American Family Insurance is broadening its corporate footprint while remaining committed to its mutual heritage.

by Lori Chordas

American Family Insurance realized it was at a crossroads. Remaining a mutual insurance company owned by its policyholders for its 90-year history could hold it back from expanding the business through new products and services as well as future acquisitions.

Lori Chordas is a senior associate editor. She can be reached at lori.chordas@ambest.com.

Key Points

Rising Tide: American Family Insurance has held steadfast in its mutuality model for 90 years.

The Transformation: This year, the company converted to a mutual holding company to gain greater flexibility to pursue customer-driven initiatives.

Potential Pay-Off: American Family continues to make strides in customer service, innovation and venture capital investments.
Also changing market conditions and the advent of innovations, such as autonomous vehicles and smart homes, had American Family CEO and then-president Jack Salzwedel and his management team searching for new ways to protect the evolving needs of its policyholders.

American Family leaders and its board of directors decided it was time for a change, one they had carefully researched.

They agreed to propose that American Family convert to a mutual holding company to provide more flexibility to meet customers’ future demands and invest in or acquire non-insurers that complement its role as an insurer. The conversion was approved by 84.5% of voting policyholders in December 2016.

“We wanted additional flexibility while also preserving our tradition of mutuality and policyholder ownership,” said Bill Westrate, American Family’s former chief operating officer who assumed the president’s role from Salzwedel in June. Today, nearly a dozen of the 50 largest mutuals, based on written premiums, operate as a mutual holding company, according to the National Association of Mutual Insurance Companies.

Mutual holding companies are formed by the reorganization of a mutual business whereby the mutual forms a stock institution subsidiary which receives all of the assets and liabilities of the mutual with the parent holding company retaining all the attributes of mutuality while owning at least a majority of the new stock subsidiary, according to the association America’s Mutual Holding Companies.

Critics have long argued that creating a mutual holding company is unfair to policyholders.

“When a mutual holding company is created, policyholders receive neither cash nor stock of the new stock insurance company,” said Joseph M. Belth, professor emeritus of insurance in the Kelley School of Business at Indiana University.

But Westrate expresses a different viewpoint. “For us, this is a step in the right direction both for the policyholders and the company. We’re not shedding our mutual status; rather we’re enhancing it to create future flexibility,” he said.

Prior to converting to a mutual holding company on Jan. 1, American Family “produced a track record of new insurance products and services, acquisitions and alliances that have allowed us to meet evolving customer preferences and provide other policyholder benefits,” Westrate said.

What the new structure accomplishes is greater flexibility to pursue customer-driven initiatives that may involve affiliations with non-insurance companies and insurance companies, “so we can reach and serve even more customers,” he said.

States began adopting mutual insurance holding company laws in the mid-1990s to address certain competitive disadvantages of the mutual organizational form and to allow mutual insurers to convert to stock companies, subject to regulatory and policyholder approval. Prior to the adoption of those laws, the only means for a mutual to gain the flexibility and competitive advantages of a stock company was to demutualize.

Under its new structure, American Family continues to operate under the principles and culture of a mutual, with its policyholders exchanging their mutual insurance company membership rights for membership rights in the mutual holding company. Mutual holding company member status was also extended to policyholders of two additional American Family subsidiaries that underwrite property/casualty products sold by American Family agents.

“The conversion to a mutual holding company upholds our legacy of policyholder ownership by providing membership rights to more current and future customers,” Westrate said.

Mutual Considerations

While its corporate structure has changed, one thing Westrate expects to never waver is the company’s commitment to mutuality and its founding promise—serving policyholders and their needs.

That’s been the heart of American Family’s mission...
Converting to a mutual holding company “is a step in the right direction both for the policyholders and the company. We’re not shedding our mutual status; rather we’re enhancing it to create future flexibility.”

since insurance salesman Herman Wittwer created Farmers Mutual Insurance Co. in October 1927 to provide auto insurance to farmers—a group he believed presented lower risks than city drivers because they drove less often and not at all in the winter.

In 1963, Farmers Mutual changed its name to American Family Mutual Insurance to reflect its broader customer base.

“Being a mutual allows us to provide clarity and purpose for our policyholders,” Westrate said. “Unlike stock companies that have owners and customers with potentially different interests, we have alignment in our owners’ interests and our policyholders as customers. That keeps us focused on effectively meeting their needs and allows us to think, act and make long-term investments—not just for near-term results to satisfy shareholders and equity holders.”

The company has already made a number of long-term investments, including major investments in its technology systems; the creation of several agency programs and the introduction of new products, including commercial, property and life insurance coverages. Today, American Family is the 13th largest U.S. P/C writer and the 8th largest U.S. homeowners insurer, based on 2016 net premiums, according to A.M. Best. Most members of the American Family Insurance Co. hold a Best’s Financial Strength Rating of A (Excellent).

“As a mutual, we have the advantage of a longer time horizon when evaluating those kinds of investments,” Westrate said. “We’re also focused on emerging technologies and insurtech companies, which we look at as investments in the future of our policyholders and our ability to provide them even greater value.”

The company has also broadened its reach—geographically, beginning in the Midwest and then expanding throughout the Southwest, Pacific Northwest and into Georgia, and through acquisitions, including its 2012 purchase of direct nonstandard auto insurer PGC Holdings Corp., (commonly known as The General) and Boston-based national direct P&C insurer Homesite in 2013. Today, American Family Insurance exclusive agents operate in 19 states.

Customer Connections

When asked what it means to be a mutual today, Westrate is quick to respond.

“That’s easy—it’s the benefit of having an intense focus on policyholders,” he said. “That’s been the key to our success for the past 90 years, and putting customers first is a big part of who we are and our culture.”

That commitment was recognized by J.D. Power over the years in several of its Insurance Shopping Study reports. Most recently, American Family captured J.D. Power’s top billing as the highest-ranked company in small commercial insurance customer satisfaction in 2016.

2016 Top Lines of Business

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>37.3%</td>
<td>Homeowners</td>
</tr>
<tr>
<td>30.1%</td>
<td>Private Passenger Auto Liability</td>
</tr>
<tr>
<td>21.0%</td>
<td>Auto Physical</td>
</tr>
<tr>
<td>5.8%</td>
<td>All Other</td>
</tr>
<tr>
<td>5.7%</td>
<td>Commercial Multi Peril</td>
</tr>
</tbody>
</table>

Source: American Family Insurance Group, A.M. Best # 000124
“Part of the reason for those accolades—and one of the advantages we have as a mutual—is our ability to respond and adapt to customers’ needs and expectations,” Westrate said. “We can look over our history and find many examples when we’ve done that. In 1975, we expanded into commercial insurance; we’ve also redefined our underwriting appetite and created new technology solutions over the years that provide products in a more effective manner.”

The company, which this year moved up 17 spots to 315 on the Fortune 500 list, is also striking a chord with millennials. “We’ve improved our direct channel and are enhancing our call center and online capabilities, and we’re also using those capabilities to streamline the process for agents,” said Jessie Stauffacher, American Family Insurance’s chief operating officer. “The key is having great relationships with both our agents and customers, and we do a lot here internally and with our corporate team to keep those relationships strong.”

More than a decade ago, American Family partnered with J.D. Power to create the American Star Program, which honors the company’s exclusive agencies that excel in customer service and satisfaction based on customer feedback as distinguished agencies. “We’re proud that over the past 10 years that satisfaction keeps growing, and last year, we reached record highs,” Stauffacher said.

On Solid Ground
Companies have long teetered in the debate: stock versus mutual.

While arguments can be made about advantages in both models, many mutuals have stood firm in their convictions: the ability of mutuality to focus exclusively on policyowners and provide them with voting rights and dividends if the company distributes them; the absent pressure of outside shareholders and the means to focus on the long-term health and stability of an organization.

But the mutual structure isn’t without some challenges.

There are some restrictions tied to the model, such as risk-based regulatory capital standards, tougher corporate governance arrangements and limitations on acquisitions and revenue related to noninsurance activities, Westrate said. “That’s one of the reasons why we modified our structure to a mutual holding because it sets the table for us for the future.”

When you think about autonomous vehicles and what they might mean to the auto insurance business model that’s a potentially big disruptor, he said. “We can debate about the length of time it will take until that disruption happens, but as a mutual we have the flexibility to do things that are connected to insurance and that provide our policyholders with more risk management-type services and products, along with the flexibility to start experimenting and investing in new technologies.”

Access to capital is another challenge some mutuals face. But it hasn’t been one that American Family has encountered, Stauffacher said. “We have been financially strong over the years, so it provides us the opportunity to have the capital we need to make investments.”

In 2016, American Family Insurance Group experienced rises in total admitted assets, to

### Geographical Breakdown — 2016 Direct Premiums Written ($000)

<table>
<thead>
<tr>
<th>State</th>
<th>Direct Premiums Written ($000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wisconsin</td>
<td>$996,761</td>
</tr>
<tr>
<td>Missouri</td>
<td>929,422</td>
</tr>
<tr>
<td>Minnesota</td>
<td>794,044</td>
</tr>
<tr>
<td>Colorado</td>
<td>663,142</td>
</tr>
<tr>
<td>Illinois</td>
<td>564,996</td>
</tr>
<tr>
<td>Kansas</td>
<td>422,611</td>
</tr>
<tr>
<td>Arizona</td>
<td>413,863</td>
</tr>
<tr>
<td>Indiana</td>
<td>295,610</td>
</tr>
<tr>
<td>Ohio</td>
<td>278,023</td>
</tr>
<tr>
<td>Washington</td>
<td>267,949</td>
</tr>
<tr>
<td>All Other</td>
<td>2,182,451</td>
</tr>
</tbody>
</table>

Source: American Family Insurance Group, A.M. Best # 000124
$17.19 billion; policyholders’ surplus ($6.87 billion) and direct premiums written ($7.8 billion) over the prior year, according to A.M. Best.

Weather-related events, however, have taken a toll on the company’s bottom line.

So far this year, American Family has responded to significant wind and hail storms in Colorado, Minnesota, Nebraska and numerous other events in other states.

During the past five years, American Family experienced fluctuating pre-tax operating gains; however, it suffered underwriting losses, largely from frequent and severe wind/hail and winter storm losses in several states, in all years but 2015, according to A.M. Best.

To help mitigate loss exposure to Midwest storms and New Madrid earthquake risks, American Family continued its geographic expansion into additional states, implemented new earthquake rating zones, changed policy language and revised named-peril deductibles, according to an A.M. Best company report.

It also purchased catastrophe aggregate reinsurance to mitigate volatility in its operating performance from the effects of those exposures; and additional management initiatives were introduced to address overall profitability through improved pricing techniques, agency management actions, continuing upgrades to policy administration and claims systems and additional distribution channels, the report said.

“One of the benefits about being a mutual is that we never have to chase quarterly returns or stock prices,” Stauffacher said. “At the same time, we need to be forward-looking and act with urgency to achieve financial performance and customer satisfaction.”

Investment Strategies

Westrate doesn’t think American Family fits either bill.

In fact, the company was an industry pioneer in the venture capital space, beginning in the early 1980s.

In 2013, it created its venture capital arm, American Family Ventures, with a $50 million allocation to focus on early-stage startups in insurance innovation, connectivity and data and analytics. American Family Ventures invests anywhere from $25,000 to $5 million per venture.

Over the years, American Family Ventures has been involved in more than 40 projects, including smart home technology provider Revolv, machine learning startup Networked Insights and a partnership with Microsoft Corp. to launch a home automation accelerator.

Financial gains aren’t the only rewards of those investments, Stauffacher said. “They really help set us apart from other insurers; we’ve become a real leader in this space. We get plenty of calls from other carriers looking to build a venture team.”

American Family Ventures’ investment partnerships have also created more than 100 jobs in Wisconsin, according to reports, and American Family policyholders are also receiving financial incentives, such as a 5% premium discount for policyholders who use home automation devices, such as Ring’s Wi-Fi-enabled video doorbell system. Ring has also agreed to pay policyholders’ deductibles in the event of a theft.

Back to the Future

Much has changed since mutuals came onto the scene in the late 1600s. Over the years, a number of mutual companies have demutualized; even fewer were created in recent years.

Also, the environment in which mutuals must now compete for revenue, capital and
policyholders is changing, forcing some to restructure or recapitalize.

But despite those wavering trends, many experts now believe mutuals’ long pedigree is far from over. In fact, mutual insurers are now experiencing a modest revival, following a retrenchment toward the end of the 20th century, according to a 2016 EY report, *Mutual Insurance in the 21st Century*.

Westrate is excited about that shift and American Family’s place in the mutual model. “While our structure has changed, our focus on customers continues to grow stronger,” he said. “When you combine our financial strength and our mutual holding company value, along with our mutual status, it sets us up in a great position to continue investing in innovation and growth that will create even greater value for our customers, agents and employees.”

Stauffacher is quick to credit that success to American Family’s agents, employees and transforming culture. “The fact that we have a lot of talented, committed people is an advantage we have, along with a culture that increasingly uses a lean startup methodology to take ideas and run them through rapid experiments rather than building a full-scale, waterfall-type of approach that many other large companies use,” she said.

“As we experiment with new things, you can expect to see more product innovation from us, including different ways we can offer elements of protection to policyholders,” Stauffacher said. Recently, American Family created American Family Insurance Connect to offer multiline products through different distribution methods, including direct. “We think that’s a real differentiator for us,” she said.

Several years ago on the life side, American Family Life Insurance Co. created a simplified issue product that doesn’t require the same degree of underwriting and medical exams found in most term products, Stauffacher said. Today that product makes up more than half of the company’s issued term life policies, she said.

Digital technology is becoming a game changer for mutuals, and American Family is continuing to promote digitalization in all areas of its operations, along with differentiating itself by becoming an innovation incubator to design and road-test new ideas to challenge conventional thinking, Stauffacher said.

The company is partnering with Starting Block Madison—an innovation hub for local entrepreneurs to start and grow businesses, create job and stimulate the regional economy, she said. “We will also have a footprint for our own employees to work on innovation, community and other projects. We believe that all ties back to being a mutual because it allows us to do innovative things for our community and policyowners.”

Mutuals share many of the same challenges that other insurers now face, such as changing market conditions, industry disruptors and the war on talent.

“But for me it’s less about what keeps me up at night and more about how we continue to build a culture of innovation and agility so we have flexibility to respond to the market and customer needs,” Westrate said. “That’s where our emphasis is now and going forward.”

The changing needs in auto insurance, for instance, is top of mind; trends in technology too, he said. “But it’s this culture of embracing change and creating organizational agility that will ensure our long-term success as a mutual.”

---

**Learn More**

American Family Insurance Group (A.M. Best # 000124)

For ratings and other financial strength information visit www.ambest.com