The demise of the mutual life insurer: An analysis of the impact of regulatory change on the performance of Australian life insurers in the 1990s

Monica J. Keneley
Deakin University

Abstract
In the 1980s and 1990s the demutualization of building societies, life insurers and general insurers was a re-occurring theme in many countries. In Australia, the demutualisation of major life insurers was linked to the deregulation of the financial sector. The experience of Australian life insurers represents an interesting case study on the impact of regulatory transition. The lifting of restrictions changed the institutional environment within which life insurers operated. In doing so it precipitated changes in the strategies and organizational structures of these financial intermediaries and the disappearance of the industry's long established mutual tradition.

Keywords: *Australia; demutualization; deregulation; mutual life insurers; organizational change*

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(Los Angeles, London, New Delhi, Singapore and Washington DC) and AFAANZ
Vol 15(1): 65–91. DOI: 10.1177/1032373210346319

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Introduction

Deregulation of financial markets has been a global phenomenon over the last two decades. Australian financial markets, like those in Britain, Europe and the USA, have undergone marked readjustments as the regulatory environment has altered. The extent and speed of this change has had far reaching implications for the financial sector and the players within it. The adjustment experience provides an interesting case study on the impact of regulatory processes, particularly on specific sectors of the financial system. The Australian life insurance industry is a case in point. Mutual firms had been leaders in this market for well over a century. This form of organization was placed under pressure by the progressive deregulation of the banking sector that occurred in the 1980s and 1990s. The lifting of these restrictions changed the institutional environment within which life insurers operated. In doing so, it precipitated changes in strategies and organizational structures of these financial intermediaries. Deregulation led to the emergence of new institutions that came into direct competition with established life insurers and challenged the status quo.

It is the purpose of this article to analyse the implications of the financial deregulation and the restructuring it encouraged in Australia's leading mutual life insurers in the 1990s. Financial statement analysis is used to provide clues to the immediate outcomes of deregulation and the pressures life insurers faced in adjusting to the new market environment. The lifting of regulatory controls removed the obstacles to market adjustment, resulting in radical change in the organizational structure of major Australian life insurers.

The Australian experience reflects that of other countries such as Britain where mutual financial firms played an important role in the development of the building society industry. As in Britain, a change in the regulatory environment was a key catalyst to the demutualization of these institutions, which sparked further readjustments in the financial services sector (Martin & Turner, 2000).

In developing the central argument, this article will proceed by outlining a theoretical framework for evaluating the process of change in the life insurance industry. The structure of the industry as it evolved will be reviewed and the impact of changes in the regulatory environment assessed. The study focuses on the fate of the three major mutual life insurers that had historically been the market leaders. The firms are the Australian Mutual Provident Society (AMP), National Mutual Life Assurance (NML) and Colonial Mutual Life Assurance (CML). These firms have had an influential role not only in the insurance market but also in the broader development of the Australian economy for nearly 150 years.[1]

In developing the outcomes of the demutualization process this article will draw on an information cost methodology to evaluate the effect on major life insurers. Such an approach suggests that the organizational structure adopted

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by the firm can be analysed as a rational response to information costs (Casson, 1997a, p.152). Information costs in this sense relate to the costs associated with doing business and focus on the processes of trade rather than the production of physical commodities. As information costs change, pressure is brought to bear on intermediaries to adapt. Such a framework suggests that changes in organizational structures are driven by changes in the process of intermediation. These in turn are a response to changes in information costs (Casson, 1997a, pp.151–3). The process is indicated in Figure 1.

Casson's framework is based on the concept of volatility. He argues that the economic environment is constantly disturbed by "shocks", which provide the stimulus to change by impacting on information costs. A significant shock in terms of the firm or organization is one that creates new market opportunities (Casson, 1997b, p.76). The outcome of this model suggests that shocks that impact on information costs will lead to the emergence of new firms, or the restructure of existing firms to take advantage of changes in market conditions. Regulation is an obvious factor restraining and distorting market behaviour. It can amplify the competitive advantages that some firms have over others, protecting them from the market pressures that would otherwise exist. The process of deregulation necessarily alters relative information cost structures between competing firms, opening up new markets previously closed to certain businesses and creating pressures for organizational change.

The extent to which firms are able to take advantage of opportunities associated with the changing nature of information costs depends on organizational knowledge and capabilities. Chandler (2001, p.4) refers to the notion of an integrated learning base in explaining the competitive strength of firms. The foundations of the learning base are the development of routines and procedures that promote technical, marketing and managerial capabilities that enhance the firm's core competencies. The ability to utilize the integrated learning base is a key factor influencing long-term corporate performance (Chandar and Miranti, 2005). In this context diversification into new markets may extend beyond the existing capabilities of the firm. This can undermine the strengths of its learning base and weaken performance outcomes.[2] A factor influencing the performance of mutual life insurers was that they were unable to take full advantage of new markets opportunities because their learning base could not adapt rapidly enough. In this context the information costs did not fall immediately as firms endeavoured to integrate new markets into corporate structures.

Figure 1: The information cost model

Information Costs ⟶ Intermediation ⟶ Organizational Change

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The information cost model provides an insight into the impact of the changing regulatory environment on players within financial markets. Together with the notion of an integrated learning base it assists in explaining the implications of financial deregulation for specific firms and markets. The lifting of controls on the banking and financial sector changed the nature of information costs, and thus put pressure on the organizational structure of firms. Within the life insurance industry, an illustration of this is the demutualization of major life insurers in the 1990s. The ability of these demutualized firms to compete was determined by their ability to extend their organizational capabilities to utilize the new forms of trade and intermediation arising from the fall in information costs.

The rest of this article will trace the impact on the life insurance industry in Australia. The next section describes the structure of the industry. Following that, regulatory influences and the impact of deregulation are considered. An analysis of post-demutualization adjustments is undertaken in the subsequent section and accounting data is used to determine the initial outcome of the demutualization process.

Ownership structures in the life insurance industry within a regulated financial market

Providers of life insurance in Australia have historically fallen into three categories: mutual associations, publicly listed companies and government agencies.[3] Of the three groups, it has been the mutual associations that traditionally held the largest percentage of industry assets. Mutuals are of particular interest because of their dominance of the market over a substantial period of time. Although there were several publicly listed companies operating in the market prior to the Second World War, it was not until the post-war period that these firms made an impression on market share. The government sector entered the market even more recently. In the 1980s, government insurers, spurred on by the expansion of superannuation, branched into life insurance in a limited way. From the mid-1980s four State insurance offices offered life insurance products. However, they were constrained to operate within their particular state and unable to expand beyond it unless application was made for registration under the federal government life insurance act.[4]

The significance of mutual associations and their role in the development of the market is a feature of the Australian life insurance industry, which distinguishes it from experiences in other countries. In Britain, major life insurers evolved as departments of composite insurance companies selling a range of insurance products (Supple, 1971, p.74). In the USA, major life insurers converted to mutuals in the early part of the twentieth century in response to public pressure to curb the perceived corporate excesses of these large firms (Keller, 1963). In European markets, mutual insurers have had a strong tradition of service

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provision (AISAM, 2007). In 2007, 61 per cent of life insurers were mutuals. In countries such as Italy, mutual life insurers such as Reale Mutua and Cattolica Assicurazioni have expanded and diversified in much the same way as Australian life insurers but have maintained their co-operative status.

Leading Australian life insurers were established as mutuals and traced their foundations to co-operative values that had more in common with friendly societies than commercial insurers. However, while life insurance mutuals and friendly societies had similar underpinning values, they operated in a markedly different manner and provided services to different types of consumers. Friendly societies were fraternal organizations providing a range of social welfare functions to members and their dependents. These included sickness, retirement, unemployment and medicinal dispensary benefits. They were historically viewed as mutual aid societies, not financial firms, and it is only recently that the federal regulatory framework has been extended to these institutions (McGing & Polic, 1997, pp.7–13).[5] While mutual life insurers originally devolved from the self help movement that formed the basis of friendly societies, they evolved rapidly into financial firms operating extensively in debt, securities and equity markets as a corollary to their life insurance business.

The first mutual life insurance association was the Australian Mutual Provident (AMP) formed in 1849. The aim of the Society was to set up a "modest life office" for the benefit of clergymen and other professionals to provide for their old age and dependents (Blainey, 1999). The AMP remained the only Australian mutual society for 20 years. The second mutual life association was not formed until 1869 by which time the AMP had established its market dominance in the life insurance industry. What competition the AMP experienced between 1849 and 1869, came from the limited number of Australian proprietary and overseas general insurance companies in operation in the colonies. Four Australian companies established in the late 1850s and early 1860s sold life insurance as part of their general business. However, all these companies had ceased to do so by 1889. These companies found that life insurance was not a profitable branch of business. Of the overseas companies, 18 British firms had agents who sold life insurance in Australia between 1860 and 1869. This number had been reduced by half in 1880 and by 1893 there were no British companies selling life insurance in Australia (Gray, 1977, pp.22–3).

By 1900 the dominance of mutual life insurers was clearly established. Although they were only a small number they accounted for a substantial share of assets and premiums sold. Five mutual firms accounting for in excess of 80 per cent of industry assets operated in the market from the end of the nineteenth century. The three largest were the AMP, National Mutual and Colonial Mutual. The two smaller mutuals were the Temperance and General Life Association and City Mutual Life Association. Of these the Temperance and General merged with

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the National Mutual in 1981 and City Life was acquired by a private provider, the Mutual Life and Citizens (MLC), in 1990.

Mutual associations captured and retained a large market share from a very early stage in the development of the industry. Table 1 demonstrates this point.

This table highlights a number of features of the Australian life insurance market. The number of life insurers in the market was historically very small and it was not until the 1970s that any significant increase occurred. In addition a small number of mutual offices traditionally accounted for around four fifths of industry assets, although this began to fall in the 1980s. These firms were the market leaders for a significant period of time. The decade of the 1990s was a period of substantial organizational adjustment that saw a reversal of patterns in ownership structures, with the disappearance of mutual life offices by the turn of the century.

An explanation for the formation of the mutual form of organization was that it dealt with the information cost problem most effectively. Hansmann (1996, pp.266–8) argued that the mutual form of organization emerged in response to the failure of the market to provide the type of service consumers wanted, given the conditions of uncertainty under long-term contracts. Buyers faced particular informational problems that impacted on their ability to distinguish between those insurance contracts and firms which adequately met their needs.

It has also been argued that the mutual governance system reduced some of the negative impact associated with information costs because it was better equipped to deal with the agency relationship (Fama & Jensen, 1983, p.347). This relationship arises when individuals (such as policyholders) engage agents to make decisions on their behalf. In terms of life insurance, the policyholder in taking out an insurance contract delegates some decision-making authority to the

Table 1: The distribution of industry assets between mutual and non mutual life insurers, 1900–2000

	Mutual firms		Non mutuals	
	Number	% of total assets	Number	% of total assets
1900	5	86	6	14
1920	5	85	11	15
1940	5	83	13	17
1960	5	80	14	20
1980	4	69	43	31
1990	4	72	54	18
1995	3	54	45	46
2000	0	0	42	100

Source: Australasian Insurance and Banking Record, 1900–60, Life Insurance Commission, 1980–95, APRA, 2000.

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insurance company. Problems may occur if decisions made by the agent deviate from those that may have been made by the individual or principal. This is known as the residual loss and represents the value of the loss to the policyholder of adverse decisions made by the agent. Mutuals, it is argued, are better placed to solve this part of the agency problem because the policyholder also has rights of ownership in the firm. This link provides a mechanism for minimising the problem of residual loss to the principal.

However, this explanation does not adequately account for why mutuals were able to sustain such a large market share over a considerable period of time. Over time it can be assumed that information costs would have fallen as actuarial standards and capabilities progressively improved. In addition, as mutuals grew, the risk of agency problems occurring increased. The major mutuals had become large multinational corporations by the beginning of the twentieth century (Keneley, 2008). The maintenance of specific forms of ownership is influenced by the type of market structure and the extent of competition in the industry. In this respect it is not possible to explain the long-term survival of life insurance mutuals without reference to the role of regulation in controlling the financial sector and influencing the behaviour of firms.

Regulatory influences

While regulatory controls had little direct effect on promoting a particular organizational structure in the life insurance industry, they had a significant yet indirect influence on the longevity of the mutual life associations. Until 1945, there was no consistent regulation of the life insurance industry. While differing regulatory provisions existed in the various Australian states, they were passive controls employed on the assumption that the market would be essentially self-regulating.[6] In 1945, a uniform regulatory environment was established with the passing of the *Commonwealth Life Insurance Act*. The aim of the Act was to establish minimum standards of probity and business conduct. The impact of this Act did not significantly alter business practices as most conditions of the Act in relation to accounting codes, actuarial valuations, solvency and policy holder interests had been in practice for over a decade previously (Royal Commission, 1937, pp.778–827).

A significant influence on the development of the Australian life insurance markets was the regulation of the banking sector. Controls were placed on Australian banks to facilitate the implementation of the government's macroeconomic policy agenda. Direct control of banking was the main monetary policy tool used to moderate fluctuations in the trade cycle (Merrett, 2002, p.277). These controls included entry restrictions, liquidity controls, interest rate and lending controls as well as captive market regulations.

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Although life insurance offices were not the target of these controls, they had repercussions for the conduct of their business. They defined the boundaries within which financial sector firms could operate and in doing so perpetuated market segmentation. The result of this segmentation was that banks and other large financial institutions could not compete directly in the life insurance market. They were forced to do so indirectly through the use of subsidiary companies that had to be accredited with a license to sell life insurance. This meant that banks were not able to make full use of their information network and thus had higher information costs than if they had been able to compete directly. Likewise it also meant that life insurers were not able to compete directly in other parts of the financial sector. They too had to do so indirectly, through subsidiary companies. The use of subsidiaries to expand into other financial markets meant that firms could not directly tap into existing sales structures and therefore faced higher information costs in developing a presence in these markets.

The implications of financial deregulation for mutual life insurers

The environment within which life insurance firms operated was altered with the progressive lifting of regulatory controls in the financial sector that began in the mid-1980s. The catalyst for this shift was the growing lack of competitiveness of banks both domestically and abroad as other financial institutions grew to provide the services banks were barred from. The process of disintermediation that had gathered strength in the preceding decades was also seriously impacting on the Australian government's ability to implement an effective monetary policy regime. In response to the increasingly apparent distortions in Australian financial markets the government commissioned an inquiry into the financial system. A key recommendation of the Report of Committee of Inquiry into the Financial System (1981) was the progressive lifting of controls on banking and other parts of the financial sector. This process began in the 1980s and continued into the next decade. During this time interest rate and exchange rate controls were lifted, restrictions on the commercial activities of banks abolished and "captive" market requirements on banks and life insurers removed (Davis, 1997, p.4).

Deregulation had far reaching implications for the structure and conduct of financial markets in Australia. With this opening up of the sector, barriers to entry and the segmentation of markets were reduced. The industry reorganization that resulted from the lifting of restrictions led to the emergence of new institutions which no longer focused on the provision of one bundle of products. The growth of large financial firms that embraced a range of activities was a feature of the Australian finance market in the 1990s (Davis, 1997, p.12).

The reduction in barriers to entry within the life insurance sector was associated with a marked increase in the number of insurers. Registered insurers

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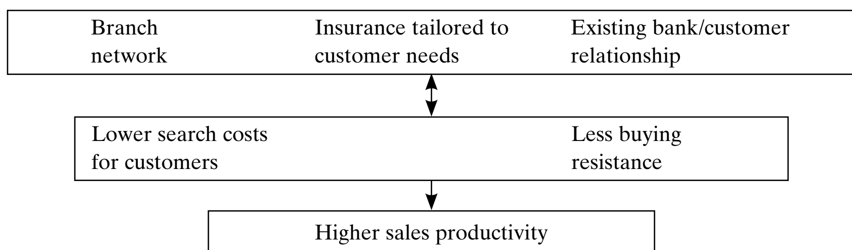
increased from 45 in 1980 to 58 in 1990 (ISC, 1990). Banks, which had previously only been able to compete indirectly in the life insurance market, rapidly gained market share from the mid 1980s. The first bank to register as a life insurer was the National Australia Bank in 1985. Over the next three to four years the other major banks followed suit. In 1990 they accounted for nine per cent of industry assets; a decade later this had risen to 44 per cent (Insurance and Superannuation Commission [ISC], 1990; Australian Prudential Regulation Authority [APRA], 2000). Banks were able to capitalize on the reduced information costs associated with selling insurance to customers in an already established retail network. Figure 2 indicates how this process worked.

By making use of existing sales networks banks were able to sell insurance more effectively than previously, when information flows were restricted by subsidiary arrangements. Within five years of entering the life insurance market the three largest banks in Australia were ranked within the top 10 life insurers with respect to new business sales. The Commonwealth Bank's life insurance business was ranked second, accounting for 13.7 per cent of new business. This can be compared to the top insurer, the AMP, which accounted for 18.7 per cent of new business at this time. The three major banks accounted for 22.6 per cent of new business while the three major mutuals accounted for 32.6 per cent (Deloitte Touche Tohmatsu, 1993a, p.17).

Aside from pressures from within the life insurance market, life insurance firms were faced with the more general pressures associated with structural change in the finance sector. The market trend both in Australia and overseas was for financial firms to become larger, spreading into other financial markets in a bid to exploit opportunities for related diversification and to improve their competitive advantage. Realignment in the financial sector in the 1990s was associated with the rise of conglomerates. The Reserve Bank (1996, pp.42–3) reported that by 1996 conglomerates accounted for around 80 per cent of financial system assets. The largest 25 held close to 70 per cent of assets. The Australian experience was

Figure 2: Characteristics of bank supplied life insurance



Source: Adapted from Deloitte Touche Tohmatsu, 1993a.

part of a global trend whereby financial enterprises sought economies of scope in the sale of new financial products (De Souza, 1995, p.21). Associated with this was the need for capital to invest in new organizational structures. This was more of an issue for American mutual insurers than the Australian mutuals, although they did acknowledge lack of capital as the single largest handicap to expansion. While some Australian mutuals argued the need for capitalization as a reason for demutualization the larger insurers did not. The AMP for example, in analysing the case for a change in organizational structure, took the view that it had sufficient capital (AMP, 1996). More fundamental issues arising from the impact of deregulation were identified at firm level. Specifically, the movement away from traditional insurance business and the emergence of new asset accumulation and risk products. This trend was attributed to the worldwide deregulation of financial sectors that broke down barriers between suppliers of financial services (AMP, 1996). The response was to consider new and alternative forms of business, to develop new markets and expand into other areas of the financial services industry.

Mutual insurers recognized the need to restructure in response to the changing face of the financial sector but were not well placed to do so. Hampered by inward looking management practices and sales systems that were not able to adapt quickly to the emerging financial environment, mutuals faced increasing costs and falling income.

The returns of both the National Mutual and Colonial Life suffered as a consequence of poor management and investment decisions in the early 1990s, undermining their cash balances.[7] Table 2 details the pattern of change in statutory

Table 2: The percentage change in value of statutory funds among major life insurers

	1990–1	1991–2	1992–3	1993–4	1994–5
Major mutual providers					
AMP	–5	+9	+3	–1	+7
National Mutual Life	–5	–4	–4	–2	–7
Colonial Mutual Life	–12	–8	–1	–4	–5
Major bank providers					
Commonwealth Life	+65	+105	+34	–17	+12
ANZ Life	+65	+81	+32	+7	+12
National Australia Financial	+24	+28	+32	+9	–7
Major private providers					
Lend Lease	+8	+12	+16	+10	+4
Prudential	+14	+23	+25	–1	+6
Mercantile Mutual	+15	+12	+25	–4	+6

Source: Compiled from Deloitte Touche Thomatsu, 1992–4.

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reserves that reflect the plight of the large mutual insurers. While the reserves of bank and private life insurers were growing strongly, those of the National Mutual and Colonial were declining. The AMP did not face the same financial constraints as the National Mutual and Colonial. However the firm had lagged behind in reacting to changes in the financial system, losing market share as a result (Kohler, 1996, p.40). Recognition of the problems facing mutuals led to an overhaul in management in the three majors in the mid 1990s. The Chief Executive Officers of the AMP, Colonial and National Mutual were replaced at this time.

Changes to management positions within mutual life insurers initiated a restructuring within these firms, the outcome of which was demutualization. In line with financial sector trends, major life insurers embarked on the process of expansion and diversification. Taking advantage of the relaxation in entry requirements the large life offices sought to enter other financial markets such as banking. The Colonial Mutual adopted an 'allfinanz' approach and acquired the State Bank of New South Wales to form the Colonial Bank (Colonial Ltd, 1997). Similarly, the AMP negotiated a joint venture with the Chase Manhattan Bank (Blainey, 1999, pp.288–9). The National Mutual on the other hand focussed on building subsidiary markets in Asia, particularly Hong Kong (National Mutual Holdings, 1995). In the 1990s the leading life insurance firms moved into the areas of integrated financial services. The AMP, National Mutual and Colonial reorganized to become institutions that offered a full range of financial services, from banking to insurance and financial planning. This was achieved through a series of mergers, acquisitions and takeovers that witnessed a restructure of the industry.

The repositioning of financial firms and the extension of large conglomerates in the life insurance industry placed pressure on the mutual form of organization. This process reflected the ongoing global trend towards demutualization that had been evident since the 1980s (Garber, 1986).[8] Demutualization of insurance offices, building societies and other thrift institutions occurred in Britain, Canada, South Africa and the USA (Reserve Bank of Australia [RBA], 1999, pp.2–3). The Canadian experience in the 1990s, for example, was very similar to that in Australia, with the public listing of four of the largest life insurance mutuals ("The Millennium Will See Many Fewer Mutuals", 1999). In Britain, alteration to the regulation of building societies with the *Building Societies Act* 1986 paved the way for the demutualization of larger building societies in the 1990s (Martin & Turner, 2000, pp.225–7). In the USA, financial deregulation was also a spur for life insurance demutualization. Between 1997 and 2001, 15 major American life insurers demutualized (Chugh & Meador, 2006). Life insurers were protected from the full force of competition by the 1934 *Glass-Steagall Act*, which restricted financial institutions from selling life insurance. The repeal of this Act in 1999 removed barriers to entry that had protected mutual life insurers and exposed

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them to increased competition in a similar way to mutual life insurers in Australia. While local influences have been important in driving organizational change, global dynamics often spurred on by regulatory change were a feature of this trend in the 1990s. Chaddad and Cook (2004, p.587) found that in industries where mutuals have traditionally played a significant role, waves of demutualization followed a period of "dramatic" institutional or market change such as deregulation. In the American life insurance industry for example, conversions decreased the mutual share of the industry from 50 per cent in 1986 to 15 per cent in the late 1990s (Chaddad & Cook, 2004, p.582).

The pressure for mutual firms to demutualize grew as the financial markets adjusted to new regulatory environments. This together with the accompanying globalization of financial markets put pressure on existing business structures. To compete with new forms of intermediation emerging in financial markets organizational change was needed. The listing of the major mutual life insurers as private companies occurred from the mid-1990s, as Table 3 indicates.

Post-demutualization adjustments

By 2000 there were no mutual providers of life insurance. The mutual system of life insurance that had been a foundation of the Australian market for 150 years had ceased to exist. While the common aim of the former mutuals was to become integrated service providers, the strategic response of each was slightly different. The AMP sought to exploit its brand name by focusing on "selective product manufacture" or providing products it believed it had the skill and scale to compete in (AMP, 1999). Part of this approach involved a strategy of acquisition of targeted national and international enterprises. In its first year of operation it acquired the UK company Henderson Investors, and the National Provident Institution. Domestically it obtained a 58 per cent share in the recently privatized

Table 3: Life insurance demutualization in the 1990s

Life insurer	Date of demutualization	Institution established	Form of demutualisation
National Mutual Life Association of Australasia	October 1996	National Mutual Holdings	Share issue to members and sale to foreign interests
Colonial Mutual Life Association	January 1997	Colonial Ltd.	Share issue to members
Australian Mutual Provident Society	January 1998	AMP Ltd.	Share issue to members

Source: RBA, 1999.

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general insurer GIO. Within two years it had purchased seven insurance and financial services firms in Australia, New Zealand and the UK.[9] In addition to expanding insurance and investment management services, the AMP also acquired retail banking outlets in New Zealand, although this was not considered one of its core strengths (AMP, 1999).

The strategy adopted by Colonial involved a greater emphasis on exploiting synergies between banking and insurance. The first arm of its strategy was based on growing its retail operations through its banking facilities. It aimed to re-model its retail network using a "hub and spokes" approach in which retail areas were relocated to high density traffic areas. These retail businesses were operated under a franchise system that replaced the older style banking network (Colonial, 1998). In addition to developing its retail network, Colonial pursued similar strategies to the AMP in building up its overseas interests in insurance and asset management, particularly in the UK, New Zealand, Fiji and Asia. An international financial services division was created to manage these operations. The aim was to encourage diversity within a set of global markets that were thought to provide a balanced exposure to risk (Colonial, 1998).

The approach taken by the National Mutual was strongly influenced by its alliance with the French based company AXA. The focus was on building the company's insurance and asset management business in Asia. Between 1996 and 1998 it entered insurance markets in Indonesia, Thailand and China. It also acquired several Asian insurance companies in the Philippines, Hong Kong and Singapore. The drive into Asian markets was at the forefront of corporate expansion. In addition, the National Mutual operated funds management, income protection and trauma insurance business in Australia as well as private health insurance (National Mutual Holdings, 1997).

A common feature of the approaches taken by the ex-mutuals after demutualization was the extent and pace of expansion. Appendix 1 provides a snapshot of the activities undertaken in the first three years after demutualization. The rapid move to become integrated financial service providers created pressures for further organizational change as the costs associated with entering new markets rose.

Initial data available on the performance of demutualized life insurers indicated that a period of instability followed the transition process, with the major firms experiencing fluctuations in profitability and efficiency measures. While financial markets expected the major mutual life insurers to continue to be market leaders this was not necessarily the case (*Business Review Weekly*, 1990, pp.30–3; *Australian Financial Review* [AFR], 4 October 1997, pp.35–6).

The use of accounting and financial data provides a clue as to the outcome of the demutualization process. While accounting data is not designed to measure efficiency per se, the information provided in financial statements can give useful indicators of the direction of changes in the performance outcomes.

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Financial statement analysis has been found to produce similar results to more complex econometric approaches when used to evaluate the efficiency of financial institutions (Esho & Sharpe, 1996). It has also been used on a number of occasions as the basis for analysis of the impact of changing ownership structures on the performance of financial institutions such as banks and insurance companies (Cagle *et al*., 1996; Chugh & Meador, 2006; Otchere & Chan, 2003). With the small nature of the sample size and the limited availability of data, econometric approaches are precluded in the current analysis. Instead, accounting ratios are used as indicators of performance of the three major ex-mutuals. It is recognized that variations in reporting practices may distort published financial data. In this case the information used is that collected and published by the APRA in accordance with the *Life Insurance Act* 1995.[10] This Act required the life insurers conform to specified reporting procedures. The data was only published for a limited period of time between 1997 and 2001, however it does provide a useful snapshot of trends immediately following the demutualization of the large life insurers.

Measures used to analyse the performance of life insurers include changes in market size and share, profitability, efficiency and solvency. These measures are based on similar yardsticks used by Hogan (1991), KPMG (1997) and Otchere and Chan (2003) to evaluate the performance of other financial institutions.

Table 4 indicates the trend in the size and market share of the major life insurers that demutualized in the 1990s. The three former mutuals still accounted for between 40 and 50 per cent of industry assets.

While the value of assets can vary for a number of reasons it is the differences between the demutualized firms and non-mutuals that is significant in this respect. The growth in the assets of demutualized firms varied considerably in comparison to the non-mutuals. From experiencing negative growth between 1998 and 1999 the trend reversed to positive growth in 1999/2000. The performance of certain firms highlight the extent of destabilization they underwent post demutualization. After demutualization the two largest firms, the AMP and National Mutual Life, experienced a fall in the value of their assets during 1998–9. The value of these firms' assets fell by 15.2 per cent and 8.2 per cent respectively (APRA, 1999). This was also reflected in the declining share of premium income attributed to the ex-mutuals.

The mixed performance of demutualized firms was mirrored in their profit outcomes. Profitability measures include operating profit before and after tax and as a proportion of net assets. They can be broken down to reflect the two main sources of the firm's income: premium income and investment income.

Table 5 indicates that the profitability record of demutualized firms was erratic after the change in ownership structure. The fall in the profitability is reflected in the ratio of operating profit to net assets. Here the volatility in the performance

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Table 4: Market size and market share in the life insurance industry

Financial year	Total assets AUS$m	Percentage change	Percentage of industry assets	Percentage of premium income
Demutualized firms				
1997/98	75,896		44.63	38.52
1998/99	66,763	–12.03	39.96	36.56
1999/00	82,561	23.66	42.39	44.65
2000/01	92,065	11.05	43.54	46.95
Non-mutuals				
1997/98	94,155		55.37	61.48
1998/99	100,323	6.55	60.04	63.44
1999/00	112,207	11.85	57.61	55.35
2000/01	119,391	6.40	56.46	53.05

Source: Calculated from APRA, 1998–2001.

of the demutualized firms is also evident. All demutualized firms experience one year of negative returns. The period between 1999 and 2000 was a turning point for the ex-mutuals when various factors combined to impact on the profitability of their operations. For the AMP, for example, it followed an aggressive takeover of the large general insurer GIO.[11] Both the Colonial and National Mutual had pursued extensive expansion programmes before the downturn in the insurance cycle in 2000 impacted on financial outcomes, as indicated in Appendix 1. The performance of these firms suggests that as they moved away from their primary business they extended beyond their core capabilities. In this respect they were unable to utilize the new skills necessary to generate a fall in information costs and improve outcomes. The turnover of senior management positions, particularly in organizations such as the AMP, is indicative of the problems associated with the extension of business into new areas (AFR, 2000).

Table 6 highlights the contrast between the performance of the demutualized firms and non-mutuals. While both experienced declining profits, for the non-mutuals this was relatively short term and recovery was evident within the next financial year. For demutualized firms recovery was not evident, with both before and after tax profit declining by over 90 per cent between 1997 and 2001.

In Table 7 efficiency is measured in three ways: operating expenses as a proportion of total assets, percentage of operating expenses to operating income and operating profit as a ratio of operating expenses.

This table indicates that while the ratio of operating expenses to assets was marginally lower among some demutualized firms, the proportion of operating expenses to income was much higher. The poor performance of the operating profit to expenses ratio is a common feature of all firms in the industry but it

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Table 5: Profitability measures

		Operating profit before tax AUS$m	Operating profit after tax AUS$m	Net investment income/total assets (%)	Net premium income/total assets (%)	After tax operating profit/net assets (%)
Demutualized firms						
AMP	1997–8	2791	1808	11.62	11.54	21.3
	1998–9	1473	1180	9.93	18.73	36.6
	1999–2000	–753	–753	5.20	17.17	–21.0
	2000–1	816	816	7.12	18.71	18.85
National Mutual	1997–8	932	601	12.93	18.58	54.7
	1998–9	458	376	4.90	21.17	46.9
	1999–2000	499	389	7.52	13.12	50.4
	2000–1	–49	71	11.52	22.28	–2.47
Colonial Mutual	1997–8	133	99	9.20	11.25	20.1
	1998–9	136	102	7.98	10.70	23.6
	1999–2000	282	250	5.20	7.74	27.8
	2000–1	–243	–243	7.03	15.39	–10.56

Source: Calculated from APRA, 1998–2001.

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Table 6: Percentage change in operating profit

	AMP	National mutual	Colonial mutual	Non-mutuals	Total industry
Operating profit after tax					
1998–9	–34.73	–37.44	3.03	–9.85	–24.96
1999–2000	–163.81	3.46	100.98	71.18	–28.92
2000–1	–208.37	–81.75	–218.98	10.28	48.78
Operating profit before tax					
1998–9	–47.22	–53.0	2.26	–18.75	–35.69
1999–2000	–151.12	13.93	107.35	48.10	–24.77
2000–1	–208.37	–109.82	–186.17	12.82	28.70

Source: Calculated from APRA, 1998–2001.

Table 7: Efficiency

		Operating expenses/total assets	Operating expenses/operating income (%)	Operating profit/operating expenses
Demutualized firms				
AMP	1997–8	1.84	7.9	2.80
	1998–9	1.96	6.8	1.63
	1999–2000	1.94	8.7	–0.75
	2000–1	2.15	8.3	0.70
National mutual	1997–8	2.95	9.4	1.85
	1998–9	2.95	13.4	0.95
	1999–2000	2.89	13.9	1.03
	2000–1	3.68	10.9	–0.09
Colonial mutual	1997–8	2.92	14.2	0.99
	1998–9	2.34	12.4	1.13
	1999–2000	0.91	7.0	2.22
	2000–1	1.96	8.7	–0.86
Non-mutuals	1997–8	2.08	6.4	1.31
	1998–9	2.14	6.6	0.97
	1999–2000	2.32	8.2	1.18
	2000–1	2.68	10.0	1.23
Total industry	1997–8	2.11	7.3	1.79
	1998–9	2.17	7.3	1.14
	1999–2000	2.17	8.7	0.74
	2000–1	2.55	9.6	0.83

Source: Calculated from APRA, 1998–2001.

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is only among the demutualized firms that negative ratios are reported. This is consistent with the findings of Jeng *et al.* (2007) who found that demutualizations of American life insurers in the 1980s and 1990s did not lead to apparent efficiency gains. This is a reflection of an industry in transition. It suggests further change may be needed to generate the necessary decrease in information costs that would improve efficiency outcomes.

Table 8 indicates that the returns to owners in respect to outlays were weak. The transformation of firms from insurance companies to financial conglomerates put pressure on returns at a time when industry profits were squeezed. This can be seen in a breakdown of available data for the three major demutualized life insurers.

The strength and soundness of life insurers can be measured by their solvency reserve and solvency coverage. The solvency reserve measures the level of reserves required by a company to meet its obligations under a predetermined set of adverse conditions. It is calculated as a percentage of liabilities. The solvency coverage ratio measures the number of times the firm's excess assets are able to cover its solvency reserve (APRA, 2000). Both these measures are indicators of the soundness of the firm and its ability to meet its premium liabilities.

Table 9 indicates that direction of change in solvency reserves is in line with industry trends. However, while the solvency of the AMP remained above the industry average during this period, both the National Mutual and Colonial Mutual fell below industry standards, reflecting the income and profit trends experienced by these firms. The solvency coverage of the National Mutual and Colonial Mutual was generally above the industry standard. The AMP though, remained below the industry average over this period. However, as the solvency reserve of this firm was much higher than the industry standard this variation was not an indicator of solvency problems. In general the solvency reserves of demutualized firms remained strong and consistent with industry standards.

Table 8: Return on equity and return on assets for former mutual life insurers

	1997	1998	1999	2000	2001
ROE (%)					
AMP	12.53	6.37	6.87	7.04	3.55
National Mutual	4.2	5.69	9.78	–22.52	11.54
Colonial Mutual	10.6	7.93	9.29	Delisted	
ROA (%)					
AMP	13.32	1.17	1.02	1.03	0.72
National Mutual	4.81	4.72	1.55	–1.44	1.79
Colonial Mutual	2.49	1.81	2.03	Delisted	

Source: AspectHuntley FinAnalysis.

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Table 9: Solvency

		Solvency reserve (%)	Solvency coverage (%)
AMP	1997–8	21.2	1.6
	1998–9	12.89	1.51
	1999–2000	11.14	1.59
	2000–1	9.62	1.59
National Mutual	1997–8	7.27	2.4
	1998–9	5.37	2.69
	1999–2000	4.87	2.67
	2000–1	4.45	2.65
Colonial Mutual	1997–8	9.73	1.82
	1998–9	5.47	2.37
	1999–2000	6.21	1.59
	2000–1	4.71	1.86
Industry	1997–8	8.93	1.79
	1998–9	6.13	1.74
	1999–2000	5.9	1.78
	2000–1	5.08	1.85

Source: Calculated from APRA, 1998–2001.

Financial statement analysis indicates that in the immediate post demutualization period the former mutuals faced a number of challenges that impacted on the profitability and efficiency of these organizations. It highlights problems the ex-mutuals had in adapting their organizational structures to take advantage of new market opportunities. Demutualization was followed by a period of destabilization among the former mutuals. As the information cost theory suggests, shocks to existing market processes, such as those prompted by financial deregulation, will lead to a period of restructure as firms adapt to new market opportunities. The performance of ex-mutual life insurers suggests that such a process was occurring. The pressure placed on the organizational capabilities of these firms resulted in erratic outcomes as they learned to adapt to changing competitive parameters.

As the information cost model also suggests, the process of organizational change did not halt with demutualization. Further adjustments continued as financial intermediaries developed strategies to enable them to make more effective use of information networks and compete in an increasingly broad range of markets. The pressures within the financial sector towards conglomeration gathered momentum in the late 1990s, and demutualized insurers were susceptible to these forces (Gizycki & Lowe, 2000, pp.190–3). While these firms expanded into other markets, competition from other financial service providers increased in the life insurance market. The degree of restructuring saw the ex-mutuals broaden their organizational base to become international players in the financial sector. However, it also made them vulnerable to take-over pressures from other larger

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firms. These pressures culminated in another round of adjustments at the end of the 1990s. Table 10 traces the outcome of these changes that saw most of the demutualized life insurers disappear from the insurance market.

These mergers have contributed to the newly emerging structure of the life insurance sector, which can be segmented into three groups. The main group consists of financial conglomerates, which represent the bulk of market share and are comprised of the major bank owned and foreign owned wealth management institutions. The top 10 in this group account for 93 per cent of industry assets. All firms with a link to a mutual heritage are ranked among the top 10 life insurers by assets and by premium income (APRA, 2004a). Table 11 indicates the industry share of firms that have a link to the mutual structure.

While the market share of mutual heritage firms has fallen in recent years, the three firms still account for nearly 50 per cent of industry assets and around 40 per cent of premium income.

The second market segment comprises smaller insurers who aspire to be "full service" wealth management institutions but do not have the scale advantages of

Table 10: The progress of demutalized life insurers

Life insurer	Date of demutualization	Institution established	Merged entity
National Mutual Life Association of Australasia	September 1996	National Mutual Holdings	AXA Asia Pacific 1998
Colonial Mutual Life Association	December 1996	Colonial Ltd.	Commonwealth Bank 2000
Australian Mutual Provident Society	January 1998	AMP Ltd.	AMP Ltd

Table 11: Mutual heritage firms' share of the Australian life insurance market

Year	Percentage of industry assets	Percentage of total premium income (Australian business)
1995	54	32
2000–1	44	46
2001–2	50	43
2002–3	49	40
2003–4	48	41
2004–5	47	39

Source: Collated from APRA, *Life Office Market Report*, 2000–5.

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the financial conglomerates (APRA, 2004b, p.4). They account for less than five per cent of industry assets but are numerically the largest section of the market. The final group are a small number of "boutique" insurers who cater for a specific market niche and are not in direct competition with the major players.

The nature of the life insurance industry has altered with the demutualization of the long-term industry leaders. However, the emerging structure has brought the major players closer to integrated financial service providers in line with global market trends. In this sense it has contributed to the maturation of the Australian financial sector post deregulation.

Conclusion

The deregulation of the Australian financial sector in the last two decades initiated a major structural and organizational change within the life insurance industry of that country. Up until the 1990s the regulatory environment that governed the Australian financial sector contributed to the preservation of an industry structure that had dominated the life insurance market for the previous 150 years. The process of deregulation in reducing barriers to entry into this industry played a role in the way information costs impacted on life insurers. The lifting of regulatory controls, for example, allowed competing institutions such as banks to make more efficient use of their own sales networks reducing their costs and allowing greater market exposure.

Pressure on the existing organizational structure of the major mutuals within the life insurance market increased as information costs changed in response to the globalization of financial markets and the greater use of economies of scope within large financial institutions. The path to the demutualization of the major life insurers became inevitable as the need for capital to transform organizational structures grew in response to changing competitive pressures. During the 1990s all mutual life insurers demutualized and the newly formed companies moved rapidly to become integrated financial service providers.

Published accounting data provides clues as to the initial outcomes of the demutualization process. Demutualized firms struggled to compete in the new market environment. The market share of these firms fell both in terms of assets and premium income. Measures of profitability pointed not only to a fall in profit but an increased volatility in the performance of these firms. Returns on Assets and Returns on Equity indicated erratic trends. Solvency standards remained solid however, indicating the underlying strength of these firms and their ability to meet their policy liabilities and other commitments.

Financial statement analysis provides insights into the adjustment process that may be associated with organizational change. In the case of Australian mutual life insurers, accounting data gives an indication of the stresses these firms faced

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and the pressures for further market adjustment. The degree of reorganization and market performance made the ex-mutuals vulnerable takeover targets. A further round of restructuring became inevitable as demutualized life insurers struggled to compete with the emerging banking conglomerates.

Mergers and takeovers within the Australian industry led to further structural and organizational change, which resulted in a three tier structure in the industry. The industry has become dominated by first tier firms represented by the large banking and foreign owned wealth management institutions. The information cost model suggests that in the deregulated environment further structural adjustment will continue while information cost differentials exist between firms within the industry. The Australian experience is in line with overseas trends. A study of the US life insurance sector by Cummins *et al.* (1998) concluded that consolidation within the industry would continue as long as life insurers lose out to non-traditional providers. The experience of organizational change within the Australian life insurance industry in the last decade illustrates the complex and in some cases unforseen impacts regulatory and deregulatory policies have on the nature of financial markets.

Notes

1. The AMP, for example, actively engaged in projects that it believed benefited broader economic and social well-being. It invested in land development schemes for example, as well as urban and regional development projects (Blainey, 1999).
2. The author is indebted to the suggestions made by an anonymous referee for this paragraph.
3. Providers of life insurance in this context are defined as firms registered under the *Life Insurance Act* 1945 (amended 1995). It does not include friendly societies which were not registered as life insurers for the purposes of the Act.
4. State insurance offices were not covered under the federal act. Only one state office applied for registration, that was the Government Insurance Office of NSW in 1988.
5. Friendly societies did not come under federal government regulatory supervision until 1999.
6. The controls were based on the assumption of “freedom with disclosure” which allowed firms to trade in an unrestricted manner as long as they published enough information to enable the public to establish the financial position of the company. In this respect life insurers had to be registered in most states (with the exception of NSW) and publish annual expenditure and revenue accounts.
7. In the case of the National Mutual lack of attention to sales management, growing policy discontinuances and poor investment outcomes threatened not only the

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company's cash flow but its solvency as well. In the case of the Colonial poor management, particularly in respect to property investment, also weakened the company's reserves (Kohler, 1996, pp.38–40).

8. Demutualization is defined as the process of changing a mutual association into a public company. It is the conversion of members' interests into shareholdings.
9. These were Cogent, GIO, Hendersons Investors, London and Life, National Provident Institution, Pearl, Virgin Direct.
10. The Life Insurance Act 1995 introduced more specific reporting requirements for life insurers. Much of the information now collected was not required before this date, this makes a meaningful comparison with the period prior to this point difficult.
11. Following the takeover, GIO the company reported an AUS$759m loss putting a severe strain on AMP resources.

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Acknowledgements: The author is indebted to the anonymous referees of this journal for the helpful comments and suggestions on earlier versions of this paper.

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Address for correspondence: Associate Professor Monica Keneley, School of Accounting, Economics and Finance, Deakin University, PO Box 423, Warrnambool Victoria 3281, Australia. E-mail: mkeneley@deakin.edu.au

Appendix 1: Selected activities of demutualized insurers 1996–2000

AMP Ltd	
Listed January 1998	
1998	acquired UK funds manager
	acquired Australian property trust
	acquired NZ retail bank
	registered AMP Bank in NZ
	acquired UK mutual pension fund
	acquired Australian financial services company
1999	acquired major Australian general insurer
	created global investment management business
	restructured general insurance business
	introduced new retail products including low interest credit card
2000	expanded global asset business in Europe
	entered partnership with UK firm to launch new financial services business
Colonial Ltd	
Listed 9 January 1997	
1997	acquired interest in large Asia/Pacific life insurer
	commenced stockbroking division
	entered partnership to sell general insurance in NZ
1998	entered joint venture to provide industry funds administration business
	completed integration of Australian financial services division
	established life insurance business in China
	consolidated funds management business
	acquired Australian business of major UK insurer
	acquired Hong Kong business of UK insurer
	acquired Australian and NZ business of UK insurer
1999	acquired 51 per cent share in National Bank of Fiji
	acquired Asian and UK business of US fund manager
	formed life insurance company in Shanghai with Chinese insurer
	introduced new investment product in Australia
	obtained license to operate joint venture life insurance business in Vietnam
2000	company delisted after merger with Commonwealth Bank

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Appendix 1: (Continued)

NML Holdings	
Listed 8 October 1996	
1996	expanded range of unit trusts in Australia and NZ
1997	entered Indonesian life insurance market
	granted life insurance license in Thailand
	opened life insurance branch in China
1998	acquired three Asian life insurers (Philippines, Hong Kong, Singapore)
	acquired interest in Shanghai life insurer
1999	introduced new superannuation product
	combined group insurance business of NMLA with other subsidiary insurer
	acquired Singapore life insurer
	acquired balance of shares in Chinese subsidiary life insurer
2000	Reorganization of parent company, name changed to AXA Asia Pacific Holdings

Source: Collated from AspectHuntly, http://www.aspectfinancial.com.au, accessed May 2006.

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