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MARKETING ARRANGEMENTS WITH FINANCIAL INSTITUTIONS

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MR. JAY M. JAFFE: Approximately 2 1/2 months ago, the business section of the Sunday *New York Times* carried two articles. The first article was by Steven Hansen who is President of the Dollar Bank in Pittsburgh. I just want to excerpt a few things he said, "As President of a savings bank I have been dismayed by the lack of attention paid to the Ford Motor Company's acquisition late last year of First Nationwide, a well-managed thrift institution with assets of $11 billion. I'm dismayed because this transaction may signal the beginning of an era of marked acceleration of concentration in economic power." This is one of the key issues underlying our discussion. Ford already owns the Ford Motor Credit Corporation which after General Motors Acceptance Corporation, is the second largest finance company in the world with $24 billion in assets -- more than all 13 United States banks. First Nationwide has branches in California, Florida, New York, Hawaii, etc. Even though this new combination will surely be a potent force in the marketplace, that effect alone will not justify my concern. Rather, I fear the precedence that this transaction sets. Fortunately, few industrial or merchandising companies other than Ford, Sears, and American Can have significant positions in banking or insurance now,

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but the trend is clear. First and most obvious is the breakdown in the once rigid separation of banking and commerce. While commercial banks are largely prohibited from offering insurance and securities services, the combination of Ford and First Nationwide is not. If Ford and First Nationwide were subsequently to acquire insurance and securities companies, they would gain an unfair competitive advantage over banks through joint marketing agreements and package deals on, say, auto financing and insurance. The author I am quoting says second, and most important, "The transaction threatens to increase the concentration of financial services," and he goes on and on. These are the opinions of a banker. Why not bank where you buy your car?

And this was written by George Benson, a professor of accounting, economics and finance at the University of Rochester Graduate School of Management, "The Ford Motor Company has acquired First Nationwide, a multi-billion dollar savings and loan with offices in several states. This acquisition most likely will raise two specters which sporadically haunt the destruction of United States banking -- fears of mixing banking and commerce and the creation of giant corporations. Are acquisitions of this sort contrary to the public interest?" And he puts a big "?" after that. And then he went on to make an announcement saying: "Imagine even a larger combination than First Ford-Nationwide (sic)." He said this was Citibank and General Motors. He points out that when Citibank and General Motors merge, and this was kind of a nice way to put it, the combination would be larger than many nations. What could this giant do that Citicorp and GM cannot do separately? Would the car division force the bank division to buy only GM cars? Or would Citibank customers have to buy GM cars to get loans? Must car buyers bank with Citibank? This is not likely, considering the large number of banks and car makers competing for business; as it is hard to imagine how the conglomerate could exercise the power it presumably has. He then goes on again to talk about some things that might happen. But, in general, he says, "I'm not arguing for combinations of banking and commerce. Each alone is difficult enough to manage, and there does not seem to be much synergy for managing them together. But this is a concern for the stockholders of the companies that are considering joining but are not concerned for the public's well being."

Again, these articles are interesting because I think they reflect many of the attitudes held by the public. Other aspects of this that you should keep in mind, elements which I think are perhaps even more significant, are the purchases which recently went on by General Motors, by Metropolitan Life and by Fireman's Fund. Does anyone know what the common thread is between these? Each of those three corporations, within the last year or year and a half purchased major mortgage servicing companies. General Motors purchased two mortgage services companies. Metropolitan is involved with Century 21 and another acquisition in the mortgage field, and I think Fireman's Fund just announced the purchase of two mortgage servicing companies. So the handwriting is on the wall. I'm just setting the stage here. You may buy your car from the person who sells you your home or your hammer and nails like you do at Sears. We have a very exciting future ahead of us.

MR. CHRISTOPHER W. TOMECEK: Jay just went through a couple of examples of different companies buying other companies to try to get into different lines of business within the financial industry. What I am going to address is what these companies are going to have to do in order to be successful, in the long term, in the financial industry.

It is clear that deregulation is removing or has removed the barriers as well as the protection that made financial services a predominately product-oriented business for more than half a century. Think about this for a minute. If an individual wanted insurance, he typically went to an insurance company. If he wanted CDs he went to a bank. If he wanted mutual funds, he went to a mutual fund company. If he wanted to buy a refrigerator, he went to Sears. If he wanted to buy a house, he went to a real estate broker. All of these are very independent organizations providing some aspect of a segment of financial or non-financial services to an individual. However, the products, customers, geography, and most importantly, the distribution systems are no longer protected as we used to know it. Banks now make discount brokerage services, insurance products and mutual funds available, and investment companies, such as my company, Fidelity, offer credit cards, money market funds with check-writing features, and insurance products. So, where is the difference? There really isn't any. Insurance companies, brokerage firms, banks, and mutual fund companies all offer IRAs, and most have very similar products. Sears, the

nation's largest retailer of *household* products and services now aspires to becoming the nation's largest retailer of *financial* products and services, leaving the consumer very confused as he will have to sort out all the choices. By the way, as you may or may not know, Sears has the largest accounts receivable of any corporation in the world. Its accounts receivable and debit owed is double any bank in this country. So Sears has tremendous power -- a tremendous asset base.

I'll now just take a minute to tell you about my company. Fidelity Investments is a privately owned firm. It is the largest investment manager in the country that is still privately owned. All the rest have sold out to various companies. Our working capital base is less than 1% of that of Citicorp, American Express, and all the big insurance companies. With all this going on, Fidelity, like many of you, has struggled with the questions, "How does a financial institution succeed in this highly competitive environment?" The answer we, and others, have found, in a word, is *marketing. Marketing* is the key to providing new focus within financial services organizations. This will be the thrust of the rest of my comments.

When I sat down to write this presentation about marketing mutual funds, I was trying to think of an example of a product that has, as a key ingredient to its success, an aggressive marketing program. I thought about a lot of products, and then I started thinking about hamburgers and what a great example they are for marketing a product.

If you remember back in the 1960s, a company came on the scene in America, and it came on by storm. We had never heard of it before; there was nothing like it before. It was called McDonald's. Its first marketing campaign, the way it introduced itself to everybody, the way it sold its product, was through the jingle "change from a dollar." Remember the ads, all those clean, bright, smiling young kids in the brand new, scrubbed clean restaurants. So what McDonald's was selling was convenience, cleanliness, and cheapness. And it worked. Ray Kroc built a multi-billion dollar corporation out of it. Then, about 6 or 7 years later, another company came into this marketplace -- Burger King. Its slogan was "Have it your way." Here is another company with a similar product, but it goes after a completely different segment, and it

appeals to a different part of you. This was a brilliant marketing strategy. Then McDonald's came back again. This time it made a very bold move. It was a multi-million dollar move and a very bold move because Burger King was making too many in-roads into McDonald's market share. McDonald's came out with a new product -- McNuggets. McDonald's got a lot of fanfare out of that. Then Burger King responded very strongly and very, very aggressively. It spent millions and millions of dollars on TV advertising. It changed its campaign to "flame broiled." It is the same product, but now it's the way Burger King prepares it. The point is that here you have two companies with a similar product, both quality products, but they approach the market differently and are both extremely successful at it. Burger King focuses on the way the product is prepared, while McDonald's first focused on the money its product cost and the convenience of it, and now focuses on the product line.

Now, you are probably asking yourselves what does all this have to do with marketing mutual funds? The point is that both industries are market driven, not product driven. If you are going to be successful in either one, you have *to know who your customers are* and *how to reach them*. And you have to go out and *aggressively* market and sell your product[s] to them.

Overview of Mutual Fund Industry

Obviously, it helps to have a great product. And just about everyone has accepted the fact that the mutual fund is the hot investment product of the day. In fact, it truly is the investment vehicle of the 1980s. It really is the easiest way for individual investors to invest in stocks, bonds, government obligations, and government-backed securities. I'd like to share some statistics with you from the Investment Company Institute to give a little background on how large this industry is and where it has come from.

1. Growth in Assets under Management:
   End of 1979: $95 billion
   End of 1985: $490 billion -- over 500% increase.

2. Number of funds has jumped from:
   End of 1979: over 500
   End of 1985: over 1,500 -- an increase of over 300%

3. Number of customer accounts has grown tenfold:
   End of 1979: 3 million
   End of 1985: over 32 million (One out of every four households)!

   So, when you look at a company like Sears, for example, if it is successful in its marketing campaigns, it will be an extremely important force to be reckoned with by all of us because the company has marketing penetration across the country. We at Fidelity, for example, signed up 450,000 new IRA accounts this past IRA season. Year-to-date through April we have brought in over one million new retail accounts. Whether it is Sears, Fidelity, Citicorp, or your own insurance company, once you sell a customer a product, you then have a brand new marketplace to cross-sell them all your other products and services. That, I think, is really a key point and is really the key hook for a lot of these companies.

4. The pace is getting even faster. To put these numbers in perspective, look at what happened with mutual funds just in the last three months of 1985.

   Mutual fund assets grew in the fourth quarter of 1985 at an unprecedented rate of:

   -- $400 million a day
   -- that's $16 million an hour
   -- $260,000 a minute

   The first quarter of 1986 was even larger than that.

Why has there been this kind of explosive growth? Basically, there are three reasons for it.

1. First, more and more individuals are leaving the stock market to the professionals. They no longer feel they can beat the professionals and the institutions in performance. Sales of *equity, bond and income mutual funds* more than doubled to $114 billion last year. That's ten times what they were in 1981. During the first quarter of 1986 alone, nearly $50

billion was invested. This is almost half of what was invested in all of 1985, which was a tremendous record year. So the momentum is continuing.

2. The second point is that mutual fund companies have broadened their product lines dramatically to attract more and different types of customers, (remember a moment ago I mentioned the growth in number of funds from 500 to 1500 in 6 years). Look at what kinds or types of people these companies can now appeal to. There are tax-exempt funds for people looking to reduce taxes. There are sector funds, like Fidelity Select Portfolios, for people who like to play the market. You have junk bond funds for people who like high yields. And this is just to name a few.

3. The third point is the surge in this business is, of course, the IRA market. Now that CD rates have dropped substantially, investors are looking elsewhere for the high returns they grew accustomed to when interest rates were in the 12-16% range. And so, you're going to see alternative investment vehicles to try to maintain a reasonably high rate of return. The mutual fund share of mutual fund companies in the IRA business grew from 12.5% in 1984 to 15.3% in 1985. In 1986, it is estimated that the mutual fund share of the market increased to more than 18%. This is dramatic growth.

Marketing Arrangements With Financial Institutions

One of the things we did was to start to develop marketing arrangements with other financial institutions. I think you are going to see this as the trend of the future. It is happening a lot now. Many institutions are now asking themselves, or if they're not they should be, how they can tap into this market. But, in order to do it, many will have to form a partnership with a mutual fund company. Just as banks are forming partnerships with insurance companies, it is a mutually beneficial relationship. One is trying to leverage the other with its product. We are doing the same with mutual funds. The cost of a company developing its own mutual fund is very expensive and for a lot of companies will be cost prohibitive. Most mutual funds need an asset base of a minimum of $100 million before they can become profitable. Legal restrictions,

resulting from Glass-Steagall and others, make it impossible for banks, for example, to get the regulatory approval necessary to sell their own mutual funds.

One thing we are doing, I believe was discussed in *American Banker* either earlier this week or late last week. A lot of insurance companies want to offer either a Universal Life or Variable Life product but, because of their size, are not able to afford to run their own investment operation like the larger companies. So, Fidelity is running mutual funds or common pools, for insurance companies, to be the underlying investment vehicles for them to wrap around the variable life product. I think you'll see that the major insurance companies are going to have more competition from the midsized to smaller insurance companies because they are going to be able to get the investment management expertise that they need from an outside source. So, they don't necessarily have to go out and buy all that themselves. To equate this to another analogy, banks want to offer mutual funds to their customers but might be in the same position as, say, that midsized insurance company. They really can't afford or don't want to bring in house and develop a rather large staff to do the investment management; so they will form a partnership with a mutual fund company to offer these funds. In choosing a partner, you should turn to an organization that has a wide variety of top performing funds, a national reputation, and a strong marketing orientation. The key point is to look at the retail marketing skills of the mutual fund company. You will need its expertise to help market and sell your program, including employee training, advertising, telemarketing, and promotional help.

Responding to the needs of our institutional clients, predominately banks, Fidelity's retail mutual funds program was developed in 1984 to allow our customers, financial institutions, to expand their product offerings by making available Fidelity's wide array of retail mutual funds to the financial institutions' customers. We currently have over 50 banks engaged in that program. We did this because several market research studies, conducted at the time by Market Facts, Gallup, Fidelity, and some of Fidelity's largest bank clients, clearly indicated a large market segment of some 20% of U.S. households which wanted to buy mutual funds, but only through a bank or thrift organization. Although these consumers wanted the funds to be managed by a nationally-known

company and have a strong track record of performance, they also wanted access to the funds through a bank for reasons of trust, convenience, and local presence.

Do any of you know how the mutual fund business grew up or is conducted today? We advertise, for example, in the *Wall Street Journal.* Fidelity Investments is the largest single advertiser in the *Journal* annually. If you want to invest, let's say in the Magellan fund, you clip out a coupon, fill it out, get a fulfillment kit in the mail, which is part of the prospectus and application, fill it out, write out your check, and mail it in. You'll never meet with anyone. Alternatively, your option is to dial an 800 number and talk to one of our telemarketing people either in Boston or Dallas, where we have another large operation. You might have some specific questions about the performance, track record, or various things to do with the fund itself. So our business is very different in terms of sales than, say, the insurance business where you have the agents, and there is a lot of personal contact with the potential customer and then the customer. So, we very rarely meet our retail customers.

Now, there is a large populace of this country that does not feel comfortable with investing in a mutual fund by just writing out a check for, say $25,000 and putting it in the mail. These people want to be able to physically hand the check to somebody and get a receipt back. They want to invest in the funds but don't want to or don't feel comfortable doing it in the traditional way the mutual fund business has grown up. So, that is why we, for example, have built relationships with a lot of key banks around the country in order to develop a leveraged distribution vehicle for Fidelity. We view our long-term competition to be not other investment managers, but companies like Sears, Citicorp, and Merrill Lynch, which have the huge brick and mortar networks around the country -- their branch networks. Merrill Lynch, for example, has four retail offices in Boston, alone. So, since a company like Fidelity can't compete with that directly, we form partnerships and develop the leveraged distribution.

What are the benefits of mutual fund product lines for banks and other financial institutions?

1. They satisfy customer needs for higher returns, diversification, and different types of products.

2. They attract new customers and increase market share, as a lot of banks have found this past IRA season.

3. They expand current customer relationships.

4. They generate fee income.

The Importance of Marketing

Providing access to mutual funds and marketing them, or any financial product, are obviously two different things. Mutual funds are products that are sold, not bought, as in insurance. You have to find innovative ways of promoting them. They are not products you leave on the shelf.

I'm sure many of you have heard this story before, but let me tell it to you once again, because it really makes an important point. Back in the early 1960s, do-it-yourself permanent hair waves were the rage, and Toni decided it was going to get into that business. So it came out with a product. The package the product was in was rather bland looking and it sold for about $7.95. It didn't sell, and it sat on the shelf. And Toni was a big player in the health care market. Toni took the product off the shelf, repackaged it, put it back out in a bigger box that was red with white Toni lettering across it, and increased the price to about $12.95. It then became the number one seller in the industry. The reason was that Toni listened to its market.

Three things sell mutual funds:

1. Performance
2. Nationally-known name
3. Aggressive marketing

Let me give you an example. Four years ago, people were saying stay away from Magellan. It's too big. With $500 million in assets, it can't get the great

returns it got in the past. Well, the price of its shares and the size of its asset base continued to grow until it reached $1.5 billion in assets. Then people said it's definitely way too big to invest in. And, of course, Magellan continued to lead the pack for five and ten year performance rankings until it reached almost $3 billion a year ago. People then said there is definitely no way it can perform the way it did in the past. And, of course, Magellan had a return in excess of 40% last year. Its rolling 12 month return through March is 56%, and that means it outperformed more than 1,400 other mutual funds. Everywhere we go people now want to hear about Magellan. Great performance, national reputation, and aggressive marketing have made it the best known and most popular mutual fund in America. Today, Magellan's assets exceed $7 billion.

Now, there is no one way to market mutual funds, just as there is no one way to market any product, although it is a lot easier if you have a great performer with a national reputation like a Magellan. With mutual funds, investors can move from one fund to another to adapt to changes in financial conditions and their investment goals. Young investors tend to be a little more aggressive. As they get older, they become more cautious and move their investments to mutual funds with lower risks; and when they get close to retirement age, they begin to look at income producing mutual funds with very low risks. The point is that every company has to tailor its program very differently to meet the needs and requirements of its customers. For example, we have two bank customers in the Houston market; but one bank's program would not be successful for the other bank. You have to look at the image, reputation, the customer base, and what you are appealing to and what they are used to dealing with. So, the marketing programs must obviously be very tailored. What works for one set of customers, again, doesn't necessarily work for another.

Let me give you another example of a retail product that might illustrate that point. Take a look at the margarine business. When it first started to become popular, there were two companies that really pioneered it. The first was Parkay. Parkay sold its margarine on taste. Open the box, and it said "butter" all the time. The other company was Fleishmann's. Parkay had come out first with the taste thrust. Taste was its marketing thrust, and Parkay was extremely successful with that. Fleishmann's did it very differently.

Fleishmann's, with the same product, decided it was not going to go down the same taste route, where it tasted like butter. They instead, went down a very different route -- health. Fleishmann's margarine is 100% corn oil, so there is no cholesterol. The two margarines are basically the same product. However, if you think about it, some of your react favorably to the fact that margarine tastes like butter, while others of you are more health conscious and want to buy the product because it is cholesterol free. It is the same product, nonetheless very different approaches. So, again, you can see my point from before that no one marketing approach is the right answer. You can have many different approaches, and they can all be quite successful.

In closing:

1. You have to research your market to know who your customers are. This goes for any company.

2. Marketing is the key to survival in the changing financial services industry. Jay did a nice job before illustrating just a few points of how rapidly our industry is changing. Despite the challenges, I firmly believe there are many creative strategies for meeting each and everyone of them, and I think there will be quire a few survivors when all the dust settles.

MS. LINDA D. REED: Believe it or not this is not a commercial for United Virginia Bank. It probably is a commercial for the careful, well thought out strategically directed expansion of a bank's role as a provider of insurance products. To give you a little background on UVB, we are one of the sixteen grandfathered bank holding companies. We have one agency, unlike many of the other sixteen. Our agency is in Richmond and in the past, up until about two years ago, this agency primarily managed the loan-related or credit-related insurance programs.

Then, about two years ago, while we had done a little bit of dabbling in direct response insurance products, we realized that there really was no strategic direction. Different areas of the bank did what they wanted to do, on a sponsored or fee basis, with insurance, and there was no plan behind it. So we

spent the time to sit down and put together a long-range strategic plan that is flexible, or dynamic, which would give us short-term profits over the first five years through programs that would fund our expansion into more capital asset intensive areas of insurance, i.e., so that we could actually start operating in a true agency context. Those programs are the ones I am going to share a little bit with you. They are what we call our other insurance programs -- retail Mass Marketing and one of the additional opportunities that we have identified in the branch sector that is in progress right now.

Just as some brief background, these are probably self-evident reasons for our entry or expansion into insurance. Obviously the corporation is very interested in a new source of income and profit. United Virginia Bank shares total just over $8 billion in assets. We got about 192 plus branches in Virginia, 13 in D.C., and another handful in Maryland, so we are a nice size regional bank. The corporation is always looking for additional fee income. It isn't looking to put out a lot of money right now, which is why we came up with the short-term five year plan that in fact will self-fund the agency for expansion. What we identified as the median in long-term profit on the two programs I am going to talk about equates over a five year period to $12 to 15 million. There are a lot of assumptions behind that, most of which I am going to touch on and most of which, in fact, have to come to fruition for us to be able to do that; but that was certainly a persuasive point to the corporation to let us go forward. One reason is investment. The key here is low does not equate no. There was an initial investment, primarily in good people and in some telemarketing staff that we needed. Low risk is another. Again, the corporation liked the idea we could stop it as quickly as we could start it. These were criteria for the initial programs that we selected. Other reasons are the usual ones cited of additional customer service, increased customer loyalty, attracting new customers, and taking advantage of the NEER theory to capitalize on Naturally Existing Economic Relationships with the United Virginia customer base. That customer base, by the way, is around 1,200,000 with about 800,000 to 1,000,000 marketable customers or records. So, it is a fairly good size which allows for some leverage with our insurance partners. So we looked at retail mass marketing or what most of us know as direct response. The reasons why we do mass marketing are obvious to most of you that have been involved in this at all. It maximizes our control over customer contact and minimizes our

response time to regulation changes. We made some assumptions that the branch personnel quite simply had more product than it could handle and that automation was reducing traffic, which in fact it has. You need only go into a branch lobby now-a-days and see what the traffic is like, especially on non-peak periods like ten o'clock in the morning. Our branches in Virginia have the wonderful feature of being open from 9:00 to 2:00, and that's it. This seemed a bit unusual to me when I got here, but one of the reasons is there's no traffic after 2:00. We are also preparing for electronic delivery of bank products, so anything that would disrupt the branch system as it currently exists didn't seem to make a lot of sense. Finally, a reason that is not cited very often by banks or by insurance companies is that, by a bank's active participation in a direct response program, these techniques are transferable to other bank product lines. Most of the banks that I'm familiar with, having come from an insurance company, had excellent marketing departments, general advertising departments, good research departments, and knew virtually nothing about direct response. I think if you polled banks today, you will find a very high interest in utilizing direct response for lead generation two-step programs for other products -- IRAs, CDs or whatever. One of the ways to take advantage of gaining this expertise is, in fact, to start up with a multi-product direct response program. Just let the skills transfer themselves.

These are the reasons to emphasize direct response:

1. Again, direct response has low capital risks. It has some risk but not a lot. We need people. The bank needs people no matter what the insurance partner says. The bank needs people to manage and run the operation, and in our case, we were joint partners with the insurance company to develop the program.

2. The start up is quick and easy, or it certainly should be.

3. Results can be quantified, which bankers, like actuaries, like.

4. The product or products could be fine-tuned for roll-out or they could be discontinued, which we liked.

Then we looked in this five year horizon at what we were going to sell, and there are two schools of thought. One school says a bank and an insurance company become partners and take a product. They say, "Let's not be unique, let's start with hospital income, and let's mail it in January of year one and see what happens. Maybe we'll mail 50,000 or 100,000 pieces. Then maybe later in year one we'll do it again, or we'll mail more and pretty soon way down the road maybe we'll add another product." This is a very cautious school -- the partners see how the customers react. They see if there's a market. The other school, which I guess is my school, says, "Why wait? People have been doing this for years. If your market is sizeable, there is a direct response portion of it which will respond. We know what the products are -- they've been offered for 20 years with some variations. So let's take hospital income; accidental death and dismemberment and some variations thereon; medicare supplement; term life and variations thereon; modified benefit whole life, limited underwritten whole life; and a credit card product, which in our case was life, disability, and unemployment, which are pretty common and pretty standard." Then we just sit down with the insurance company. Both schools of thought say that since the products are traditional and supplemental, going through one distribution system, and relying on 800 numbers for customer service, let's take one carrier that can provide all the products and is competent enough to do all the marketing of those products, rather than bidding out each product. So that's what we do.

Those glorious income assumptions over a five year period are based on a fairly aggressive marketing plan, which says the full portfolio of direct response products is to be sold utilizing solo direct mail and insert opportunities in conjunction with a customer based file where we can apply market segmentation by age and/or date of birth. This should maximize product positioning so that we have continuities that are ongoing, products positioned as birthdate life continuities, with new customers identified, in our case on a quarterly basis, as they come on. A new customer in many cases is your best customer. Finally, we need one program that would generate a significant block of policyowners so that we could start doing some cross selling immediately, in year one, and some telemarketing on the side. We don't have any telemarketing expertise -- I wish we did. Hopefully some of this income will go to acquiring some, but we're trying to acquire the experience through parties.

The result in year one was a mailing schedule that some people call aggressive, though I like to call it logical, basically taking advantage of our ability to work the customer base with the insurance company on a well thought out, well managed mailing schedule. The schedule is fairly aggressive in year one, and all the projections in years 2 through 5 are based on this schedule, but there are a lot of assumptions behind it. The primary assumption is that you have a data-rich customer base, which fortunately we do. One of my delights in joining UVB was to find out how far ahead the company was in geographic coding and householding its file. We had dates of birth on about 30% of our files; and, through an arrangement with our insurance partner, applied additional dates. We both recognized that in the long term of the short-term plan, this was going to be very important if we were going to realize the income we needed. We also have the ability to identify multiple product relationships on a bank customer's record, to give priority to checking or a VISA, or over-savings, to know which mortgage customers also have CDs or have Virginia bank relationships, and to know which are now living in, say Hawaii. An account inception date is needed, as is the ability to go in and pull accounts as they come on to the bank's board. The customer base had to be flexible for us to do this. We had to be able to flag, to not mail flags, and we had to be able to flag product flags, as much for the insurance company as for ourselves. This was very much a two way street as the insurance company had to agree to as aggressive a program as we had and, thus, make the largest possible financial commitment. We needed to be able to provide to the bank a clean list of people who didn't currently have the products on an ongoing basis. Finally, the data base had to be easily accessible, easily updated, and able to be referred to easily on an ongoing basis. This didn't happen overnight. Right now I feel very good about it because I've forgotten what it was like a year ago, but I think we're just about there right now.

One of the other assumptions, which may seem obvious to insurance people but is not that obvious to banking people, is that we needed and assumed that there would be an integrated business line marketing approach. What that meant was that all the insurance offerings, all the product offerings from the corporation would come through United Virginia Insurance agencies, and all the contracts would be signed there. In other words, the mortgage company would not be out signing a contract to generate fee income for the company's bottom line

for insurance products. It will be one large deductive customer base. It made things a lot easier, and I think made us much more attracted to the insurance companies. Instead of coming with a file of 400,000 checking accounts, we are able to come with a file of 1.2 million customers. We could tell you how many checking accounts, VISAs, savings accounts, CDs, installment loans, and mortgages there are. The final assumption is that we had automated billing systems in place, which seems pretty simple. Fortunately we did, but we are a clearing house for both VISA and transaction accounts, so we are able to direct debit monthly, quarterly, and so on. We fortunately found an insurance partner that was able to bill us that way. It sounds very simple, but in speaking to a group of insurance companies a couple of weeks ago, I saw they are all in agreement that half of the banks that they talked to cannot do that, and half of the insurance companies really don't have the ability to direct debit. You don't want to be the test case. Fortunately we didn't have to be. So, those are the assumptions basically behind that rather aggressive, dynamic, logical plan.

The final assumption was a product positioning that would make aggressive use of the products, selling them or offering them in every way that makes sense, from day one. A good example here is the credit card product or standard life, disability, or unemployment product. We simply line out on a separate calendar, like the schedule you saw before, when we would utilize direct mail, which, again, we're not using right now as a primary distribution since it is just not cost effective for the insurance company in this case. We are using it on a secondary basis as a ride along with prospecting for new credit cards, monthly statements, inserts, bang tails, and billhead enrollments making the product available on the credit card application to both prospective customers and to new and renewing cardholders when they get their new cards. All of those income assumptions say that we are going to maximize the number of times we are in the mail and the ways the products are made available.

We did some rough income projections by product to make sure that the 12 to 15 million amount, which by the way is not just with these direct response programs but involves the program I will get to in a minute, was feasible. We looked at everyone's favorite, hospital income. We looked at simply year one of that mailing schedule where we maximize the number of times and exposures

for that product, and we said, given our customer base in year one (of course these are rolling months -- bankers don't know this but insurance people do -- so you don't really see all that income in year one), we should be able to generate about $205,000 in commissions for the agency assuming we did everything that was in that program. In that year, we expected to see about $87,000 in List Fees; and obviously these commission percentages and List Fees are based on our arrangements with our insurance company. We then said, "Let's assume we never ever offer the product again, just stopping right there in year one." We assumed what I think was fairly conservative lapse rates and brought down a bottom line which showed up at the end of six years that we'd have somewhere around $867,000 in income from that product. So, it was very persuasive. With a large customer base that we could easily manipulate, there didn't seem to be many reasons not to try it at least for a year.

So, these programs seemed like a logical expansion of our current insurance activities, supported rather than diminished any current efforts, had low risk but some risk, and called for minimum investment but some investment. For those of you with insurance companies which are talking to the banks, I would stress that you point out that there is some investment because you're going to need somebody on the banking side to control this.

These programs also require only incidental actual banking office support, primarily informative. Our 192 branches in Virginia need to be aware of what we're doing because people do walk into the branches with AD&D brochures, etc. They provide what we think is significant fee income, and it has certainly proved to be thus far. Finally, they allow internal development of direct marketing expertise, which we are seeing right now. We are currently utilizing some of the things that our corporation has learned from these first few programs as a new way of marketing CDs.

There is really nothing too unique about what we are doing in our grandfathered situation there. I think we are being fairly aggressive, which may be unique, but there is nothing that most other banks couldn't find a way to do -- we can call it commissions; they can call it fee income. So, we looked at another sensible opportunity if it should appear that we could do immediately. Most of these relationships or possibilities are still being looked at by us. What we

needed was something to do right away. We made a short-term commitment that at the end of five years we'd be able to provide substantial self-funding. We looked very closely at the life areas and ended up with what a lot of institutions, primarily S&Ls and state chartered banks, are doing right now, which is single premium deferred annuities. Our only problem was the decision on how to sell it. Since we had already said that the branches and branch personnel had too many products, we then had to go back and convince the corporation that it didn't really have too many products and that it could easily have one more, which was easy to do when the bank saw the income projections. What we did, in fact, was to license branch personnel -- a new program for us. It is only about 2 1/2 months old. At the end of this month we'll have about 58 branches licensed, about 100 by the end of the year, and probably 150-160 by the middle of next year. It's not quite as quick and easy a start up as some of the other programs, but branches seemed like a logical place to put the product. Branch people know their customers, and they retain follow up information. The people we licensed were branch managers. We didn't want a hard sell, but at the same time we, like many banks, wanted to introduce a sales environment into the branches. Branch personnel don't sell products; they are available, just as CDs are available. I doubt many people in this room have been called by their banker, (I may be wrong), to see if they wanted to buy a CD. Banks generally don't have that kind of sales environment. So, we felt this might be a way, on a soft-sell basis to introduce that kind of environment, because that is the direction that we are moving in. As electronic delivery takes over, more things move out of the branches. The training we came up with is ongoing -- we aren't just throwing these people out there and saying, "Here, sell the products." We assumed time spent would be minimal and not have much impact on their other activities. Telemarketing, the kind of marketing we were asking these people to do, is primarily confined to answering leads that have already been provided.

Briefly, I'll tell you how we got into this in case any of you are approaching banks, or there are any other bankers here. It took us quite a while. We spent a lot of time selecting the product and the company; and, because of the nature of annuities, the insurance company went through a process called our Central Loan Committee, which no one ever wants to go through. They dissected it inside and out using every ratio you can possibly imagine, and then came to

me and said, "You're an insurance person, which of these ratios are important?" I really had no idea, but they went through a very lengthy process so that, in the end, they could say, "O.K. the company has our blessing, so be it, we believe that down the line the company can pay out millions of dollars in annuity payments."

After that we needed to go through branch selection and training and put together an aggressive promotion. We have identified 14 areas initially being as systematic as we have become, things that are going to have to be done that needed sub-steps in order for us to accomplish this in the time table we put together. After that, we identified 87 steps underneath them. The contracting with the insurance companies, selection of branches, agent licensing and training, and the branch training, which was referral training, took about three months the first time we went through it. Now it takes us about four to five weeks. Implicit in this is that we made mistakes. We also needed all that time, however, to get the advertising ready.

As Chris mentioned, marketing was and is everything, especially in this program. We needed the bank to start selling with qualified leads in its hands. So, we utilized direct response to turn suspects into prospects. We did the normal direct response things. We sent out a mailing to all IRA customers. It had a BRC (Business Response Card) telling where they would reply, "Yes, I'm interested, here is my telephone number, home and work, please call me." These were in the agents' hands the day they started selling. It was very, very easy. We also did a lot of seminar development. We had buttons. We started this right during the tax season, so our IRA sales were very, very good this year. The buttons helped a lot in addition to annuities. We're pretty happy with it, but it's a new program. In the long term and even in the first year, it will be the best, most profitable program we have from an income generation standpoint. It has very easy sells; we don't have to sell too many to make a significant income; and so far the customers seem very happy with it. We've done a lot of seminars and contest, which have actually been new for me, and I'm enjoying it, having been stifled by direct response for ten years.

We're trying to learn several things. One is whether branch personnel can sell. It appears they can on a low key basis. Some have been very aggressive,

actually making calls on their own. It's been fairly easy to implement. The initial start up took a bit of time. Setting up wire transfer agreements took more time than we thought it would. We'd pay these people commissions, by the way, so that they had an additional incentive for selling. We haven't seen much measurable impact. Not much time has been allocated to insurance sales, as people now licensed are saying that they are spending about one and a half to two hours a day on it. They have a lot of time between two and five. As far as the product assumptions are concerned, after only two and a half months, we really don't know if they are reasonable, but they seem to be. We may have been unusually fortunate during the start up, but I think we may level off as far as sales go. Referrals do seem to be working as branch personnel, in fact are referring. Of the first ten sales that we got, nine came from referrals from another rail of branch personnel. Finally, can cross-sell production be tracked, i.e., can we in fact move money out of other institutions into other UVB products? That's been real hard to track. We're kind of relying on word of mouth right now, but we'll see what happens.

Those basically are the two programs that we're using for the short term first five years to generate the money to basically self-fund our entry into insurance. There are some ancillary programs that we have going on, really on a niche marketing basis through bank personnel. We also have commercial referrals for placing certain types of commercial insurance and for talking to a lot of insurance companies; but these are the programs we are relying on.

MR. H. NEIL LUND: On this panel, I am the only person representing an insurance company. Therefore, it may be helpful if I give you a little background on my company.

Monumental General is a niche player. The company, as it is currently constituted, was formed approximately three years ago. It is a subsidiary of Monumental Corporation and a sister company to Monumental Life.

Our primary niche is to market specific insurance offerings through regional banks, bank holding companies, savings and loans, and mortgage bankers. We have approximately $95 million of non-credit insurance premium in force and

write about $65 million in credit a year. We are not a large company, but in three years we've come a long way.

Institutions

I mentioned that our primary niche is with financial institutions. The primary institutions we serve are banks, savings and loans, and mortgage bankers. I am going to concentrate on these, although we do have arrangements with other types of financial institutions. We look for an institution which has significant credit activities, significant mortgage activities, and good sized blocks of checking account customers, savings customers, or cardholders. Not all of these elements have to be present in a financial institution, but we do feel that there has to be significant consumer contact from an institution, name recognition within the area that it services, positive image with its customers, and, within the institution itself, a centralized insurance function, something that Linda alluded to.

We further feel that there are four primary reasons why a financial institution will offer insurance programs to its customer base. Again, these are not all present in all cases.

1. The first is to protect an asset, that is, a loan or mortgage. Here the institution is trying to protect itself from default or having to foreclose or recover a car or other piece of property in the event of death or disability of one of its customers.

2. The second reason is to generate additional fee income for the bank. The banks we deal with are appropriately compensated for their role in the insurance venture. For a successful insurance program, these fees can generate significant additional income for the bank.

3. Third, the bank is providing a service to its customers via a product covering certain of their insurance needs. People want the product or service to cover their mortgage or credit transactions, and it is a very important feature to many consumers. Also, supplementary insurance

programs, non-credit or mortgage related programs, are often a convenient way to add to customers' existing insurance programs.

4. Finally, insurance programs can enhance the bank's image in the community: they can improve its service image, broaden its product line, or aid whatever image the bank is trying to create.

To accomplish these goals the insurer and financial institution must enter into a cooperative venture.

Products

Linda alluded to some products, and while there are some broad product categories that banks may wish to offer, we as a company do not offer all of these, instead concentrating on only three:

1. credit insurance;

2. mortgage insurance;

3. supplementary forms of insurance, primarily supplementary direct mail.

We feel that these areas offer the most potential for the institution itself and for us as a company. Note that we are not an agent in the lobby sort of company.

Let me examine each of these product categories a little more.

Credit Insurance

Credit insurance is a heavily regulated industry that provides, by and large, single, uniform premium, life and disability coverages surrounding a loan transaction. The loan transaction may be for an automobile, second mortgage or some other acquisition of the individual. This is a product area that has received little attention from the Society of Actuaries, but in actual fact is far from a simple product and certainly deserves actuarial work and scrutiny,

especially today. With deregulation, we are seeing dramatic changes in the way banks and savings and loans are creating their financial services and loan transactions. As they become more creative in their financial approaches, we need to become more creative in the credit products that we offer.

Fortunately, there are a handful of actuaries who have certainly been a help to me in the credit area. Problems with a lack of literature and a lack of places to turn are at least partially being addressed by Gary Fagg, who is a Society member, and is writing a textbook on credit insurance in conjunction with the Consumer Credit Insurance Association. Gary expects that the textbook will be available in the fall.

Credit insurance, for a bank that has a lot of consumer loans, is probably the most important insurance product it can offer. Through a well run credit program, the bank will be able to protect a significant amount of its assets. A well run program should provide a penetration level of 70%; that is, 70% of the people eligible to be covered by credit insurance should be taking the credit insurance offering. Such a level of penetration will generate significant income to the bank and addresses specific insurance needs of the consumer. Despite its unsavory reputation, credit insurance has significant use by consumers in America and with valid reason.

Within the bank context, credit is usually solicited face to face by a loan officer at the time of the credit transition.

Mortgage

The second product area is mortgage insurance, which, quite logically, is designed to cover a mortgage loan. Within the mortgage area, we have three basic subsets:

1. amortized decreasing term life;

2. mortgage disability, usually covering only a short period of disability -- one to two years, sometimes as much as five years; and,

3. mortgage accidental death, which is designed to be a very low cost form of mortgage protection.

Again, we are protecting assets of the bank, addressing specific insurance needs of the consumer, and providing fee income to the bank itself.

The trick with mortgage products is to balance a product that has a low enough premium, so that consumers who have stretched their financial resources thin in acquiring a house are still attracted to and can afford the coverage, yet provides sufficient margins so that the coverage is attractive to both the financial institution and the insurance company.

Mortgage insurance is usually solicited through a combination of direct mail and telemarketing campaigns.

Supplementary Insurance

Finally, we come to the supplementary insurance products, an area Linda touched on significantly. These products include:

1. term life;

2. hospital indemnity;

3. a variety of small whole life products;

4. medicare supplements; and

5. a variety of accidental death related products.

Each of these products is, again, designed to generate fee income and is offered primarily to checking account or savings customers of a bank. Each product is designed to supplement already existing insurance programs; whether it be existing medical programs through the use of Medicare supplements or hospital indemnity, or existing life programs through small term life or whole life programs. These products are not intended to be a primary form of

insurance. At Monumental General, we market through the bank's customer list using direct mail approaches. On occasion, these mailings are supplemented with telemarketing efforts, although today that is still relatively rare.

The primary thrust here is to enhance the bank's image and to generate additional fee income.

Roles

Through all these products, the bank and insurance company have certain specific roles that need to be played.

More specifically, the insurance company provides:

1. a saleable product to the bank;

2. marketing support through training of loan officers in the credit or mortgage area;

3. the development of solicitation materials for the direct mail programs;

4. direct mail expertise to conduct the programs on behalf of the bank;

5. claim adjudication services, which must be handled very carefully since we are dealing with the bank's customers; and

6. appropriate accounting services to the bank.

Further services may be required in some of the more exotic arrangements.

The bank's role is primarily, though not exclusively, to provide the customer. This is the bank's customer, not the insurer's. These customers are never our property -- they always remain the property of the bank. That has to be clear to you and your company if you are dealing with financial institutions. The bank also provides its endorsement that the offer we are making is a sound insurance program and should be pursued by its customers. The third thing the

bank provides is a billing/collecting vehicle. In credit, this is not so important since you are dealing primarily with single premium transactions. But in the mortgage business, the premium is traditionally collected monthly along with the normal loan payment. With supplementary products, the monthly premium is debited either from the checking account, savings account, or from the insured's bank card. This ability of the bank to provide a collection and billing service to use is a crucial aspect of dealing with a bank. The final element that the bank provides is direct service to the customer. As Linda mentioned, people do walk into bank lobbies with their Accidental Death or Medicare Supplement mailing in hand and ask questions about them. We expect this to occur to a certain extent and must provide some level of training to the bank so that the bankers themselves can handle a certain level of requests.

In all of this, the fundamental key is it takes a cooperative, joint venture in order to market insurance. It's not the insurance company standing alone or the bank standing alone. It is truly a *cooperative* venture.

Arrangements

We approach this market through several arrangements. The simplest is a very straightforward commission and/or service fee arrangement. The bank is compensated on a percentage of premium basis for the use of its names and for the billing/collecting, and other services that it provides. The insurance company accepts the full marketing risk; and those of you familiar with direct response know that this risk can be significant. The insurance company also has full responsibility for any underwriting gain or loss from the block of sub-business.

A modification to this is to enter into some form of profit-sharing arrangement with the bank. This may be done with pre-set loss ratio levels where additional bonuses are paid to the bank for excellent claim experience. It may be based on solicitation results, whereby if higher levels of penetration are obtained, the bank receives additional consideration. Or, it may be through a true experience rating in the classical group insurance sense, where specific costs are charged against the account; for example, solicitation costs, either in full or on an amortized basis, claims, premium tax, and retention for the

insurance company itself. Any underwriting gain that emerges is either returned to the bank for use for its customers or shared between the bank and the insurer.

A third type of arrangement is the use of captive reinsurance or other reinsurance arrangement. Captive reinsurance companies are usually a reinsurance company licensed in the state of Arizona, with the expressed purpose of accepting reinsurance from the primary carrier on the business written through the institution which owns the captive. The concept of captives originated with credit insurance. The bank-owned captive and the fronting insurer enter into a traditional reinsurance arrangement, where risk is indeed passed back to the reinsurance company. Some portion, or perhaps as much as all of each individual risk of the bank's insured customer, is passed to the bank's reinsurance company. Underwriting gains or losses fall to the reinsurance company, while the primary insurer really provides only administrative and claims adjudication services. Captives are usually run with little or no staff. Accounting and actuarial services, appropriate filings, annual statement preparation, tax preparation, etc., are usually handled by a consulting firm on a straight fee basis. Monumental General will, through one of our subsidiaries, establish and manage captive reinsurance companies for banks and savings and loans, or we will assist the bank and savings and loan in running their existing captive. Or, if they desire, we will point them towards one of a number of reputable consultants that provide these services. The important thing to us is that the captive be well run and appropriately capitalized. We closely examine these aspects annually through significant audits of the captives that we deal with. A relatively recent development is expanding the role of captives to include mortgage insurance. Within the last month or so, there has been significant activity in federally chartered banks to move towards reinsuring their mortgage business through captives. This was previously not available to them. Passing mortgage business through captives will result in increased complexity in the administrative services that captives need to have; but this is only a small deterrent to their growth. The use of captives for mortgage insurance will grow. Currently, it is extremely rare to find supplementary coverages reinsured through a captive reinsurance company; although I feel that somewhere down the line this will happen. But it will only happen with large

institutions that have a very large existing captive reinsurance company, so that there can be spreading of risk in these ventures.

Two modifications of the captive arrangement exist. One is the exotic reinsurance company. An exotic is a form of captive where the reinsurance company is formed and controlled usually by the principle insurance company, and is designed as a reinsurance vehicle for smaller institutions or institutions which do not wish to invest the large amount of capital required to form a captive company. The exotic works by issuing a special series of stock for relatively nominal cost. Performance of this series of stock depends upon the underwriting experience of the block of reinsured business supporting the stock; that is, the performance the insurance business generated by the institution itself. Administrative fees for management of an exotic are higher than those of a true captive. On the other hand, the bank or savings and loan has not had to put up the capital needed to form the captive itself.

The second arrangement, which has been tried in a few instances with mixed success, is that of forming what I would classify as a true reinsurance company. That is, a group of financial institutions would band together and form a true reinsurance company capable of accepting risks of any nature, not just the business associated with their own institutions. Dividends back to the individual banks and, of course, stock performance, would be based on the experience of the total company itself and on the percentage of shares owned by each institution, not on the experience of each separate institution. As I said, this is relatively rare. I know of three instances where this has been done.

Again, all of these arrangements, dealing from straight commission all the way through to exotic or true reinsurance, are cooperative ventures between the insurance company and the bank itself.

Final Notes

For final remarks, there are several things that need to be emphasized:

1. The insurance company, to be successful in this market, has to take a very service-oriented approach. You've got to understand that you are providing services to the bank and its customers. You have no ownership of these customers.

2. You're dealing in an area of significant regulatory change; not only within the insurance industry, but within the banking community itself. Regulatory change occurs at varying speeds. You must be cognizant of this, keep abreast of the changes, and be ready to move whenever a regulatory change breaks.

3. Mergers, acquisitions, consolidations, and failures are part of what's happening out there. Through mergers and acquisitions you may gain significant volume of new accounts, or you may lose accounts entirely. You have to be willing to play that game if you are in this market. We have one institution that, through a variety of acquisitions, found itself dealing with over 20 different insurance companies on its mortgage program. This institution presented us with the very special problem of consolidating its business and simplifying its mortgage insurance programs. To do so required a lot of work on our part, strong cooperation from the financial institution, a reasonable degree of cooperation from the existing carriers, most of which, but not all of which, provided that cooperation. In this case, the existing carriers need to realize that for them the game is over, and they need to accept a buyout of some sort from the primary insurance carrier.

4. This is a small margin business as there is not a lot of margin available for the insurance company. Competition is fierce from both other insurance carriers and from the banks, themselves, who are entertaining a large variety of competing bids. You *absolutely* must have a tight rein on your expenses and be able to tie your expenses down to specific items. Know where you are spending money, where you should be spending it, and where you can't be spending it.

5. The final thing that needs to be considered is failures. Banks fail and programs fail. You must accept the fact that some of your programs will

not be successful. Your banking partner has to understand that mail campaigns can fail for a variety of reasons and be willing to accept that fact.

In summary, if ventures with financial institutions are to work, both sides must cooperate, move quickly to solve problems, and accept the fact that there will be occasional failures and perhaps some enormous obstacles to get around. There are no turnkey opportunities available. Both sides must work cooperatively to make the most of the potential.

MR. JOHN W. H. TAYLOR: Linda, several years ago in the Single Premium Deferred Annuity marketplace, financial institutions were not very warm to the suggestion that some of their assets go outside to a life insurance company. What is the view today in a bank like UVB as to assets leaving the door to go to an insurance company?

MS. REED: The question of disintermediation was one that we thought, on the agency side, would be an issue in convincing the bank to go forward with this program, but it wasn't at all. I think there are a number of reasons for this. One was that we make a nice commission up front, and it takes the bank much longer to make that on its spread on CDs. The other issue is that we are well aware that about 30-40% of our CD money is going to move anyway. It is an ongoing cycle, and the hope was that we would retain some of what we were going to lose. We also hoped we could attract some new money; although, primarily, in the first couple of years, we were fairly sure that the money would come from our own base. We are tracking this very closely. So far, after 2 1/2 months, which probably is not a significant amount of time, I think we have had only two CD conversions, while the rest of the money has come from other vehicles such as savings accounts and outside money. One reason for this is that until last week we hadn't targeted the CD base. Last week we did do that targeting through the mail, so we'll see what happens. If there were a major disruption of the CD base where deposits just left en masse, we'd probably find a different way to sell the product.

MR. MICHAEL G. REILLY: Chris, you were describing the program you have at Fidelity for small and medium sized life insurance companies where Fidelity

would serve as investment manager for variable life and variable universal life insurance. I have a couple of questions relating to that. First, who does the administration of the life policies?

MR. TOMECEK: The insurance company.

MR. REILLY: Are you doing this for variable annuities as well as variable life, or is this program exclusively for the latter?

MR. TOMECEK: Right now it is just for variable life.

MR. J. ROSS HANSON: After listening to what the panel has said, I am puzzled about one thing. You have to make some money. Profit is necessary, and if you are going to have any, you must relate your expenses to your income. It sounds like the cost of marketing through financial institutions is larger for the insurance company here than it is in other marketing methodologies. The trend has to be exactly in the opposite direction. What must happen here is that the cost of marketing insurance products to the ultimate consumer has to be less than it would have been had other methodologies been used, or it will fail. So, the SPDAs sold at UVB cannot compensate the bank for all the income it would have received had it retained those assets, while at the same time compensating the insurance company for the income it would have made had it retained those assets for itself, unless there is a reduction in other marketing expense. Could one of you advise me whether it is indeed possible to market a life insurance product through a financial institution at a significantly lower marketing cost than is done otherwise?

MS. REED: To use the annuities as an example, we have no marketing cost except that we do have a 50-50 arrangement for sharing of advertising costs incurred to develop the market. The commission income we take in is clearly in excess of this. We have made the conscious decision not to tie salaries or bring people on in the agency side unless they are attached directly to an income producing program. So, from our point of view, other costs don't matter. My assumption is that our volume has been and will continue to be great enough that the insurance company, which is making a lot more than our four points on that money, will continue to make money.

MR. LUND: We don't offer annuities because we are not convinced we could make money on them. For our other programs, our products are priced appropriately to cover the marketing costs involved in going through the financial institution arena. A principle criteria in our pricing is that we expect to break even in four years or less. This certainly indicates lower marketing costs than in many other forms of marketing.

MR. KIRAN DESAI: The two keys are affinity and availability. In any market true bank, the added affinity produces lower distribution costs to some extent which, in turn, produces lower marketing costs, and thus total costs are reduced. The other key is availability. As mentioned in the keynote presentation by Nancy Austin, many customers are willing to pay extra margins if you make better products and customer service available.

MR. LUND: Looking at our principle offerings of credit and mortgage insurance, and to some extent Medicare supplements, these are products that when timed to some external event, such as the purchase of a house, trigger some activity by the consumer. Kiran has mentioned availability, and what we have tried to do is make the product available at these critical points in an individual's life. If the product is there at these critical junctures, then a higher percent will buy, for example, 70% in a well run credit program and something in excess of 20 to 25% in a well run mortgage program.

MR. JAFFE: As far as distribution systems are concerned, a case in point is SPDAs. This was a sleepy old product until the mid 70s when the stockbrokers discovered they could sell SPDAs and distribute them at substantially less cost than the insurance industry was incurring to do so. The several hundred billion SPDAs sold since then reflect that this group of individuals built a better mousetrap, or, rather, already had one to begin with, saw it, and used it. Chris hit the nail on the head in that it is marketing that we are talking about. There are a lot of things we can do in talking about marketing. It need not be the cheapest form of marketing to work. In some cases it is difficult to compare apples and apples as you often have apples and oranges. Both Neil and Kiran commented on availability. We all know that, since we all incur a certain level of fixed costs, the customer can get a better deal on a $100,000 life insurance policy than on one for $10,000-$20,000, on a per 1,000

basis, so you must be careful in what you are comparing. In many respects the distribution system we are talking about may provide lower distribution costs, but in others this remains to be seen. In large part, the public is telling us what it wants, and we have to respond to that. While there is not perfect information available to the public, it does have close to very good information available if the public wants to take advantage of that information. We in this industry must make sure the products we are distributing are both profitable and reasonable buys. Sometimes we find they are unreasonable, as perceived by the customers, such as the nursing home product recently introduced by AARP in conjunction with Prudential which, though not yet conclusive, seems like a product that customers do not want to buy and are rejecting.

MR. TAYLOR: Neil, in line with the mini-cap orientation to much of the credit and other financial institution sales, you described sort of a continuum line from a full insurance function to a sort of service function. With regards to this service function, the insurance company is basically providing a consulting service. How did your company look at the investment in that area and the expectation for return on that investment?

MR. LUND: We approached this through the marketplace. We are again talking about marketing here. We felt that the larger financial institutions will become insurance manufacturers directly. The next tier of institutions, the regional ones, may or may not want to. The most convenient approach for them to take in the marketplace would be for them to enter into a partnership with a company such as ours and participate, in some fashion, in the underwriting gain or loss. Our retention is designed to compensate us for the use of our capital in the way of up-front surplus and marketing expenses provided by us, and for our administrative services. But, it is true that you must take a different view. You are now providing services in the way of product and marketing and administrative services. We are acting more like a consultant and processing center. You have to change your thinking and price your products accordingly.

MR. JAFFE: It's amazing how some people write better quality business when they are the risk takers. The degree of your risk has shifted in these arrangements. You are no longer a risk taker in the quality of the business.

Your risk is that this little company, supported by this billion dollar financial institution, will go belly up, and your return on investment may have to be lower.

MR. BERNARD RABINOWITZ: Chris, about two months ago the front page of *Forbes* quoted a mutual funds manager, saying that "unless trees grow up to the sky the mutual fund industry is headed for disaster." The market goes up and down. Interest rates go up. Stock prices go down. There is no doubt in my mind that a large part of your expansion is due to people hanging onto the coat tails of this rise in the stock market. What do you propose to do if the market starts declining and interest rates go up. How do you propose to hold on to your customer base and your profits?

MR. TOMECEK: That is really quite easy. You'll see a shift of assets from equity funds to corporate and long-term government bond funds and money market funds by the customers. We typically do not lose a lot of customers or assets in a declining equity market. Assets just shift to different products.

MR. RABINOWITZ: You don't think that customers will be disillusioned with your ability to manage and say that they'd rather try someone else?

MR. TOMECEK: When one has a customer base of 3 million customers, there must obviously be some of that. Again, performance is the key. If the Dow-Jones is down by say 4% and a fund is down 2%, it has done very well, so it is all relative.

MR. RABINOWITZ: It seems to me that the mutual fund industry is selling a commodity. You yourself pointed out that Fidelity runs an ad in the *Wall Street Journal* so that one need only clip the coupon and send in a check. Why would investors pursue your organization rather than another?

MR. TOMECEK: The mutual fund industry is by no means a commodity. It is far from it. Equity management is a very difficult thing to do well. Why would a consumer choose Fidelity versus any other? They will look at the track record and performance of funds over a 1, 3, 5 and 10 year period. Granted, past performance is no guarantee or indicator of future performance, but if a

fund is up 17% over the last 10 years versus its universe, the odds are good that the manager has a good handle on what he is doing. So, first time buyers' will carefully look at what the track record and performance is of a particular fund, and then, within that, it will depend completely on the buyers' risk propensity whether they wish to go into a high beta fund, such as OTC or Magellan, or a more conservative one such as Puritan or Equity Income.

MR. RABINOWITZ: So, what you are in effect saying is that your significant marketing factor is your past performance?

MR. TOMECEK: Absolutely.

MR. REILLY: Linda, I thought you had described selling annuities using IRAs, and I didn't really understand what you meant.

MS. REED: We initially targeted the IRA customer, positioning the annuity as a supplement to an IRA. We hope to be utilizing, assuming the compensation will be what I think it will be, these same annuities to assist in our IRA distributions. We do not now have automated IRA distributions at our bank. It is all on a manual basis. So, relative to how we now distribute our IRAs we will save money by utilizing the annuity as a distribution vehicle and the insurance company as the administrator. That's the IRA relationship.

MR. REILLY: Chris, you have described several basic ways in which Fidelity distributes its products. One is through the ads in the *Journal*, and another is through regional banks around the country. Since the bank gets some fee income, there is obviously some extra cost involved; but does the customer get the same product regardless of his means of purchase?

MR. TOMECEK: Yes he would. There is no price difference to the end user.

MR. CRAIG F. LIKKEL: Family Life Insurance Company is a subsidiary of Merrill Lynch, and I mention this because Jay said that brokers built a better mousetrap for selling SPDAs. The only problem is that this company got caught in the trap with the Baldwin United situation. But, the company learned from it and is now a little more careful.

In general, I thought Neil's comments were particularly accurate regarding the financial institution business, especially with respect to mortgage insurance which we do quite a bit of. The company must truly be service oriented, and the margins are small. Neil, you also mentioned merger-acquisition activity and the consolidation or takeover situations that we've seen over the last few years. We've been involved on both ends of these situations and been involved where the motivation from the institution is very legitimate in terms of consolidating a bunch of small, insurance types of blocks of business. We've also been involved where the motivation is purely commission and more income for the institution. It's been frustrating on occasion. What is your company's philosophy in situations regarding, specifically, the equity to the company that is losing the business in terms of its vested, unamortized acquisition costs? Do you talk about those and try to negotiate a reimbursement of them? To what extent does the opinion of the institution modify or change your philosophy in a given situation?

MR. LUND: You've touched on a difficult and controversial subject, and one that several states are attempting to address, probably to no one's satisfaction. In our agreements with financial institutions in the marketing area, we provide a scheduled buy-out, if the institution wants to break its arrangement with us, whereby the institution or the incoming carrier will buy-out what is essentially our unamortized marketing costs. When we are dealing with an institution where we are the company that is taking things over, we use a formula approach to estimate what a fair price is for that cost. We've been on both sides of the fence, like everyone else has, and from an equity standpoint, do try to give the prior carrier a reasonable chance to recover its investment. If that carrier did a lousy job and has very high acquisition costs, we will not compensate it for that. We try to do it on an appropriate level basis.

MR. LIKKEL: We basically have a similar philosophy in that we try to negotiate for the reimbursement of recoverable acquisition costs. You mentioned regulations; so you're probably familiar with some of the positions that have been set in terms of regulations and opinions. Particularly, Missouri and Texas have made pronouncements in these areas. Would you care to comment on these or any experience you have with those?

MR. LUND: Among others, Illinois also has significant activity right now. What you are faced with here is a replacement question. In simplified terms, where one carrier is replacing another, the question is what degree of replacement disclosure is required by the companies. A number of departments have been extending this question to group transfers. We use primarily the group vehicle in the mortgage area, as do a number of other companies. Even where we replace existing group coverage, some states want full disclosure to the insured individual and, in some instances, the right of that individual to continue with the prior carrier, even if the original contract did not provide for it. This puts us in a quandary on both sides of the fence. Our position is that there needs to be some level of disclosure. Of course, we would prefer the negative enrollment where people, if they do not respond, will be enrolled under the new coverage, since it is more convenient for both us and the institution involved. There are instances, Minnesota for example, that require a positive response to roll business from one carrier to another.

MR. DESAI: In response to Mr. Rabinowitz's comment, as a customer of Fidelity, I know it has done an excellent job in a brochure utilizing bar charts showing the income, growth, and risk potentials of all its funds, to make it easy for laymen to understand. Fidelity also has counter funds which go against the trend. The point is that the portfolio clearly shows a diversification of funds, and it is very easy for most people to switch if they so choose.