. 73.
agree with the merger program. However, any disagreement from a member or members of the management will sometimes indicate the need for making modifications of the criteria which should be conducted after a thorough examination of their point of view.

Organizing for Merger

Following the establishment of the company's objectives and criteria, organizing for merger or acquisition represents an extremely important step in the planning process. To organize for the job is to institute a staff group for acquisitions headed by a competent key executive who will work closely with the chief operating executive.

The involvement of the chief operating executive is crucial to the success of an insurance company's merger program. This is because of his responsibility to plot the growth of the enterprise and his authority to represent the corporation in relation with others. He is the one who can convince the board of directors of the desirability of the merger program and secure its approval.

The major role of the staff group is to advise the company's management with regard to the effect of outside financial, social, and economic factors on the company's acquisition plans and objectives. Further, it performs economic and financial analyses related to the merger plans. Finally, it presents recommendations about the feasibility of growth through merger based on identifying and evaluating prospects for merger.

The size of the staff group depends upon the size of the acquiring company. It may range from one specialist in a small company to a
dozen financial analysts, market analysts, attorneys, and other insurance specialists in a very large company.

The fact that the merger processes are different from administration of a going business, calls for the assignment of functional specialists to a staff group for planning the venture. The merger process involves financial and personnel evaluations which are quite different from the daily operating problems found in a company. Some insurers who lacked the needed talent for evaluating merger proposals, have employed consultants to provide the professional services needed to complete merger transactions.

**Merger Problems -- The Individual Company**

The growing popularity of insurance companies' mergers in recent years has somewhat obscured the fact that they can raise more problems than they solve unless careful thought and preparation to dealing with such problems is given by both the managements of both the constituent companies. Most of these problems are a result of the consummation of a merger because some managements of the acquired companies do not reveal their weaknesses, if any, since the answers for questions of "how do you do this and why" may take a long time. The competition between big and medium-size companies to absorb other insurance companies necessitates this expedience of summing up the deal.

The problems presented in this chapter are not general but merely incidents based on individual cases. Personal interviews with executives of fourteen fire and casualty insurance companies helped to furnish the information needed at this stage of the study. The
interviewed executives expressed their desire that their company's identity should not be revealed or associated with these problems for whatever reasons they have in their minds. Table 9, however, summarizes the results of the personal interviews with regard to the problems which emerge as a result of the merger.

Many problems arise following the consummation of a merger transaction which may cause trouble for the acquiring company. Some insurers may not give such problems sufficient attention before entering into a negotiation to acquire another company by reason of enthusiasm for such transaction. The fact that some merger transactions might appear to be promising or successful does not mean that all mergers are good. A careful consideration of the pros and cons of a merger transaction will help to avoid serious consequences.

The main problem which faces management in the merger or acquisition of an insurance company is how to integrate the activities of the merging companies. Integration is defined by the New "Standard" Dictionary as "the act or process of integrating, or of being integrated; the bringing together of parts into a whole." The word "integration" assumes a special meaning to the management team in a merger case. It means "the bringing together of two or more companies, formerly operating under different management concepts, which now must continue according to a single concept."  

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Source: Personal interviews with executives of 14 acquiring companies.
The fact that concepts are the product of people's thinking creates the necessity of changing their thinking in order to change concepts. This could be achieved by comparing the different procedures used by the merging companies and selecting the methods which prove to be most efficient regardless of whether these methods are used by the acquiring or the acquired company.

Such headings as underwriting, personnel, accounting and finance, and marketing will be dealt with in the following pages. No attempt has been made to list these problems according to their importance.

**Underwriting**

Underwriting is the process of "selecting and rating of risks and continued observation and management of risks upon the insurer's books." It is the function of the underwriting department to develop, create and maintain a well-diversified, and profitable portfolio of business for the insurer.

The underwriting department prepares an underwriting program for the guidance of the production department in the solicitation of business. This program is based on the fundamental objectives that the insurer is attempting to achieve.

Risks are divided into three classes for underwriting purposes: (1) those the insurer will reject; (2) those which the insurer will consider but may not be written by the producer without the insurer's

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7 Gostave F. Michelbacher, op. cit., p. 170.
consent; and (3) those the insurer will write freely. This classification requires the underwriter to exercise whatever legitimate discretion is available to him in the execution of his function.

The underwriter's job includes preparation of policy forms, establishment of rating systems, preparation of an underwriting program, examination and acceptance of business rating, reinsurance, checking experience, and renewal of business. These activities may be handled in a single underwriting department or a number of departments according to the volume of insurance business and the classes of insurance written. For the purpose of specialization, several underwriting departments for fire and allied lines, automobile insurance, inland marine insurance, accident and health, and other classes of insurance may be found in one company.

With this brief background about the nature and the function of the underwriting department, it is expected that some problems will develop as a result of merger of two or more companies. These problems are as follows.

Integration of underwriting department.--Methods of underwriting differ materially from one insurance company to another. The existence of some different practices and philosophies in the underwriting of a particular risk calls for the evaluation of the underwriting programs in force. The fact that no two companies are identical in their methods of operation explains why some insurance companies are making profits

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8 Ibid., pp. 174-175.
9 Ibid., pp. 172-189.
while others are losing. This, however, poses a problem when two or more companies are combined.

A certain underwriter may consider a certain type of risk a bad risk and refuse to write it or at least be very careful when considering such risk while another underwriter may consider it good and write it freely. It is hard to change the view of an underwriter with, for example, twenty years of experience in the insurance business merely because a merger transaction has taken place, unless the insurer is willing to run the risk of losing him.

Underwriters are handicapped in their work of selection because of the competitive conditions which prevail in the insurance business. Several insurers may be competing for the business of valued insureds or producers (agents and brokers) and each insurer wishes to convince them that he can take care of all their underwriting requirements. The insurer is keen to retain the patronage of the insured or producer by accepting all his business. Some of the accepted business would be uninsurable if taken by itself. This unwelcome business is termed as "accommodation risk." Underwriters' ideas differ with regard to this type of risk. It is noticed that the portfolio of insurance of the acquired company is put under thorough investigation and refinement following the merger. In most cases, the acquiring company discontinues a remarkable portion of such portfolio because of the differences between the underwriting practices. The underwriting process can never be standardized or reduced to a formula since it involves a large element of personal judgment.

It was found that seven of the fourteen insurance companies
interviewed had experienced such a problem in the course of their merger transactions. These insurers suggested a remedy for this problem through the evaluation of the underwriting practices of both the merging companies and adoption of the better one or compromise between both programs.

However, an underwriting program may look better at the time of merger under the existing circumstances but may later prove to be inadequate. This requires the continuous and careful revision of the adapted program from time to time according to the insurer's experience and the practices of other competitive organizations.

**Line limits of retention.**—The limit of retention is the amount of insurance which an insurance company must retain for its own account on every claim arising under any of its business coming within the scope of the cover. The amount to be reinsured depends upon the amount which the company desires to carry net for its own account on a risk.

To avoid excessive exposure to a single hazard, insurance companies set their limits of retention according to their financial strength. Such decision involves the determination of the largest amount of loss which could be met at one time without causing insolvency of the insurer, as well as the possibility of several individual risks being involved in the same loss.

The fact that line limits of retention vary from one insurer to another, poses a problem in the case of merger. Some underwriters will continue to insist on using their past limits of retention despite the increase in the company's capital and surplus merely because they want to be more cautious and are influenced by their company's practice
before the merger. Four of the interviewed companies experienced such a problem and stated that it was a minor one compared to major problems. The surviving company's decision with regard to the amount of insurance to be retained at one time prevailed, all through.

The practical solution for such a problem is to determine the acquiring company's financial position following the consummation of the merger. In order to protect the solvency of the insurer, limits of retention must be set with regard to the company's capital and surplus at that time.

Reinsurance practices.--Reinsurance is among the important responsibilities of the underwriting department. To satisfy field representatives or insureds, the insurer must often write an amount of insurance on a single risk or in a single territory larger than its financial capacity permits it to carry safely by itself. To achieve this goal, the insurer divests itself of part of the liability it assumes when writing such a volume of insurance through an arrangement with one or more other insurers to share the risk. This type of arrangement is termed reinsurance.

Owing to the wide differences between the requirements of individual insurers and the divergent ideas of the underwriters with regard to proper distribution of the assumed risk, there exist several types of reinsurance contracts. These contracts could be classified under either (a) share reinsurance which is based on sharing the volume of risk insured against or (b) excess reinsurance which is based on sharing in the losses which take place over the limit of retention.

In the case of the merger of two different companies -- fire
with casualty or vice versa -- there will be no problem in the area of reinsurance since there will be no change in the limits of retention. On the other hand, if the constituent companies write similar lines of insurance, the problem of how to bring together both reinsurance practices under a single concept takes place particularly if two different contracts are used such as share vs. excess reinsurance. Also, some insurers (A) are known as growth-line underwriters who look only to the gross-value of the value of $500,000, for example, while other insurers (B) are known as net-line underwriters who look for insurance not to exceed $100,000, for example, since they do not care about using the reinsurance media. So, if the amount of insurance against a particular risk exceeds $100,000, an insurer in group B will not write it while it will be written by any insurer in group A.

It was found that nine insurers out of the interviewed insurers stated that this is an important problem with which the underwriting department of the acquirer has to make a fast and careful decision since it involves changing and cancelling some reinsurance contracts. In any case the decision with regard to this problem is based on the determination of the line limits of retention following the merger. The only party which is going to be affected by such decision is the reinsurer since the reinsurance needs for a larger company are different as a result of the increase in the limits of retention.

Reinsurance is not considered a problem in the case of merger or acquisition of companies that are members of the same group or "fleet." The practice is that the several companies agree among themselves to reinsure 100 percent of their direct writings automatically.
and immediately with the largest company of the group which is con-
sidered the head of the group. That company, after procuring such
outside reinsurance on individual risks which its underwriters deem
necessary, distributes the remainder among the group members in fixed
ratios. This practice which is known as "pooling agreement" was used
by the Royal Exchange Assurance Group and Carron and Reynolds group
which acquired members of the same group during the period of study.

In some cases the smaller companies in the group are in effect
only agencies which reinsure all the business written to the parent
company and receive an appropriate share of its underwriting profits,
if any. Louisiana Fire Insurance Company reinsures all business as
written with its parent Great American Insurance Company. Also Fulton
Insurance Company reinsures all its business annually with Hanover
Insurance Company.

In either case, pooling agreement or agency operation, merger
has no effect since the reinsurance practice in existence at the time
of the merger will not be subject to change and all reinsurance contracts
with outside reinsurers continue as if nothing had taken place.

**Standardization of policy forms.**—One of the functions of the
underwriter is the drafting of policy forms. There is a multiplicity
of policy forms used by the various fire and casualty insurance com-
panies. These forms are the result of an extensive study of the line
of business written by the insurer and whether the company is a member
of a rating organization "Bureau" or a deviator "Non-bureau."

In the case of the merger of a bureau company with another
bureau company there will be no problem. A merger of a bureau company
with a non-bureau company creates the problem of drafting new policy forms and getting them oriented which may prove to be expensive since they have to dispose of all the old forms. However, this may be a minor problem which faces the underwriting department since only two of the interviewed companies agreed that it took much time to draft policy forms and endorsements as well as to instruct representatives in their proper use.

**Personnel**

Integration of personnel represents a ticklish situation which needs to be handled by guidance rather than control; by friendly cooperation rather than domination. If a merger is based wholly on a purely financial basis without consideration of the management capabilities and personalities, it is bound to give rise to integration problems. The values to be derived from a merger transaction depend largely upon the skill with which these problems are handled.

Most merger negotiations are conducted under secrecy, and relatively few people from each company are involved. When an agreement has been reached, employees of the constituent companies must be informed and advised. However, the impact of such agreement on all the acquired company personnel is sharp and real. The following are some of the problems which may rise as a result of the merger.

**Difference in management philosophies.**—There has been a marked increase of interest in the problem of management philosophy, since
1945, among business executives. Such philosophy expresses the attitude of management towards major things such as subordinates, the community, the government, society, and the belief in the economic values provided by the business.

This philosophy of management, whether officially formulated or not, is the basis for managerial action and the framework within which the business is conducted. It may be reflected in objectives and policies, and in the attitudes of management toward employees and others.

Since philosophy of management is a system of thought for the logical analysis and rational solution of business problems, it is necessary to provide a suitable climate for this philosophy. This climate could be provided by having the philosophy accepted by the parties concerned through a meeting of minds.

Meeting of minds could be achieved through education and indoctrination. Education helps to qualify the person concerned to view the various aspects of different opinions with regard to a set of problems which he faces. Indoctrination is to get communication of ideas to a degree that enables the manager to behave in a manner which will permit the company to accomplish its objectives with maximum competitive effectiveness.

There is no established pattern of personal philosophy of


management which may help to compromise between two different philosophies in the case of a merger transaction. Although, the purposes of the managerial work are found in the objectives of the company employing a group of executives, they are normally unique to that company. 12

Thus, it is important for the top management of the acquiring company to compromise between the different philosophies of the merging companies in order to minimize any conflict of interests among all the concerned groups. Failure to compromise may create many problems which could be a threat for the continuation of the new organization.

One of the major areas where differences exist is the management philosophies toward incentives and employee morale. Management is likely to find, following the consummation of a merger, low morale among the acquired company's employees as a result of the abrupt change between the previous and the new management philosophy, particularly with regard to incentives.

It is the responsibility of top management to provide the climate for high morale among its employees. A good incentive system based on the employee's contribution to the whole organization is a basic factor in the development of high morale.

It was found that four of the interviewed companies experienced the problem of incentives and employee morale due to differences in management philosophies between the constituent parties. The practical solution suggested in this situation is to reconcile any differences between the new system and the previous which affect employee morale.

Achieving uniformity of employee benefit plans.--The continued growth of pension funds and the existence of a large number of fringe benefit plans makes it a necessity for a company to establish a satisfactory pension plan and other fringe benefits for its employees. However, many contrasts of design and funding exist. Also many costly, troublesome, and unsatisfactory arrangements have been made. This calls for a careful analysis of the employee benefit plans in existence when contemplating a merger.

Some of the problems which may take place as a result of the merger are as follows:¹³

a. Absence of any pension plan in the acquired company suggests the problem of funding the past service liabilities, if service with the previous employer is recognized in the revised plan for the merged company.

b. The same problem of unfunded past service liabilities could also be raised in case of a non-funded or "pay-as-you-go" pension plan. This problem is further complicated since a benefit scale has already been established and this scale may or may not provide benefits which would integrate easily with the plan of the acquiring company.

c. Difficulties may arise when one company has a contributory plan while the other has a non-contributory plan. To integrate the pension plans, either the first plan has to be made partly or wholly non-contributory, or the employees of the other company will have to

face the establishment of employee contributions under the revised plan. This may create problems of presentation, acceptance, bargaining, etc.

d. A plan with liberal or immediate vesting of all funds in employees (if the plan is terminated) may raise problems if it does not provide for its continuation in another form, or through another funding medium. It is difficult to secure waivers from each covered employee unless the plan is liberalized.

Employee benefit plans of the acquired company represent another problem to be dealt with. Many small and medium-sized companies, particularly those which are closely held, have salary, bonus, expense account and other fringe benefits far more generous than usually are found in larger acquiring companies. The explanation generally given is that these high benefits are required in order to keep the employees with the company.

The experiences of a number of interviewed executives who had dealt with employee benefit plans indicated that such a problem can be taken care of much more effectively before the merger rather than after. If there exists any element of a benefit plan, it should be determined, evaluated, negotiated, and made part of the merger agreement.

Those employees who are going to be affected by any change in the benefit plans should be informed in advance to avoid lowering their morale. The problem of administering a subsequent change must be handled with considerable administrative skill and efficiency.

The major problems created by pension plans and group benefits in a merger are centered around valuation of corporate worth prior to
the merger and integration of employee benefits after the merger. The proper handling and solving of the first problem will help to fix the policy and the solution to the second problem and make it simple.

Both the acquiring and the acquired parties must decide, prior to the merger, the type of pension plan to be adopted following the consummation of the merger. On the basis of the proposed pension plan, they then can proceed to evaluate the pension plan liabilities for a pension plan, such as entry-age-normal-cost, attained-age-normal-cost, unit-credit, and others. It is desirable to use the same method for all members of the proposed merger to avoid confusion and injustice. The use of the services of an expert will save the merging companies much trouble. These services include making recommendations of a suitable method, figuring or directing the calculations, and assisting in the choice of such funding factors as mortality rates, interest rate, turnover rates, salary or wage increase rates, and expense rates.

Once the parties to the merger have agreed about the valuation of the various pension plans in existence before the merger, the post-merger plan to be followed, the funding medium, and the mechanics and timing of changes, the successful integration of both pension plans depends upon the action taken by the acquiring management. If there is going to be any cut-back in the benefits, management must act promptly. Since any cut-back is always unwelcome, there will be less harm if it


is blamed on the merger action, rather than in its being blamed on the penuriousness of the merged companies, where any delay results.

Achieving uniformity of employee benefit plans was considered a major problem in ten of the interviewed companies. These companies were faced with the problem in varying degrees. For example, one acquired company had no retirement plan while the acquiring company has one. On the other hand, an acquired company has an insured pension plan while the acquirer did not have a formal plan. However, the merging company adopted a trustee plan after the merger.

Most of the insurance company mergers are assumed to be aware of the need for establishing employee benefit plans. This is in contrast to the general agencies which are run for the benefit of their owners and have no established plans at all. In case of the acquisition of an agency by an insurance company, funding of the plan may prove to be more costly than the value of the agency itself. Finally, in the case of the merger of two companies operated under common management, there will be no such problem at all.

Individual adjustment.--In today's society, the individual finds recognition in, and identifies himself with, a group. When this group is changed or enlarged, the individual loses his sense of identification to some extent. This is the reason why it is important to re-establish the acquired group as an integral part of the new organization and try hard to establish in it the corporate character of the acquiring

organization. This will enable the acquired group to identify itself fully with the merged company and gain personal satisfaction and recognition.

The problem of individual adjustment was recognized by all the interviewed companies despite the fact that only six companies dealt with such problems in their merger transactions. It was suggested that it always exists at the management level. Proper integration of these individuals will enable the acquiring company to retain valuable personnel and to evaluate employee morale.

Following the consummation of a merger, it is the job of the acquiring company management to plan and implement a program which will integrate the acquired group into the new organization fairly and wisely. The underlying objective behind such a program is to meet and dispel any suspicion or anxiety which might exist over the change of ownership.

However, it takes time for the acquired group to realize that it works for a different management. Therefore, the new management must be tactful, patient, and understanding on the one hand, and firm and convincing on the other hand.

The practical way to achieve successful integration is to go to the people of the acquired group and understand their problems. Direct contact with them will prove to be very helpful in erasing a number of doubts and fears in their minds which will have a definite influence on the success or failure of the integration program.

Completing personnel transfers and placement.--This problem is closely related to the former problem of individual adjustment. It is
one of the most emotion-filled problems of merger since it deals with personnel transfers and placement in the new organization according to standards of performance set by the acquiring company's management.

Previous owners of the acquired companies frequently express their views with regard to the moral responsibilities of management to care for long-term employees. It was said, "Letting 50- and 55-year old key people out on the streets with limited alternatives for employment is immoral and inconsistent with the ethics of responsible businessmen. Business has a responsibility toward these key people."\(^7\)

Acquirers of companies, on the other hand, base their selection, transfers, and placement of personnel on their best judgment. One of the major reasons for merger or acquisition is to reduce cost of operating the business. Thus if it is concluded that employee X will not make useful contributions to the new organization and could not perform efficiently, then he has to go no matter how long he has worked or been in the insurance business. Lay off of personnel represents a humanistic problem. Such a problem, however, can not be avoided where the merger transaction involves duplication of personnel for the same job and results in having many people in areas such as clerical units, automation, accounting, etc. Although executive staff is flexible to move, it is hard to transfer or shift clerical units. A casualty man can easily move to fidelity lines but not to the fire lines since he has different views with regard to the risk insured.

Displacement of personnel represents a human problem which is

\(^7\)Myles L. Mace, *op. cit.*, pp. 267-68.
felt more by the aged employees than the young ones. It was stated, "Many loyal employees who have given the best years of their life have been turned out to graze only to find the door closed to new employment in many cases because of age and company retirement plans, although we have had some mergers where to my knowledge the company assuming the business has gone overboard to take care of the personnel. This, however, is the exception rather than the general practice." 18

It was noted that only three of the interviewed companies experienced such a problem. The reasons underlying its emergence included duplication of personnel for the same job and location of the constituent companies in two different states.

The handling of this problem varied from one company to another. One executive stated that his company issued a manual of transfers which included liberal payment of expenses for the employee, his family, and his household. Another executive stated that some layoffs could not be avoided since it was essential to reduce the cost of doing business, but they considered the age of the employees and their opportunities for employment. Liberal compensations were paid to them to ease such a hardship. Finally, the third executive stated that although they had extra people as a result of the merger, they re-assigned these people and in due course they may expect some employees to quit voluntarily. They did not plan to hire or replace those people, but to wind up with a certain number of people who can do the job much more economically.

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and effectively without the need for paying a severe penalty involved in the layoff.

**Accounting and Finance**

In Chapter IV, some accounting and financial problems encountered in mergers were discussed, namely, the accounting view and valuation methods of the merged companies. Certain combinations may be considered to involve the emergence of a new ownership "purchase," while others represent no more than a continuation in combined form of the former ownerships (pooling of interests). The distinction between both treatments assumes significance as a determinant of the approach that is to be taken in accounting for the combination.

Furthermore, whether a company plans to grow by internal development or by merger or acquisition, a program of any proportion runs into the problem of finance. A preliminary step in a growth program is to review the company's inside resources and its policy toward the use of those or outside resources.

Not all the financial problems, however, relate to the first cost of acquisition; instead there are those which occur when the merger has been consummated and the need arises to finance programs brought about by the merger transaction.

It is not unusual that the acquired company may not turn out to be as attractive as first analyzed. Some additional funds may be needed to cover weaknesses about which the acquiring company had not been aware.

Competition between insurance companies may force the acquiring
company to follow a stepped-up promotion program to retain its experienced key personnel.

The following are also some problems which may emerge after a merger because of the different procedures used by each individual company.

Centralization or decentralization of the merged companies.--As the acquiring company expands through merger with other companies, it tends toward bureaucratic operation with a loss of efficiency and rising costs. 19 The fact that every decision must pass through a long chain of command creates personnel problems and makes communication within the organization increasingly difficult. Decentralization might be the remedy to solve such problems.

Decentralization helps the company to make realistic decisions with regard to the needs and desires of the communities it serves. More rapid service could be rendered to the agents and policyholders. There will be more opportunities for advancement of key personnel and more line jobs which will help in training future executives. Furthermore, the problems of limited space in the home office and limited supplies of secretarial and office talent are overcome. 20

Although these are some advantages of decentralization, it involves some problems such as the inadequate supply of technically competent personnel for the decentralized office. Since field personnel have to make decisions for major problems, they must be qualified to make

19 John S. Bickley, op. cit., p. 49.
20 Ibid., p. 50.
such decisions. Also, home office personnel have to be adjusted for the new policy-making role into which they are placed. Finally, as a result of the growing interest in electronic operation, many insurance companies have invested substantial amounts in electronics equipment. Decentralization will reduce the amount of information to be handled to allow economical use of such machines.

Only three of the interviewed companies were faced with the decision of whether to centralize or decentralize. Two of these companies are tending toward centralization, which they considered the answer for cost control. The third company, on the other hand, is working to decentralize most of its operations except those which have to be maintained at the home office such as accounting and investment policies.

**Standardization of accounting and reporting procedures.**—Under normal conditions, alternative accounting procedures may be recognized as fully acceptable in their treatment of items such as valuation methods, allowances relating to receivables, amortization of intangibles, policies applied to recognition of deferrals and accruals and others. The use of different accounting and reporting procedures by the parties of a merger will create the problem of standardizing such procedures.

A merger transaction calls for the selection of particular procedures or policies and their uniform application. Income statements for the constituent companies must be recast (as well as the balance sheets) to achieve a full and comparable accounting. In case of
differences in income measurement processes are found, restatement in terms of a uniform process is required.

It was found that six of the interviewed companies faced such a problem. One executive stated that they discovered the existence of five different systems of accounting and reporting procedures used by the constituent parties. They took the best of each system and arrived at a new system which is now used by the surviving company. Other executives stated that such a problem is difficult but it has to be done and suggested the use of an experienced consultant. Finally, an executive stated that they kept both of the constituent companies separate for about three years and started to put them together gradually after a comprehensive study and comparison between both systems. This resulted in the existing system becoming a combination of the best procedures of the previous systems.

Electronic data processing.--In recent years dynamic changes have taken place in the insurance market out of which came the new services offered by insurance companies, e.g. packaged insurance policies such as homeowners, budget plans, merit rating, and experience rating. All of these services created the need for information within the insurance community. Many insurance companies, in order to accomplish such services, invested substantial amounts of money in electronic machines.

There are several brands of electronic machines which use different codes for operation such as IBM and Remington Rand. In addition to this, insurance companies using such electronic devices are in different stages of electronic development.
Merger of two insurance companies using two different electronic devices raises the problem of achieving uniformity in the system which has to be used by the surviving company. Only four of the interviewed companies experienced such a problem, which requires the greatest degree of attention, otherwise the whole operation will be upset. One company approached such a problem by putting all the new business on their IBM machines till they ran out of all materials used on the Remington Rand machines. Another company achieved uniformity by setting a new code of operation. A third company hired a very highly-skilled technician to put both operations in shape.

Such a problem was disregarded by some merged companies when the acquiring company did not use any electronic devices before the merger, while the acquired company did. They just turned all the business over to the acquired company's machines. Some insurance companies are accustomed to rent electronic machines "one shift" from other companies since their volume of operation did not cover the full capacity of the machines.

Methods of maintaining reserves.--Reserves set aside by property and liability insurance companies may be classified as liabilities or earmarked surplus, depending on whether or not they are required by statute. In other words, there are two general types of reserves, (a) statutory or otherwise required reserves; and (b) voluntary and general contingency reserves and other special funds which must be reported in the annual statement as special surplus.

There are two distinctive statutory reserves, namely, the un­
earned premium reserves, which represent "the portion of the gross
premiums on contracts in force corresponding to their unexpired peri-
22od," and the loss reserves, as of a certain date, representing "the
amount which would liquidate all unsettled claims made against the
insurer up to and including that date" including both regular (known
losses) and incurred (unknown losses).

There are various methods of calculating these statutory
reserves. The more important and most used in practice are the half-
yearly method and the semi-monthly method for determining the unearned-
premium reserves. 24 Also used are the individual case estimate; the
average value; the tabular; and the formula or loss ratio method for
determining the loss reserves. 25

Although insurers are somewhat restricted by statute to the
use of specified methods, there is no uniformity among them in the use
of these methods. Each insurer chooses the methods which it thinks to
be suitable to its case and which will assure an adequate reserve. No
method has proven to fit all property and casualty insurance companies.
Each method fits a particular situation and the insurer relies heavily
on its judgment in its choice for the method which best fits.

Beside these two reserves, the insurance company is required by

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22Ibid., p. 397.
24Ibid., p. 126.
25Ibid., p. 117.
statute to set aside reserves for dividends, declared and unpaid and
either due or undue, taxes, and all other outstanding liabilities. 26

Finally, insurers maintain voluntary reserves, namely, general contingency reserves and investment fluctuation reserves.

These voluntary reserves are wholly set up by insurers on the
basis of their own decision. The purpose is to meet emergencies and to
iron out fluctuations in experience. This requires forecasting of the
future events and changes in economic conditions, which is merely a
matter of judgment.

The existence of several methods of setting the various reserves
in which personal judgment plays a vital role raises the problem of de-
termining which method is to be followed subsequent to the merger.
Such a problem was experienced by five of the interviewed companies in
the course of their mergers. It was found in one merger case that the
acquired company was over-reserved while in another case the acquired
company was considered under-reserved from the acquiring insurer's
point of view.

The problem of maintaining reserves was approached in two dif-
ferent ways by the interviewed companies. Some of them followed the
survivor's policy without any change despite the differences which
existed before the merger. The others adopted a new policy based on
a careful investigation of the pre-merger reserve methods, and including
the best features of the previous policies.

26Ohio Insurance Laws Annotated, 1960 (Cincinnati, Ohio: The
Investment policies.--The investment policy of a property insurance company is different from the policy of a casualty company. This difference is due to the fact that a property company writes a limited commitment on a risk for a one-year, three-year, or five-year period, whereas the casualty company, as a general rule, writes for only a one-year term and its liability can reach very high figures. Consequently, property companies lay less stress on the matter of liquidity and can go deeper into certain investment outlets than can casualty companies. In other words, property companies can afford to invest more heavily in equities than casualty companies. Table 10 indicates the significant difference in securities holdings of both the property and liability companies in 1962.

Investment policies of insurance companies also vary to a marked degree within the property and liability insurance companies. Such variations, however, are within the framework of state and self-imposed regulations. These investment policies could be classified, according to the company's holdings of securities, into three classes.

The first class includes those companies which place major stress on ownership of bonds. The underlying reason behind this investment policy is their reluctance to venture their funds in the security market and assume another burden beyond the existing risk and liability assumed in underwriting. Some of the large and financially strong companies follow this conservative policy. Also, some companies which are relatively strong financially or with an unusually high or concentrated insurance hazard (as well as the very small companies), have generally followed the same pattern.
## TABLE 10

PORTFOLIO PATTERNS, SELECTED STOCK PROPERTY AND LIABILITY INSURANCE COMPANIES, BY TYPE, 1962
PERCENT OF TOTAL ASSETS (ADMITTED)

<table>
<thead>
<tr>
<th>Portfolio Pattern</th>
<th>Bonds</th>
<th>Common Stocks</th>
<th>Preferred Stocks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock Multiple Line (98 Standard Rate)</td>
<td>40.9%</td>
<td>41.6%</td>
<td>2.8%</td>
</tr>
<tr>
<td>Multiple Lines, Fire Predominating (29 Standard Rate)</td>
<td>35.2</td>
<td>47.7</td>
<td>3.1</td>
</tr>
<tr>
<td>Multiple Lines, Casualty Predominating (22 Standard Rate)</td>
<td>52.8</td>
<td>24.1</td>
<td>2.1</td>
</tr>
<tr>
<td>Fire and Allied Lines Predominating (86 Standard Rate)</td>
<td>30.4</td>
<td>55.6</td>
<td>1.6</td>
</tr>
<tr>
<td>Fire and Allied Lines Predominating (38 Rate Deviating)</td>
<td>53.6</td>
<td>17.9</td>
<td>1.4</td>
</tr>
<tr>
<td>Casualty and Surety Lines Predominating (41 Standard Rate)</td>
<td>58.9</td>
<td>25.9</td>
<td>0.7</td>
</tr>
<tr>
<td>Casualty and Surety Lines Predominating (20 Rate Deviating)</td>
<td>49.2</td>
<td>18.6</td>
<td>0.8</td>
</tr>
<tr>
<td>Automobile (115 Participating and/or Deviating)</td>
<td>55.9</td>
<td>21.4</td>
<td>3.5</td>
</tr>
<tr>
<td>Automobile (40 Standard Rate)</td>
<td>42.7</td>
<td>17.1</td>
<td>3.5</td>
</tr>
<tr>
<td><strong>Grand Total -- 809 Stock Fire and Casualty Companies</strong></td>
<td>46.4%</td>
<td>35.4%</td>
<td>2.7%</td>
</tr>
</tbody>
</table>

The second class includes those companies which have followed a more aggressive investment policy by placing greater emphasis on equi-
ties. These companies reason to some extent that the erosion of inflation on the value of fixed income securities represents a threat to their financial strength the same as unprofitable insurance opera-
tions. They have invested in common stocks the most part of the funds left after maintaining cash and bond holdings in sufficient amounts to cover insurance liabilities and reserves, and to meet the regulatory re-
quirements. These companies seek higher income and appreciation to reduce the squeeze on surplus from the rise in liabilities in an infla-
tionary period.

The final class of investment policies is followed by those companies which could not be considered either conservative or aggres-
sive. These companies generally maintain a well balanced portfolio of bonds and stocks. They could not be considered heavy investors in either type of security.

The fact that investment policies vary from one company to the other creates the problem of compromising between both the merging parties' policies following the merger. Only seven interviewed com-
panies were faced by such a problem when combining both companies. One executive stated that their investment policy depends largely on the capital structure of the new company following the merger. However, regardless of what the acquired company's policy was before the merger, they are accustomed to invest fifty-seven percent of the surplus in equities. Another executive stated that the survivor's investment policy dominates since it puts its assets behind the acquisition.
A third executive stated that they utilize their investment portfolio to gain maximum return on the invested funds by adjusting their holdings of securities continuously according to the stock market. The other companies followed the same policy of compromising between both the investment policies of the acquirer and the acquired company and wound up with a single policy which was thought to serve both interests most effectively.

Another financial problem which has to be settled in the early stages of a merger is the problem of long-term leases. Some companies lease buildings to be used by its branch offices or even for the home offices for periods which may run to twenty years or more. If such company is acquired it will be hard to settle such leases without payment of a penalty, which may be a substantial amount of money.

**Marketing**

The marketing concept covers the "study or analysis of all business activities expended to effect the transfer or flow of goods and services from the producer to the consumer or user." It is the objective of any marketing program "to evolve the most efficient methods attainable in providing the consumer or user with the goods and services desired by the elimination, or reduction to a minimum, of waste of resources, goods and services, with the resultant effect of encouraging a maximum of protection and consumption."

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28 Ibid., pp. 57-8.
The major objectives of marketing programs of insurance companies include their desire to achieve proper service to the insured, at reasonable cost, with the development and maintenance of an adequate, competent, and satisfied group of agents to achieve a profitable volume of business.29

There are four distinct distribution systems for the marketing of property and liability insurance. Although there are variations or modifications within each system, the basic characteristics are fairly uniform. In general, the four systems are:

1. The independent agency system which is characterized, besides other features, by the independence of the agent as to choice of company representation and selection of markets. The agent owns the right to renew the insurance contracts he has written and usually receives his compensation in the form of commissions.

2. The direct writers' system when salaried employees are employed to solicit and serve the policyholders, thus all ownership rights of expirations are vested in the company.

3. The exclusive or captive agency system, which is a modification of the independent agency system, includes agents who represent only one carrier, receive a commission, and have no ownership rights of expirations.

4. The mail order system is generally confined to the field of accident and sickness insurance and, consequently, offers no serious competition to the first three systems of marketing property and liability insurance.

29 John S. Bickley, op. cit., pp. 2-4.
The selection of the marketing system by an insurer hinges directly on the degree of selling and servicing required. Many insurance companies use combinations of these systems as the situation of the market may dictate in order to maintain their competitive positions. Owing to these differences in the marketing systems and programs used by insurance companies, one must expect some problems in case of merger of two companies using different systems.

Selling the surviving company's goals to new agencies.--The term "selling" used in this study implies the process of inducing the sales force of the acquired company to accept the ideas of the acquiring company with regard to merchandising its product, in order to achieve satisfaction, security, and loyalty of the combined group. These ideas are reflected in the marketing program to be followed by the new organization and which is thought to serve all the interested parties -- the company, the agents, and the policyholders.

As the insurance company grows, its agent may worry about his importance in the scheme of things. As companies grow there develop numerous intervening levels of authority which may insulate the agent from the policy-making decisions of the company.

In practice, selling a company's goals to agents is a problem even when no merger is involved. In any case, the agent's satisfaction depends to a large extent on the marketing techniques employed by the company he represents. Insurance companies, recognizing this fact, are showing more concern about offering their agents new tools to assist them to do their jobs. These tools include advertising, offering a complete line of business, and establishing branch offices to assure prompt
dealing with their problems and settlement of claims submitted by their insureds.

The fact that the marketing programs or tactics of insurance companies are not identical creates the problem of enforcing a new program on the acquired group. The acquiring company must "sell" the agents the same innovations it is putting before the consumer. Agents are often much tougher to sell than is the layman. A good communication program between the company and its agency force will help to erase any confusion or misunderstanding with regard to the company's goals and objectives. Agents always express their preference for companies geared to make immediate and supportable decisions. Such on-the-spot decisions depend largely on the authority given to the company's local representative to make decisions that will receive home office support.

Furthermore, the development of package contracts entails an obligation of the insurance company to its agents. This is because when a package is written in one company, someone is bound to lose the individual policies which it replaces, without any opportunity to recapture the line. Consequently, the acquiring company must follow an "alert" package policy program in order to provide its agents with the kind of package needed to meet the insured's requirements.

It was found that five of the interviewed companies were faced with the problem of convincing the acquired sales force of the value of their marketing programs. Direct contact with the new agencies assisted

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in selling the acquirer's strategy with complete satisfaction. Any changes in the acquired company's marketing program must be explained to agencies in order to gain their support.

**Integrating the agency force.** Integrating the agency forces of both the acquired and the acquiring company represents a distinct problem following a merger and requires prompt action. The existence of a multiplicity of distribution systems complicates such a problem and requires considerable analysis of the systems used by both the combined companies to work out a new uniform plan. Also, the degree of control over the agency force has a major bearing on the execution of the survivor's marketing program. The distinct difference between the independent agent and the direct writers lies in the line of control exerted by the insurance company. There is no straight line of control over the sales activity of the independent agent. The insurance company can only suggest sales maneuvers which may be either accepted or rejected by such agent. The direct writers, on the other hand, are not faced by such problems with agents.

Following the merger, relationships with independent agents may be of considerable importance to the continued success of the combined companies. Such agents should be promptly informed of the marketing policies of the acquiring company and of any modifications anticipated in existing agreements.

Also, the acquiring company's policy toward the exclusive agents of the acquired company should be made clear to avoid possible misconception. The fact that a large number of insurance companies are licensed to write insurance in more than one state makes it possible to
find a representative of both the acquiring and acquired company in the same locality. A decision should be made as to whether to continue both agents operating separately, bringing them together, or eliminating one agent. The refinement of the agency force and discontinuance of company representation where minimum volume requirements cannot be gained or met by the agent that represented that merged company is an important problem which requires careful handling.

Furthermore, the acquiring company's treatment of the salaried agents is relatively easy since they are employees and subject to their employer's control. It is the practice of the merged companies to combine two branch offices serving the same territory into one to achieve economy and convenience.

The integration of the marketing force was considered an important problem and experienced by eleven of the interviewed companies. One executive stated that his company's policy is to eliminate the weak and keep the strong agents on the basis of their sales records. Another executive stated that they continued operating the acquired company as a separate entity for a period of time to get better acquainted with its agency force and then they combined both companies after keeping only the successful agencies. A third executive stated that on the basis of valuation of the acquiring and acquired company agency forces they decided to keep all the agencies representing the merged company. They were faced in some localities by opposition from some agents who refused to have another representative for the same company in one locality. The company decided to continue the agency which was thought
more important with regard to the volume of business written, its
growth, and its profitability.

Agents' remuneration.--Another marketing integration problem
requiring prompt action is the agents' remuneration for the business
they solicit. The existence of differentials in the scale of commis-
sions between the acquiring and the acquired company's agents should
be settled before any attempt is made to combine the marketing policies
of the constituent companies into a unified company-wide policy.

Agents' remuneration varies according to the type of agency
system used, the degree of effort needed to solicit the business,
volume and quality of the risk insured. Typically, the independent
agent receives his compensation in the form of commissions calculated
as a fixed percentage of the policy premium. The exclusive agent also
is compensated on the same basis with some variation in the amount of
the commission as a result of the differences in the relationship with
the company and the amount of administrative work required from each
type of agency system.

The fact that the independent agent represents more than one
insurer in his agency requires careful consideration when determining
his scale of commission. It is not unusual that this agent places the
business he solicits with the company offering relatively higher com-
mission. This situation requires continuous analysis of not only the
combined companies' scales of commissions but also of the remuneration
policies of competitors who are represented in the same agency.

The remuneration problem was felt by eight of the interviewed
companies. One executive stated that their salary scales and
commissions were different. Following the merger, they balanced the salaries of the equivalent job positions and enforced the acquiring company's scales of commission since it was higher than the acquired's commissions.

Another executive stated that they have to continue different scales of commission for agents but they have to get their acceptance through negotiation. The amount of such difference depends upon how much work is required in soliciting the business, volume of business, its kind and quality, and who writes the policies. Thus, they continued variations in the scales of commissions for competitive purposes. The other five executives agreed with this view of varying the scales of commissions from one locality to the other since they were faced with similar problems.

Finally, an executive was faced with the problem that the acquired company pays higher commissions. He suggested that this problem must be solved during the negotiation process and no later than when they sign the deal. The reaction of the acquired agencies toward reductions in commissions should be tested on a limited basis before there is enforcement of a general policy for all the agencies.

Training programs.--Since the major purpose of property and liability insurance is to protect the assets of the insureds against fortuitous losses, it is the responsibility of the insurers to provide their customers with competent, well qualified and trained agents. These agents should be capable of analyzing and evaluating the many exposures to loss in order to allocate the customer's insurance budget according to the relative importance of the various lines of insurance
available. Many insurance companies recognized this fact and established training programs for their agents in order to keep them abreast of developments in the insurance business.

Training programs are vital for the continuous growth of insurance companies (particularly following merger) in order to sell the agents of the acquired company the acquiring company's philosophy and views in addition to its insurance programs. The existence of a training program for only one of the merging companies may pose a problem following the merger since some agents think they might be wasting the time which should be devoted to selling activities when they accept the enrollment in such programs. It was found that four of the interviewed companies experienced such a problem. One executive stated that they have to get these people to think on the acquiring company's level. The only solution to this problem was through their training programs. Another executive stated that they overcame this problem through regional training meetings in addition to inviting the agents to visit the home office where they were taught what the merged company was trying to achieve.

Finally, an executive stated that the basic objective of their training program is to reduce agents' turnover. Such training programs are designed to equip their agents to handle competition more effectively and to increase their loyalty toward the company.

These are some of the common problems that emerge because of merger of two or more insurance companies. Post-merger problems are, however, endless in number and variety. The fact that it is impossible to foresee all these problems explains the philosophy of one high
executive who said, "No matter how fully I investigate potential problems, I still go into a merger knowing it looks better than it really is, that every merger has its disillusionments."\(^{31}\)

Administrative attention during the early days of completing a merger is needed to avoid compounding such problems. Changes in the acquired company should be handled with care and proper attention since the manner in which such changes are made characterize the acquirer's attitudes and policies. Ruthless and devious methods will prove to be ineffective and may result in compounding rather than alleviating the merger problems. Some changes, however, must be made and it is impossible to satisfy everybody in the acquired organization. It is possible, however, to perform the integration phase of a merger or acquisition according to its definition, "Harmonious coordination of behavior and personality with one's environment."\(^ {32}\)

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\(^{32}\) Myles L. Mace, \textit{op. cit.}, p. 276.
CHAPTER VI

GENERAL EFFECTS OF MERGERS

The statement frequently is made by the management of insurance companies, in the case of merger or acquisition, that such transactions will help to secure advantages for the acquiring company. Although this view has been expressed often in prospectuses distributed to the acquiring company's stockholders, it has not been documented. The purpose of this chapter has been to provide an empirical measure of the effect of mergers on the insurance industry in general and on the merged companies in particular. These are considered under the impact of merger on concentration of economic power, competitive environment, growth of companies' assets, and the results of insurance companies' operations.

Concentration of Economic Power

An analysis of the insurance companies' merger movement necessarily involves consideration of the movement's impact upon concentration of economic power. The study of changes in concentration is significant since it is a major factor in the determination of public policy for the regulation of merger activity within the insurance business. Also, the degree to which a merger or acquisition may increase
the combined shares of the major companies in a given market has been a marked feature of most acquisition decisions. 1

An analysis of concentration in the insurance industry is an analysis of the forces determining changes in the relative importance of insurance companies of different sizes. A variety of indexes have been used to measure concentration in a general sense with regard to an industry's output at any given time. 2 The significance of any index of concentration depends upon the measures used.

There are two distinct concepts of going about the measurement of concentration. The first concept is concerned with inequality in the size distribution of companies within the industry, known as relative concentration. 3 The second concept is concerned with the extent to which the quantity being measured is concentrated in the hands of a few companies, known as absolute concentration. 4

Although changes in absolute concentration may affect inequality or relative concentration, the use of the latter concept may in some circumstances be misleading. If five companies, for example, each hold about twenty percent of total industry assets, the measurement used would indicate no relative concentration, or very low inequality. Yet absolute concentration, however measured, would be very high.


3 Edith Tilton Penrose, op. cit., p. 245.

4 Ibid.
This study is only concerned with absolute concentration since the analysis of the impact of merger on concentration of economic power is most directly relevant to the question to what extent economic activity becomes concentrated in the hands of a few large companies. Absolute concentration was also considered in previous studies concerned with the issue of concentration of economic power in the insurance industry. 5

The usual indexes of concentration are either based on the percentages of output accounted for by a stated (few) number of companies or measure the number of companies required to account for a given (substantial) proportion of output or other measure of size. Size can be stated in several terms; the most common are output, total assets, net capital assets, employment, and sales. The use of one scale or another depends largely upon the availability and usefulness of data, on the one hand, and the purpose of conducting such measurement on the other.

It is noted that some scales of measurements which might prove to be meaningful in the analysis of concentration in other industries are essentially of less importance in insurance. The fact that insurance companies do not employ a large number of employees and use relatively small amounts of physical capital (furniture, buildings, automobiles) rules out the possibility of using measures based on employment or net capital assets for the current study. 6

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5 The Insurance Industry, Part II, testimony of the Department of Justice before the Antitrust and Monopoly Subcommittee in 1959, p. 945. Also, Roy J. Hensley, op. cit., pp. 27-29.

6 Roy J. Hensley, op. cit., p. 27.
Concentration in the non-life insurance industry will be measured by using three different scales of size measurement. These are total assets, volume of net premiums written, and policyholders' surplus. The analysis will cover the change in concentration of the percentages held by the largest company, the largest four, and largest ten companies at the end of the years 1939, 1949, and 1959.

The level of concentration which seriously threatens competition eludes precise determination by the economist. It is generally recognized that "in a properly defined industry, if the largest firm has less than ten percent of the output, competition will be effective -- in the absence of collusion which itself generally will be less probable and effective when concentration is low. And when one firm has forty or fifty percent or more, or two to five firms have seventy-five percent or more of the industry's output, competition will seldom plague the industry."  

The major asset items on a fire and casualty insurance company balance sheet are bonds, stocks, real estate, cash and bank deposits, premium balances, reinsurance recoverable, and accrued interest.

Concentration in the insurance industry on the basis of total assets held by the largest, the largest four, and largest ten stock companies in the years 1939, 1949, and 1959 is shown in Table 11. There are 0.99, 1.62, and 4.12 percent increases in the largest, largest four, and largest ten stock companies' shares of the industry's total assets, 

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respectively; and 1.55, 3.09, and 7.30 percent increases in their shares of the stock companies' total assets.

### TABLE 11

**CONCENTRATION OF ADMITTED ASSETS IN PROPERTY AND LIABILITY INSURANCE BY THE LARGEST, LARGEST FOUR, AND LARGEST TEN STOCK COMPANIES, COMPUTED FOR BOTH THE INDUSTRY AND STOCK COMPANIES, UNITED STATES, 1939, 1949, AND 1959**

<table>
<thead>
<tr>
<th>Assets</th>
<th>INDUSTRY</th>
<th></th>
<th></th>
<th>STOCK COMPANIES</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1939</td>
<td>1949</td>
<td>1959</td>
<td>1939</td>
<td>1949</td>
<td>1959</td>
</tr>
<tr>
<td>Total</td>
<td>$4,921.0</td>
<td>$12,100.0</td>
<td>$28,601.9</td>
<td>$4,062.8</td>
<td>$9,519.7</td>
<td>$21,800.5</td>
</tr>
<tr>
<td>(in millions)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Percent of Assets held by:

<table>
<thead>
<tr>
<th></th>
<th>1939</th>
<th>1949</th>
<th>1959</th>
<th>1939</th>
<th>1949</th>
<th>1959</th>
</tr>
</thead>
<tbody>
<tr>
<td>Largest Firm</td>
<td>2.60%</td>
<td>2.63%</td>
<td>3.59%</td>
<td>3.16%</td>
<td>3.34%</td>
<td>4.71%</td>
</tr>
<tr>
<td>Largest Four</td>
<td>9.62</td>
<td>9.06</td>
<td>11.34</td>
<td>11.78</td>
<td>11.52</td>
<td>14.87</td>
</tr>
<tr>
<td>Largest Ten</td>
<td>18.83</td>
<td>15.40</td>
<td>22.95</td>
<td>22.81</td>
<td>19.58</td>
<td>30.11</td>
</tr>
</tbody>
</table>

Source: *Best's Aggregates of Averages, 1941*, pp. 1, 15, and 16; *1950, pp. 1, 17, and 18; and 1960, pp. 1, 16, and 17.

Net Premium Written represents retained premium income, direct or through reinsurance, less payments made for reinsurance ceded. It is considered one of the most reliable indicators of market control in the insurance industry.

Table 12 shows the market shares of the largest, the largest

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8 *Best's Insurance Reports, Fire and Casualty* (1961), op. cit., p. xiii.

9 Frederick G. Crane, *Automobile Insurance Rate Regulation* (Columbus, Ohio: The Ohio State University, Bureau of Business Research, 1962), p. 36.
### TABLE 12

CONCENTRATION OF PREMIUMS WRITTEN IN PROPERTY AND LIABILITY INSURANCE
BY THE LARGEST, LARGEST FOUR, AND LARGEST TEN STOCK COMPANIES,
COMPUTED FOR BOTH THE INDUSTRY AND STOCK COMPANIES,
UNITED STATES, 1939, 1949, AND 1959

<table>
<thead>
<tr>
<th>Volume of Premiums</th>
<th>INDUSTRY</th>
<th>STOck COMPANIES</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1939</td>
<td>1949</td>
</tr>
<tr>
<td>Total (in millions)</td>
<td>$2,201.8</td>
<td>$6,356.2</td>
</tr>
</tbody>
</table>

Percent of Premiums held by:

<table>
<thead>
<tr>
<th></th>
<th>1939</th>
<th>1949</th>
<th>1959</th>
<th>1939</th>
<th>1949</th>
<th>1959</th>
</tr>
</thead>
<tbody>
<tr>
<td>Largest Firm</td>
<td>2.85%</td>
<td>2.53%</td>
<td>3.07%</td>
<td>3.67%</td>
<td>3.38%</td>
<td>4.35%</td>
</tr>
<tr>
<td>Largest Four</td>
<td>9.37</td>
<td>7.20</td>
<td>9.66</td>
<td>12.06</td>
<td>9.61</td>
<td>13.70</td>
</tr>
<tr>
<td>Largest Ten</td>
<td>17.71</td>
<td>12.45</td>
<td>19.32</td>
<td>22.80</td>
<td>16.62</td>
<td>27.40</td>
</tr>
</tbody>
</table>

Source: Best's Aggregates of Averages, 1941, pp. 1, 15, and 16; 1950, pp. 1, 17, and 18; and 1960, pp. 1, 16, and 17.

... and by stock companies only in the years 1939, 1949, and 1959. It indicates 0.22, 0.29, and 1.61 percent increases in the largest, the largest four, and largest ten stock companies' share of the industry, respectively, and 0.68, 1.64, and 4.60 percent increases in their shares of premiums written by stock companies.

The Policyholders' Surplus is the amount by which the assets of a property-liability insurance company exceed its liabilities. It is the counterpart of net capital assets in other industries. It is...
defined as the sum of paid-in capital, net reported surplus, and any special voluntary reserves which are in the nature of surplus.\(^\text{10}\)

There are several sources of surplus on which insurance companies depend to strengthen such items. The following are the major sources of surplus:

a. Contribution of premiums on stock sales "new issues."
b. Retained earnings.
c. Appreciation in the prices of the company's holdings of securities.

Policyholders' Surplus serves primarily as a protection for the insureds and third parties against any deficiency in provision for meeting the insurer's obligations. Such deficiency may result from inadequate premiums, inadequate reserves, or decrease in the value of assets.\(^\text{11}\)

The financial position of a property and liability insurance company is measured by its surplus to policyholders. In order to remain solvent, an insurer must constantly watch the growth of its business to maintain a proper balance between its commitments and its surplus to policyholders.

Table 13 shows concentration in the insurance industry on the basis of policyholders' surplus accounted for by the largest, the largest four, and largest ten stock companies in the years 1939, 1949, and 1959. It indicates 4.01, 6.21, and 5.95 percent increases in the

\(^{10}\) Best's Fire and Casualty Aggregates and Averages (1963), p. iii.

\(^{11}\) Mowbray and Blanchard, op. cit., p. 414.
TABLE 13

CONCENTRATION OF POLICYHOLDERS' SURPLUS IN PROPERTY AND LIABILITY INSURANCE BY THE LARGEST, LARGEST FOUR, AND LARGEST TEN STOCK COMPANIES, COMPUTED FOR BOTH THE INDUSTRY AND STOCK COMPANIES, UNITED STATES, 1939, 1949, AND 1959

<table>
<thead>
<tr>
<th>Policyholders' Surplus</th>
<th>INDUSTRY</th>
<th></th>
<th>STOCK COMPANIES</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1939</td>
<td>1949</td>
<td>1959</td>
</tr>
<tr>
<td>Total (in millions)</td>
<td>$2,562.7</td>
<td>$4,720.4</td>
<td>$11,633.0</td>
</tr>
<tr>
<td>Percent of Policyholders' Surplus held by:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Largest Firm</td>
<td>3.11%</td>
<td>3.45%</td>
<td>7.12%</td>
</tr>
<tr>
<td>Largest Four</td>
<td>11.71</td>
<td>11.78</td>
<td>17.92</td>
</tr>
<tr>
<td>Largest Ten</td>
<td>22.41</td>
<td>20.22</td>
<td>28.36</td>
</tr>
</tbody>
</table>

Source: Best's Aggregates and Averages, 1941, pp. 1, 15, and 16; 1950, pp. 1, 17, and 18; and 1960, pp. 1, 16, and 17.

largest, the largest four, and largest ten stock companies' shares of the industry, respectively, and 5.17, 8.46, and 8.81 percent increases in their shares of the stock companies' surplus between the years 1939 and 1959.

Merger and the Competitive Environment

In its amendment of Sec. 7 of the Clayton Act, the Congress recognized the connection which has historically existed between mergers and acquisitions and the changing character of competition in the U.S. national economy. The growth of some companies by acquisition had
produced a twofold effect through the years: \textsuperscript{12} (a) there had been a loss of important competitors, not only in terms of specific markets but on an industry wide basis; and (b) there had been a change in the character of competition as some few companies controlled a larger percentage of production in industry after industry.

Section 7 of the Clayton Act recognized the fact that competition in the U. S. economy is not static and that rigid rules cannot be established to define illegal acquisitions. The Act stated two tests to judge illegal mergers and acquisitions: An acquisition or merger which may result (1) in a substantial lessening of competition or (2) in a tendency toward monopoly. A substantial lessening of competition may appear to be the immediate consequence of a merger or it may develop from a series of mergers, the result of which could not be known in advance. On the other hand, a tendency toward monopoly would normally appear only as the long-run result, since few mergers would be attempted if monopoly were the immediate outcome.

Although the Clayton Act contained provisions dealing with mergers and acquisition, the law is silent as to what factors are to be taken into account to determine the probable effects of such ventures on competition or how great the danger to competition must be. This fact puts the merger transactions in a unique situation since their validity is subject to challenge in terms of their probable effects upon competition.

In industries other than insurance, the application of the law

\textsuperscript{12}Irston R. Barnes, \textit{op. cit.}, p. 288.
is continuously being reshaped through the flow of decisions in merger cases. Any of these decisions could be a useful guide for insurance departments when considering a merger transaction.

To determine the competitive effects of a merger or acquisition, there are several structural factors which were considered by the commissions and the courts in one or more decisions in anti-trust cases. These factors are as follows:\(^\text{13}\)

1. Size and growth history of the acquiring company.
2. Past acquisitions by the acquiring or the acquired unit.
3. Market position or market shares of the acquiring and acquired companies.
4. The relative scarcity of the major companies operating in the relevant markets.
5. The possibility of dominance of a market by an acquiring company, either before or after a merger.
6. Elimination of a significant competitor from the relevant market.
7. Foreclosing or narrowing substantial sources or outlets.
8. Reducing opportunities for competition by small companies.

New York insurance department established measures to determine the competitive impact of mergers. These are measures which were cited

\(^{13}\)Betty Bock, op. cit., pp. 93-115.
in Chapter III and could be considered to be in line with those measures used by courts and commissions in merger decisions.

In order to examine the competitive environment as it exists in the property and liability lines, the rate of entry of new companies will be compared with the rate of exit during the period of study. Entry to non-life insurance is defined as constituting "the arrival of a new firm or an addition to an existing firm's line of products, and the introduction of additional policywriting capacity to that already in use in the industry."\textsuperscript{14} Exit is also defined as "the removal of an independent decision-making unit from an industry."\textsuperscript{15}

\textbf{Entry.}---Although certain barriers to entry of new companies into the insurance business exist, if compared with other industries, entry may be considered relatively free. Financial requirements include paid-in capital, surplus, and additional funds to cover working capital and physical facilities. The total outlay required is small if compared with an automobile manufacturer, for example.

Furthermore, access to the necessary technology is not a significant barrier to entry.\textsuperscript{16} There are no patent rights to protect insurance techniques, and a large supply of trained personnel is available, along with a remarkable competition for it.

One of the serious barriers to new entrants in the insurance

\textsuperscript{14} Roy J. Hensley, \textit{op. cit.}, p. 39.

\textsuperscript{15} Ibid., p. 66.

\textsuperscript{16} Frederick G. Crane, \textit{op. cit.}, p. 17.
industry is gaining access to the consumer market. The fact that some insureds place all their coverage with certain agents, and other insureds are attracted and like to keep their business with an old established company imposes a serious impediment to the formation of a new company. It requires a considerable amount of investment to build a large and efficient sales force. Thus, in order to capture a share in the market, a new entrant has to offer high agency commissions to agents, or premium concessions to insureds, or both.

The existence of economies of large-scale operation might discourage new company formation in the insurance industry. A study of the expense data of 127 property and liability company groups of various sizes in 1953 indicated that "the largest firms have the lowest unit cost." A most recent analysis conducted of a sample embracing approximately ninety percent of the property and liability insurance business showed that "no meaningful relationship exists between the premium size of a company and its strength as measured by the ratio of surplus to net premiums written."

It seems, therefore, hard to determine the optimum size of insurance companies. It is likely to find efficient and inefficient companies of all sizes existing side by side.

Data of actual company formations furnished by the American Mutual Insurance Alliance shows that 9,051 property-liability insurers

17. Ibid.

18. Roy J. Hensley, op. cit., p. 41.

have existed in the history of the United States. Some 5,762 of these have retired for one reason or another . . . leaving 3,289 in operation as of August 1, 1962. Also, of approximately 1,200 property and liability companies in 1959 listed in Best's Insurance Reports, 357 stock, 115 mutual companies, and 52 Lloyd's and reciprocals, a total of 524 companies were formed within the decade of 1950 as shown in Table 14.

TABLE 14
ENTRY INTO THE NON-LIFE INSURANCE INDUSTRY, UNITED STATES, 1950-1959

<table>
<thead>
<tr>
<th>Year</th>
<th>Stock</th>
<th>Mutual</th>
<th>Reciprocal and Lloyd's</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>41</td>
<td>21</td>
<td>7</td>
<td>69</td>
</tr>
<tr>
<td>1951</td>
<td>28</td>
<td>8</td>
<td>4</td>
<td>40</td>
</tr>
<tr>
<td>1952</td>
<td>33</td>
<td>6</td>
<td>11</td>
<td>50</td>
</tr>
<tr>
<td>1953</td>
<td>49</td>
<td>25</td>
<td>5</td>
<td>69</td>
</tr>
<tr>
<td>1954</td>
<td>48</td>
<td>15</td>
<td>5</td>
<td>68</td>
</tr>
<tr>
<td>1955</td>
<td>47</td>
<td>14</td>
<td>9</td>
<td>70</td>
</tr>
<tr>
<td>1956</td>
<td>30</td>
<td>7</td>
<td>1</td>
<td>38</td>
</tr>
<tr>
<td>1957</td>
<td>27</td>
<td>7</td>
<td>5</td>
<td>39</td>
</tr>
<tr>
<td>1958</td>
<td>24</td>
<td>4</td>
<td>3</td>
<td>31</td>
</tr>
<tr>
<td>1959</td>
<td>40</td>
<td>8</td>
<td>2</td>
<td>50</td>
</tr>
<tr>
<td>Total</td>
<td>357</td>
<td>115</td>
<td>52</td>
<td>524</td>
</tr>
</tbody>
</table>


This explains the lack of an effective barrier which can actually be considered a serious impediment to the formation of new companies. Thus, it could be concluded that although certain barriers to entry exist, entry to the insurance business is relatively free.

Exit.--Exit from the insurance industry occurs in at least three ways, namely, mergers, portfolio reinsurance, and liquidations (voluntary and involuntary). The reasons behind such methods of retirement have already been covered in Chapters II and IV. Table 15 includes a summary of the rate of retirements during the period of study. It shows that 230 stock, 228 mutual companies, and 46 Lloyd's and reciprocals, a total of 504 property and liability insurance companies retired during the decade of the 1950's.

Thus, according to the data furnished by Best's Insurance Reports, 524 insurance companies were formed while 504 companies retired for one reason or another during the years 1950-1959. Since entry outweighs exit, it could be concluded that although merger accounts for about fifty percent of the companies retired, it has no direct impact on the competitive environment in the property and liability insurance industry.

Merger and the Growth of Insurance Companies' Assets

An analysis of the relationship between merger and the growth of insurance companies' assets involves the problem of determination of the role of merger in the process of growth and its contribution to the size of the individual company at any given time. It is impossible to determine the quantitative contribution of merger to the growth and size.
### TABLE 15

**EXIT FROM THE NON-LIFE INSURANCE INDUSTRY, UNITED STATES, 1950-1959**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>STOCK COMPANIES:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Merger and Acquisition</td>
<td>16</td>
<td>5</td>
<td>12</td>
<td>8</td>
<td>8</td>
<td>19</td>
<td>17</td>
<td>16</td>
<td>25</td>
<td>9</td>
<td>135</td>
</tr>
<tr>
<td>Portfolio Reinsurance</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>1</td>
<td>9</td>
<td>3</td>
<td>6</td>
<td>3</td>
<td>33</td>
</tr>
<tr>
<td>Voluntary Retirement</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>--</td>
<td>3</td>
<td>5</td>
<td>2</td>
<td>9</td>
<td>2</td>
<td>1</td>
<td>27</td>
</tr>
<tr>
<td>Involuntary Retirement</td>
<td>1</td>
<td>1</td>
<td>--</td>
<td>5</td>
<td>3</td>
<td>7</td>
<td>8</td>
<td>4</td>
<td>2</td>
<td>4</td>
<td>35</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>21</td>
<td>10</td>
<td>15</td>
<td>15</td>
<td>17</td>
<td>32</td>
<td>36</td>
<td>32</td>
<td>35</td>
<td>17</td>
<td>230</td>
</tr>
<tr>
<td><strong>MUTUAL COMPANIES:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Merger and Acquisition</td>
<td>3</td>
<td>9</td>
<td>8</td>
<td>6</td>
<td>4</td>
<td>8</td>
<td>9</td>
<td>23</td>
<td>11</td>
<td>9</td>
<td>90</td>
</tr>
<tr>
<td>Portfolio Reinsurance</td>
<td>8</td>
<td>3</td>
<td>4</td>
<td>3</td>
<td>5</td>
<td>10</td>
<td>8</td>
<td>9</td>
<td>--</td>
<td>9</td>
<td>59</td>
</tr>
<tr>
<td>Voluntary Retirement</td>
<td>3</td>
<td>1</td>
<td>4</td>
<td>4</td>
<td>5</td>
<td>3</td>
<td>3</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>28</td>
</tr>
<tr>
<td>Involuntary Retirement</td>
<td>7</td>
<td>8</td>
<td>6</td>
<td>5</td>
<td>6</td>
<td>7</td>
<td>3</td>
<td>6</td>
<td>1</td>
<td>2</td>
<td>51</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>21</td>
<td>21</td>
<td>22</td>
<td>18</td>
<td>20</td>
<td>28</td>
<td>23</td>
<td>39</td>
<td>14</td>
<td>22</td>
<td>228</td>
</tr>
<tr>
<td><strong>RECIROCAL AND LLOYD'S:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Merger and Acquisition</td>
<td>2</td>
<td>--</td>
<td>1</td>
<td>--</td>
<td>1</td>
<td>1</td>
<td>--</td>
<td>1</td>
<td>7</td>
<td>1</td>
<td>14</td>
</tr>
<tr>
<td>Portfolio Reinsurance</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>5</td>
<td>1</td>
<td>--</td>
<td>--</td>
<td>1</td>
<td>17</td>
</tr>
<tr>
<td>Voluntary Retirement</td>
<td>1</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>1</td>
</tr>
<tr>
<td>Involuntary Retirement</td>
<td>--</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>3</td>
<td>1</td>
<td>4</td>
<td>--</td>
<td>2</td>
<td>--</td>
<td>14</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>6</td>
<td>4</td>
<td>3</td>
<td>3</td>
<td>6</td>
<td>7</td>
<td>5</td>
<td>1</td>
<td>9</td>
<td>2</td>
<td>46</td>
</tr>
<tr>
<td><strong>GRAND TOTAL</strong></td>
<td>48</td>
<td>35</td>
<td>40</td>
<td>36</td>
<td>43</td>
<td>43</td>
<td>67</td>
<td>64</td>
<td>72</td>
<td>58</td>
<td>504</td>
</tr>
</tbody>
</table>

Source: *Best's Insurance Reports, 1960, pp. 715-26B.*
of companies through empirical analysis.  

Even if one could measure the proportion of total assets that a given insurance company had acquired by merger, the effect of such transaction on the company's present size must remain unknown. An acquiring company does inherit the potentialities for growth of the companies it acquires. Also, a merger tends to leave pools of unused productive services available to the surviving company which would not have been available in each of the combined companies. An important source of such unused productive services is often found in the personnel who had to be taken over with the acquired company but who could be efficiently used only in an expanded program of operations.

Furthermore, the fact that external expansion draws on the existing productive services of the acquiring company, affects the availability of existing resources to be used for internal expansion. It follows that the more extensive the external expansion in any given period of time the less can existing resources be used for internal expansion in the same period.

An analysis of the effect of merger or acquisition on growth must cover a particular period of time. One cannot, therefore, safely

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22 Ibid.
23 Ibid.
24 Internal expansion or growth includes "all growth except that which comes about by absorbing firms or substantial properties from firms with formerly independent existence." External expansion or growth may take place by "the purchase of assets, by consolidation, by merger, by lease, or by the holding company device." See J. Fred Weston, op. cit., p. 3.
assume that the growth of a given company in that period through internal expansion would be equal to the difference between the company's total growth reduced by an amount equal to the amount acquired through merger or acquisition.

Although merger or acquisition might be considered the shortest path of expansion for a firm to follow, that does not mean that this external way of expansion is the only available way. Firms can internally expand by any means other than merger or acquisition which are considered to be external expansion. It might be safely assumed that they can reach through internal expansion the same size and scope they might have reached through merger nowadays. This expansion, however, requires a longer span of time.

**Merger and Results of Insurance Companies' Operations**

To examine the effect of merger on the acquiring companies it is necessary to use a set of ratios. Each ratio helps to explain a particular purpose as will be discussed later in this chapter. These ratios are as follows:

1. Loss ratio.
2. Expense ratio.
3. Loss and expense ratios combined.
4. Underwriting profit ratio.
5. Ratio of common stocks to total assets.
6. Ratio of policyholders' surplus to total "true" liabilities.
7. Investment results to total assets ratio.
8. Profitability ratio before and after federal taxes.
It was hypothesized that merged companies differed in their underwriting results, solvency, stability and profitability from other companies which were not involved in such activity. After excluding those merged companies formed after 1947 or retired from the insurance business, sixty-three out of ninety-six acquiring companies were classified into two groups:

1. Merger with independent company included twelve large, nine medium-size, and eleven small companies, a total of thirty-two acquiring companies.

2. Merger within the group included twelve large, twelve medium-size, and seven small companies, a total of thirty-one acquiring companies.

A stratified sample of thirty-two companies which were not involved in merger activity was drawn.

After excluding all companies involved in merger activities and those formed after 1947, twelve out of seventeen large companies, nine out of seventy-six medium-size companies, and eleven out of 206 small-size companies were selected at random.

In order to prove the stated hypothesis a null form of the statement was tested. Such test was accomplished by comparing the changes "before" and "after" in each of the two groups of merged companies with non-merged companies. To test the significance of difference of such changes, analysis of variance was used because it was the most appropriate statistical test to be used in this study. Differences between merged and non-merged and also different sizes within each of these two classifications were analyzed by this tool.
Due to the nature of this study and the variations among companies with respect to such things as rate levels, agency systems, types of business underwritten, areas served, age of the companies involved and their rates of growth it was decided on a ten percent level of significance. If insurance companies were functionally homogeneous, i.e., dealing with similar activities, a more critical level of significance such as ninety-five or ninety-nine percent could have been used.

The calculations of the analysis of variance, shown in Appendix B, yielded three results as follow:

1. Between merged and non-merged companies -- this result shows whether the difference in change between the merger within group, for example, and non-merged companies is significant or not at the stated level of significance. If the F ratio turned out to be significant, the null hypothesis, which implies that no difference exists between the two compared groups, is rejected.\textsuperscript{25} That means that merger has an effect on the merged companies within the limits of the study.

2. Between different sizes -- as already discussed in Chapter I, the companies in this study were further classified by size into large, medium, and small. This result will show whether a difference exists between merged and non-merged companies when comparing each size

\textsuperscript{25} The value of F is equal to the ratio of the largest to the smallest in a set of k independent random variables, each having the chi-square distribution with f degrees of freedom. The distribution is useful in testing the hypothesis of homogeneity of variance in a sample from a normal distribution; if the value of F is exceeded, the variance is assumed to be heterogeneous. See D. B. Owen, \textit{Handbook of Statistical Tables} (Massachusetts: Addison-Wesley Publishing Co., Inc., 1962), p. 100.
separately, i.e., large merged companies with large non-merged companies, medium with medium, and small with small. The size of the group which is mostly affected by merger could be easily detected by comparing the arithmetic means of the different groups.

3. Interaction -- was the study of the effect of the size of the merged companies as compared with a different size of non-merged companies. Should the variation between medium-size merged and medium-size non-merged companies be significantly different from the variation between small merged and small non-merged companies, then an interaction exists between size and structure.

Loss ratio.--The Loss Ratio is used to measure the percentage of the premium dollar which is spent to pay the insureds' claims and claim expenses. It is composed of two items: losses incurred plus loss adjustment expenses incurred related to earned premiums.

It should be noted that losses incurred are used instead of paid losses to obtain an undistorted picture of the company's experience. If paid losses were to be used rather than incurred losses, the resulting ratio might be deceptively low since some claims at the end of the fiscal year are not reported or settled, although they actually belong to that year's experience.

To achieve the same goal, earned premiums are used instead of written premiums. Using written premiums rather than earned would also result in a deceptively low ratio in a year of increasing premium volume and a deceptively high ratio in a year of decreasing writings.

Loss Ratio is used to measure the underwriting efficiency of property and liability insurers. A low ratio over an extended period
of time (five years, for example) is a vital proof of underwriting success if it is not the product of a ruthless resistance to claims, and denying the insureds the protection they sought. On the other hand, a high loss ratio is undesirable if it results from liberal claim settlements since the insureds will be over-charged for the protection given.

Within the limits of the study, both the merged (with independent company and within group) and non-merged companies showed unfavorable changes in their loss ratios. When comparing loss ratios in the two periods before "1947-1949" and after "1960-1962" there was 8.52 percent increase for merger with independent companies; 9.03 percent increase for merger within company group; and 10.22 percent increase for non-merged companies.

However, the value of F ratio for changes in the loss ratio of the merged companies, whether acquiring independent company or member of group, and change in loss ratio of non-merged companies showed no significance at the ten percent level. Thus the null hypothesis failed to be rejected.

Expense ratio.--The Expense Ratio is used to evaluate the relative efficiency of an insurance company's management. An efficient and good management requires a close control over expenses.

This ratio relates Expenses Incurred to Written Premiums. The items included in Expenses Incurred are salaries, wages, supplies, maintenance, loss prevention activities, advertising, and commissions to agents.

The fact that a large portion of the expenses (other than loss expenses) are incurred at the time the premium is written requires that
such expenses be related to written premiums. If expenses are related to Earned Premiums rather than Written, it would result in a deceptively high ratio, particularly in times of increasing premium volume. On the other hand, in times of a shrinking premium volume, it would produce an unrealistically low ratio, particularly when earned premiums are greater than written.

A high Expense Ratio may indicate that the company is spending too much for its business, thus leaving too small a fraction of the premium dollar to meet its liabilities. A low Expense Ratio is desirable since it may indicate the nonexistence of waste in spending.

Within the limits of the study, only merger within company group showed favorable change in the expense ratio while merger with independent company and non-merged companies showed unfavorable changes. The comparison of the two periods, before and after, showed 1.64 percent decrease in the expense ratio of the companies acquiring members of their groups; 0.20 percent increase for companies acquiring independent companies; and 0.48 percent increase for non-acquiring companies.

However, the F test showed no significant difference at the ten percent level between changes in the loss expense of companies acquiring either independent companies or members of group and non-merging companies. Thus the null hypothesis was accepted with ninety percent confidence interval.

Operating ratio.—Combining both the Loss and Expense Ratios represents one of the most important ratios for testing an insurance company's earning capacity. The result is referred to as the Operating Ratio.
If the Operating Ratio is under 100 percent, the difference reflects the approximate profit margin. On the other hand, if this total exceeds 100 percent, it means that underwriting was conducted at a loss in the degree indicated by whatever percentage is over 100 percent.

The study indicated unfavorable changes in the loss and expense ratios combined of both the merged and non-merged companies for the period under study. There was 7.39 percent increase for merger within the same group; 8.72 percent increase for merger with independent company; and 10.70 percent increase for non-merged companies.

The value of F ratio, however, was not significant at the ten percent level for the changes in the Operating Ratio of the two groups of merged companies on the one hand and non-merged companies on the other hand. Thus, the null hypothesis was accepted indicating no difference between changes in these groups.

**Underwriting profit ratio.**—Another ratio that might be used to gain an over-all picture of the company's results is the Underwriting Profit Ratio. This ratio relates the Statutory Underwriting Profit (or loss) to Earned Premiums. The term Statutory is used due to the fact that the computation of the underwriting profit (or loss) is recognized by the various insurance departments and income tax authorities.

Underwriting Profit Ratio is similar to the Operating Ratio since it gives some indication of the percentage of the premium dollar which came in as underwriting profit.

Statutory Underwriting Profit is the product of (1) net premium earned, less (2) loss, loss expenses and other underwriting expenses
incurred. It was noticed that policyholders' dividends which are returns of parts of premiums to policyholders are not reduced from the reported statutory underwriting results. Thus, statutory underwriting results in this study were credited by the policyholders' dividends (if any) to reflect the underwriting results (profit or loss) available to stockholders.

Comparing the underwriting profit ratio in the two periods "before" and "after" the study showed unfavorable results for both the merged and non-merged companies. There was 3.84 percent decrease in underwriting profit ratio for merger within company group; 4.83 percent decrease for merger with independent company; and 7.21 percent decrease for non-merged companies.

The F test showed no significant difference in the underwriting results between merged companies with independent companies and non-merged companies at the ten percent level. However, the difference turned out to be significant between merged companies with members of group and non-merged companies even at the five percent level. Also, the interaction in the latter group showed significant difference at the ten percent level. The null hypothesis, therefore, was accepted in the case of merger with independent companies and rejected in merger with members of group.

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Ratio of common stock to total assets.—A useful ratio which could be used to determine the stability of Policyholders' Surplus is reached by relating the company's holdings of common stock to its total assets.

The value of common stocks tends to fluctuate more than the value of bonds or preferred stocks. This calls for the need to check on the amount of common stock holdings in a company's investment portfolio.

Underwriting activities of an insurance company are mainly determined, beside other factors, by the size of the company's surplus. Therefore, it is necessary to know whether the company's surplus as shown on the balance sheet was exposed to sudden decline caused by a sharp turn down in market values of common stock holdings.

Furthermore, the percentage of common stock holdings in a company's investment portfolio depends largely upon the size of its surplus. A company with a small surplus would not be in a position to invest any greater proportion of its assets in common stocks since it might underwrite against its surplus; and a decline in values of common stocks would put the company in a critical situation with too many liabilities against its resources. In an attempt to avoid such a situation, insurance companies set aside a voluntary reserve, "Reserve for General Contingencies," to meet fluctuations in the value of its holdings of securities. Such reserve enables an insurance company to underwrite against its surplus as stated in its balance sheet, under a reasonably stable condition.

Increases in the values at which common stocks are carried on the balance sheet might be the result of either inflation or new purchases of such securities, or both. During a period of general inflation the values of the insurance company's liabilities tend to increase, premium reserves grow due to the increase in business, and loss reserves grow due to the increased value of claims and losses submitted by insureds.

A balance between a company's assets and liabilities can be maintained either by a decrease in its surplus or an increase in values of its investments. An appreciation in the value of the company's holdings of common stock would have been useful in the latter action and would maintain the desired balance without forcing a decrease in its surplus.

Beside this, the common stock ratio helps to check the extent to which the earning capacity of funds available for investment is being used. Although appreciation in the value of equities is not a primary consideration in the investment policies of property and liability insurance companies, they increased their holding of common stocks within the limits permitted as a method of building capital strength. 28

The study showed favorable changes in the ratio of common stocks to total assets of both the merged and non-merged companies for the period under study. There was 12.11 percent increase for merger with

independent company; 11.59 percent increase for merger within company group; and 18.85 percent increase for non-merged companies.

The value of the F ratio for the percentage of the total assets invested in common stocks showed significant difference between the merged companies with independent companies and the non-merged companies at the ten percent level. The F test in the case of the merger with group was significant at the five percent level for differences between the merged and non-merged companies. It also showed a significant difference between the different sizes of companies (large, medium, and small) at the five percent level. Thus, the null hypothesis was rejected, indicating the existence of differences between the merged and non-merged companies.

**Policyholders' surplus to total "true" liabilities.**—The amount of debt when related to the net worth of an enterprise indicates the financial solvency of such enterprise. Too much debt may result in bankruptcy due to a possible inability to pay interest and repayment of principal in times of stress. Thus, the net worth to debt ratio is used as a common tool of financial statement analysis.

For the property and liability insurance company the net worth to debt ratio is probably the most significant ratio employed to measure the degree of ultimate solvency. It is also one of the most widely used ratios. Policyholders' surplus is the counterpart of the term "net worth" on an insurance company balance sheet. Also, the "debt" is the sum of various miscellaneous or total "true" liabilities.

Insurance laws of the various states provide certain minimum requirements with regard to the size of surplus fund in relation to the
the amount of capital. Furthermore, insurance commissioners restrict the minimum size of the surplus in relation to the amount of unearned premium reserve. Thus, the size of property-liability insurance company's surplus imposes certain limitations on its ability to expand premium writing. 29

The study indicated favorable changes in the policyholders' surplus ratio of both the merged and non-merged companies for the period under study. There was 1.56 percent increase for merger with independent company; 2.70 percent increase for merger within company group; and a remarkable 36.02 percent increase for non-merged companies.

The F test for the financial solvency ratio was significant for differences in changes between the merged companies (both acquiring independent companies and members of group) and the non-merged companies at both the ten and five percent levels. It was also significant between the three sizes of companies in the case of merger with group and non-merged companies only, at the ten percent level. Finally, the interaction in the merger with independent company group showed high significant difference at the one percent level. Thus, the null hypothesis was rejected when relating the policyholders' surplus to total liabilities.

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29 The ability of an insurance company to expand premium writing could be referred to as its capacity. The term "capacity" refers to "the financial ability of an insurance company to do business by providing protection in return for insurance premiums . . ." and the term "capacity use" refers to "the actual extent to which the capacity limits have been used . . ." See, David L. Bickelhaupt, op. cit., pp. 122-123.
**Investment efficiency.**—The fact that when an insurance company issues an insurance policy, the premium is generally paid in advance for periods varying from six months to five years gives rise to funds held by the insurer for the policyholders. Such funds, as well as the paid-in capital, accumulated surplus, and other types of reserves must be invested in some manner.

Insurance companies are statutorily restricted to a certain degree as to the manner the company's funds should be invested. They are required to hold a minimum amount of cash or high-grade bonds, but they are free to invest the major part of their investments as they see fit.

The investment income is a vital factor to the success of any property and liability insurer. Such income has accounted for a very substantial portion of total profits and has served to offset frequent underwriting losses. 30

A good investment department could place its investment in such a manner as to earn a reasonably safe return and at the same time be sufficiently liquid to be promptly and economically released to insurance activity as occasion demands. Investment policies, however, vary from one company to another and range between conservative (largely confined to bonds) and liberal (largely confined to stocks). Such policies are subject to the discretion of the management of the companies thus resulting in significant differences between companies.

The efficiency of the investment department could be measured by relating the sum of the net investment income and other investment gains

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or losses to total assets invested. Net investment income includes the interest, dividends and rents earned, less investment expenses incurred, before Federal income tax. Other investment gains or losses reflect the adjustment of capital gains and losses due to the fluctuations in value of investments, whether measured by actual sales or maturities or by changes in market or book value.

The study showed slight changes in the investment ratios of the merged and non-merged companies. There was 1.21 percent increase for merger with independent company; 0.78 percent increase for merger within company group; and 1.22 percent increase for non-merged companies.

The value of the F ratio showed no significant differences between changes in merged companies and non-merged companies. However, when comparison was made in changes by size of the merged companies and non-merged companies, the F ratio was significant at the five percent level. Furthermore, the interaction was found to be significant between the merged companies with independent companies and non-merged companies at the ten percent level. Consequently, the null hypothesis was rejected in changes in the investment efficiency.

**Profitability ratio.**--Insurance companies obtain income from two sources -- underwriting profit and return on investment. An overall picture of the profits in the insurance business must combine both of these elements.

To stand upon the size of existing profit levels in the insurance business, actual return must be related to a measure of capital at

risk. The latter is represented by the stockholders' equity in the stock insurance company.\(^{32}\) Thus, it could be stated in other words: relating actual return on stockholders' equity measures the profitability of the business to its owners or the profitability ratio.

In calculating the profitability ratio in this study several adjustments took place. This was necessary because the way insurance accounts are kept tends to obscure profits.\(^{33}\) The profitability ratio before federal taxes was calculated as follows: the sum of Net Investment Income, Other Investment Income, and Adjusted Underwriting Profit divided by the sum of Paid-in Capital, Policyholders' Surplus, and Stockholders' Equity in the Unearned Premium. The resulting ratio may be positive (reflecting profits) or negative (reflecting losses).

Adjusted Underwriting Profit is the Statutory Underwriting Profit less policyholders' dividends (if any), adjusted for change in the stockholders' equity in unearned premiums. It was necessary to reduce the statutory underwriting profit by the amount of policyholders' dividends in order to obtain a true picture of the underwriting results.

Adjustment for change in stockholders' equity in unearned premium is obtained by adding forty percent (for fire company) or thirty-five percent (for casualty or multiple-line company) of the increase in unearned premium reserve to the statutory underwriting profit.\(^{34}\) These percentages are supposed to be the expense of soliciting and putting

\(^{32}\) Roy J. Hensley, op. cit., p. 174.

\(^{33}\) Ibid., p. 178.

\(^{34}\) Roger Kenney, Fundamentals of Fire and Casualty Insurance Strength (2d ed.; Dedham, Massachusetts: 1953), pp. 74-75.
the business on the company's books when written. The reason behind such adjustment is that in case of an increase in the premium volume -- involving an increase in the unearned premium reserve -- the statutory underwriting results are penalized by the upward movement of the reserve. Also, in case of a decrease in the premium volume -- involving a decrease in the unearned premium -- the statutory underwriting results obtain the benefit of a release from the unearned premium. Hence, to calculate the true underwriting results, the equity in the increase (or decrease) in the unearned premium must be added (or credited) to the statutory underwriting results.

The study indicated unfavorable changes in the profitability to owners ratio of the merged and non-merged companies, both before and after federal taxes. The comparison of the "before" and "after" periods showed 7.99 and 6.85 percent decreases for merger with independent company; 8.79 and 7.76 percent decreases for merger within company group; and 16.53 and 14.37 percent decreases for non-merged companies before and after federal taxes respectively.

The value of the F ratio for the profitability ratio before federal taxes showed significant difference between merged companies and non-merged companies at the five percent level for merger with independent companies and at the ten percent level for merger with company group. The same result was reached for the profitability ratio

35 Ibid., p. 72.
36 Ibid.
after federal taxes. The null hypothesis was rejected in the case of the profitability ratio before and after federal taxes.

In summary, merged companies achieved certain favorable results that could be attributed to the merger transaction. Within the limits of the study, the merger transactions indicated no effect on the acquiring company's loss ratio, expense ratio, and loss and expense ratios combined. Furthermore, the underwriting profit ratio was not affected in the case of companies acquiring independent companies, but for merger within company group it was positively affected.

In measuring the investment efficiency of the merged companies, merger showed no effect on such companies as a group. However, when size was considered it showed an effect on the merged companies.

For the profitability to owners of the merged companies, merger proved to have a positive effect on such companies whether before or after federal taxes.

Finally, calculations indicated an unfavorable effect of merger on the merged companies when relating common stock holdings to total assets, and policyholders' surplus to total "true" liabilities since in both cases the changes in the non-merged companies were more than the merged companies.

The interpretations of this chapter will be considered, within the limits of the statistical measurement used, before final conclusions are drawn. This will be done in the next, and final, chapter.
CHAPTER VII

SUMMARY AND CONCLUSIONS

In summary, an analysis of mergers of property and liability insurance companies deals with several facets of major interest to insurers who might be involved in this type of activity.

1. Since 1900 the property and casualty insurance company mergers have been the principal factor that has helped to reduce the number of United States insurance companies. The merging activity of property and liability insurance companies has been especially pronounced during two periods: the great depression and Post-World War II.

When viewed from point of origin, the insurance industry witnessed four major waves of mergers. The first real wave of mergers took place by the end of the nineteenth century at the point when insurance companies started putting together a number of independent companies. The major force behind this merger movement was competition between insurance companies; the result was absorbing competitors.

The second period of merger activity followed World War I within the years 1918-1922. The result -- caused by the strict enforcement of the mono-line principle, the emergence of casualty as a separate field, and statutory limitations on the number of agents to represent a single company -- was the development of insurance groups as a method of merger.

The third intensive period of merger activity, which took place
within the period 1929-1933, was caused by the great depression of 1929. The major economic factor contributing to the merger movement was the prevention of insurance company failures.

The fourth and present merger movement began following World War II and has continued to the present time. The major forces behind this movement were the passage of multiple laws, and the elimination of rules with regard to the number of agents to represent one company.

Generally, during the period studied, there were other motivations underlying the number of mergers completed.

Management considerations.--To find adequately trained personnel to keep pace with the rapidly growing economy, insurance companies were impelled to acquire companies with personnel, departments, or experience that were lacking within the acquiring company.

Marketing considerations.--In an attempt to enhance and augment their market positions, insurance companies used merger as a means to increase sales organizations through acquisition of a ready-made volume of business and to increase the importance of certain lines of business in the acquiring company's portfolio.

Financial considerations.--Inflation and steadily rising costs were partially responsible for the merger trend since they were the major causes for the underwriting deficits, particularly in the casualty fields. Merger was used as one method, among others, by which to eliminate companies faced by financial difficulties or instability. Also, the expected savings due to the simplification of the corporate structure was another reason for merger.
Investment considerations.--The squeeze between rising costs and the more or less fixed rates has served to enforce the trend to economize through large units and to spread overhead cost on a larger volume of business. Merger also will enable the company to use mechanical or electronic equipment more effectively. In addition, it will enable the company to diversify its operations either geographically or by the line of business written, or both.

Tax considerations.--Tax savings are possible under various provisions of the Internal Revenue Act, namely, more favorable rates of capital gains, tax-free exchange of stock, and carrying forward of past operating losses as credits against future earnings.

2. All insurance company merger transactions are now enacted within a definite framework formed by the laws and regulations of the various insurance supervising agencies. For a period of seventy-five years prior to 1944, the federal anti-trust laws were not considered applicable to the insurance business. The Supreme Court had consistently held that state regulation of the insurance business did not violate the commerce clause of the Constitution. In 1944, in the case of United States v. South-Eastern Underwriters Association, this redundant precedent was set aside by the Supreme Court in favor of the view that insurance is commerce, and, when crossing state lines, inter-state commerce.

This extension of the scope of the Commerce Clause upset the long insulation of the insurance business from the numerous federal statutes resting on this Clause. Due to arguments against federal control of the insurance business and a move to maintain and strengthen
state regulation, Congress enacted legislation (the McCarran Act) in 1945 which created a "moratorium period" for three years during which the insurance business was to be exempt from the operation of the federal anti-trust laws. At the end of this period, the federal anti-trust laws were to be applicable to the extent that the business of insurance is not regulated by state law.

The application of the Sherman Act by the Courts proved to be inadequate to prevent or to correct mergers which took place in the early 1900's. The Clayton Act was enacted to revise and fill its gaps. However, this Act proved also to be ineffective in coping with successive merger movements, particularly in the 1920's and after 1945.

With the amendment of Section 7 of the Clayton Act, Congress closed the loopholes of the original Act and established a new test of illegality. Section 7, as amended, applies to all mergers and acquisitions which may have the effect of substantially lessening competition or a tendency to create monopoly.

Generally speaking, all mergers and acquisitions subject to the Amended Section 7 could be evaluated according to their market effects. These are classified into three types of mergers: horizontal, vertical, and conglomerate.

The degree and amount of regulation of the insurance business by the various states varied widely at the time of the passage of the McCarran Act, in 1945. State regulation ranged from strict supervision of all aspects of insurance in some states, to little or no regulation in others. Due to efforts of the National Association of Insurance
Commissioners and the All-Industry Committee, this situation was relatively corrected.

Many states apply their general corporation laws, particularly the part dealing with mergers and acquisitions, to insurance. Advance approval of the insurance commissioner is required in mergers and acquisitions of domestic insurers. Foreign companies have to seek the approval of the state of incorporation if they are involved in a merger transaction. In the case of the acquisition of a domestic company by a foreign company, most states provide that the latter company has to comply with the part of the law dealing with the admission of foreign companies.

Two problems might emerge from merger transactions which affect the competitive environment within which the insurance business operates: The first is due to the existence of some companies writing at less than full bureau rates. If one of these companies merge with a company writing at bureau rates, this means the elimination of a competitor and could be harmful to competition.

The other problem is a result of the existing statutes which require only domestic companies to seek the approval for merger from the states of incorporation. A merger transaction may look ideal from the point of view of domestic states and, therefore, is granted approval, while it might seriously affect the competitive situation in other states where the local insurance department would have no jurisdiction or power to prevent the merger.

The fact that states have devoted little time to the merger activities, and, in many cases they are not technically equipped to
handle the problem, represents a threat of federal control of the insurance business. As the merger movement continues to include a large number of insurance companies, the proponents of federal control will act more forcefully toward federal supervision of this type of activity.

3. There are several ways of classifying merger transactions. From a tax point of view, they might be either taxable or non-taxable acquisitions. Three types of acquisitions are considered non-taxable at the time of the transaction: (a) a statutory merger or consolidation; (b) an exchange of stock for stock; and (c) an exchange of stock for assets.

Taxable acquisitions depend upon when a plan of liquidation is adopted by the owner of at least eighty percent of the acquired company. The acquired corporation can be liquidated tax free into the parent company if the liquidation takes place within two years of the purchase.

The accounting view involves two concepts which determine the particular type of accounting treatment of the financial structures of the merged companies. A combination is viewed either as a purchase of one corporation by another or as a "pooling of interests" for accounting purposes, based on the motivation behind the merger transaction.

According to the motives underlying the merger transaction, mergers of insurance companies could be either "aggressive" or "defensive." A combination of both motives, "aggressiveness and defensiveness" is often found in a merger transaction.

According to the lines of business conducted by the constituent companies, merger could result in mono-line, multiple-line, or all-line insurance company. Mono-line insurance companies write only one line
of insurance. Multiple-line insurance is insurance combining coverage by either a casualty or a fire-and-marine insurer of perils that were formerly covered only by one of these types. All-lines insurance is insurance which combines fire, casualty, and life written by one insurer.

From the management point of view, there are four types of merger: (1) Intra-company mergers -- the acquisition of companies already operated under common ownership and management; (2) intercompany mergers -- the acquisition of a separately owned fire company into a casualty company and vice versa to form a multiple-line company; (3) the assembly of two or more groups of companies into a larger fleet; (4) the acquisition of the stock of an existing life company by a property-liability company to offer all-lines of insurance.

Mergers and acquisition of insurance companies could be accomplished by several methods. These include (1) exchange of acquirer's stock for acquired company's stock -- this method is widely used by insurance companies in merger transactions; (2) acquisitions effected through purchase of stock from individual persons or firms at private sale or in the open market, or both; (3) purchase of assets from the acquired company.

Valuation of insurance companies represents the major bargaining stage between the interested parties of the merger transaction. The following are methods of valuation which might be used when acquiring a non-life insurance company: (a) Book-value -- the least reliable measure of a company's value. (b) Market value -- reflects many factors which are difficult to assign a value for each individually,
but contribute to public confidence. (c) Liquidating value -- the value which theoretically accrues to the owners of an insurance company should liquidation be resorted to. (d) "Going Concern" value -- entails a complete investigation of the company's records to ascertain both tangible and intangible values. It is based on the assumption that the business in force will be carried to expiration.

Mergers and acquisitions are not the only actions taken in the case of an insolvent or near insolvent insurance company. Certain alternative approaches may be taken. These include reinsurance, liquidation, rehabilitation, and receivership.

Reinsurance shifts the liability from one insurer to another through the reinsurer's assumption of each outstanding risk written by the ceding insurer. Portfolio reinsurance is subject to approval by the insurance commissioner.

Liquidation of non-life insurance companies might be either (a) voluntary liquidation -- resulting from a decision of the company's management to discontinue and retire from the insurance business or (b) involuntary liquidation -- when it is inadvisable for an insurance company to continue doing business while it is considered insolvent or delinquent by the insurance commissioner.

Rehabilitation refers to the action of the insurance commissioner when he takes possession and runs the business of an insolvent or near insolvent insurance company.

Receivership is usually applied for when an insurance company is in financial difficulties. The insurance commissioner may file a
suit against an insurer to obtain the appointment of a receiver and an injunction against the further continuance of business.

4. Of the many potentially troublesome problems which follow upon the consummation of a merger transaction, that of integrating the activities of the merging companies, is the acquiring company's primary concern. Several common problems have been outlined under such headings as underwriting, personnel, accounting and finance, and marketing.

Underwriting problems include the integration of underwriting departments, establishing limits of retention, reinsurance practices, and standardization of policy forms.

Personnel problems entail the reconciling of differences in management philosophies, achieving uniformity of employee benefit plans, the readjustment of individual, and completing the transfer and placement of personnel.

Accounting and finance problems involve the decision to centralize or decentralize the merged companies, the standardization of accounting and reporting procedures, data processing, methods of maintaining reserves, and investment policies.

Marketing problems include selling the surviving company's image to new agencies, integration of the agency force, establishing training programs, and the remuneration of agents for solicited business.

Although post-merger problems are all but endless in number and variety, advance planning and careful consideration of all aspects of a merger transaction will help to minimize the more serious consequences.

5. The effect of mergers on the insurance industry in general
and on the merged companies in particular was measured in this study. Concentration of economic power was measured by using three different parameters of size measurement. These were total assets, volume of net premiums written, and policyholders' surplus. The analysis covered the change in concentration of the percentages held by the largest company, the largest four, and the largest ten at the end of the years 1939, 1949, and 1959.

The competitive environment as it exists in the property and liability business was examined by comparing the rate of entry of new companies with the rate of exit during the period of study. It was found that 524 insurance companies were formed while 504 companies retired for one reason or another during the decade of the 1950's.

Suggested ratios for analyzing effects of mergers on property and liability insurance companies' operations include (1) loss ratio, which expresses losses incurred plus loss adjustment expenses incurred to earned premiums, (2) expense ratio, which relates expenses incurred to written premiums, (3) operating ratio combines both loss and expense ratios, (4) underwriting profit ratio, relates the statutory underwriting profit (or loss) to earned premiums, (5) ratio of common stock to total assets determines the stability of the company's surplus, (6) the financial solvency of the company is determined when relating policyholders' surplus to total "true" liabilities, (7) investment efficiency ratio relates the sum of the net investment income and other investment gains or losses to total assets invested, (8) the profitability to owners ratio before federal taxes expresses the sum of net investment income, other investment income, and adjusted underwriting
profit to the sum of paid-in capital, policyholders' surplus, and stockholders' equity in the unearned premium. By deducting the federal taxes incurred from the nominator the profitability to owners' ratio after federal taxes is computed.

Net Appraisal of the Merger Movement

This study has shown that the recurrent merger movements within property and liability insurance companies were generally motivated either by the liberalizing of restrictive legislation, or by such economic considerations as tax advantages, more effective use of capital, personnel and equipment.

The major forces behind the present merger movement were the passage of the multiple-line laws and the statutory elimination of rules limiting agents' representation of a single company. In this wave of mergers, two types of combination were differentiated -- merger within company groups or "fleets" and merger with independent companies.

Company groups, in an attempt to establish certain economies, absorbed some of their subsidiaries when they found the practice of continuing such subsidiaries costly. The absorption, however, could not be total as it was made uneconomical by existing conflictive state laws.

Merger with independent companies was motivated by several considerations in areas such as management, investment, marketing, finance, and taxation. Several of these reasons may contribute to any one merger transaction.

Mergers of insurance companies are subject to federal anti-trust laws in two cases: (a) when an insurance company acquires the assets
or stock of an organization other than an insurance company, and (b) when regulation covering merger or acquisition cases by the state where this transaction took place, does not exist.

However, the existence of frictions in some state laws with regard to their attitude toward mergers (some are not staffed to investigate the problem and others do not give it too much consideration) represent a major threat of federal control to the insurance business. The mere fact that a few states have strict regulation of the merger transaction does not guarantee that the other states will follow. It was recommended that state insurance departments give the merger activity more consideration by adding qualified employees to the staff of these departments. In judging any merger proposal, consideration should be given to its effect not only in the domestic state of the merged company but in all the other states where it operates.

The findings of this study indicate the emergence of several problems following the consummation of a merger transaction in areas such as underwriting, personnel, accounting and finance, management, and marketing. The impact of such problems on the acquiring companies varies greatly from one company to another. Administrative attention during the early days of completing a merger is needed to avoid serious consequences.

In addition, the study indicated the very slight impact of the property and liability insurance merger movement upon concentration in economic power. Although the size of the largest firm, as measured by its share of assets, volume of premiums written, or policyholders'
surplus, is still below what Professor Stigler considers a threat to competition, there is an obvious trend toward more concentration.

The entry and exit in the insurance industry reveals a relative freedom of entry to new entrants and continued existence for those companies which are considered solvent by the regulatory authorities. In the history of the United States, 9,051 property and liability insurance companies have been organized, 5,762 have retired. Many have been merged, leaving 3,289 in operation as of August 1, 1962. Furthermore, out of 2,220 retirement cases in the non-life business 643 carriers representing 28.9 percent of such cases retired through merger during the period 1930 to August 1, 1962.

Non-life insurance, unlike most other kinds of business, involves uncertainty with regard to the magnitude of claims or losses which might take place at future time. Insurance rates are partially based on past experience which might turn out to be greatly different from the actual claims or losses. As a result, what is now a solvent company may become insolvent in the near future. Therefore, to the extent that merger helps to eliminate financially unstable companies, it is to be recommended as far as the end result will be financially strong companies capable of fulfilling their obligations.

The findings of this study demonstrate the effect of merger and acquisition on the results of the acquiring companies' operations. Within the results reached through the statistical approach used in the study, it was found that mergers have no effect on the underwriting results of the acquiring companies as measured by changes in their loss ratios, expense ratios, and loss and expense ratios combined, compared
with similar changes in ratios of non-acquiring companies of the same size. However, when relating statutory underwriting profits to earned premiums, the study showed a favorable lower rate of decline in merger cases of companies which are members of groups or "fleets," but not for companies acquiring other independent companies. This might be the direct outcome of economies resulting from the simplification of the corporate structure and sharing physical plants and manpower of the company groups. Such economies would not show in the case of the merger of two independent companies, since the loss incurred during administrative readjustment (due to differences in the philosophies of the combined companies) must be subtracted from that gain.

Furthermore, mergers have an adverse effect on the merged companies when relating common stock holdings to total assets, and policyholders' surplus to total "true" liabilities. This is explained by the facts that most of the merged companies had a sizeable amount of common stock holdings in the period of 1947-1949, and that their policyholders' surplus permitted them to expand their premium volume. Thus, when these companies absorbed other companies with relatively low surplus funds and smaller holdings of common stocks, the result was a smaller change between the "before" and "after" than changes shown in the non-merging companies in comparable periods. However, this does not represent a dangerous result since these merging companies are trying to take advantage of all the "capacity use" they possess.

With regard to the investment efficiency of the merged companies, the ratio of the sum of the net investment income and other investment gains or losses to total assets invested showed no effect on company
investments. This was expected as most insurance companies follow definite investment policies. Hence, although individual company investment policies vary greatly from one company to another, change is slow within the company itself. If any individual company does not change, its statistics should not show marked changes in its comparative investment standing.

The foregoing study has pointed out, within the period of the analysis, the general profitability of merger transactions to the owners of merged companies compared with non-merged companies. The profitability ratio (see Appendix B) representing the actual return on the stockholders' equity in the insurance company and which was computed while considering necessary adjustments in the reported items appearing in the balance sheets of such companies, bears this out. Although the study indicated a decline in the profitability ratios of both the merged and non-merged companies, the former group whose ratio dropped 6.85 percent for merger with independent company and 7.76 percent for merger within company group was in a favorable situation compared with non-merged companies whose ratio dropped to 14.37 percent.

Over and beyond restrictive anti-trust laws, there are mutually irreconcilable philosophies, widely differing tactics, underwriting, marketing, administrative and financial policies within the insurance companies themselves. These differences may be so variable that the prospective difficulties faced in attempts to integrate them far outweigh any advantage which might accrue through merger.

In the prevailing definition of a "good merger," if one dollar earned by the acquiring company plus one dollar earned by the acquired
company equals only two dollars earned by the merged company, the prospective merger venture will create only problems for the merging companies.

A successful merger is more analogous to a useful chemical combination than any summing up of discrete arithmetical quantities. If the acquired company can supply some necessity -- even an intangible one -- to the acquiring company which is floundering without it, the merger stands a good chance of being successful.
APPENDIXES
APPENDIX A

SAMPLE STATE-STATUTES TREATING INSURANCE MERGERS--NEW YORK
(1) **State antitrust law.**—Applies generally (McKinney's Law, N.Y. Ann., sec. 340 (1957):

1. Every contract, agreement, arrangement or combination whereby

   A monopoly in the conduct of any business, trade or commerce or in the furnishing of any service in this State, is or may be established or maintained, or whereby

   Competition or the free exercise of any activity in the conduct of any business, trade or commerce or in the furnishing of any service in this State is or may be restrained or whereby

   for the purpose of establishing or maintaining any such monopoly or unlawfully interfering with the free exercise of any activity in the conduct of any business, trade or commerce or in the furnishing of any service in this State any business, trade or commerce or the furnishing of any service in this State any business, trade or commerce or the furnishing of any service is or may be restrained is hereby declared to be against public policy, illegal and void.

2. Subject to the exceptions hereinafter provided in this section, the provisions of this article shall apply to licensed insurers, licensed insurance agents, licensed insurance brokers, licensed independent adjusters and other persons and organizations subject to the provisions of the insurance law, to the extent not regulated by provisions of article eight of the insurance law; and further provided, that nothing in this section shall apply to the marine insurances, including marine
protection and indemnity insurance and marine reinsurance, exempted from the operation of article eight of the insurance law ***.

(2) **Little Clayton Act.**—Applies only to insurance (Insurance Law, sec. 67 (1958)):

1. Any domestic insurer and any foreign or alien insurer authorized to do business in this State may retain, invest in, or acquire the whole or any part of the capital stock of any other insurer or insurers, or have a common management with any other insurer or insurers: **Provided,** that such retention, investment, acquisition, or common management is not inconsistent with any other provision of this chapter: **And provided further,** that by reason of such retention, investment, or acquisition of such capital stock, or common management, the business of such insurers with the public shall not be conducted in a manner which substantially lessens competition generally in the business of insurance or creates a monopoly therein.

2. Any person otherwise qualified may be a director of two or more insurers having a common management but no such interlocking directorate shall be used as a means of substantially lessening competition generally in the business of insurance or of creating a monopoly therein.

3. Whenever the superintendent has reason to believe that there is a violation of this section, he shall serve upon the insurer or insurers and the director or directors, as the case may be, a notice pursuant to section 22 of a hearing before the superintendent to be held not less than 30 days after the service of such notice, and requiring such insurer or insurers and such director or directors, as the case may be, to show cause why an order should not be made by the superintendent.
directing such insurer or insurers and such director or directors, as the case may be, to cease and desist from such violation.

If, upon such hearing, the superintendent finds that there has been a violation of this section, he shall issue and cause to be served upon such insurer or insurers and such director or directors, as the case may be, an order reciting the facts found by him, and setting forth the respects in which there has been a violation of this section, and directing such insurer or insurers and such director or directors, as the case may be, to cease and desist from such violation, and he may in such order direct such insurer or insurers to divest itself or themselves of the stock held or rid itself or themselves of the directors serving contrary to the provisions of subdivisions 1 and 2 of this section.

Any such cease-and-desist order of the superintendent shall be subject to judicial review. A violation of any such cease-and-desist order shall, subject to said judicial review, be deemed a violation of this chapter.

The attorney general may maintain an action upon his own information to prevent and restrain violations of this section and in such action the judgment against the defendant or defendants may grant affirmative relief to the same extent as may the superintendent by an order issued pursuant to this section.

Any person, firm, corporation, or association shall be entitled to maintain an action for the purpose of obtaining injunctive relief against loss or damages by a violation of this section when and under the same conditions and principles as injunctive relief against conduct that will cause loss or damage is granted by the court under the laws
of this State governing such proceedings, and in such action the plain-
tiff also may recover the damages by him sustained and the cost of suit, including a reasonable attorney's fee.

4. Nothing contained in this section shall be deemed to alter or abridge any rights or remedies which may otherwise be available to any person, the superintendent, and the attorney general under any law of this State.

(3) Approval by superintendent (Insurance Law, Sec. 486 (1949)).-- Upon the adoption of the agreement of merger or consolidation, as provided for herein, such proposed agreement shall be duly executed by the president and attested by the secretary, or the executive officers corresponding thereto, and under the corporate seal of each of the consolidating or contracting companies, and thereupon a certified copy of such agreement, together with a certificate of its adoption, as provided for herein, verified by the affidavits of such officers and under the seal of each of said companies, shall be submitted to the superintendent for his approval. The superintendent shall thereupon consider such agreement, and if satisfied that the same is in accordance with the provisions of this article, is fair and equitable, and is not inconsistent with the laws and the constitution of this State and of the United States and that no reasonable objection exists thereto, he shall approve such agreement as submitted. If the superintendent shall refuse to approve such agreement, notification of such refusal, assigning the reasons therefor, shall within 30 days from the date of submission to him of such agreement be given in writing by such superintendent to each of said companies parties thereto. No agreement shall take effect unless
and until the provisions of this chapter have been compiled with and the approval of the superintendent has been obtained as herein provided. The action of the superintendent in approving or refusing to approve such agreement shall be subject to judicial review at the instance of either company affected thereby or of any person aggrieved thereby.
APPENDIX B

ANALYSIS OF VARIANCE IN CHANGES IN RESULTS OF MERGED AND NON-MERGED
PROPERTY-LIABILITY COMPANIES FOR THE PERIOD
(Appendix for Chapter VI)
TABLE 16

THIRTY-TWO PROPERTY AND LIABILITY INSURANCE COMPANIES ACQUIRING INDEPENDENT COMPANIES: THIRTY-ONE COMPANIES ACQUIRING MEMBERS OF COMPANY GROUPS: AND THIRTY-TWO NON-ACQUIRING COMPANIES

<table>
<thead>
<tr>
<th>Company Number</th>
<th>Company Name</th>
<th>Location</th>
<th>Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Aetna Casualty &amp; Surety Co.</td>
<td>Hartford, Conn.</td>
<td>Large</td>
</tr>
<tr>
<td>2</td>
<td>The American Insurance Co.</td>
<td>Newark, N.J.</td>
<td>&quot;</td>
</tr>
<tr>
<td>3</td>
<td>American Motorists Insurance Co.</td>
<td>Chicago, Ill.</td>
<td>&quot;</td>
</tr>
<tr>
<td>4</td>
<td>American Reinsurance Co.</td>
<td>New York, N.Y.</td>
<td>&quot;</td>
</tr>
<tr>
<td>5</td>
<td>Continental Insurance Co.</td>
<td>New York, N.Y.</td>
<td>&quot;</td>
</tr>
<tr>
<td>6</td>
<td>Federal Insurance Co.</td>
<td>New York, N.Y.</td>
<td>&quot;</td>
</tr>
<tr>
<td>7</td>
<td>Fireman's Fund Insurance Co.</td>
<td>San Francisco,</td>
<td>&quot;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Cal.</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>General Reinsurance Corp.</td>
<td>New York, N.Y.</td>
<td>&quot;</td>
</tr>
<tr>
<td>9</td>
<td>Great American Insurance Co.</td>
<td>New York, N.Y.</td>
<td>&quot;</td>
</tr>
<tr>
<td>11</td>
<td>United States Fidelity &amp; Guaranty Co.</td>
<td>Baltimore, Md.</td>
<td>&quot;</td>
</tr>
<tr>
<td>13</td>
<td>Agricultural Insurance Co.</td>
<td>Watertown, N.Y.</td>
<td>Medium</td>
</tr>
<tr>
<td>14</td>
<td>American Guarantee &amp; Liability Insurance Co.</td>
<td>Chicago, Ill.</td>
<td>&quot;</td>
</tr>
<tr>
<td>15</td>
<td>Central Surety &amp; Insurance Corp.</td>
<td>New York, N.Y.</td>
<td>&quot;</td>
</tr>
<tr>
<td>16</td>
<td>The Connecticut Indemnity Co.</td>
<td>New Haven, Conn.</td>
<td>&quot;</td>
</tr>
<tr>
<td>17</td>
<td>Hawkey-Security Insurance Co.</td>
<td>Des Moines, Iowa</td>
<td>&quot;</td>
</tr>
<tr>
<td>18</td>
<td>The Monarch Insurance Company of Ohio</td>
<td>New York, N.Y.</td>
<td>&quot;</td>
</tr>
<tr>
<td>20</td>
<td>Phoenix Assurance Company of New York</td>
<td>New York, N.Y.</td>
<td>&quot;</td>
</tr>
<tr>
<td>21</td>
<td>State Farm Insurance Co.</td>
<td>Bloomington, Ill.</td>
<td>&quot;</td>
</tr>
<tr>
<td>22</td>
<td>American Union Insurance Company of New York</td>
<td>Hartford, Conn.</td>
<td>Small</td>
</tr>
<tr>
<td>23</td>
<td>The Eagle Fire Insurance Company of New York</td>
<td>Hartford, Conn.</td>
<td>&quot;</td>
</tr>
<tr>
<td>24</td>
<td>Freeport Insurance Co.</td>
<td>Freeport, Ill.</td>
<td>&quot;</td>
</tr>
<tr>
<td>25</td>
<td>Merchants Indemnity Corporation of New York</td>
<td>New York, N.Y.</td>
<td>&quot;</td>
</tr>
<tr>
<td>26</td>
<td>National Farmers Union Property &amp; Casualty Co.</td>
<td>Denver, Colo.</td>
<td>&quot;</td>
</tr>
<tr>
<td>Company Number</td>
<td>Company Name</td>
<td>Location</td>
<td>Size</td>
</tr>
<tr>
<td>----------------</td>
<td>--------------------------------------------------</td>
<td>------------------------</td>
<td>------</td>
</tr>
<tr>
<td>27</td>
<td>Northwestern Fire &amp; Marine Insurance Co. (changed to Guaranty Security)</td>
<td>Minneapolis, Minn.</td>
<td>Small</td>
</tr>
<tr>
<td>28</td>
<td>Provident Insurance Company of New York</td>
<td>New York, N.Y.</td>
<td>&quot;</td>
</tr>
<tr>
<td>29</td>
<td>Rocky Mountain Fire &amp; Casualty Co.</td>
<td>Seattle, Wash.</td>
<td>&quot;</td>
</tr>
<tr>
<td>30</td>
<td>Secured Insurance Co.</td>
<td>Indianapolis, Ind.</td>
<td>&quot;</td>
</tr>
<tr>
<td>31</td>
<td>Southern General Insurance Co.</td>
<td>Atlanta, Ga.</td>
<td>&quot;</td>
</tr>
<tr>
<td>32</td>
<td>Western Pacific Insurance Co.</td>
<td>Seattle, Wash.</td>
<td>&quot;</td>
</tr>
</tbody>
</table>

**Companies Acquiring Members of Company Groups**

1. Aetna Insurance Co. Hartford, Conn. Large
2. American Automobile Insurance Co. Newark, N.J. "
5. Globe Indemnity Co. New York, N.Y. "
12. The Travelers Indemnity Co. Hartford, Conn. "
16. Fidelity & Deposit Company of Maryland Baltimore, Md. "
22. Royal Indemnity Co. New York, N.Y. "
<table>
<thead>
<tr>
<th>Company Number</th>
<th>Company Name</th>
<th>Location</th>
<th>Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>24</td>
<td>Selected Risks Indemnity Co.</td>
<td>Branchville, N.J.</td>
<td>Medium</td>
</tr>
<tr>
<td>25</td>
<td>American Liberty Insurance Co.</td>
<td>Birmingham, Ala.</td>
<td>Small</td>
</tr>
<tr>
<td>27</td>
<td>Pan American Insurance Co.</td>
<td>Houston, Texas</td>
<td></td>
</tr>
<tr>
<td>28</td>
<td>Sun Insurance Company of New York</td>
<td>New York, N.Y.</td>
<td></td>
</tr>
<tr>
<td>29</td>
<td>Transcontinental Insurance Co.</td>
<td>Hartford, Conn.</td>
<td></td>
</tr>
<tr>
<td>30</td>
<td>Universal Insurance Co.</td>
<td>New York, N.Y.</td>
<td></td>
</tr>
<tr>
<td>31</td>
<td>The Yorkshire Insurance Company of New York</td>
<td>New York, N.Y.</td>
<td></td>
</tr>
</tbody>
</table>

**Non-Acquiring Companies**

<table>
<thead>
<tr>
<th>Company Number</th>
<th>Company Name</th>
<th>Location</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>Allstate Insurance Co.</td>
<td>Skokie, Ill.</td>
</tr>
<tr>
<td>4</td>
<td>The Fidelity &amp; Casualty Company of New York</td>
<td>New York, N.Y.</td>
</tr>
<tr>
<td>5</td>
<td>Firemen's Insurance Company of Newark</td>
<td>Newark, N.J.</td>
</tr>
<tr>
<td>7</td>
<td>Government Employees Insurance Co.</td>
<td>Washington, D.C.</td>
</tr>
<tr>
<td>8</td>
<td>Hartford Accident &amp; Indemnity Co.</td>
<td>Hartford, Conn.</td>
</tr>
<tr>
<td>10</td>
<td>The Home Insurance Co.</td>
<td>New York, N.Y.</td>
</tr>
<tr>
<td>11</td>
<td>New Hampshire Insurance Co.</td>
<td>Manchester, N.H.</td>
</tr>
<tr>
<td>13</td>
<td>American Central Insurance Co.</td>
<td>New York, N.Y.</td>
</tr>
<tr>
<td>14</td>
<td>The Buckeye Union Casualty Co.</td>
<td>Columbus, Ohio</td>
</tr>
<tr>
<td>15</td>
<td>Calvert Fire Insurance Co.</td>
<td>Baltimore, Md.</td>
</tr>
<tr>
<td>16</td>
<td>Industrial Indemnity Co.</td>
<td>San Francisco, Cal.</td>
</tr>
<tr>
<td>18</td>
<td>The Manhattan F &amp; M Insurance Co.</td>
<td>New York, N.Y.</td>
</tr>
<tr>
<td>21</td>
<td>The Reinsurance Corporation of New York</td>
<td>New York, N.Y.</td>
</tr>
<tr>
<td>Company Number</td>
<td>Company Name</td>
<td>Location</td>
</tr>
<tr>
<td>----------------</td>
<td>-------------------------------------------------</td>
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</tr>
<tr>
<td>22</td>
<td>Atlantic Insurance Co.</td>
<td>Dallas, Texas</td>
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<tr>
<td>23</td>
<td>Casualty Insurance Company of California</td>
<td>Los Angeles, Cal.</td>
</tr>
<tr>
<td>25</td>
<td>Imperial Insurance Inc.</td>
<td>Washington, D.C.</td>
</tr>
<tr>
<td>26</td>
<td>Maine Bonding &amp; Casualty Co.</td>
<td>Portland, Maine</td>
</tr>
<tr>
<td>27</td>
<td>Millers National Insurance Co.</td>
<td>Chicago, Ill.</td>
</tr>
<tr>
<td>28</td>
<td>Mt. Beacon Insurance Co.</td>
<td>New York, N.Y.</td>
</tr>
<tr>
<td>29</td>
<td>National Indemnity Co.</td>
<td>Omaha, Neb.</td>
</tr>
<tr>
<td>30</td>
<td>Netherlands Insurance Co. (Holland)</td>
<td>Keene, N.H.</td>
</tr>
<tr>
<td>31</td>
<td>New York Underwriters Insurance Co.</td>
<td>Hartford Conn.</td>
</tr>
<tr>
<td>32</td>
<td>Utah Home Fire Insurance Co.</td>
<td>Salt Lake City,</td>
</tr>
</tbody>
</table>

$^{a}$Based on average of 1960-1962 "net premium written," less than $5 millions—"small"; $5 to $10 millions—"medium"; and $50 millions and over—"large."

Source: Best's Insurance Reports, 1960, pp. 715-726B.
<table>
<thead>
<tr>
<th>Company</th>
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<th>MERGER WITHIN COMPANY GROUP</th>
<th>NON-MERGED</th>
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<tr>
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<td>55.85</td>
<td>64.34</td>
<td>8.49</td>
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<td>2</td>
<td>53.55</td>
<td>64.37</td>
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<tr>
<td>4</td>
<td>63.86</td>
<td>58.10</td>
<td>-5.76</td>
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<td>51.26</td>
<td>64.93</td>
<td>13.67</td>
</tr>
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<td>MERGER WITHIN COMPANY GROUP</td>
<td>NON-MERGED</td>
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<td>50.18 63.54 13.36 67.77 62.85 5.08 46.73 67.84 21.11</td>
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<td>52.24 63.99 11.75 50.05 85.10 35.05 73.49 67.67 3.18</td>
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<tr>
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<td>46.17 65.11 18.94 63.90 64.07 0.17 45.94 52.10 6.16</td>
<td></td>
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</tr>
<tr>
<td>25</td>
<td>67.70 63.09 5.39 47.46 60.18 12.72 45.59 60.29 14.70</td>
<td></td>
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</tr>
<tr>
<td>26</td>
<td>51.71 59.92 8.21 52.81 63.18 10.37 46.70 55.42 8.72</td>
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</tr>
<tr>
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<td>48.37 80.11 31.74 56.10 56.44 0.34 49.76 59.21 9.45</td>
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<tr>
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<td>54.65 61.70 7.05 68.42 64.32 -4.10 67.92 75.99 -0.93</td>
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<tr>
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<td>45.70 70.33 24.63 50.76 60.43 9.67 53.73 67.42 13.69</td>
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<td>59.26 61.89 2.63 52.90 67.96 15.06 58.98 61.65 2.67</td>
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Arithmetic Mean 8.52 9.03 10.22

\[ \text{Loss Ratio} = \frac{\text{Incurred Losses}}{\text{Earned Premiums}} \]

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**TABLE 18**

COMPUTATION OF CHANGE IN EXPENSE RATIO\(^a\) OF SELECTED NUMBER OF MERGED AND NON-MERGED STOCK PROPERTY-LIABILITY INSURANCE COMPANIES BETWEEN THE PERIODS 1947-1949 AND 1960-1962, UNITED STATES
TABLE 18—Continued

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Arithmetic Mean 0.20 0.48

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*aExpense Ratio = Expenses Incurred / Premiums Written.

TABLE 19

COMPUTATION OF CHANGE IN OPERATING RATIO* OF SELECTED NUMBER OF MERGED AND NON-MERGED STOCK PROPERTY-LIABILITY INSURANCE COMPANIES BETWEEN THE PERIODS 1947-1949 AND 1960-1962, UNITED STATES

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Arithmetic Mean: 8.72  
7.39  
10.70

\(^a\)Operating Ratio = Loss Ratio + Expense Ratio.

TABLE 20

COMPUTATION OF CHANGE IN UNDERWRITING PROFIT RATIO\(^{a}\) OF SELECTED NUMBER OF MERGED AND NON-MERGED STOCK PROPERTY-LIABILITY INSURANCE COMPANIES BETWEEN THE PERIODS 1947-1949 AND 1960-1962, UNITED STATES

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Arithmetic Mean: -4.83  -3.84  -7.21

*aUnderwriting Profit Ratio = \( \frac{\text{Underwriting Profit or Loss}}{\text{Earned Premiums}} \).

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Arithmetic Mean: 12.11  11.59  18.85

\(^a\)Ratio of Common Stocks to Total Assets = \(\frac{\text{Common Stock Holdings}}{\text{Total Assets}}\).

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\[ \text{Policyholders' Surplus Ratio} = \frac{\text{Policyholders' Surplus}}{\text{Total "True" Liabilities}} \]

### Table 23

**Computation of Change in Investment Efficiency Ratio\(^a\) of Selected Number of Merged and Non-Merged Stock Property-Liability Insurance Companies Between the Periods 1947-1949 and 1960-1962, United States**

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aInvestment Efficiency Ratio = Net Investment Income + Other Investment Income
Total Assets

TABLE 24

COMPUTATION OF CHANGE IN PROFITABILITY TO OWNERS RATIO (BEFORE FEDERAL TAXES) OF SELECTED NUMBER
OF MERGED AND NON-MERGED STOCK PROPERTY-LIABILITY INSURANCE COMPANIES BETWEEN THE PERIODS
1947-1949 AND 1960-1962, UNITED STATES

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Arithmetic Mean:
-7.99 -8.79 -16.53

^Profitability Ratio "before federal taxes" = [Underwriting Profit or Loss + Net Investment + Other Investment Income + 40 or 35% of increase in Unearned Premium Reserve] ÷ [Capital Stock + Policyholders' Surplus + 40 or 35% of Unearned Premium Reserve].

TABLE 25

COMPUTATION OF CHANGE IN PROFITABILITY TO OWNERS RATIO (AFTER FEDERAL TAXES)\(^a\) OF SELECTED NUMBER OF
MERGED AND NON-MERGED STOCK PROPERTY-LIABILITY INSURANCE COMPANIES BETWEEN THE PERIODS
1947-1949 AND 1960-1962, UNITED STATES

<table>
<thead>
<tr>
<th>Company Number</th>
<th>MERGER WITH INDEPENDENT COMPANY</th>
<th>MERGER WITHIN COMPANY GROUP</th>
<th>NON-MERGED</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>61.18</td>
<td>34.50</td>
<td>-26.68</td>
</tr>
<tr>
<td>4</td>
<td>10.04</td>
<td>8.05</td>
<td>-1.99</td>
</tr>
<tr>
<td>5</td>
<td>14.96</td>
<td>0.73</td>
<td>-14.23</td>
</tr>
<tr>
<td>6</td>
<td>14.97</td>
<td>5.97</td>
<td>-9.00</td>
</tr>
<tr>
<td>7</td>
<td>20.24</td>
<td>8.81</td>
<td>-11.43</td>
</tr>
<tr>
<td>8</td>
<td>1.54</td>
<td>15.09</td>
<td>13.55</td>
</tr>
<tr>
<td>9</td>
<td>16.84</td>
<td>10.47</td>
<td>-6.37</td>
</tr>
<tr>
<td>10</td>
<td>11.06</td>
<td>10.93</td>
<td>-0.13</td>
</tr>
<tr>
<td>11</td>
<td>21.78</td>
<td>21.93</td>
<td>0.15</td>
</tr>
<tr>
<td>13</td>
<td>4.94</td>
<td>8.35</td>
<td>3.41</td>
</tr>
<tr>
<td>14</td>
<td>13.32</td>
<td>5.91</td>
<td>-7.41</td>
</tr>
<tr>
<td>15</td>
<td>11.27</td>
<td>-3.34</td>
<td>-14.61</td>
</tr>
<tr>
<td>16</td>
<td>9.19</td>
<td>10.36</td>
<td>1.17</td>
</tr>
<tr>
<td>17</td>
<td>16.01</td>
<td>12.37</td>
<td>-3.64</td>
</tr>
<tr>
<td>18</td>
<td>13.92</td>
<td>2.72</td>
<td>-11.20</td>
</tr>
<tr>
<td>19</td>
<td>18.78</td>
<td>5.26</td>
<td>-13.52</td>
</tr>
<tr>
<td>20</td>
<td>2.72</td>
<td>-1.35</td>
<td>-4.07</td>
</tr>
<tr>
<td>21</td>
<td>21.44</td>
<td>25.53</td>
<td>4.09</td>
</tr>
</tbody>
</table>
### TABLE 25—Continued

<table>
<thead>
<tr>
<th>Company Number</th>
<th>MERGER WITH INDEPENDENT COMPANY</th>
<th>MERGER WITHIN COMPANY GROUP</th>
<th>NON-MERGED</th>
</tr>
</thead>
<tbody>
<tr>
<td>23</td>
<td>1.34</td>
<td>-19.55</td>
<td>-20.89</td>
</tr>
<tr>
<td>24</td>
<td>25.36</td>
<td>-0.17</td>
<td>-25.53</td>
</tr>
<tr>
<td>25</td>
<td>11.09</td>
<td>5.84</td>
<td>-5.25</td>
</tr>
<tr>
<td>26</td>
<td>34.99</td>
<td>10.74</td>
<td>-24.25</td>
</tr>
<tr>
<td>28</td>
<td>0.47</td>
<td>4.61</td>
<td>4.14</td>
</tr>
<tr>
<td>29</td>
<td>9.07</td>
<td>-4.15</td>
<td>-13.22</td>
</tr>
<tr>
<td>30</td>
<td>8.60</td>
<td>3.08</td>
<td>-5.52</td>
</tr>
<tr>
<td>31</td>
<td>5.53</td>
<td>15.06</td>
<td>9.53</td>
</tr>
<tr>
<td>32</td>
<td>5.71</td>
<td>8.33</td>
<td>2.62</td>
</tr>
</tbody>
</table>

Arithmetic Mean: 
-6.85 | -7.76 | -14.37

*Profitability Ratio (after federal taxes) = [Underwriting Profit or Loss + Net Investment Income + Other Investment Income + 40 or 35% of increase in Unearned Premium Reserve - Federal Taxes] * [Capital Stock + Policyholders’ Surplus + 40 or 35% of Unearned Premium Reserve].

### TABLE 26

ANALYSIS OF VARIANCE OF LOSS RATIO OF SELECTED NUMBER OF MERGED AND NON-MERGED STOCK PROPERTY-LIABILITY INSURANCE COMPANIES FOR THE PERIODS 1947-1949 AND 1960-1962, UNITED STATES

<table>
<thead>
<tr>
<th>Source of Variation</th>
<th>Merger with Independent Company</th>
<th>Merger with Company Group</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sum of Squares</td>
<td>Degrees of Freedom</td>
</tr>
<tr>
<td>TOTAL</td>
<td>3,627.063</td>
<td>63</td>
</tr>
<tr>
<td>Between Merged and Non-merged Companies&lt;sup&gt;a&lt;/sup&gt;</td>
<td>30.567</td>
<td>1</td>
</tr>
<tr>
<td>Between Different Sizes&lt;sup&gt;b&lt;/sup&gt;</td>
<td>80.462</td>
<td>2</td>
</tr>
<tr>
<td>Interaction</td>
<td>216.058</td>
<td>2</td>
</tr>
</tbody>
</table>

<sup>a</sup> F 0.90 = 2.79, F 0.95 = 4.00, and F 0.99 = 7.08.

<sup>b</sup> F 0.90 = 2.39, F 0.95 = 3.15, and F 0.99 = 4.98.

Source: Computed from Table 17.

Source: Computed from Table 17.
TABLE 27

ANALYSIS OF VARIANCE OF EXPENSE RATIO OF SELECTED NUMBER OF MERGED AND NON-MERGED STOCK PROPERTY-LIABILITY INSURANCE COMPANIES FOR THE PERIODS 1947-1949 AND 1960-1962, UNITED STATES

<table>
<thead>
<tr>
<th>Source of Variation</th>
<th>MERGER WITH INDEPENDENT COMPANY</th>
<th>MERGER WITH COMPANY GROUP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sum of Squares</td>
<td>Degrees of Freedom</td>
</tr>
<tr>
<td>TOTAL</td>
<td>1,799.690</td>
<td>63</td>
</tr>
<tr>
<td>Between Merged and Non-merged Companies&lt;sup&gt;a&lt;/sup&gt;</td>
<td>1.671</td>
<td>1</td>
</tr>
<tr>
<td>Between Different Sizes&lt;sup&gt;b&lt;/sup&gt;</td>
<td>9.093</td>
<td>2</td>
</tr>
<tr>
<td>Interaction</td>
<td>3.847</td>
<td>2</td>
</tr>
</tbody>
</table>

<sup>a</sup> F<sub>0.90</sub> = 2.79, F<sub>0.95</sub> = 4.00, and F<sub>0.99</sub> = 7.08.

<sup>b</sup> F<sub>0.90</sub> = 2.39, F<sub>0.95</sub> = 3.15, and F<sub>0.99</sub> = 4.98.

Source: Computed from Table 18.
### TABLE 28

**ANALYSIS OF VARIANCE OF OPERATING RATIO OF SELECTED NUMBER OF MERGED AND NON-MERGED STOCK PROPERTY-LIABILITY INSURANCE COMPANIES FOR THE PERIODS 1947-1949 AND 1960-1962, UNITED STATES**

<table>
<thead>
<tr>
<th>Source of Variation</th>
<th>MERGER WITH INDEPENDENT COMPANY</th>
<th>MERGER WITH COMPANY GROUP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sum of Squares</td>
<td>Degrees of Freedom</td>
</tr>
<tr>
<td>TOTAL</td>
<td>6,189.610</td>
<td>63</td>
</tr>
<tr>
<td>Between Merged and Non-merged Companies&lt;sup&gt;a&lt;/sup&gt;</td>
<td>44.840</td>
<td>1</td>
</tr>
<tr>
<td>Between Different Sizes&lt;sup&gt;a&lt;/sup&gt;</td>
<td>36.230</td>
<td>2</td>
</tr>
<tr>
<td>Interaction</td>
<td>324.580</td>
<td>5</td>
</tr>
</tbody>
</table>

<sup>a</sup>F 0.90 = 2.79, F 0.95 = 4.00, and F 0.99 = 7.08.

<sup>b</sup>F 0.90 = 2.39, F 0.95 = 3.15, and F 0.99 = 4.98.

Source: Computed from Table 19.
### TABLE 29

ANALYSIS OF VARIANCE OF UNDERWRITING PROFIT RATIO OF SELECTED NUMBER OF MERGED AND NON-MERGED STOCK PROPERTY-LIABILITY INSURANCE COMPANIES FOR THE PERIODS 1947-1949 AND 1960-1962, UNITED STATES

<table>
<thead>
<tr>
<th>Source of Variation</th>
<th>MERGER WITH INDEPENDENT COMPANY</th>
<th>MERGER WITH COMPANY GROUP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sum of Squares</td>
<td>Degrees of Freedom</td>
</tr>
<tr>
<td>TOTAL</td>
<td>4,428.521</td>
<td>63</td>
</tr>
<tr>
<td>Between Merged and Non-merged Companies&lt;sup&gt;a&lt;/sup&gt;</td>
<td>94.649</td>
<td>1</td>
</tr>
<tr>
<td>Between Different Sizes&lt;sup&gt;b&lt;/sup&gt;</td>
<td>229.291</td>
<td>2</td>
</tr>
<tr>
<td>Interaction</td>
<td>63.668</td>
<td>2</td>
</tr>
</tbody>
</table>

<sup>a</sup>F 0.90 = 2.79, F 0.95 = 4.00, and F 0.99 = 7.08.

<sup>b</sup>F 0.90 = 2.39, F 0.95 = 3.15, and F 0.99 = 4.98.

Source: Computed from Table 20.
TABLE 30

ANALYSIS OF VARIANCE OF THE RATIO OF COMMON STOCKS TO TOTAL ASSETS OF SELECTED NUMBER OF MERGED AND NON-MERGED STOCK PROPERTY-LIABILITY INSURANCE COMPANIES FOR THE PERIODS 1947-1949 AND 1960-1962, UNITED STATES

<table>
<thead>
<tr>
<th>Source of Variation</th>
<th>MERGER WITH INDEPENDENT COMPANY</th>
<th>MERGER WITH COMPANY GROUP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sum of Squares</td>
<td>Degrees of Freedom</td>
</tr>
<tr>
<td>TOTAL</td>
<td>11,693.875</td>
<td>63</td>
</tr>
<tr>
<td>Between Merged and Non-merged Companies(a)</td>
<td>665.382</td>
<td>1</td>
</tr>
<tr>
<td>Between Different Sizes(b)</td>
<td>161.363</td>
<td>2</td>
</tr>
<tr>
<td>Interaction</td>
<td>401.966</td>
<td>2</td>
</tr>
</tbody>
</table>

\(a\)F 0.90 = 2.79, F 0.95 = 4.00, and F 0.99 = 7.08.

\(b\)F 0.90 = 2.39, F 0.95 = 3.15, and F 0.99 = 4.98.

Source: Computed from Table 21.
### TABLE 31

**ANALYSIS OF VARIANCE OF POLICYHOLDERS' SURPLUS RATIO OF SELECTED NUMBER OF MERGED AND NON-MERGED STOCK PROPERTY-LIABILITY INSURANCE COMPANIES FOR THE PERIODS 1947-1949 AND 1960-1962, UNITED STATES**

<table>
<thead>
<tr>
<th>Source of Variation</th>
<th>MERGER WITH INDEPENDENT COMPANY</th>
<th>MERGER WITH COMPANY GROUP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sum of Squares</td>
<td>Degrees of Freedom</td>
</tr>
<tr>
<td>TOTAL</td>
<td>229,640.488</td>
<td>63</td>
</tr>
<tr>
<td>Between Merged and Non-merged Companies&lt;sup&gt;a&lt;/sup&gt;</td>
<td>19,092.331</td>
<td>1</td>
</tr>
<tr>
<td>Between Different Sizes&lt;sup&gt;b&lt;/sup&gt;</td>
<td>1,845.074</td>
<td>2</td>
</tr>
<tr>
<td>Interaction</td>
<td>40,096.686</td>
<td>2</td>
</tr>
</tbody>
</table>

<sup>a</sup> $F_{0.90} = 2.79$, $F_{0.95} = 4.00$, and $F_{0.99} = 7.08$.

<sup>b</sup> $F_{0.90} = 2.39$, $F_{0.95} = 3.15$, and $F_{0.99} = 4.98$.

Source: Computed from Table 22.
<table>
<thead>
<tr>
<th>Source of Variation</th>
<th>MERGER WITH INDEPENDENT COMPANY</th>
<th>MERGER WITH COMPANY GROUP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sum of Squares</td>
<td>Degrees of Freedom</td>
</tr>
<tr>
<td>TOTAL</td>
<td>145.259</td>
<td>63</td>
</tr>
<tr>
<td>Between Merged and Non-merged Companies&lt;sup&gt;a&lt;/sup&gt;</td>
<td>.002</td>
<td>1</td>
</tr>
<tr>
<td>Between Different Sizes&lt;sup&gt;b&lt;/sup&gt;</td>
<td>13.029</td>
<td>2</td>
</tr>
<tr>
<td>Interaction</td>
<td>10.723</td>
<td>2</td>
</tr>
</tbody>
</table>

<sup>a</sup>F 0.90 = 2.79, F 0.95 = 4.00, and F 0.99 = 7.08.

<sup>b</sup>F 0.90 = 2.39, F 0.95 = 3.15, and F 0.99 = 4.98.

Source: Computed from Table 23.
TABLE 33

ANALYSIS OF VARIANCE OF PROFITABILITY RATIO (BEFORE FEDERAL TAXES) OF SELECTED NUMBER OF MERGED AND NON-MERGED STOCK PROPERTY-LIABILITY INSURANCE COMPANIES FOR THE PERIODS 1947-1949 AND 1960-1962, UNITED STATES

| Source of Variation | MERGER WITH INDEPENDENT COMPANY | | | | | MERGER WITH COMPANY GROUP | | | | |
|---------------------|---------------------------------|---|---|---|-----------------|---|---|---|---|---|---|---|---|
|                     | Sum of Squares | Degrees of Freedom | Mean Squares | F | | Sum of Squares | Degrees of Freedom | Mean Squares | F | |
| TOTAL               | 14,583.476      | 63                     | 231.484 | -- | | 15,593.451      | 62                     | 251.507 | -- | |
| Between Merged and Non-merged Companies<sup>a</sup> | 956.665 | 1 | 956.665 | 4.538 | | 755.927 | 1 | 755.927 | 3.290 |
| Between Different Sizes<sup>b</sup> | 409.120 | 2 | 204.560 | .970 | | 943.394 | 2 | 471.697 | 2.053 |
| Interaction         | 778.863 | 2 | 289.431 | 1.847 | | 568.560 | 2 | 284.280 | 1.237 |

<sup>a</sup>F 0.90 = 2.79, F 0.95 = 4.00, and F 0.99 = 7.08.

<sup>b</sup>F 0.90 = 2.39, F 0.95 = 3.15, and F 0.99 = 4.98.

Source: Computed from Table 24.
### Table 34

**Analysis of Variance of Profitability Ratio (After Federal Taxes) of Selected Number of Merged and Non-Merged Stock Property-Liability Insurance Companies for the Periods 1947-1949 and 1960-1962, United States**

<table>
<thead>
<tr>
<th>Source of Variation</th>
<th>MERGER WITH INDEPENDENT COMPANY</th>
<th></th>
<th></th>
<th>MERGER WITH COMPANY GROUP</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sum of Squares</td>
<td>Degrees of Freedom</td>
<td>Mean Squares</td>
<td>F</td>
<td>Sum of Squares</td>
<td>Degrees of Freedom</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>13,147.919</td>
<td>63</td>
<td>208.697</td>
<td>--</td>
<td>14,144.046</td>
<td>62</td>
</tr>
<tr>
<td>Between Merged and Non-merged Companies$^a$</td>
<td>831.241</td>
<td>1</td>
<td>831.241</td>
<td>4.300</td>
<td>653.108</td>
<td>1</td>
</tr>
<tr>
<td>Between Different Sizes$^b$</td>
<td>341.093</td>
<td>2</td>
<td>170.546</td>
<td>.882</td>
<td>875.923</td>
<td>2</td>
</tr>
<tr>
<td>Interaction</td>
<td>571.227</td>
<td>2</td>
<td>285.614</td>
<td>1.478</td>
<td>566.784</td>
<td>2</td>
</tr>
</tbody>
</table>

$^a$F 0.90 = 2.79, F 0.95 = 4.00, and F 0.99 = 7.08.

$^b$F 0.90 = 2.39, F 0.95 = 3.15, and F 0.99 = 4.98.

*Source: Computed from Table 25.*
APPENDIX C

PERSONAL INTERVIEW QUESTIONNAIRE
1. Please check the method by which the merger or acquisition was accomplished:
   a. Purchase of stock by:
      (1) Negotiation with individuals or firms.
      (2) Open market.
   b. Purchase of assets from the acquired company.
   c. Exchange of stock.
   d. Other. (specify)

2. Please check the method by which the value of the acquired company was determined:
   a. Book value.
   b. Market value.
   c. Liquidating value.
   d. Other. (specify)

3. Please check the appropriate reasons for the merger or acquisition including the advantages and/or disadvantages that you expected to result from the action taken.

   A. Reasons and advantages for merger or acquisition:
      (1) Marketing Considerations
         a. Secure additional distribution facilities
         b. A desire of the company to establish or strengthen and enlarge its business in a particular territory
         c. Other (specify)
      (2) Management Considerations
         a. Fully qualified top management is hard to find
         b. Other (specify)
      (3) Underwriting Considerations
         a. Secure additional production facilities
         b. Secure diversification through new productions and additional lines
         c. Other (specify)
(4) Financial Considerations
   a. Fixed costs generally have risen sharply
   b. Financial instability of the company or companies acquired
   c. Secure additional capital
   d. Secure additional profit potential
   e. Other (specify)

(5) Other reasons not primarily one of the above.

B. Possible disadvantages of merger or acquisition:
   (1) May be subject to anti-trust laws.
   (2) May prove to be more costly than other methods of growth.
   (3) Dislocation of company employees.
   (4) The acquired company is, in some cases, a weak concern which may be a backbone for the acquiring company growth.
   (5) Post-merger problems which need time and high talents to solve.
   (6) Conflict in corporate policies.
   (7) Other (specify)

4. Please check the most important problems resulting from the merger or acquisition in each of the following areas and state briefly how you dealt with:

A. Underwriting.
   (1) Integration of underwriting department.
   (2) Differences in underwriting practices.
   (3) Line limits of retention.
   (4) Reinsurance practices.
   (5) Standardization of policy forms.
   (6) Other. (specify)

B. Personnel.
   (1) Difference in management philosophies toward incentives and employee morale.
   (2) Achieving uniformity of employee benefit plans.
   (3) Difference in the philosophies and aims of the merged organizations' union groups.
   (4) Individual adjustment--Re-establishment of the new groups as an integral part of the larger organization.
   (5) Completing personnel transfers and placement in new lines of business.
   (6) Other. (specify)
C. Accounting and Finance.
   (1) Centralization or decentralization of the merged companies.
   (2) Standardization of accounting and reporting procedures.
   (3) IBM set-ups.
   (4) Calendar differences.
   (5) Difference in methods of maintaining reserves.
   (6) Difference in investment policies.
   (7) Difference in dividend policies.
   (8) Conflicting types of financial control employed.
   (9) Other (specify)

D. Loss Adjustment.
   (1) Difference in adjustment procedures.
   (2) Difference in attitude on the part of the merged companies.
   (3) Difference in attitude of the merged companies agents or brokers.
   (4) Other (specify)

E. Marketing.
   (1) Selling the surviving company's goals to new agencies.
   (2) Integration of the agency force.
   (3) New make-up of the company agency force.
   (4) Training.
   (5) Compensation.
   (6) Other (specify)

F. Other problems under areas not primarily one of the above.
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