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DIVERSIFICATION OF LIFE INSURANCE COMPANIES

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1. What has been the recent experience in the acquisitions, diversification and corporate structure of life insurance companies?

2. What factors cause companies to change the forms of their operations?

3. How do life insurance companies go about deciding on the paths they wish to take and ultimately follow?

4. How is such change affecting the products (insurance and otherwise), marketing, profitability, administration, and management of our industry and our profession?

5. How might these developments further evolve in the 1980's and beyond?

MR. ROBERT D. SHAPIRO: The subject of diversification conjures up the image of the many different mergers and acquisitions of recent years. Too often forgotten are the specific strategic reasons of the buyers and sellers in each of these transactions. Our objective is to provide an overview of what is happening in terms of life insurance company diversification. We will also identify some of the building, buying and selling types of strategies and discuss the process of determining what form, if any, diversification should take within our companies.

Economic, regulatory and market trends have created significant new issues for all financial institutions. New competitive entrants and changing technology will have an impact on the future direction of financial services. Banks looking forward to deregulation in any event look forward to competing directly in the life insurance business. Banks also look at their electronic progress as a major advantage strategically in competing with life insurance companies.

Product distinctions are blurring -- between group and individual, life and casualty -- and it will be difficult to describe, with one word, what type of institution each company will become. All of these factors, combined with increasing consumer awareness, are causing each of us and our companies to re-evaluate missions and strategies and generally restructure those strategies in a way that requires consideration of diversification.

Ideally, the corporate strategy will reflect each company's unique strengths, weaknesses, opportunities, resources, policies, systems and culture. Diversification often is focused on the development of marketing substrategies... e.g., efficient extension of markets, distribution or products. Markets may be extended in many ways (e.g., geographically, by income level or by

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development of policyholder base). Depending on the nature of one ultimate target market definition, appropriate distribution techniques can range from captive agents on one hand to direct response methods on the other. The various products that might be considered range from extended insurance coverages (e.g., annuities and economic guarantee products) to others including:

- Investments
- Money Handling
- Real Estate
- Other Financial Products/Services
- Other Non-Financial Products/Services

In addition to internal development and traditional mergers, diversification involving life insurance companies in the 1980's will take many varied forms. Examples include:

1. Demutualizations and mergers.
2. Joint ventures.
3. Mutuals buying/organizing stock subsidiaries.
4. Segmentation of large companies for modular sale.
5. Mutual mergers.

Our panelists will relay their own personal diversification experiences with a focus on the structure of the transactions and the reasons for such structures.

MR. RICHARD S. ROBERTSON: Lincoln National is a moderately diversified organization. We have a strong presence in the property-casualty insurance market and in the title insurance market. We have not, however, gone outside of financial services or even outside of the insurance business. Recently, much of our activity has involved diversification within the life insurance industry itself. We have long had a presence in reinsurance markets and in direct career agency markets. Two years ago, we acquired Security Connecticut Life which gave us a major brokerage marketing organization. We have now, therefore, developed into an organization which has a number of independent, autonomous and competing distribution systems.

In addition, Lincoln National has a sales organization which provides life insurance for property-casualty agents, and a small company which specializes in distributing Universal Life to its own sales organization.

This is a little different twist to diversification than most insurance companies have, although it is by no means unique.

MR. RODNEY R. ROHDA: How diverse is diversification? Is it limited to just stock life insurance acquisitions? In preparing for this panel I was somewhat surprised to discover that <u>every one</u> of the top 25 mutual companies at this point owns one or more stock life companies.

Within mutual companies there have been basically two waves of diversification. Eleven of the twenty-five stock subsidiaries were established in the late sixties to early seventies when companies were getting into equities for the first time. The remaining fourteen were acquired since then.

If you look at the non-life subsidiary activities of the big mutuals you will find:

-- Mutual funds of all types - stock, bond, money market and real estate investment trusts

-- Realty development companies that develop, operate and own or lease real estate

-- Property and casualty companies

-- Data processing hardware and software firms

-- Equipment leasing

-- Pension administrative and consulting services

-- Reinsurance, both life and property and casualty

-- HMO ownership and operation

-- Tax shelter formation and distribution

-- Joint venture investments in such activities as real estate, and energy ventures including oil exploration and coal gassification.

Home Life, my employer, was established in 1860 and distributes through a career agency force. We have purchased an existing stock life company which is currently licensed in thirty-seven jurisdictions. We have formed a joint venture with another old line mutual for the marketing and administration of individual disability income policies. We will be introducing a money market fund within the next 30 to 60 days. We plan to organize a pension subsidiary which will offer consulting and administrative services for pension plans, and we are considering the establishment of additional mutual funds.

From the mutual company side, it is literally impossible to find any organization that is just a mutual life insurance company without any subsidiaries of any type. At this point virtually all of the subsidiaries relate to the financial services sector. There is little exotic such as breweries or steel mills.

MR. JOHN C. HEAD, III: There are many different deals that are taking place right now. They can be characterized in two ways -- asset side implications and liability side implications. Actuaries tend to concentrate on the liability side so I will start on the asset side.

Insurance companies and other companies are spending much money trying to get into other businesses. This can be seen in terms of changes in their asset portfolio. They are starting to be willing to own and operate businesses majoring in other areas such as oil and gas fields. This is just as important a diversification effort for the mentality of the insurance company as getting into another product or another distribution system.

On the liability side, we see companies trying to more directly face some of the problems that the industry has. In the past ten years a substantial number of companies have not had real growth in terms of net premium income growth or asset growth. They are saying old ways do not work...Something different needs to be done.

The next question to be answered is, "Do I build it or do I buy it"? Do I build by committing resources -- both financial resources and people resources -- and distributing new products? Do I get into a new line of business or disinvest an old line of business? Do I determine that I cannot spend the time and do not want to take the risk to build internally, and seek to go out and buy? Acquisition usually means buying another company which has a distribution system or product line or geographic base needed to meet a business problem.

From an investment banker's point of view, the Lincoln National acquisition of Security Connecticut Life appeared to be a company trying to add an additional spoke to its distribution system.

Other companies do not want to hire people, buy a building, and staff an operation to get into another line of business. They go out and buy another company because they know exactly what it is going to be. Some might say they paid too much for it, but if you take into account opportunity cost, it quite possibly was the proper move to make. Maybe it was the right move to buy that company because the next day it is up and running and works.

We get brought in as bankers to execute the plan that the company is developing. Many times that means that the income work has already been done, and they know which way they want to go. In some companies, the decision has been made to make an acquisition on a geographical basis. Other companies pick something that has not worked well in the past and plan on fixing it.

MR. SHAPIRO: All of these diversification examples reflect a strategy, either explicit or implicit. Diversification strategy is really just a substrategy of the overall corporate strategy. Most of the diversification that we have observed involves marketing extensions to some extent. We all tend to think of marketing as the core of strategy, and in most of our organizations, it is and should be. But, there are other types of diversification, and one we might talk about is the recent Aetna acquisition of Geosource. That is a move that is more difficult to identify in more general strategic terms and perhaps provides a good base from which to discuss diversification beyond the normal type of marketing diversification.

MR. HEAD: Aetna looked at a new business and was comfortable with it. They had been associated with Geosource for fifteen years. Geosource is primarily in the petroleum service, geological and geophysical supply business.

We at Morgan Stanley were brought in to assist them in executing the transaction. Aetna was spending on the order of magnitude of $650 Million. In terms of where the petroleum industry is and where it is going to be, the outlook appeared favorable. Aetna is basically saying that the expected rate of return is clearly acceptable to make the investment in, and in fact, it is so acceptable that they are willing to issue common stock for equity ownership in the company to make the acquisition. They feel they can manage it, and in the end, it will enhance the financial return to the owners of the Aetna.

MR. SHAPIRO: Where do you separate diversification as an extension of corporate strategy, which is often centered in the marketing area, from deployment of assets with a pure investment motive?

MR. HEAD: You do not. What is the job of senior management and the board of directors of the company? Isn't it to increase the financial reward to the owners of the company consistent with the policies of doing good business at the senior level? Many times it is advantageous for the owners of the company to disinvest in certain businesses and invest in others.

MR. ROBERTSON: One of the problems that our business is facing is that our traditional ways of doing business are under serious challenge. Our traditional distribution system is under severe pressure -- inflation, high interest rates, changes in product mix. The profitability of traditional products is under pressure. If you look at the rates of return that life insurance companies are producing currently, they are not attractive relative to other businesses.

I agree that our managements are being forced to consider whether life insurance as we have known it is the best place to put our financial resources. There is also a defensive implication to the extent that our competitors are diversifying. There is a danger that we will be left behind and find ourselves uncompetitive. We are often, in a sense, searching for new markets or new activities just to position ourselves in case they may be needed sometime in the future.

MR. HEAD: There are a significant number of people viewing the rates of return of being in the traditional life insurance business as basically unacceptable. Insurance companies are having rates of return on a historical basis in the ten to fifteen percent range. Why take the risk of being in the insurance industry when municipal bonds are earning fourteen to fifteen percent tax free?

Many people are saying they are going to disinvest in the life insurance business or make an acquisition or diversify such that the sum of the two increases the return on equity.

MR. ROBERTSON: One of the "buzzwords" of the sixties and early seventies was synergy. Is anyone looking at putting together operations to get economic efficiencies anymore?

MR. HEAD: Absolutely, there are many deals that are going to lower what I call the "actuary per policy" ratio. You do not need as many actuaries per policy if you can combine organizations. There are many insurance companies which are overstaffed in terms of Home Office. You only need one investment officer, whether he is investing one million of assets or three billion.

MR. ROHDA: John, what you say makes good sense on the surface, but we all tend to recoil a bit when the "actuary per policy" ratio comes up. I have seen studies of the economies of scale within the life insurance industry and as I recall, they show economies of scale occurring when you go from, fifty up to about two hundred and fifty million dollars of assets and then the economies of scale seem to disappear for a while. They appear again around the one to two billion dollar of asset range, and above the five billion dollar range there do not appear to be any demonstrated economies of scale.

A major reason for this has to do with the fact that we were in a comfort zone and a comfort industry for years and management was not brought to bear to bring economies of scale. We are now in a different world, and we must look at it differently.

MR. ROBERTSON: In our case, the most efficient operating units are not the largest for a variety of reasons. You mention a key point, however, that efficiency is much more a factor of good management than size.

MR. HEAD: I agree that there are subfunctions in being able to squeeze economies of scale out of the system. There are step functions in terms of building the organization. The life insurance industry has also been an industry where certain companies have had a very comfortable existence for a very long time.

Companies are now saying they do not need as many people, and they are going to have to eliminate certain luxuries which they can no longer afford. Many of the diversifications that are being done are for the purpose of buying the management of a company. Some feel the easiest way to get into a line of business is to buy a company with a proven track record. This is not only from a financial point of view but a proven record of being able to attract and retain the type of senior management that produced a successful track record. In the end, for that kind of company, there are synergisms. Many times it is not only that the "actuary per policy" ratio can be lowered but that the company has brought in people with a different insight -- people who market and distribute different products and who look at problems very differently from the way they were historically viewed.

MR. SHAPIRO: Synergy to me means something different than economies of scale. There are few examples where an acquisition was a life company and the organization was integrated. Most involve marketing extensions where the organization purchased was not tampered with because of the fear of destroying the very thing that was sought. How much actual synergy is created or is possible in these types of transactions?

MR. ROBERTSON: We are getting more than we thought we would. We did not expect to get any when we acquired Security Connecticut, but it turns out that one of the things we are doing in an attempt to make the career agency organization work is to get a better management of the brokering of business to other companies by our agents. Owning one of the companies that is a major factor in the brokerage market is helping us to try to institutionalize the sale of other companies' products by Lincoln National agents. We have also considerably strengthened our overall corporate management by the type of people and their perspective that we obtained through the acquisition. This is also true of our acquisition of First Penn Pacific last year.

MR. DONALD S. BOGER: Wouldn't you feel that one of the motives for mergers might be to create opportunities for the people who could become stagnant in your own organization?

MR. ROBERTSON: We have not done that significantly in our organization partly because the organizations we acquired were at least as strong in personnel as the company we started with. My general observation is that our experience may well apply with many organizations.

MR. HEAD: Any company that has excess good people is in a very good position. Most companies are husbanding not only their financial resources but their good people resources.

MR. ROHDA: I would agree with both of you. A more challenging environment for your staff might be the result of a diversification activity, but the motivating force for making those moves is not trying to keep people happy and challenged. It is trying to keep the organization together and getting the kind of financial trends you should. I would also agree with John that there are few organizations in the life insurance industry which have a surplus of people and a shortage of problems to challenge them with.

MR. SHAPIRO: In large companies, particularly those which have not done much more than "maintain" over the past twenty years, there often develops a management approach which hinges on administration and the minimization of risk and error. When new strategies develop, involving creative new directions, too often those existing systems are applied to measure and manage those operations that are supposed to create the future company.

Perhaps the use of subsidiaries, especially by the larger mutual companies, will extricate some of the managers out of the extrapolated administrative machine. This would facilitate risk taking and would allow the separation of the image of that subsidiary from the image of the company as the new directions are developed.

I see considerable constraint in many life companies. Most of the desired motives and strategies are there, but the organizational structure does not allow change to happen.

MR. ROBERTSON: When you acquire a life insurance company, you acquire one of two things -- assets, whether physical or in force policies, or people. You may think of acquiring new products or a distribution system, but if you have surplus management and are going out looking for more opportunities, you do not have to go out and buy something. You can build it.

As everyone has been saying, I cannot think of any life insurance company which has an excess of quality management. There are many well managed companies, but they have enough challenges within their own area and do not have to go out looking for more.

MR. HEAD: Let me comment on things which I believe are going to happen. People are still going to go out and try to solve the business problems that they have. They are going to try to increase the return on equity for the owners of the company. By owners, I mean stockholders or policyholders in the case of a mutual company.

There will be more people becoming competitors in the life insurance business. I would be very worried that in ten years there are going to be banks like the Bank of America in the business. They have two billion dollars in surplus, not assets! A one percent return on assets is very good for a bank. Bank of America gets about one-half percent on assets. They also have a very strong nationally oriented distribution system. They are on every corner in California!

There will also be people who will diversify by buying a bank and redeploying it into a business which will have a return on equity substantially in excess of the traditional sale of life insurance.

MR. ROBERTSON: We as a company see Prudential and Allstate getting into the brokerage business. We see the banks as being another type of financial institution which may well be in our business. We see the American Express type of activity, and we have to ask the question -- where do we fit in?

Having asked the question, that requires that we try to do some forecasting of how these things might possibly work out.

One other thing that we see is that the low rate of return in the life insurance business is a very critical problem. Why would a bank put money into the life insurance business with the kind of profits that we are making? Why would anybody put money into it? We do not know and that is one of the reasons why we have to have a very thoughtful and well organized planning method.

A lot of people think of planning as creating a scenario of the year 2000, trying to figure out where they want to be, and then drawing a map for getting there. It is not that at all. It is developing a system of looking at all of the strategic alternatives that might be available to us now and in the future, and continually monitoring the factors that might make us choose one of those alternatives. It is a management of change process, and we are going to have to get much better at it or someone will have to do it for us. I am talking now from an industry perspective as well as a company perspective.

Looking at the future, the life insurance industry has to become more consolidated. We are not efficient enough to manage the kind of economy that is out there with as many organizations as we have.

As to whether outside money is going to come into our business, money will go both ways. A number of companies are getting out of the life insurance business, and others are getting in. Much depends on the future profitability of our business. We are going to continue to see foreign money coming in. Our profitability may be low, but it is much lower in Europe. We look attractive to them.

MR. ROHDA: I would like to take a few minutes to put into perspective the challenge that mutual companies are facing in this situation. Mutual companies have to look at return on investment as do stock companies, but it is really a somewhat different situation. Mutual companies exist to provide protection to their policyholders.

There are some very disconcerting things going on right now among mutual companies. One of the "gallows humor" jokes currently making the rounds is that a "full time agent" is one who attends the conventions of three or fewer separate companies in the course of a year. Home Life has been built over the past 122 years with a full time field force, and there are a number of companies who have done the very same thing.

It is a well documented fact that the life insurance industry's share of the total expenditure for financial services has been steadily decreasing. In addition, mutual companies' share of total expenditures for life insurance and annuities has been decreasing. At the same time our expenses have been escalating. This vicious combination has left Home and many companies like it with the challenge of developing an expanded portfolio of products and service which:

- will allow it to reverse the significant decline that has occurred within the past two to three years in the percentage of their total business which its "full time agents" place with it, and

- bring increased income into the life insurance company to broaden the base against which its escalating expenses can be charged.

MR. ROBERTSON: The life insurance business will probably grow at least as fast as the gross national product. If money is running away on the stock side, the mutuals will grow faster than average. Even if they grow at average, mutual companies today are not producing enough of a return on equity to produce surplus growth sufficient to keep up with the growth in business. The industry must manage a return to accomplish that or something will have to give.

MR. SHAPIRO: Diversification, as a part of strategy, is a long term activity, not a short term one. How do you go about balancing the long and short term aspects of an acquisition, particularly where the short term financial impact is not positive?

MR. HEAD: Make sure the accounting ramifications of something are not driving the business decisions. It is a good and sound business decision for some companies to diversify, and for others it is not. Many deals in many industries should not be done. They are not planned or thought through well.

MR. ROBERTSON: I am afraid in today's environment, long term means two or three years. We could not justify an acquisition that did not pay for itself in a short period of time. Some might question whether that is shortsighted, but when you start looking beyond five years, there is so much uncertainty that the possibility of not being able to accomplish what you think you are accomplishing is very large. You have to discount very carefully what you think the long term potential of something might be. We would not do anything in terms of acquisitions which did not have a fairly tangible payout.

MR. ROHDA: Let me respond and go back to somewhat of a challenge that Dick gave with regard to the importance of return on investment to a mutual company. My comments were not meant to say that return on investment in a mutual company is not important. It certainly is. As you look at diversification and the challenge that the mutual companies have right now, it comes right back to the challenge of return on investment.

Decades went by where the insurance industry in general, and the mutual companies specifically, went rolling along very happily while all kinds of things changed in the economy and the financial services world. Now everybody is being forced to look at things from first principles.

If you take as a given fact that a mutual company is going to have to do some amount of diversification to get itself back into a sound position and that no significant change can come about without a significant financial effort, it all comes back to looking at the return on investment. Even with a fairly high surplus ratio, the real challenge comes down to earmarking some portion of that surplus for diversification and then assessing for yourself and convincing your board that the diversification is going to provide a good return on investment and makes a worthwhile expenditure.

This type of analysis and discussion with the board is not something that mutual companies have had to do over the years. There is certainly a challenge to do it now, however.

John Head made the comment that it can be very frustrating to have management turn their back on diversification that is going to "mess up" earnings for the next few quarters. I agree with that, but I also agree with Dick in that I think a mutual company is hard pressed to justify a diversification that will show a return in, say, twenty-five years. Somewhere in the three to eight year range there has to be fairly well researched proof that this expenditure of surplus is going to have a payback.

Another point as you look at return on investment for a mutual company is that if you take as given the assumption that the economy and interest rates are going to remain somewhat volatile and that there is going to be increased competition in the financial services world, you can develop some distressing scenarios about what is going to happen if you just sit back and conduct business on a business as usual basis. A diversification should not just be looked at in absolute terms, but rather you must ask what is the differential between the emerging results if we change and those that will emerge if we do not change?

MR. SHAPIRO: There may be two factors in the mutual life company environment which work at cross purpose.

One is the focus on statutory surplus and the traditional goal of maintaining surplus levels as high as possible. In stock companies, the objective often is to minimize surplus, deploying it elsewhere at higher earnings rates.

The other factor is the historical approach to measuring performance of a mutual company and assessing accountability for that performance.

Many expect that within the next x years, approaches to performance measurement and accountability in mutual companies may change. This may create an opportunity for mutual companies because until these things change, mutual companies have a time when they can change with a long term view even if short term effects may be adverse.

MR. ROHDA: Bob, you have raised kind of an exotic topic. I read with some interest the action against Massachusetts Mutual concerning whether they were paying enough in dividends or too much to the top management of the company. What you mentioned about mutual companies and shifts in the way they are measured all sounds pretty good. We on the technical side recognize that statutory accounting is at best imperfect and perhaps an erroneous way to keep track of financial trends. I am hard pressed to think that in the next three to five years we are going to change to a totally realistic results oriented measurement system. This is quite a condemnation but having just gone through the travails of trying to justify to our insurance department the merits of a relatively modest stock life acquisition, it has been impressed on me how slowly change really occurs.

Therefore, for the near term (2-5 years), we are going to be stuck with looking at statutory type results and must educate top management and the board to the fact that they cannot just look at statutory results.

MR. ROBERTSON: When you spoke about mutual companies investing their surplus, that brought to mind that as of the end of 1980, in the top 15 mutual companies, statutory surplus was about 4.5% of assets which was down from 5.7% 10 years earlier. Except in the case of a few specific companies, there is not much in the way of excess surplus for mutual companies. The larger problem is that the surplus ratio cannot continue to decrease indefinitely. There is a limit on how little surplus a company can have and survive, and some companies are testing those limits.

The problem of performance standards is an industry problem, not just a mutual company problem, and it is very critical. If we are to survive, we must get more productive and efficient. In order to accomplish that, we must have a better way of measuring what our productivity and efficiency is so we can develop strategies for improving it. Stock companies have an advantage here because we have a way of measuring profits which, while not perfect, has many of the attributes of a good performance measuring system.

MR. HEAD: If one looks at real dollars rather than nominal dollars, a substantial number of life insurance companies in the U.S. are in liquidation. Every year they become less powerful in terms of the economic scene of the U.S. That cannot continue. A net long term liquidation means "the last one out turns out the lights". People are saying that if the returns are not growing in terms of real dollars, then they have to do something about it. Companies are saying they will buy or they will build. Sooner or later the insurance companies which are not growing are going to become less and less a power in terms of the products and services they have been providing to society.

MR. SHAPIRO: The following critical issues must be addressed in any strategy or diversification thinking:

1. What business(es) should we be in?

2. How should we define our market?

3. What products and services should we offer to these markets?

4. What are the most efficient ways of distributing these products and services?

5. How can we optimize our use of capital?

6. What organizational structure is best in terms of facilitating overall strategy?

7. How do we develop and retain management that is compatible with the needs of our strategic objectives?

How have your diversification programs reflected your unique set of answers to such questions?

MR. ROBERTSON: I very much believe that if an acquisition or diversification program is going to work, there has to be some kind of overall strategic program behind it. As I observe what is happening in the marketplace, I have a strong suspicion that that is true in only about half of the cases going on today. Many of the acquisitions that are taking place at least appear to be primarily opportunistic. A company really needs to know what it is after or it is going to spend much time trying to make sense out of something which makes no sense to begin with. It has to do a lot of internal analysis, taking stock and understanding before it begins to develop the acquisition and diversification strategy.

MR. ROHDA: It might be said that diversification is going to force and is forcing people to do planning whether they had planned to do it or not and that that in and of itself is a good move.

MR. HEAD: More and more companies are coming in and saying they have done their homework. They indicate they are ready to be this kind of company, and they need our help as bankers to get them from point A to point B. If it is not thought through, then the deal is not going to work properly.

MR. ROBERTSON: Another aspect of this is that after you make a major change in your organization you almost have to step back and start your planning over again because you are a different company. You may have decided, as in our case, that you wanted to have a presence in the brokerage business and you get exactly what you wanted but you will also get a few things you did not think you had. You are a different company with different resources, strengths, weaknesses, needs, advantages and financial position. You may have started with an excess of money and ended up a leveraged company and that has different implications. Your stock may be at a different level and that represents different opportunities or problems for you. So, in a sense, part of the process involves rethinking your strategic operations each time you make a move of this kind.

MR. DAVID E. NEVE: I have a question for Mr. Robertson. Earlier in the presentation in defining the planning process, you were saying that you really cannot put a peg on where you want to be and you have to monitor and react to the situation. Now I hear you saying that you have to know where you want to be. There must be a balance. Can you try to explain that a little more?

MR. ROBERTSON: Our planning really has a short term horizon. Five years is a very long term for us. We really do not have a firm idea of what kind of company we are going to be ten or twenty years from now. Most of our planning focuses on the next two to three years. We want to get a good clear understanding as to where we want to wind up. For example, we may conclude twenty-five percent of our revenue is from property-casualty business and we want to have a strong presence. On the other hand, we do not want forty percent of our revenue from this source so we might say we want to be a property-casualty company of a certain size and we know how much resources we have to spend. We know the kind of operation we want, and we may have some idea of the type of business we want. This is the type of thinking we need to be going through rather than saying "we want to expand our business so bring us all of your property-casualty deals".

MR. PETER PALMER: There is much concern over banks getting into the insurance business. Do you see insurance companies buying banks?

MR. HEAD: Yes, but it is going to be different from what you picture a bank as now. Insurance companies are already in the banking business. Much of the annuity business is what I call banking business. The insurance companies are not taking on a great deal of traditional insurance risk. This is being borne by the policyholder. Insurance companies are operating as a money manager, and as a money manager, they are taking a margin. This is the banking business. Insurance companies and banks in the future will not be dissimilar.

MR. ROBERTSON: Most of what I have read and seen is that as deregulation comes -- and even if it does not -- the banking business will consolidate. The bank of the future is Citibank. It is not the Fourth National Bank of Kansas City. That would suggest that if insurance companies are going to buy into the banking business, it will have to be the larger ones. I would not be at all surprised to read in the future that one of the larger companies has bought a significant bank. We will also see some smaller acquisitions which might be more in the character of the purchase of a small regional bank by a medium size insurance company. I do not know that those will succeed. I suggest it will be just trying to hold off the inevitable on the part of both the insurance company and the bank.

There will be a fair movement in the other direction also with banks getting into the insurance business one way or another. As John says, there will then be new forms. American Express is in the banking business and the insurance business but who bought whom is hard to say.

I would like to address the concern that banks seem to be better able to merge themselves into larger organizations than insurance companies. Right now the banks, with the exceptions of the large money center banks, are very small in the scope of their operations. They are much more decentralized than we are. I think in a sense we both have the same problems and some of the same directions.

MR. ROHDA: One of the concerns I see in the insurance industry with regard to banks is that of a large bank using its clout as a corporation's banker in the placement of the corporation's life insurance business. A life insurance company without a banker type connection would then lose out competitively.

MR. SHAPIRO: I believe that many of our large life insurance companies can muster substantial clout of their own, although the public "image" of banks often reflects greater trust than that held for life companies. The banks may also have a significant electronics capability advantage in some cases. On the other hand, banks sell nothing that a life company cannot sell, and generally lack the marketing capacity and distribution systems found in many of our life companies.

MR. ROBERTSON: I am not overly pessimistic about the large banks getting into the life insurance business. Citibank cannot sell life insurance the way we can. I am pretty optimistic about our ability to compete.

Of more concern is can we compete with whatever the next generation of financial institution is? There is a lot more uncertainty in this area.

MR. MICHAEL SPROULE: Many of the acquisitions discussed can be construed as creating a company which can deliver one stop financial shopping for consumers. To what extent do you see that as myth or reality? As a corollary question, comparing the strategies of large companies versus smaller or mid-size companies downstream, do you see them trying to compete across all segments of this market or in fact having different market niches?

MR. SHAPIRO: Very few organizations will or should compete across market and product segments. Most well-managed life companies will limit the focus of their strategies based on their special characteristics, strengths, limitations and opportunities. The Sears, Citicorp, Merrill Lynch, American Express and Prudential organizations of the world clearly can have a much wider focus. However, even they will generally not be "all things to all people", ...targeting specific market segments, utilizing particular distribution mechanisms and recognizing that "one stop selling" often is easier to dream of than to effectively implement.

MR. ROBERTSON: One stop selling as an idea is nothing new. It will take place if and only if the economics are such that it becomes desirable, necessary and attractive. The life-property-casualty one stop concept has only grown significantly in recent years. The reason is not that someone had a better idea that it was more convenient for the shopper, but rather the life insurance companies cannot afford to sell only life insurance to the majority of their potential customers. We are being forced out of the middle America market into the upper income markets and the multi-line companies are moving in simply because they are more efficient selling through that mechanism than we are through ours. On the other hand, we continue to predominate in the areas that require a highly trained creative one on one type sale, and as long as we can afford to deliver that type of estate planning, no one is going to take it away from us.

MR. ROHDA: There is going to be a movement toward more broad gauge financial services, but I question where the focal point is going to be. Will it be at the company level or the distributor level? Home Life and a number of companies profess to be, and in fact are, in the upper income market. Perhaps five to ten years from now there are going to be more agency type operations that focus on upper income clientele and draw in life insurance resources, investment resources, etc. It could be at the distributor level rather than the company level where the focus of broad based financial services are.