NEW YORK STATE DEPARTMENT OF FINANCIAL SERVICES
PUBLIC AFFAIRS OFFICE

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IN THE MATTER OF SBLI USA MUTUAL LIFE INSURANCE COMPANY, INC. DEMUTUALIZATION :

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WRITTEN SUBMISSION OBJECTING TO PLAN OF REORGANIZATION OF SBLI USA MUTUAL LIFE INSURANCE COMPANY, INC.

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1. Howard L. Grossman, by his undersigned attorneys, a policyholder (policy number [redacted]) of SBLI USA Mutual Life Insurance Company, Inc. ("SBLI" or the "Company"), respectfully presents this submission in opposition to SBLI's proposed Plan of Reorganization to Convert From a Mutual Company to a Stock Company (the "Plan").

BACKGROUND OF THE PLAN

2. SBLI, through the SBLI USA Mutual Life Insurance Company, Inc. Policyholder Information Booklet (the "Booklet") dated July 18, 2014, which includes a Notice of Public Hearing on Plan of Reorganization to Convert From a Mutual Company to a Stock Company (the "Notice"), solicited Mr. Grossman and other similarly situated SBLI policyholders (the "Policyholders") to vote in favor of the Plan.

3. The Plan provides that the Policyholders' ownership interests in SBLI, also known as Policy Membership Interests, will be converted into a stock life insurance company (the "Converted Company"), the stock of which will be held by SBLI USA Holdings, LLC ("Holdco"). Booklet at A-1. At the same time, the Policyholders, including Mr. Grossman, will receive in exchange for their Policy Membership Interests all of the limited liability company interests of Holdco. Plan of Reorganization §3.3; Booklet at A-4. The Policyholders will then have their interests in Holdco (which represents an indirect ownership interest in the common stock of the Converted Company), converted into a right to receive a total of $36 million in compensation which is expected to amount to approximately $190 for each of the Policyholders. Booklet at 5.

I. THE PLAN'S PROPONENTS HAVE THE BURDEN OF DEMONSTRATING THROUGH SUBSTANTIAL EVIDENCE THAT THE PLAN IS "FAIR AND EQUITABLE" TO POLICYHOLDERS

4. The hearing will constitute an "adjudicatory hearing" within the meaning of New York law because it involves "activity which is not a rule making proceeding or an employee disciplinary action before an agency . . . in which a determination of the legal rights, duties or privileges of named parties thereto is required by law to be made only on a record and after an opportunity for a hearing." N.Y. A.P.A. §102(a)(3). Because SBLI and the related parties are seeking approval of the Plan, they have the burden of proof based upon substantial evidence to establish their right to the relief sought, *i.e.*, approval for the Plan. N.Y. A.P.A. §306(1).

II. THE PLAN'S PROPONENTS HAVE FAILED TO PROVIDE SUBSTANTIAL EVIDENCE DEMONSTRATING THAT THE PLAN IS "FAIR AND EQUITABLE" TO SBLI'S POLICYHOLDERS

5. The Plan is being proposed pursuant to N.Y. Ins. Law §7312(d)(4). *See* Booklet at 13. That provision of the Insurance law provides, *inter alia*, that in order for the Plan to be approved, the consideration to be received by the policyholders must be determined by the superintendent to be "fair and equitable" to the policyholders. N.Y. Ins. Law §7312(d)(4)(A).

6. It is well established that the best way to obtain a fair or optimal price for a company such as SBLI, which is being sold, is to conduct a public auction. *See, e.g.*, *Revlon, Inc. v. MacAndrews & Forbes Holdings*, 506 A.2d 173, 182 (Del. 1986) (an auction for the sale of a company is an appropriate method to obtain the highest price for the company's shareholders); *Edgewater Growth Capital Partners LP v. H.I.G. Capital, Inc., et al.*, 68 A.3d

197, 227 (Del. Ch. 2013) (auction designed to get the best price for the company).[1] *Accord Gasser v. Infanti Int'l Inc.*, 358 F. Supp. 2d 176, 184 (E.D.N.Y. 2005) (public auction to be conducted to obtain best price for corporation's assets). Here, SBLI has failed to demonstrate that it created a competitive bidding environment since at least September 2010 -- almost four years ago – when four proposals were made to acquire the Company. Booklet at 13. However, market conditions and financial conditions particularly as they obtain to SBLI have changed dramatically since that time when the financial sector was living more closely in the shadow of the early 2009 financial collapse.

A. SBLI's Finances Have Vastly Improved Since 2009

7. Pointedly, one of the reported reasons for SBLI's poor financial condition which caused the Company to stop writing new insurance policies, were losses it had suffered from investments in mortgage backed securities. Thus, for example, in downgrading the credit rating of SBLI in June 2009, A.M. Best observed that "SBLI USA Group's fixed income portfolio is currently exposed to a substantial gross unrealized loss position ***more than two times total capital and surplus***. This gross unrealized loss position is concentrated primarily in its sizeable portfolio of mortgage-backed securities both commercial and residential with exposure to the Alt-A and subprime residential markets as well as its investments in financial sector corporate bonds." *A.M. Best Downgrades Ratings SBLI USA Mutual Life Insurance Company and Its Subsidiary* (June 8, 2009); *see also A.M. Best Downgrades Ratings SBLI USA Mutual Life*

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[1] Many courts, including New York courts, look to the well-developed Delaware corporate law for guidance. *See RSL Communications PLC v. Bildirici*, 649 F. Supp. 2d 184, 206 (S.D.N.Y. 2009); *see also Abbey v. Montedison S.p.A.*, 143 Misc. 2d 72, 76 (N.Y. Co. 1989) (New York court looked to Delaware law because it has the most well-developed body of corporate law in the country).

Insurance Company and Its Subsidiary (June 8, 2010) ("Although improved, SBLI USA Group's fixed income portfolio remains in a net unrealized loss position that still exceeds total capital and surplus as of March 31, 2010. This unrealized loss position is concentrated primarily in its sizeable portfolio of mortgage-backed securities-both commercial and residential with some subprime and Alt-A exposure-as well as investments in financial sector corporate bonds.").

8. However, between 2010 and the present, market prices of mortgage backed securities have rebounded. Thus, as *The Wall Street Journal* subsequently reported in 2013 "[I]nvestors . . . scored large gains last year buying investments such as residential mortgage-backed securities and collateralized loan obligations, among others, many of which were crunched in the financial crisis. The prices of these instruments rallied in 2012 amid the U.S. housing rebound and the hunger by investors for debt with sizable yields, and have risen further in 2013." G. Zuckerman, *Bold Bet Brings In $2 Billion*, The Wall Street Journal (Apr. 12, 2013).

9. Thus, for the fiscal year ended December 31, 2012, SBLI reported on its Statement of Operations net unrealized capital gains of $23,663,005 which was followed by $15,127,000 of net unrealized capital gains reported for the fiscal year ended December 31, 2013 and $3,672,830 for the fiscal quarter ended March 31, 2014. Indeed, a review of SBLI's most recent financial statements reflects the fact that, if anything, the Company currently has net unrealized ***gains***, rather than losses, in its portfolio from which it was suffering in 2010.

10. Equally troubling is that it appears that the terms of the Plan were agreed upon in October 2012. Booklet at 13. However, since that time SBLI's financial condition has continued to improve and the market value of insurance companies has also advanced dramatically. Thus, for example, the Phoenix Companies, Inc., which is specifically identified as

a company comparable to SBLI (Booklet at 32) has seen the price of its stock increase by more than 140% from approximately $25 per share to over $60 per share at which it currently trades.

B. Sherman & Company's Fairness Opinion Fails to Demonstrate That the Plan is Fair and Equitable to Policyholders

11. Having failed to properly shop the Company for four years or more, it appears that the purported fairness of the Plan is premised entirely on a fairness opinion provided by Sherman & Company ("Sherman") in or about November 2013. *See* Booklet at 30-36. *See also* Booklet at 13. That opinion, however, does not support the fairness of the Plan based upon SBLI's current financial condition and most recently reported results of operations.

12. Indeed, one of the most striking things about the Booklet is the effort to obscure and avoid reporting on the Company's most recent results of operations. Instead, the Booklet provides cursory and summary balance sheet information for the periods ending March 31, 2014, December 31, 2013 and December 31, 2012. *See* Booklet at 11. However, no analogous information from the Summary of Operations filed with the Superintendent of Financial Services is provided anywhere in the Booklet. Those results are, instead, "incorporated by reference" with a statement that they can be inspected at SBLI's principal office after arranging for an appointment. Booklet at 44.

13. Those results reveal a surprisingly robust company, the financial results of which are very much at odds with what appear to be the underlying assumptions key to the Sherman financial fairness opinion. An examination of those financial reports reveals that for the period ended March 31, 2014, the Company's net gain after payments of dividends and federal income taxes amounted to $3,341,146. This compares favorably and, indeed, represents an increase,

from the $3,214,841 reported for the comparable year earlier period ended March 31, 2013. Also, quite jarring is that the Company's reported net gain after payments of dividends and federal income taxes for the fiscal year ended December 31, 2013 amounted to $14,116,335. In other words, the $36 million proposed to be paid to the Policyholders represents only approximately 2.5 times the most recent fiscal year's earnings which appear to be remaining stable in the current fiscal year.

14. SBLI's reported net income is lower and appears as a loss of $632,927 for the fiscal quarter ended March 31, 2014, a gain of $613,726 for the fiscal quarter ended March 31, 2013 and a loss of $2,218,589 for the fiscal year ended December 31, 2013. However, these net income numbers are not representative of the Company's earnings capacity because they are a direct product of the Company's decision to realize capital losses on certain investments, perhaps for tax reasons.

15. Moreover, those realized capital losses are not indicative of the overall financial health of SBLI's portfolio. Thus, with respect to the bonds owned, which constitutes the Company's largest category of assets, the aggregate fair value of those assets is listed as $1,328,735,000 compared to an admitted value of $1,279,458,000. In other words, as opposed to the losses realized, there is an almost $50 million unrealized gain hiding out in the Company's financial statements.

16. It is against this background of solid profitability and asset values which the fairness of the Plan must be weighed. The situation may (or may not) have appeared differently at the time Sherman rendered its financial fairness opinion in November 2013 when compared to SBLI's reported results for the fiscal year ended December 31, 2013 and the fiscal quarter ended

March 31, 2014. However, the fairness of a transaction must be evaluated based upon the date on which the transaction is considered. *Accord Boyer v. Wilmington Materials, Inc.*, 754 A.2d 881, 895-96 (Del. Ch. 1999) (plaintiffs' expert and defendants' expert each performed valuation analyses as of the time of the transaction); *Corwin v. De Trey*, No. 6806, 1989 Del. Ch. LEXIS 166, at *9 (Del. Ch. Dec. 1, 1989) (transaction must be fair when the agreement is reached and when it is executed).

i. The Comparable Publicly Traded Companies Analysis Does Not Support the Plan's Fairness

17. The first metric employed by Sherman in order to evaluate the financial fairness of the Plan is the "Comparable Publicly Traded Companies Analysis" which is, in turn, divided into a "book value" and a "price multiple" section. Booklet at 32-33. The book value section indicates a mean value of $58.2 million and a median value of $57.7 million. Booklet at 33. The two numbers are sufficiently close in range that they validate the respective reasonableness of both measures, which exceed by more than $20 million the $36 million in compensation proposed to be paid to the Policyholders through the Plan.

18. In addition to the median and mean values, Sherman provides a low valuation of $27.5 million and a high valuation of $83.7 million. Given the strength of SBLI's current financial situation with the fair value of assets exceeding the admitted value, there seems little reason to believe that the low valuation should obtain. Instead, if anything, the high valuation which is more than double the price being paid to the Policyholders pursuant to the Plan seems the most relevant benchmark.

19. The price multiple section of the Comparable Publicly Traded Companies Analysis is completely opaque. Reference is made to SBLI's estimated 2013 and 2014 earnings without any disclosure or discussion of the amount of those estimated earnings. In addition, no disclosure is provided as to whether and to what extent the Company's actual 2013 earnings compared to those estimated earnings.

20. However, applying the 12.2x and 6.2x multiples utilized in Sherman's analysis to the $14,116,335 in reported 2013 earnings yields a value of, respectively $87,521,277 and $172,219,287, which range between approximately 2.43 times and 4.78 times the $36 million offered to Policyholders in the Plan. It is possible that tax considerations might affect these calculations but the Sherman analysis is so cursory that it is impossible to fully analyze that factor because not enough information has been provided.

21. Sherman's efforts to devalue and demean SBLI by claiming that a lower valuation is justified by the negative 1.2% return on average equity in 2012 lacks merit. Instead, much like the case for the fiscal year ended December 31, 2013 (*see* ¶¶13-14, *supra*) SBLI actually achieved a substantial net income which was reduced by realizing non-recurring capital losses. Indeed, before such capital losses, SBLI earned more than $22,000,000 making its return on average equity substantially higher than the 11.9% of comparable companies.

22. The values obtained through both the book value and price multiple portion of the Comparable Public Companies Analysis undervalue SBLI because they are only designed to provide a hypothetical trading value if the Company had been public. Sherman's analysis acknowledges this fact by referring to a takeover premium traditionally paid in corporate

acquisitions. Booklet at 33-34. Sherman, however, fails to adjust any of the values obtained through the Comparable Public Companies Analysis which averages 35%. Booklet at 34.

ii. The Precedent Transaction Analysis Does Not Support the Plan's Fairness

23. The next portion of Sherman's analysis, which is a Precedent Transaction Analysis (Booklet at 34-35), also points to an undervaluation of SBLI in the Plan. This analysis points to a mean and median valuation respectively of $66.4 million and $73 million (Booklet at 35) which far exceed the $36 million proposed to be paid to the Policyholders. Although a low valuation of $7 million is also obtained as well as a high valuation of $100 million, no facts are presented to suggest that the low valuation is appropriate especially given the current strength of SBLI's financial condition.

iii. The Discounted Cash Flow Analysis Does Not Support the Plan's Fairness

24. The next portion of Sherman's analysis is the Discounted Cash Flow Analysis which as Sherman observed "represented only a ***theoretical value*** for purposes of comparison . . . ." Booklet at 35 (emphasis added). Discounted cash flow analyses are notoriously subject to manipulation. *Accord Wilson v. Great American Industries, Inc.*, 746 F. Supp. 251, 260 (N.D.N.Y. 1990) (discounted cash flow analyses susceptible to manipulation based on relatively slight adjustments to variables).

25. The cash flow analysis does not reveal the management projections which formed a key element of the input in the cash flow analysis. In addition, Sherman utilized a weighted average cost of capital of 16.5% which is both arbitrary and excessive and compounded that error by adding an undisclosed premium to SBLI's cost of equity to reflect its small size.

Booklet at 35. At the same time, the Sherman analysis does not reveal which companies it looked to in order to provide a comparable yardstick for arriving at these discount rates. However, we note that elsewhere Shermán refers to a 6.0% cost of capital as being appropriate for the Company. Booklet at 36.

iv. The Embedded Value Analysis Does Not Support the Plan's Fairness

26. The next and final analysis performed by Sherman was an Embedded Value Analysis which, once again "represented only the theoretical value for purposes of comparison . . . ." Booklet at 35. This analysis incorporates assumptions to embedded capital losses in SBLI's investment portfolio. Booklet at 36. However, as discussed above, based upon current market conditions, the Company has net embedded **gains**, rather than losses, in its investment portfolio.

27. The Embedded Value Analysis also suffers from the infirmity that it "assumed a scenario in which no new business was written . . . ." Booklet at 36. However, it is unclear whether Sherman then made the necessary adjustments to the Company's expenses in order to reflect a need for less personnel in order to perform the Company's business. Also, it is unclear what projections and assumptions were provided by SBLI which Sherman relied upon in this analysis and the date they were formulated by SBLI's management.

28. The Embedded Value Analysis suffers from the additional infirmity that in "determin[ing] the value of the In Force block Sherman & Company utilized a discounted cash flow model, and used ***the same discount rate employed in its discounted cash flow analysis.***" Booklet at 36 (emphasis added). As part of that analysis, Sherman utilized an undisclosed compound annual decline rate. The specific inputs into this theoretical model are not disclosed and it is unclear what, if any, value Sherman assigned to the In Force block.

CONCLUSION

29. Therefore, because SBLI has failed to provide substantial evidence necessary to demonstrate that the proposed Plan is "fair and equitable" to the Policyholders, the Superintendent should not approve the Plan.

Dated: September 2, 2014

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VERIFICATION

I, Howard L. Grossman, am a policyholder of SBLI USA Mutual Life Insurance Company, Inc. ("SBLI"). I have authorized my attorneys to make the attached submission on my behalf in connection with SBLI's Plan of Reorganization to Convert From a Mutual Company to a Stock Company. I have read the submission, approve of its contents and adopt it as a statement of my own position with respect to the proposed demutualization of SBLI USA Mutual Life Insurance Company, Inc. and the related proposed transactions.

I verify under penalty of perjury that the foregoing statements made by me are true and correct.

Howard L. Grossman

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

I, the undersigned, a Notary Public in and for the State of New York do hereby certify that Howard Grossman personally appeared before me, who being by me first duly sworn, does hereby depose and state under oath that he has read the foregoing submission and that the facts and statements therein contained are true and correct and that he acknowledged to me that he executed the same in his authorized capacity and that by his signature on the instrument, he has executed the instrument.

GIVEN under my hand and official seal this 29 day of August, 2014

Notary Public

JEAN DEL GUIDICE
Notary Public, State of New York
No. 01DE4738533
Qualified in New York County
Commission Expires Jan. 31, 2018