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DEREGULATION OF FINANCIAL INDUSTRIES

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MR. BRADLEY M. SMITH: Good afternoon. We have four panelists who collectively bring with them a diversity of vantage points of the deregulation that has already occurred within the financial industries. Hopefully, their differing perspectives will lend us some insight into possible future deregulation.

Our lead-off speaker will be Charles Eggleston. Chuck is a Senior Manager for Price Waterhouse within their financial services industry specialty group. He has 14 years of banking experience, most recently as Vice-President and Manager of Financial Planning and Analysis at the $3.5 billion Centerre Bank of St. Louis. Chuck is a member of the faculty of the graduate school of banking at the University of Wisconsin and the Illinois Bankers School at Southern Illinois University. He is the author of several articles on banking and finance which have appeared in national banking publications. He will address us today on the history in banking law, particularly as it relates to banks selling insurance.

Our second speaker will be Lewis Roth. Lew is currently Vice-President at Mutual of New York, the company he has been a part of since his graduation from Columbia College in 1959. He has been a contributor to Society and industry publications in the past. As his experience would indicate, Lew is well qualified to address the area of financial industries deregulation from the life insurance company perspective.

Our third speaker, Michael Rosen, is a graduate of the University of Pennsylvania. He attended and was graduated from Boston University of Law where he served as Law Review Editor in 1971. He served as Senior Attorney of the Federal Reserve Board of Washington for four years and has spent another four years as Associate Counsel of First National Bank of Boston. He joined his present firm of Gaston Snow & Ely Bartlett in 1982. He currently serves as a partner of that law firm. I would like to express my special thanks to Mike because he has been asked to step in as a last second replacement for Allen Feldman, one of his associates at Gaston Snow who recently was involved in an automobile accident. Mike will talk about the cross-fertilization of the financial services industry and what the law currently provides.

Our final speaker is one very familiar to Society members. Robert Shapiro is a graduate of the University of Wisconsin. He spent the first two years of his career as an actuarial student at Northwestern Mutual Life. He joined Milliman and Robertson as a consulting actuary in 1965. In 1980, Bob became Director of Life Insurance Consulting for Towers, Perrin, Forster and Crosby. Bob has been an active member of the Society and contributor to its publications. He currently serves as Vice-President of the Society. He will speak to us today on possible strategies for dealing with deregulation that may occur as well as that which has already occurred within the financial services industry.

*Mr. Eggleston, not a member of the Society, is a Senior Manager at Price Waterhouse.
**Mr. Rosen, not a member of the Society, is a partner of the law firm of Gaston Snow & Ely Bartlett.

If time permits, the panel will address questions from the audience after the presentation. Our first speaker is Chuck Eggleston.

MR. CHARLES EGGLESTON: Thank you Brad. It is an exciting time in the financial services industry today. Banks want to sell insurance. Insurance companies want to sell securities. Sears Roebuck wants to sell everything.

I will discuss the insurance activities of banks and bank holding companies. Specifically we will review:

- The current and proposed banking regulations regarding the underwriting and selling of insurance.
- The current activities of banks in the insurance business.
- The future role of banks in the insurance business.

CURRENT REGULATIONS

Section 4(C)(8) of the Bank Holding Company Act of 1956 gave the Federal Reserve Board authority to determine those activities which are closely related to banking. In its Regulation Y, the Fed has specified 15 activities that are permissible for bank holding companies, including insurance brokerage and underwriting.

A subsidiary of a bank holding company may act as an insurance agent or broker for insurance that is directly related to an extension of credit or other financial services. What we mean by other financial services are securities safe keeping, safe deposit boxes and trust services.

A bank holding company can be a general insurance agent provided it is located in a community having a population not exceeding 5,000. In addition, a bank holding company subsidiary can act as an underwriter for credit life and credit accident and health insurance which is directly related to extensions of credit by the bank holding company system.

These activities have been slightly modified by the Garn-St. Germain Depository Institutions Act of 1982. Title VI of that act amended the Bank Holding Company Act to specify the types of insurance activities in which bank holding companies may engage. The Garn-St. Germain Act specifically prohibits bank holding companies from providing property and casualty insurance and no longer permits the sale of insurance related to "other financial services." The act does allow the following activities:

- Permits bank holding companies to provide credit life, disability, or involuntary unemployment insurance.
- Permits finance company subsidiaries of bank holding companies to provide credit property damage insurance on loans of not more than $10,000, or $25,000 in the case of residential manufactured homes.
- Permits bank holding companies to engage in insurance agency activities in places with a population not exceeding 5,000, or in towns which have inadequate insurance agency facilities. The bank holding company does not have to be physically located in these towns.

- Permits any insurance agency activities engaged in by a bank holding company on or before May 1, 1982.

- Permits bank holding companies to supervise, on behalf of insurance underwriters, retail insurance agents who sell fidelity insurance and property and casualty insurance on the real and personal property of the bank holding company, and group insurance that protects the employees of the bank holding company.

- Permits any insurance agency activity by a bank holding company with total assets of $50 million or less.

- Permits bank holding companies engaged in insurance agency activities prior to January 1, 1971 to continue to engage in such activities.

To receive approval from the Federal Reserve to engage in credit insurance underwriting, bank holding companies must provide rate reductions or increased policy benefits. In addition, these rate reductions or increased benefits must be maintained on a continuing basis. The Fed staff publishes schedules of rate reductions required in specified states. So today, for a bank holding company to acquire or establish a credit licensed insurance underwriter, it needs to establish a reduction in rates or increase in benefits.

In November 1983, the Fed proposed a change to Regulation Y which would remove the requirement to provide rate reductions or increased policy benefits for underwriting credit life and credit accident and health insurance. The intended purpose of the proposal is to remove the competitive disadvantages faced by bank holding companies in providing such insurance. That proposal has not yet been acted upon.

Finally, in an existing regulation, the national banking laws allow federally chartered banks to act as general insurance agents if the banks are located in communities with a population of less than 5,000.

PROPOSED DEREGULATION

Let's turn now to the legislation proposed by Senator Jake Garn, chairman of the Senate Banking Committee. His bill (S.2181) "Financial Services Competitive Equity Act," is before the Senate Banking Committee and hearings have been held during the past couple of months. Senator Garn proposes to specifically permit bank holding companies to engage in insurance underwriting and brokerage. However, banks would be required to provide additional protection to the consumer, including:

- A written explanation that insurance may be purchased from any insurance company or agent must be provided.

- The bank cannot solicit insurance until it has given a commitment in writing that the loan will be extended.

- The bank could not unreasonably reject a contract of insurance furnished by a borrower for the protection of the property securing the loan.

- A written explanation stating the reasons for any rejection of an insurance contract must be provided.

- Banks could not require the payment of a separate charge in connection with the handling of any contract of insurance required as security for a loan.

- It cannot require any procedures or conditions not customarily required of insurance agents or brokers.

- Banks cannot use or disclose without prior written consent, information relative to a contract of insurance which is required by the credit transaction for the purpose of replacing such insurance.

- Banks must provide for a 30-day cancellation period.

- It must provide for a refund of the unearned portion of the premium within 20 days after receipt of a notice of cancellation, assuming no liability for loss under the insurance has been incurred.

Because of the upcoming election and the far reaching ramifications of the proposed deregulation rules, I don't expect to see any banking legislation enacted in 1984. We have some differences of opinion again from the panelists as to that matter.

SOUTH DAKOTA

One of the most interesting developments in the regulation of banks in the insurance business comes from the state of South Dakota and its aggressive Governor Bill Janklow. On March 4, 1983, South Dakota passed a law allowing state chartered banks to engage in insurance activities of all kinds outside of South Dakota, while limiting those activities within the state. South Dakota presently is the only state in the nation to permit banks to buy and operate an insurance company. Citicorp has moved its whole credit card operation to South Dakota. This is just one more of the governor's activities to expand the financial services business within the state.

As a result of this law, major bank holding companies have moved to acquire or form banks in South Dakota in order to enter the insurance business on a national scale. Three of these holding companies are from California and one is from New York. Bank America Corp., First Interstate Bancorporation and Security Pacific Bancorporation are all from California, and Citicorp is from New York.

So far, nothing has taken place with respect to the applications filed with the Federal Reserve because the Fed has "postponed" acting on the applications, pending the outcome of the legislation that is before the Senate Banking Committee. In the "Depository Institutions Holding Company Amendments of 1983" (S.2134), Senator William Proxmire proposes to prevent bank holding companies from engaging in nationwide insurance activities through a bank in a state with permissive laws, such as South Dakota.

NEW YORK

On February 16, 1984, the New York State Temporary Commission on Banking, Insurance, and Financial Services issued its report to Governor Cuomo. The report recommends that New York state chartered commercial banks and thrift institutions be allowed to underwrite and sell insurance. Banks would also be allowed to acquire insurance companies, and insurance companies could

acquire banks. According to the Commission's report, banks would be permitted to do the following:

- Act directly as insurance agents and brokers beginning January 1, 1985. I point out that this is still in the proposal stage and the governor is attempting to have these recommendations enacted into law but that is certainly not that far away. Banks that act as insurance agents or brokers should be licensed and regulated by the New York State Insurance Department.

- Sell insurance on the premises of existing branches or at other locations.

- Own, manage, and control subsidiary corporations that act as insurance agents and brokers beginning January 1, 1985.

- Own and acquire stock life insurance companies through a parent holding company beginning January 1, 1986.

- Own and acquire property and casualty insurance companies beginning January 1, 1988.

This is the essence of the proposal, but Lew Roth will have more details. Governor Cuomo has endorsed the commission report, and is working to have the proposals enacted into law. There is clearly a great deal of legislative activity regarding the insurance activities of banks, both from a federal and a state perspective. Whether or not you agree with the various proposals, I believe that the outcome will be that banks will be more involved in the insurance business than they are today.

CURRENT ACTIVITIES

Through the recent actions of bank regulatory agencies, as well as those of bank holding companies, we see the continual penetration of banking organizations into the insurance business. On December 23, 1983, the Comptroller of the Currency, who was the administrator for Nationally Chartered Banks, announced approval of the first acquisition of a credit life insurance company by a national bank. The comptroller authorized First & Merchants National Bank of Richmond, Virginia to acquire Security Atlantic Life Insurance Company. Security underwrites credit life and credit accident and health insurance in connection with loans made by the bank and its subsidiaries, again consistent with the federal law we just mentioned.

The Comptroller stated that the sale of credit life insurance is clearly incidental to the business of banking and that banks have traditionally offered credit life insurance to borrowers in order to protect ordinary loans on personal security. The OCC noted that underwriting credit life insurance is not a new activity for national banks. Since 1964, the OCC has authorized national banks to provide for losses arising from cancellation of outstanding loans on the death of borrowers by entering into debt cancellation contracts. This is the equivalent of underwriting credit life insurance.

In January of this year, the Liberty National Bank and Trust Company of Louisville, Kentucky, received permission from the Kentucky Department of Insurance to form an insurance subsidiary. The point of note is that Liberty National will be the only commercial bank in Kentucky, and one of the first in the

country, to provide insurance to customers through a bank owned company. The insurance subsidiary can only again write life, accident, and health insurance for customers who have loans from the bank.

Norwest Corporation, a $29 billion bank holding company based in Minneapolis, has recently consolidated its 64 insurance agencies into one company, Norwest Agencies, Inc. Norwest is one of 16 bank holding companies whose insurance operations were grandfathered in the Bank Holding Company Act of 1956. Norwest has been in the insurance agency business since 1929, and its agents represent more than 100 different companies. Norwest Agencies sells all types of property and casualty insurance and is the 26th largest agency in the country. beginning last month, Norwest Agents began selling renewable term life insurance policies developed by I.T.T. Life Insurance Corporation.

In the past year, several savings banks in New York state have established insurance agencies to sell life insurance. Savings banks in New York can sell up to $30,000 of life insurance under the Savings Bank Life Insurance Fund. For amounts beyond $30,000, the savings banks are selling life insurance underwritten by the American Life Insurance Company. Goldome, the sixth largest savings bank in the country, sells life insurance under an arrangement with Comp-U-Plan of New Jersey.

Recently, some banks have entered into joint venture arrangements with insurance companies to sell insurance. In support of these arrangements, the Comptroller of the Currency, again the administrator of national banks has ruled that national banks may lease space to insurance companies.

On February 16, 1984, Bank of America announced that it will allow insurance to be sold at certain branches by the $4.6 billion Capital Holding Corporation of Louisville, Kentucky. According to Bank of America, the arrangement is part of the bank's strategy to offer one-stop shopping for consumer financial services. Capital Holding will sell auto, homeowner, and life insurance, and will pay Bank of America a fixed rental payment for the use of office space.

Other banking organizations involved in cooperative agreements with insurance companies are:

- Banc One of Ohio in cooperation with Nationwide Life Insurance Company also of Columbus.
- Hawkeye Bank Corporation of Des Moines, Iowa in cooperation with the Travelers Corporation.
- First Bank Systems of Minneapolis, Minnesota in cooperation with the I.T.T. Life Insurance Corporation.

THE FUTURE

As the foregoing illustrates, banks are clearly in the insurance business today. Between 150 and 250 banking organizations own a credit life reinsurance company. In the Midwest, banking and insurance have traditionally been closely related. Bank insurance agents make up a significant portion of the Midwest chapters of the Independent Insurance Agents of America and the Professional Insurance Association.

Why are banks in the insurance business? First, it is a logical service for banks to offer because:

- Insurance is an intangible financial service that consumers might expect to find in a bank. In contrast, consumers generally don't go to a bank to buy pots and pans. Although a couple of years ago, it seemed that way as we gave you these incentives to open up your deposit account. We don't expect people to go to the bank to buy pots and pans and shoes and so on, but it is logical to see consumers go to a bank to buy life insurance because it is an intangible financial service just like all bank financial services.

- Bank loans often finance purchases that must be insured, like homes, boats, cars, etc.

Second, banks are searching for ways to increase fee income to cover the costs of their retail distribution system, that is, their branches. Banks are searching for ways to increase fee income as deregulation has removed some of the profit that was in the business. You can make an interesting comparison of banks with McDonald's. McDonald's copied banks by providing drive-up facilities to increase customer convenience. McDonald's has expanded the products it sells through its system, and not only offers hamburgers but breakfast, chicken, and desserts. Now banks want to copy McDonald's by expanding their product offerings to include insurance, discount brokerage and other financial service. In this period of deregulation, insurance is a natural addition to bank services to help cover the fixed cost of branches and to maintain bank profitability.

Third, banks have a large customer base and believe that they can sell insurance at less cost than independent agents. Banks already have the space and often the personnel to sell insurance. Thus, the bank's selling costs are probably lower than independent agents. Citicorp, for example, claims that it could sell homeowners', automobile, and term life insurance for about one-half the cost of an insurance agent. William F. Ford, an executive vice-president of Security Pacific Bank Corporation, estimates that banks could trim 20% to 30% from life insurance premiums.

Finally, according to a survey by Research & Forecasts, Inc., insurance agents ranked last in trustworthiness in providing financial advice. In addition, the survey found that consumers ranked banks second to insurance agents as a source of insurance. Banks want to sell insurance because they are perceived by consumers as credible sources of insurance.

What do we think banks will do? When the law allows, banks will probably focus on insurance brokerage. In the brokerage business, banks can leverage their resources - public image, distribution network, and customer bases - to profitably sell insurance. Banks are attracted to insurance brokerage because it does not require much capital and does not require extensive expertise. To begin in the business of selling insurance, banks will most likely hire insurance agents, or acquire an insurance agency, or develop joint ventures with insurance companies.

Banks are not expected to enter the insurance underwriting business to any great degree because:

- It requires a significant amount of capital.
- It is a risky and cyclical business.
- It requires significant specialized skills and knowledge.
- It is a low growth business.
- It is a competitive business and not highly profitable.

In conclusion, banks are in the insurance business today. When and if banking deregulation laws are enacted, probably sometime in 1985, banks will extend their activities into the insurance brokerage business. As Walter Wriston, chairman of Citicorp, has stated, "Insurance and information distribution are businesses poised for explosive growth, and Citicorp plans to become a preeminent provider in each field."

I believe that you are going to find banks more deeply involved in the insurance business as laws are changed and I think that will begin in 1985.

MR. LEWIS P. ROTH: Good afternoon, my name is Lew Roth and I work for MONY. What name could be possibly more fitting for a totally integrated, totally diversified financial services company?

What are we going to do with the likes of Sears and Kroger's? I can't imagine buying socks and stocks in the same store. Is it really true that Kroger's is going to put the insurance counter between the turkeys and the bologna? I have even heard that Avon is setting up a nationwide chain of boutique glamour stock shops. Where is all of this leading? Well, it is somewhat like the upsurge in teenage attendance at X-rated movies. There appears to be this uncontrollable desire for companies to enter other businesses but only where it is prohibited or restricted by law. With all the opportunities that exist within the legislative boundaries, companies are pushing down the walls to enter each other's business. Looking specifically at banks, if the legislation before Congress is passed, and I am one of those who believe it will not be this year, banks would not only be in the businesses shown on that chart but in the securities business, the real estate development business, underwriting and brokerage business, could own thrift institutions and be insurance underwriters and brokers. Should this be allowed to happen?

This next chart shows the industry groups that are supporting or opposing deregulation generally. Most industry groups are opposing. The only industry group saying yes are the American Bankers Association and the Association of Bank Holding Companies. Aside from a group of seven financial conglomerates including American Express and Citicorp, which was formed expressly for this purpose, all the other groups supporting deregulation are federal agencies.

Those opposing deregulation are all the financial institutions other than banks and even one Bankers' Association, the Independent Bankers Association, which is a group of several thousand small or medium-sized banks. Among the most vehemently saying no are the NAIC, NALU and the ACLI.

On what grounds are these organizations opposed to further deregulation? In August of 1982, the ACLI turned a task force on integration of financial services into a full ACLI committee. The chairman of that committee is John McElwee from John Hancock. The other members of the group include some of

the largest companies: Prudential, Equitable and New York Life; smaller and mid-sized companies like Security Benefit and Liberty National are evenly divided between stocks and mutuals.

At an ACLI forum which was held in November of last year, Walter Wriston, Chairman of Citicorp, made some interesting observations. He said that deregulation will happen, not so much because of the banks' aggressive lobbying, but because the public wants it. In the long run, the public interest will dominate. Our national policy will be established not based on what the banks want or what the life insurance companies want, but based on what the public wants. In his mind, the public wants freedom of choice.

John Filer, the Chairman of Aetna, at the same meeting gave the life industry's position. He said our products are complex and need special expertise, that life insurance requires personal contact because a poor distribution system will result in mis-sales.

Insurance is not a commodity. Expertise is needed both in marketing and in underwriting. He went on to explain that the level playing field is probably not possible, especially when one looks at the way banks and insurance companies are taxed and that the credit power of banks is much too coercive. He explained that the pressure exerted on a credit customer who has been asked whether or not he would like insurance is too strong. Whether that pressure be intentional or unintentional and even though such pressure is not allowed by law, it still exists. Further, it is totally essential yet highly unlikely that when two organizations are run by the same management, even if legally separated and with giant walls built between them, there will be a tendency to aggregate the insurance risk with the credit risk and jeopardize the soundness of one or the other. John Filer and other home office types have argued well on behalf of our industry, but our most powerful and convincing lobbyist generally come from the agency force.

Lowell Beck is the president of the National Association of Independent Insurers, which is the nation's largest property and casualty insurance trade group and one of the organizations which has testified before the Senate Banking Committee oversight hearings. He has discussed this quite well. Some of you may have seen his article published in the Wall Street Journal on February 21. He said, "The Feds correctly sensed that the emergence of integrated financial institutions is a complex and potentially dangerous step, raising serious questions. For instance, will consumers of credit be coerced into buying insurance coverage from the lender? What will be the effect of these new institutions on small regional banks and insurers and the regulatory systems governing the two industries? Will bank holding companies be allowed to transfuse insurance company funds into other ailing subsidiaries? Insurers have been accused of opposing the banks out of fear of competition. But a comparison of the business cycles of banking and insurance, especially property and casualty insurance industries, reveals that there is much more to worry about than new competitors. The much publicized collapse of Baldwin-United is an illuminating case history on how fast and far instability can spread." Mr. Beck concluded his article with the following statement: "The walls of separation built by Glass-Steagall and the Fed are not fortress walls to protect the occupants from competition. Rather, they are intended to be fire walls to prevent the spread of damage to other parts of the economy. When it comes to the safe operation of financial services, truth may lie in that old saying that 'good fences make good neighbors'."

Jack Bobo has also made some interesting comments recently with regards to deregulation. Jack responded to Walter Wriston's comments in the following ways. He gave an interesting example of how banks may semi-automatically add insurance coverage to cover loans. He also showed clearly that allowing department stores and supermarkets to sell insurance is not the same as allowing a bank holding company which is driven by banking activities. He says that unlike banks, no government conferred privileges have been bestowed on Sears, such as access to funds at low cost, access to the Feds discount window, FDIC insurance and IMF credits. What about those loans to Argentina and Poland and Brazil and other third-world countries? Such privileges are ultimately underwritten by taxpayers and the quasi-public function of banks provides a rather sharp distinction with other investor-owned entities.

Another powerful argument presented by the Life Industry in this regard is summed up by quoting some parts of the ACLI presentation to the Senate Banking Commission.

The history of banking and its regulations in this country make it clear that the public does not want the banking industry to fit into a framework that readily tolerates business failure. The public wants reassurance that the banking system will always provide a quick and efficient system of making payments available on demand and assure back-up sources of liquidity. Deposit insurance - FDIC - gives an unfair advantage to banks.

Because a bank and its affiliates are closely associated in the public mind and because public confidence is essential to the solvency of a bank, a bank might be tempted to shore up the affiliate through unsound loans or other ways if the affiliate should fare badly.

When individuals or businesses come to a bank seeking credit, they come with hat in hand. They need that money and they often know that a denial of credit can have dire consequences. Such people know, to the extent implied or expressed, that they are more likely to get a loan if they agree to purchase other banking services.

We have heard that the banking industry, to counter this argument, has stated that they do not engage in tie-in sales because they are illegal. Prohibiting them by law and preventing them from occurring are two very different propositions.

The arguments on both sides have merit. The Justice Department has recently come out in favor of free market forces. A member of the Anti-Trust division of the U. S. Department of Justice believes that it is inappropriate for regulation to control or contain free market forces.

As recently as the end of January, the Alliance of American Insurers pulled out of the coordination of industry effort against deregulation calling integration inevitable. Andrew Maisonpierre said on January 23, "I can't speak for the industry, but I am convinced in my own mind we are going in the direction of integration. I think it's inevitable and we have an obligation to shape that legislation."

In a slow-down effort which may temporarily keep brokers out of the S & L business, the Federal Home Loan Bank Board has allowed applications for securities dealers to languish on the shelf. Brokers say they want to buy Thrifts to offer consumers a broader range of services, but S & L's fear that Wall

Street will use the FDIC insurance to guarantee all sorts of brokerage company products. But such efforts by bank boards and others may temporarily put moratoria on pending action, but it is hard to believe that such action will actually halt the tide.

I want to speak a little bit more about the New York Temporary Commission. Being a representative of a New York domiciled mutual company, those proposals are very important to us. They have been put forward by the Temporary State Commission on Banking Insurance and Financial Services, commonly referrred to as the DeWind Commission Study. Some of you may recall in 1982 the Heimann Commission proposed sweeping changes in the New York insurance law in three important areas: accountability of insurers, subsidiaries, and investments. That commission recommended that New York domiciled insurance companies be allowed to form subsidiaries to engage in any legal business. Due to the pressures from the bank lobbyists, the final legislation, the Cuomo-Cochran Bill, was enacted with the bank carve-out. But that same legislation, Chapter 567, also created the New York State Temporary Commission on Banking Insurance and Financial Services.

The Commission's charge was to study and evaluate the changes reshaping the financial services industry, both in New York and the nation, and to recommend modifications the commission deemed appropriate in the state's laws, regulations and policies governing financial institutions. Seventeen members were appointed from the major financial areas, such as insurance, banking, securities, thrift organizations, the Stock Exchange, a professor, a consumer advocate, and politicians. The commission released its report recently, which also has Governor Cuomo's support, by a vote of 12 to 4. It recommended very broad powers for banks, including the ability to enter the insurance business.

The package is designed to appeal to a number of different interest groups. Commercial banks would get unprecedented powers, including the ability to own insurance companies and insurers could own banks. More specifically, beginning January, 1985, banks which include commercial banks, savings banks and savings and loan associations would be authorized by statute to sell insurance either on the premises of their existing branches or other locations. In addition, they would have authority to lease space to independent insurer agents. It was further recommended that the prohibition from writing property casualty insurance on property subject to a loan be repealed.

State chartered banks, effective 1986, would be allowed to own and acquire life insurance companies. They would be authorized to own and acquire property and casualty insurance companies, but only after January 1, 1988, and only after further study by the legislature. Mutual savings banks would be authorized to own insurance subsidiaries. Existing limitations on savings bank life insurance would be examined by the legislature.

The formation of non-bank banks, banks that either don't make commercial loans or don't accept demand deposits, could be established by any organization. The restraint of State chartered commercial banks' ability to affiliate with a company engaged in underwriting or other related securities activities would be repealed, but to be effective in the event of a repeal of Glass-Stegall. State chartered thrifts would have enlarged powers. Limitations on conventional mortgage lending outside of New York would be eliminated. Banks would be allowed to make equity investments in real estate. Mutual life insurance companies would be permitted to demutualize.

Section 214, dealing with Compensation and Fringe Benefit Plans would be repealed. There would be some changes in life insurance guarantee corporations. There are 38 proposals, and I've highlighted only some of them.

It is interesting to note that the four dissenting votes came from John Creedon of the Met; Bob Best, Security Mutual; Al Howes, an agents' representative; and Louis Lefkowitz, the former Attorney General of New York. All the bankers, all the securities industry people, all the consumer advocates, were unanimously in support of the package. It is most significant that Hank Greenberg from AIG voted with the majority. Although AIG is primarily a property/casualty company, it does have life insurance subsidiaries. Some people may perceive this as an indication of some sort of split in the insurance industry. Actually, I don't think that is true, and I think there were reasons why AIG and the other securities people voted with the banks.

The securities industry received a nonaction proposal on banks entering the securities area until and unless Glass-Stegall is repealed. The property/casualty industry received a deferred 1988 date for bank entry.

Various papers have been presented speaking both for and against all of these various provisions and the arguments all have a familiar ring. The paper presented to the agents was given by George Bernstein who is now practicing law in Washington and New York, but you may recall he served as First Federal Insurance Administrator and prior to that was Deputy Superintendent in the New York Insurance Department. He is now representing the Independent Agents of America, the Professional Insurance Agents, and the New York State Life Underwriters Association. His points are these:

- Small insurance agencies cannot compete with the raw economic power which bank institutions can and do exert.

- The authority to extend or deny credit has the additional power to affect consumers' decisions.

- Banks have used this power, not to provide efficient and personal service at the lowest cost but to make sure that borrowers buy from the lending institution, regardless of whether or not this is in their best interests.

The discussion by life insurance members, submitted by LICONY, presents five reasons for maintaining the current legal barriers between insurance and banking:

- A revolution has already occurred in the financial services, and consumers would best be served by allowing some time to go by to digest these changes.

- Banking deregulation is based on a competitive free market theory which requires the sanction of failure, but public policy requires a stable banking system, essentially free of failure.

- The essence of the insurance business is the assumption of mortality, morbidity, casualty and liability risks. The essence of the banking business is the assumption of credit risk. The risks assumed and the related investment policies are different and require regulation and protection. Public policy requires that neither the bank nor the FDIC assume the significant and unfamiliar risk.

- The credit leverage of banks is powerful.
- The advantage of undue concentration in economic power in banks must be guarded against, as a matter of public policy.

This is one of the hottest issues in this arena today. The proposals are such that a complete revision of powers and authority and regulations will make competing in the financial services arena a totally new ball game. I hasten to remind you though that these are just proposals, at least at this stage. Final legislation has yet to be enacted, but I can say from personal experience that portions of this are being worked on and draft legislation is being prepared. Whether they will happen at this legislative session or not is still unclear. Most of us think not, but there is a flurry of activity in this area.

So much attention is currently being focused on banks and on bank entry into insurance, that one is likely to pass over too quickly the virtual revolution that has occurred in the securities business. Merrill Lynch's CMA account was just the beginning. We've coined a whole new vocabulary in just a few short years. Now we have banks, we have near-banks, we have non-banks, we have almost-banks, sort-of banks. The securities industry has been expanding its base. Insurance companies haven't been totally asleep either. Of course there is Pru-Bache, but then there is Kemper, Penn Mutual, John Hancock purchased Tucker Anthony, Aetna bought Federated Investors, Metropolitan has taken over State Street, not to mention activity with Phoenix, New England and many others.

Other insurance companies have entered the securities industry through symbiotic relationships with mutual fund organizations and discount brokerage houses. What we can't or don't want to do directly, we've managed to find a way to do indirectly. Yes, we have even entered the banking business. Pru has recently purchased Capital City Bank of Hapeville, Georgia; Kemper, Liberty and Jefferson have purchased wholes or parts of savings and loan associations; Travelers has a cash management account; so has the Equitable. By the way, the Equitable's Asset Management Account will offer interest-bearing check accounts, sweep dollar market funds, VISA credit cards, overdraft protection, a secured line of credit through brokerage accounts and discount brokerage activity.

Another large area of insurance activity under deregulation is the real estate business. MONY, New England National of Vermont, and others are all marketing real estate syndications. Finally, technology which is the pillar in the ability for financial services integration has provided opportunities for even further diversification. Prudential has major ownership in the United Satellite Group; CIGNA has interest in a microwave communications system, Aetna has purchased Redshaw Inc., which provides insurance agents with computer software.

While all this has been going on, MONY has looked at its strengths and said, "We're pretty good at uncovering or creating needs, and we're very good at personal selling," so we've entered these symbiotic relationships in the mutual fund business in association with mass financial services, and have entered discount brokerage through Fidelity Management, are syndicating real estate and other tax shelters, and will soon have a cash management account.

By the way, it is interesting that when a major life insurance company gets involved in one of these, they immediately go to the top of the charts. We

are the first New York domiciled company to offer discount brokerage under the Cuomo-Cochran Bill. Since we have 2200 full time agents who are NASD registered reps, that makes us automatically the tenth largest sales force in the nation selling discount brokerage.

In closing, it appears we can look at deregulation both as an opportunity and as a threat. As an opportunity it allows us to expand into new businesses, but in so doing we need to emphasize our particular strengths: marketing, personal contact, financial stability and a national presence. As a threat, we need to fend off those who would invade our territory.

It seems unlikely that government is going to keep those walls up for us or at least not as securely up as in the past. We can only stand off our competition by being more market driven. We need simple investment-efficient products. We have to stay financially sound, and to my mind, most importantly, we need to maintain strong, continuing personal relationships with our customers.

MR. SMITH: Thank you Lew.

MR. MICHAEL ROSEN: My name is Michael Rosen, a partner in the Boston law firm of Gaston Snow & Ely Bartlett. I'm the mystery man today. Today's topic on deregulation of financial institutions could have easily been changed to be "Who is going to provide financial service products to consumers and how are those products going to be provided?" It seems to me that if you were to start out with a blank slate on providing financial service products you wouldn't have the structure that you have in this country. In fact, you don't have to look too far to see plenty of other models for providing banking services, investment banking services, insurance, and a whole host of other services in other countries. In fact, in Japan it is not uncommon to have not only all of those industries under one roof, but to combine financial services also with automobile manufacturing, chemical plants, and so forth. I am not suggesting that we should do that in this country. I'm just saying there are other models.

What has gone on in this country in the past decade is the conglomerization of the financial services industry. I think a lot of people have suggested that when Sears Roebuck bought a savings and loan, then bought Dean-Witter, then bought Coldwell Banker, one of the largest mortgage banking companies in the country and also happened to own at the same time Allstate Insurance; that this was the work of some clever lawyer who was finding loopholes.

I don't take responsibility for that either. I think what's really been happening is that the marketplace has been responding to changes in our economy over the past decade and that while some lawyers may have helped businessmen find their ways into other businesses, the lawyers neither created the marketplace nor the chaos that has ensued.

I've heard a number of comments from the other panelists about banks being similar to McDonalds, about banks being privileged to have loans to Argentina, Poland, and Brazil. I think the truth lies somewhere in between. I must also say, having represented banks, insurance companies, mutual funds, and brokerage houses, that the banks will be thrilled to hear how powerful you think they are. Let me tell you, they think that you are a lot more powerful than they are. I can tell you based on the history of what has happened in legislation in this country, that the insurance industry has certainly done a lot

better than the banking industry. I'll get into that in just a minute. In a sense, I feel the same way here, speaking to people that are in the insurance industry. I don't have any doubt that each of the financial services industries will continue to remain viable so long as they continue to adapt to the marketplace and innovate and compete. I would like to spend a few minutes going over what the changes have been in the financial services marketplace over the past decade and to take a look at what may happen in the marketplace in the next few years.

I'd like to go back to banking and insurance for a minute if I could. The cornerstone of the separation of banking and insurance is a law called The Bank Holding Company Act of 1956, which is a federal law. There are several states that have similar laws. This law got started in the Federal Legislature about 1937. Nothing happened from 1940 to 1945. After the war, the law picked up momentum and what it did was say that if you wanted to own two or more banks, you would have to restrict your activities primarily to banking. The law was aimed at a company called Trans America Corporation, which at the time the law was enacted, happened to own a bank called Bank of America. Insurance and banking were separated in the Bank Holding Company Act of 1956 and there really were not many activities by banks in insurance from 1956 until 1970. The late 1960's saw the formation of one-bank holding companies. The 1956 law did not cover corporations that owned just one bank. They could do just about anything they wanted to do. In the late 60's, Citicorp (then First National City Corporation), started to do some of these things, and one of the rumors was that Citicorp was going to merge or acquire the Chubb Insurance Group. That never happened, but we did have The Bank Holding Company Amendments of 1970. This law said that bank holding companies had to restrict their activities to managing and controlling banks and to engage in activities that were so closely related to banking as to be a proper incident thereto. As Chuck described earlier, there are about 15 activities, most of which sound a lot like banking: commercial finance, consumer finance, credit card leasing, and so forth. Things seemed pretty stable around 1970. You could look at the financial services marketplace as a number of relatively neat segments. There were commercial banks that offered checking accounts and commercial loans and consumer services. There were savings and loan institutions, which didn't at that time offer either checking accounts or NOW-accounts, but did make housing loans. There were the investment banks that did underwriting and provided brokerage services. There was, of course, the insurance industry. And, there was the mutual fund industry.

Up until the early 70's, we had a pretty stable economy in this country and everything seemed to move along pretty well in these segments of the industry. But then, all of a sudden, we had the oil embargo, and we had a lot of inflation; mortgage rates went from 5%, 6%, 7%, and further up. There were dislocations in the economy. There were troubles in each of these industries, and there was a need to innovate and to try to generate income from different sources. So in the early 70's we saw a major innovation. A little bank in Worcester, Massachusetts decided that it couldn't offer checking accounts because it was a savings bank, but it would offer something better. It would offer a NOW account, which stood for Negotiable Order of Withdrawal. It was really a checking account that paid interest. Before any regulator could put a stop to this, it became pretty popular. So, Congress in their wisdom, decided to allow NOW accounts as an experiment in New England. It only took another ten years for NOW accounts to be lawful on a nationwide basis. Perhaps that is a commentary on the relationship between what happens in the marketplace and what happens in the legislature.

In any event, after NOW accounts, which were sort of model for the types of things that would happen in the marketplace, inflation continued. Consumers could not get market rates of interest on their deposits, because under federal law, there is a ceiling that banks could pay on deposit accounts. Another clever institution offered Money Market accounts, which was a mutual fund that had check writing capability through a bank that paid market rates of interest, so long as you had a reasonably good-sized minimum deposit.

Now we have the thrift industry and the mutual fund industry encroaching on the historic turf of the banking industry. But again, this happened because of market forces.

From that time until the later 1970's, there really wasn't a tremendous amount of activity on cross-marketing. In the late 1970's we saw the Merrill-Lynch Cash Management account. I'm sure I don't have to describe that to you. You have to keep a minimum of $20,000 in cash or securities in your account. You can write checks against the account at a bank, of course, not at Merrill-Lynch because Merrill-Lynch is not a bank. They did recently charter a bank and are operating in Princeton, New Jersey. The Cash Management account also allows you to use a VISA account. I think they are going to offer Master Charge and you can literally take your VISA account, write against it or charge against it on your securities account.

Rates for deposit accounts were being bid up and the thrifts had to go out into the marketplace and to the regulators and buy money at close to market rates of interest. Well, I'm sure I don't have to tell a group of actuaries that if you're buying money at 15-20% and you are selling it at 8%, you're not going to make it up on volume. So the thrifts decided that what they really needed were more powers, that they had to become more bank-like, that they had to offer more services, and that they had to find a way to compete in the marketplace. This resulted in legislation in 1980 and again in 1982. In 1980 we had something called the Depository Institutions Deregulation and Monetary Control Act, which has become affectionately known as DIDIC. Then in 1982 we had another bill which further broadened the powers of thrift institutions so that they could provide checking accounts, NOW accounts, more commercial loans, more commercial real estate loans, and really, pretty much look like a bank to all but the largest corporation since they don't have high enough lending limits to be making loans to General Motors. That was the Garn-St. Germain Act of 1982. As Chuck mentioned earlier, the Garn-St. Germain Act of 1982 also resulted in cutting back on the insurance activities of bank holding companies.

During this same time period, we also had the formation of what could be called the financial conglomerates, American Express, and Boston Safe Deposit and Trust Company, which was the original non-bank bank. A non-bank bank, or consumer bank, is a bank that either does not accept demand deposits or does not make commercial loans. The 1970 Amendments to the Bank Holding Company Act redefined the term "bank" to require that you do both or you wouldn't be considered a bank. That loophole, or that provision of law, however you want to look at it, was pretty much for the benefit of Boston Safe. I suppose Congress didn't expect that American Express would buy Boston Safe and then merge with Shearson. The Federal Reserve Board has recently called in Shearson American Express and told them that the exemption no longer applies to them. I can't tell you why, and I spoke to the fellow from American Express and he couldn't tell me why either.

We also had Sears buying Dean-Witter and Coldwell Banker; we have JCPenney buying a bank; we have John Hancock buying Tucker-Anthony; we have Prudential-Bache merging and then buying a bank; and that's where we are today.

So where does this all leave us? Well, I think it's pretty fair to say that the neat segments that I spoke about in 1970 no longer exist. Lew said that the tide is moving swiftly. Perhaps it is a tide, and if it is a tide, maybe it is not going to wait for any industry, just as the real ocean waits for no man.

We now have an insurance industry that has merged with the security industry, owns non-bank banks, offers IRA's, offers cash management accounts, and a wide variety of other products.

We have the large banks that are offering discount brokerage activities, money market mutual fund accounts, mutual funds through private labels. They are expanding on an interstate basis throughout the country as we read in the newspaper every day. They are forming nationwide electronic funds transfering networks, so that you can take your East Coast piece of plastic and plug it into a machine on the West Coast and get cash while you are on vacation. And we even have a few banks that are experimenting with what they call videotext home banking.

The securities industry has not stood still during this period either. They have gone out and bought insurance companies and non-bank banks. They offer money market accounts, they've been brokering deposits and they seem to be having a lot of success with what they call the Equity Access account. This is a revolving line of credit that is secured by a second mortgage on your house.

The thrift industry hasn't stood still either; they've become more bank-like. They have even formed a mutual fund. They've branched out on a multi-state basis. One of the things they have done best is that they've been bought up by others.

That is what has happened over the past ten years. Now we can take a look at what is likely to happen. To quote Walter Wriston again, he said that when he was a young man he went to London. In order to get food he would have to go first to a butcher shop, then to a fruit store, then to another store to get vegetables, and if he wanted some dessert he would have to go to a bakery. He also said he had to bring his own bag because none of those stores would give you a bag. Now we have supermarkets; you can do all your shopping at one spot.

I think that is what has happened in the financial services industry and I think the reason for it is convenience. The consumer is beginning to get used to going to one place to write their checks, buy their stocks, buy their insurance, make their investments, and who knows what else in the future.

Some people say that the day will come when we will be able to do all of these things with our home computers over our television sets and in addition to that, do a lot of shopping at Sears Roebuck and JCPenney.

There are going to be a relatively few mega-institutions. You can name them as well as I: Shearson American Express, Sears Roebuck, Citicorp, Bank of America, Prudential-Bache, John Hancock, and you pick your own favorites for the rest of the list. These are going to be the supermarkets.

There are going to be the mega-institutions, there are going to be the middle-market institutions, that find a particular niche and remain profitable by providing superior products, superior convenience, superior service; and then there are going to be the "Ma and Pa's," and they too, if they are careful and clever, will remain successful.

MR. ROBERT D. SHAPIRO: The deregulation of the financial services industry has been "happening" for many years. Flashes of the potential revolution were discernible in the 1960's when mutual fund/life insurance packages and one-stop-selling were buzzwords of the day.

However, the guns of deregulation have been firing with ever increasing power and consistency over the past five years. Is there little doubt that the traditional monoline life insurance business of the past is rapidly disappearing?

WHAT CAN WE EXPECT?

How are our life companies coping with these changes? Where can they turn for a sense of direction? If the deregulation experience of other industries is examined, one will observe the expected "leveled ice-rink" to look like this:

- Regulatory barriers initially fall in the areas of pricing and product within traditional industry boundaries. Then, amid substantial turf-defense pressures, the marketing and organizational barriers between insitutions begin to fail.

- Marketplace change accelerates with each toppled barrier. The winning companies are those that anticipate future changes and position themselves accordingly. The losers are either companies that have no leverageable strengths or companies that cling tenaciously to the vanishing past.

- There is a period of time during which those companies that keep their eyes open can modify and re-orient their strategies.

- There are many failures, acquisitions, and divestitures. The early sellers are often those companies that do not have the strengths, capital or management to make it. The later ones are most likely to be today's "failures in process."

- The large companies generally will survive, sometimes for no other reason than they have sufficient capital to finance false starts and faulty decisions. A number of small companies will locate emerging market niches and adeptly move in to take advantage of these opportunities. The mid-size companies with limited capital, vision, and flexibility will find survival difficult.

THE STRATEGIC ISSUES

Deregulation is but one of several major change forces that must be dealt with by life insurance companies. In developing successful strategies for dealing with deregulation, increasingly unpredictable economic patterns, improving technological capabilities, and changing family patterns must also be considered. Examples of specific changes that are occurring include:

- Increasing pressure for tax law parity among financial institutions and between similar financial instruments.

- Increasingly aware consumers, with desires for convenience, liquidity and flexibility in their acquisitions of financial services.

- Increasing potential for delivering convenience through technological power, enchanced by increasing consumer comfort with technology.

The competitive response to these changing environmental and marketplace factors has been dramatic. There have been many mergers and acquisitions, and a number of new players joining the life insurance game. The playing rules are changing, product life cycles shortening, and the risks of doing business increasing. There is a greater awareness of the importance of strategic planning in forging a solid track for managing our life companies. The same herd instinct that resulted in the industry's slow initial reaction to deregulation is now leading the industry to much greater emphasis on planned change.

As a result, we are seeing many companies improving productivity, cutting fat (both people and subsidiaries) and broadening management skills. New products are being launched continuously, and many companies are undergoing major culture changes as they modify their traditional values and processes.

ALTERNATIVE STRATEGIES

There are a number of strategic options available to life insurance companies as they face the deregulation of financial services. In choosing a change strategy (i.e., note the word "change" substituted for the word "deregulation"), a company must carefully examine:

- Its size, image and financial resources.

- The size and loyalty of its customer base.

- The size and loyalty of its distribution network.

- Its competitive position in the marketplace.

- Its administrative systems and technological progressiveness.

- Its asset management capabilities.

- Any special skills it possesses; for example, skills in mass marketing or payroll linkage.

- Its management environment and management style.

- Its capacity for creativity, adaptability and change.

Life insurance companies must remember that they are "special" vis-a-vis the other financial institutions. A life insurance company uniquely has the ability to take risk. Obviously the favorable taxation of accumulating policy values is a current competitive advantage. Other advantages such as the presence of a large, comparatively stable pool of investable funds in most life companies needs to be factored into strategy development.

The limitations of life insurance companies are often found in the level of customer identification and loyalty, and in the progressiveness(?) of the management environment. On the other hand, the president of a good size bank was recently quoted in the Wall Street Journal as saying: "I'd start over as an insurance company. They can do just about everything."

The strategies available to life insurance companies might be categorized as follows:

1. Broad Spectrum Providers: These companies distribute a broad line of products and services through a multidimensional national network. This strategy requires large size, strong national image, broad expertise, and strong strategically-linked financial performance measurement systems.

2. Low Cost Manufacturers: These companies distribute a simple line of products and services through a relatively simple and well-defined distribution system to a price-sensitive marketplace. They rely on low costs created by streamlined organizations, resulting in low priced products.

3. Boutiques: These companies market differentiated products and services targeted and distributed to a special marketplace. They generally are very creative both in product design and in marketing.

4. Center of Influence Developers: These companies assist centers of influence in becoming more successful by helping them to more effectively design and provide products and services to their markets. Employers, banks, and large insurance agencies are examples of such centers of influence. More and more special relationships are being formed with this kind of strategy as the driving force.

5. Head-In-Sand: These companies distribute last year's products and services through last year's distribution systems to whatever market these distribution systems are operating in. These strategies often reflect fear, false hope and change paralysis. Such companies often eventually revert to strategy #6.

6. Head-On-Block: These companies have had their strategies determined for them and are either being dismantled by state insurance departments or acquired by other organizations.

CONCLUSION

Deregulation is "alive and well" and proceeding rapidly in the financial service industry. The decline of traditional product "values", the proliferation of new products, the pressure on cost reduction, and the wide differences in experience from company to company are clear reflections of the change. Product rebundling, demutualization, and internationalization are three examples of changes that we see on the horizon.

Although deregulation and rapid changes caused a great deal of discomfort, they also create many opportunities for those companies willing and able to take advantage of them. Success will require major changes in most of our life companies - changes demanding a move from being driven by the past and industry tradition, to being driven by a clearly defined vision of a desired future and a plan to get there built upon internal competencies.

MR. SMITH: We do have a little time for questions. To start off, this group met over lunch and had a lot of differing opinions, as you can tell by their presentations. I know that Mike was particularly vocal at lunch, and has a question he would like to address to Lew.

MR. ROSEN: Now that the Federal Deposit Insurance Corporation has decided that broker deposits are not a wonderful thing, in fact no longer legal, why would an insurance company want to own a bank?

MR. ROTH: My background and training tells me to answer that question with another question, which is, why not? Seriously, I think you must approach the question from two sides. First, the insurance industry is not "pushing" to own banks. What it is doing is trying to prevent, for the time being at least temporarily (although I don't think it will work), banks from owning insurance companies. But, on the other hand, if banks are eventually and inevitably going to sell insurance, why not insurance companies providing banking services? From the other side, coming from a career agency company, there are only three things which an agent in the field really needs to be successful. They are control, control, and control. In order to maintain control, you have to be able to provide enough through-put. The bankers have talked about pushing more through-put through their branches and therefore want to get into the insurance business. I think insurance companies with big agency plans should be desirous of having more through-put through their agency system in order to maintain control. There is a non-answer for you.

Question: I'd be curious to hear what Bob has to say about that, in relation to strategic planning.

MR. SHAPIRO: I would say that many of the companies are looking at Prudential, for example. Basically, they are doing it for three reasons:

- They are positioning themselves strategically "just in case," not quite sure how this might work out;

- Number two, getting in there before regulations, possibly, cover up the opportunity to get that bank; and,

- Third, I think, it's the $100,000 coverage, which may be packaged with something else and seems to have more meaning when it comes from the government than when it comes from the Pru.

I really don't have many more ideas on it. Those are relatively minimal reasons to buy a bank and all the problems that entails, unless you get an awfully clean bank.

MR. SMITH: Lew, I'll give you an opportunity to come back. I know that Mike was saying at lunch that outside the insurance industry, our distribution system, our captive agency force is viewed as a great asset. I know that you had some comments on that.

MR. ROTH: We consider it a great asset. McKinsey uses the words "sustainable, competitive advantage." What do insurance companies like ourselves have as a sustainable, competitive advantage, if not our distribution system? So, yes, I do consider it an asset.

It is a very expensive asset, but nevertheless an asset. There was a comment made about how the public views insurance agents as opposed to bankers, brokers, and other people in the financial services industry. I think our friend Walter Wriston used it in his speech about the somewhat low regard the insurance agent is held. There have been a number of surveys done, but there was only one survey, the one of course that Wriston picked, that showed insurance agents low on the list of esteem. Many other surveys, sponsored by the insurance industry, no doubt, have shown a fairly high regard for the ability of life insurance agents to provide financial planning. As a matter of fact, it has shown over the years, if you follow the trend studies, that it has actually improved. There is more public confidence in the value of the services of an insurance agent as time progresses. I think that is something we shouldn't pass over too lightly.