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MARKETING INSURANCE PRODUCTS THROUGH BANKS AND SAVINGS AND LOANS

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- o Regulatory environment
- o Investment crossover opportunities
- o Types of distribution alternatives
- o Corporate culture obstacles
- o Agency only versus risk sharing opportunities

MR. JOHN E. TILLER, JR.: Mr. John Marr is a CLU, a CFP, and a ChFC. He started as an insurance agent, became a group sales representative, a pension consultant, then worked with a large mutual company in the group insurance area, and has held a variety of executive marketing positions. In Mr. Marr's last position as an insurance company employee, he was responsible for the agency distributed products of Fireman's Fund. He is now an independent consultant, working primarily with banks and insurance companies in joint marketing programs.

Before Mr. John Sweeney joined Tillinghast, he was Vice President and Manager of Insurance Operations for Branch Banking and Trust of Raleigh, North Carolina. Prior to that, he was Treasurer, Chief Investment Officer for the MCM Corporation, which includes a number of insurance companies in the U.S. and Puerto Rico. Mr. Sweeney has prior consulting experience with Booz, Allen & Hamilton in the financial and investment areas. He has recently published a LOMA special study entitled "Creating Shareholder and Policyholder Wealth--Strategic Financial Planning for Life Insurance Companies."

MR. JOHN C. SWEENEY: Let me begin with a brief overview of the regulatory aspects of banking and insurance. The Bank Holding

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Company Act (1956) basically drew a line between banks and insurance companies and their respective activities. The 1982 Depository Institutions Act (Garn--St. Germain) basically reaffirmed the 1956 Act and created the 16 grandfather banks (that concurrently distribute insurance). In addition to these 16, we have the state chartered banks in about 23 states.

A nationally chartered bank is regulated by the Federal Reserve and the two previously mentioned Acts. A state chartered bank is allowed to participate in the distribution (and technically also the underwriting) of insurance, by its state charter, in between 15 and 23 states. The differentiation between a national charter and a state charter is important now, since deregulation hasn't yet occurred. The remaining states either prohibit such activities or make no statement in this regard. Thus, 16 nationally chartered banks, most of them in the Midwest and in Virginia, and approximately 500 to 1,000 state chartered banks are basically in the business of distributing insurance through an agency setup.

I assume that total deregulation will be in place within 12 to 24 months. Obviously, there have been a couple of recent setbacks. The focus of my talk will be distribution through a direct writing company or agency system. Banks could also get into reinsurance; of course, many banks are already there in the area of credit reinsurance. (Credit reinsurance, incidentally, does not come under those two laws. It's grandfathered in every bank, so when I talk about insurance I am not talking about credit life insurance. I'm talking about those ordinary life insurance activities that fall outside of credit life; i.e., universal life, permanent, term, and so on.)

<u>Trust Services and Investment Management</u>--Obviously the banks are already involved in this, but given deregulation, you could actually funnel some of this activity back into an insurance company environment. The current Australian environment is probably an interesting microcosm of what will happen in the U.S. as deregulation becomes a reality. Australia is totally deregulated, and the banks and the insurance companies are heavily involved in a broad range of activities. Of course, the banks are already doing a lot in trust and investment management in Australia, and there is a tax efficiency if you acquire an insurance company and handle trust and investment management activities within the insurance company. During the last two or three weeks, Chase Manhattan Bank has joined forces with the Australian Mutual Protective Society (AMP)--the largest life company with about 30 percent of the market. Chase and AMP have embarked on a joint venture introducing banking services, but they likely will be moving into the insurance area as well, through the AMP operation. The Royal Bank of Canada has joined with the second largest Australian insurance company, the National Mutual, which has approximately 20 percent of the market. So 50 percent of the Australian life insurance market has joined forces with the bankers, and these organizations expect to be major players in the insurance market soon. There are several other large banks, and I'm sure they're all going to be involved as well. If you want a potential glimpse of the future, keep an eye on how things

have evolved in Australia vis-a-vis our experience in the U.S. as deregulation comes on.

A quote from Pogo is relevant: "We are confronted by insurmountable opportunity." When banks look at all the opportunities I just summarized, they have a problem in that it seems there are so many opportunities that they are insurmountable. Banks don't understand the insurance activity in which they would be involved and are almost overwhelmed. Banks are trying a number of different ways to get into insurance within the existing legal framework. The opportunities are enormous, once they recognize them and figure out ways around the legal roadblocks.

"Why would a bank want to get into reinsurance?" These objectives would obviously apply to both banks and savings and loans.

Multiple Services to a Target Market--The target market is the banks' locked-up market. For a bank, there is a strong association with the customer base, those of us who have an account and/or identification with that bank. In fact, when selling insurance products through a bank, even if selling a major insurance company's product, almost invariably the customer thinks that he is buying a bank's product as opposed to an insurance company's product. As long as the bank endorses the product, by merely distributing it through a branch or however the bank sells it, the insurance product takes on the credibility of the bank. Studies indicate that bankers are held in high repute and insurance agents are held in low repute by the financial services consumer. By distributing insurance through a bank, you actually increase the esteem in which the insurance agent will be held. He becomes a banker and the product becomes more acceptable to the consumer and easier to sell. In fact, the productivity of an insurance agent in a banking environment is increased to between three and seven times that of the normal agent, due to the credibility that he holds in association with the banking institution.

Spreading the Primary Distribution Cost--Many banks are overexpanded in that they've got too many branches. In California, the Bank of America is having a lot of those kind of problems, for example. That's fairly representative of most banks, whether they are major New York City banks or regional banks. They'd like to be able to market more products and spread the cost of the existing branch distribution system.

Capture Discretionary Savings Dollars--This is what banks do best. When you walk into a bank, you usually have money in your pocket. S&Ls are usually much less transaction-oriented than a bank. You have savings with the S&L, but you don't have a lot of checking accounts, trade financing, or many of the other activities that go on in a bank. An S&L relationship is much more service- and deposit-oriented than is a banking relationship. Once the customer in the S&L makes a loan, his loan is usually bundled up and sold off to the Government National Mortgage Association, or one of the other mortgage pass-through organizations. The loan is off the books and out to the secondary market, and the S&L doesn't worry about the borrower so much. A bank, on the other hand, worries about both its depositor and its borrower. They tend to be the same person. There is a much greater emphasis on gathering deposits and servicing those deposits and the client at a bank. The S&L never wants to disturb the depositor either, but it is much less concerned with service to the borrower.

Building the Life Cycle Relationship--Obviously, both banks and S&Ls want to accomplish this. The whole idea of having a number of insurance products is to be able to serve the clients' needs from the time they walk in the bank and start up their checking account and/or put their first savings into an S&L, until the time that they retire and start drawing on their savings and using the trust services of the bank.

Preparing for the Electronic Store--If you ask bankers about their automatic teller machines (ATMs), most will tell you the ATMs are efficient distributors of cash, and that's about it. They're expensive distributors of cash right now, but in the long run the bankers expect the ATMs will be efficient. When I went to Australia, I kept that in mind, and I was saying, "You know, there's no way we're going to be distributing or selling insurance through ATMs or through electronic means in a bank." Then I talked to the Head of the Electronic Banking Section for a major bank in Sydney, Australia, and he indicated that he had just come back from a presentation that showed a TV screen in front of an ATM, and they were selling insurance through it. There was detailed instruction by a lovely lady, who would walk you through the process of filling out the application right on the ATM, and then have the policy issued on the spot, assuming it met the underwriting standards that were built into that particular computer. Obviously there are restrictions on the type of product you could sell in this way, but they were actually thinking about putting it in place. Twenty days later, a newspaper in Australia ran a story about the first of these teller machines, with the capability of selling insurance and other complicated trust products, being put into place and being used by several of the banks in Australia. Now I'm not so sure that sales through ATMs are a minor issue. National Cash Register is the company that has built this option for an ATM. I don't know of any application in the U.S., but from what I've seen in Australia, it may be that we'll be selling insurance via an ATM within the near future.

Look at bank strategies and insurance. (This also applies to the S&L.) Assuming deregulation for most banks, there are two alternatives: (1) produce and distribute and (2) distribute only. "Produce" means underwriting, and no bank that I know of, at least in the U.S., is underwriting insurance. Citibank does have a life insurance underwriting operation in Europe. They've extensive insurance operations there. In view of the problems that banks and S&Ls have been having, the Federal Reserve Bank and the regulatory authorities have been asking the banks to supply more capital to support their assets and liabilities. Thus, there is a shortage of capital within the banks, and only those major banks that are capital rich are going to even consider underwriting insurance. This limits this sort of activity to a handful of the major money center banks.

The strategy of "distribute only," via an agency system, is probably the way 99 percent of the banks are going to move into insurance. This should be the case, whether it's via the agent in the bank lobby or some other distribution system.

Insurance Underwriting--The Pros--Leveraging the distribution system is obviously a desirable objective. It returns to the idea of incurring a given overhead expense and hoping to get the most out of the operating leverage. A little increase in sales on a heavy fixed cost basis will give you a big jump in profits, and the assumption is that life insurance generates this sort of leverage. You may include property and casualty (P&C) here, also, since banks may find it easy to sell P&C insurance as well. It's a commodity, and banks are probably more accustomed to selling commodity-like products than life insurance.

Greater Control--This is the biggest reason in the banker's mind for considering underwriting. The whole idea of product design, integrating the product into the current banking structure and the banking product system, marketing the product, and then, most importantly, establishing pricing strategies, is very appealing. The banker may feel that he can design and price products that will be much more competitive and pass the value onto the consumer, while still making a good profit because his distribution channels are already set up.

Favorable Risk Selection--This is more pertinent in the P&C situation, but it applies to life insurance, as well. Knowledge of its customers and marketing directed towards its customers are always advantages for a bank. You'll find that most banks, whether regional or money center banks, do a great deal of market research, and they know the esoteric characteristics of their client base. So there's a great deal of favorable risk selection. Banks know who to go after, and they will design the products accordingly.

Establishing Alternative Uses of Capital--This is interesting from a financial perspective. You must explain to a bank that it is an effective use of its capital to go into insurance. When you actuaries look at insurance, you know the problems associated with draining surplus in a life insurance organization in the early years. Explaining that to a banker is very difficult. He usually has a five-year planning horizon, and you want to show him how much money you're going to make selling insurance products. You'll have a problem when he tries to capitalize the fifth year's cash flow, and it's zero (or negative) because of high growth in the early years. You must explain how the cash flows work. You must find out what hurdle rate is for the bank and then work out the details of pricing an insurance product and analyzing it in terms of profitability.

Providing Protection Against Disintermediation--Banks see insurance as a possible hedge against disintermediation, especially with the universal life type products. If interest rates were to rise dramatically and bank customers were to pull out their lower yielding deposits, then any move to other investments at higher current rates would be offset somewhat by the sale of universal life with current insurance rates. So the bank might lose deposits, but that would flow back to the bank-owned insurance underwriter.

Spreading the Cost Over a Wider Product Basis--This is the same type of thing as leveraging the distribution system. An insurance product line would help lower the per unit cost of doing business for a bank.

Insurance Underwriting--The Cons--The cons certainly outweigh the pros, much more so than any other factors. Manufacturing is capital intensive. Bankers don't have a lot of cash to invest into an underwriting operation. If you're going to start one up and write a great deal of life insurance, you're going to have some real problems in the early years if you don't have a lot of cash to invest. The bankers are aware of that, and that's probably the major restraint discouraging them from going into underwriting.

Exposure to Adverse Risk--This is more of a P&C problem, but it also appears on the life insurance side.

Regulatory Inconsistency--Banking Versus Insurance--This is a real problem, because you've got a multitude of organizations involved in regulation: the Comptroller of the Currency, the Federal Reserve System, the Treasury, and then on the state level, there are the state regulatory authorities, all of whom claim some right to control the banking organization, and on top of that there is the state insurance regulatory commission. It becomes quite confusing as to who's supposed to regulate what.

May Increase the Cyclical Nature of the Earnings--This is more P&C oriented.

Cultural Differences--There is an enormous gap between the way a banker perceives his role in the community and the way the insurance organization and the insurance agent are perceived in the community. All the studies indicate that insurance agent has a negative connotation; the "huckster" or "peddler" type image. These are observations described in the Stanford Research Institute Study in particular. The banker, on the other hand, has a professional image. He's performing a social good for the community; he's building the community and doing very many good things. The gap between the insurance agent and the banker comes down to the perception of themselves in the community. The compensation system at a bank is generally salaried. Bankers will tell you that they don't compensate their loan officers on a commission basis or bonus basis simply because they don't want to give them an incentive to go out and make bad loans. If you try to compensate insurance agents on a salary basis, you run into some real problems, especially with people who have been compensated on a commission basis for most of their careers.

Tax Uncertainties--This is an obvious problem at this time.

Technological Incompatibilities--The banks have a huge investment in electronic data processing (EDP) equipment, software, manpower, and so on; if you add an insurance distribution system, none of the equipment is relevant to what you are going to be doing in insurance, so you have a duplication of effort. Given the huge operating overhead in a bank geared towards banking operations--making loans, taking deposits and so forth--and given that much of this bears no relationship whatsoever to an insurance operation, you are looking at major outlays on a start-up cost basis, especially in EDP administrative systems. All of this almost precludes most of the banks from moving into underwriting when and if they can, legally.

Distribution System/Customer Relations--The customer base is obviously those people who are already customers of the bank, and this is the immediate target market. The bank's branches, its distribution system, can reach out and attract new clients. The correspondent network is something that may be new to insurance people, but most of the smaller banks have correspondent relationships with the bigger banks. They tend to be good customers of the big banks, so you have maybe 100 to 125 large banks which have 14,000 plus correspondent bank relationships, where they sell various services to these smaller banks. The bigger banks can distribute insurance to the employees and/or customers of their correspondents; it's another distribution network for the banks.

DISTRIBUTION--PROS

Banks naturally attract funds. Most banks have anywhere from 150 to 200 products; if you don't think they're anxious to get the money out of your pocket, try to explain what they're doing with those 200 products. Now, insurance just becomes number 201 on their product list. Secondarily, distribution creates desirable fee income. With the problems that banks have been having, making loans to underdeveloped countries, making loans to energy companies, and more, and the concurrent deregulation of interest rates, we have a situation where the spread on these loans (bad or good) is shrinking dramatically. All bankers are looking for forms of fee income; insurance represents a great form of fee income. If you are a distributor, the insurance company pays you to sell its product, whatever it might be. The potential fee income is probably the greatest incentive at this time for a banker to offset some of the interest rate risks to which he's exposed in his other product lines. "Distribution only" requires a fairly small capital commitment; it doesn't take that much to set up an agency distribution system. It does require some capital, but certainly most of the banks can easily buy an agency within their territory or start from scratch almost immediately.

Cross-selling Opportunities--This is something bankers talk about with a great deal of headiness, but it remains to be seen whether a banker can go out and actually cross-sell an insurance product with a bank product. The whole idea of cross-selling is almost precluded by the fact that bankers are never going to learn how to sell life insurance well unless they recruit former life insurance agents to become loan officers. There are some limitations on this, but you can't expect a banker to cross-sell an insurance product, when they have yet to prove dramatically that they can sell insurance at all within a bank.

Cost Effectiveness of the Sale--Obviously selling insurance would be cost effective if you're using the distribution system wisely, spreading the cost through the existing bricks and mortar.

Enhancing the Full Service Concept--Everybody is on this bandwagon--the insurance company wants to be a full service insurance company, and the bank obviously wants to be a full service bank. Putting insurance brokers or insurance agents into the bank lobby obviously is a step in the direction of being a full service financial service center.

DISTRIBUTION--CONS

When I was head of an insurance operation within a state bank, 95 percent of my time was taken up with the cons of insurance distribution. This is the area on which you have to concentrate, because it's an unusual format for a bank.

Poor Insurance Service/Loss of a Bank Account--This sounds insignificant. You're probably more aware of it if you're currently selling P&C as well as life insurance. When a fellow has a claim or there's a problem with an annuity, and the insurance company services that account poorly, then the bank account walks out the bank's door. Now that fellow doesn't get mad at the insurance company, he gets mad at the local branch banker and/or the president of the bank. Not only have you lost an insurance account, but you've also lost the certificates of deposit, the checking account, and probably the loan as the customer walks out the door.

Good Banking Client/Poor Insurance Risk--A perfectly good bank client may have health problems and be looking for key-man insurance, buy-sell arrangements and so forth, and you can't service him. Again, the problem is you've got a major account, a key-man account, and you've just extended a $5,000,000 line of credit, he's got $2,000,000 in certificates of deposit at your bank, and he wants heavy coverage for his key-man account, and you can't sell him the insurance because your carriers won't cover him.

Culture and Reward Problems--These are most evident when the bank is distributing insurance and is the sole provider; i.e., the owner of the distribution system, and the distribution system is not merely a fee-based agency arrangement, as many have set up right now under nonderegulation. In a deregulated environment or in a state bank environment, you're going to be seeing more salaried insurance salesmen, and it can work. I have seen sales forces of approximately ten salesmen on the life insurance side, where the top three men all made the Million Dollar Round Table. The best salesman made Top of the Table. All of them were substantially underpaid relative to what they would have been doing on a commission basis. However, they all knew that they had been marginal insurance agents out on the street. That's the type to recruit when you go into a banking environment. You're obviously not going to be able to attract a tested and true insurance agent who is accomplished in the area. The marginal fellows with a good technical knowledge of the product but who have a hard time prospecting, are the kinds of fellows who will gravitate to an insurance environment on a salaried basis. The bank can pay them at a level appropriate for bank employees, and they know that paycheck will be there regardless of whether or not they produce. They may have the title of Vice President if they're very good. Their business cards say that they are bankers and not insurance men. This instills a sense of status within the community, allows the bank to pay them on the bank's salary scale, and yet they perform at a level comparable to some of the best salesmen in the industry.

Credit Tie-in Programs--This is a problem. The claim is that banks are "tying-in" loans and other bank arrangements with the sale of insurance. Banks do it almost without question when they talk about credit insurance. That's always grandfathered by law, and you're never sued over that. It's when you're offering universal life products or the standard whole life family of products that this issue arises. It's almost irrational to claim that banks are tying-in insurance sales. If you're in a competitive banking environment, and you twist someone's arm to buy insurance when they take out a loan, the customer will walk out your door to the next competitor with his loan request. Nonetheless, the insurance agents within your region are going to claim that this exists.

Big Institutions/Consumerism--The reason banks are threatened with adverse legislation is that they are perceived as the big, bad bank; a major institution putting the thousands of small insurance agents out of business. That's a problem with which any insurance company must contend when switching to another distribution system, and any bank getting into insurance will have to contend with it as well.

The key strategic issues for selling insurance through a bank is the people problem. Bankers aren't known for their knowledge of salesmanship, but if you are selling life insurance, you have to take a positive approach to selling the product. People don't simply walk in, sit down at a desk near the lobby, and ask for a life insurance product. That will happen with P&C, but not with life insurance. Life insurance needs to be sold. Take an inventory of who you have. Are you going to use bank employees to sell life insurance? Nine times out of ten, banks are going to start by looking at present employees to start up an insurance distribution operation, but they usually will not find one person within the bank who's qualified. You will typically have to search outside of the bank for people to come in and service an insurance organization within the bank.

Generally, banks have adequate backroom ability. They can do many good things with the people available to them, but these people generally can't do the kind of start-up operations, bookkeeping, EDP systems, and so forth that will be necessary in an insurance distribution system, so you will need to move outside of the normal bank employment operation.

Attitudes and culture are involved. You will find that 99.9 percent of the bankers in the bank environment of today will not want to shift from banking responsibilities into the insurance operation. Of course, there will be exceptions, but most bankers want to stay in banking. Now, all of the branch bankers want to sell insurance (and so do the S&L managers), but they don't want to do it themselves. You can make a good case for bringing in insurance agents, sitting them in the bank's offices or branches, and having the agents sell rather than having bankers or S&L managers do so.

How you motivate the sales force becomes a major problem. In many cases, those top three or four people will achieve the "Million Dollar Round Table" level. They're really performing, and they're very crucial to you. You have to expand your vision a bit further and compensate them because they will eventually learn that they know a little bit more about this system than they realize. If they walk out the door, there goes your sales force, so you must figure out a way to keep them happy within a bank environment.

Look at current commitments. If you walk into any bank, you're going to find that bankers are doing banking business. When you initiate an insurance operation within the bank, the bankers knowledge of it and their commitment to it are only minor. You can't do a fair amount of good quality insurance business within a bank environment unless the people at the top are totally committed. The most crucial aspect of commitment comes from the branch managers and the distribution system. Salesmen who work for the bank rely on referrals that come out of the branches. (That's the distribution system that has been set up in most of the state operations.) If your branch banks aren't reporting the referrals and if they're not committed to selling the product every time they make a loan, then those salesmen sit at their desks in the life insurance operation and never see a customer come in the door. In a bank environment, the insurance agent won't be going out in the evenings and knocking on doors. The insurance operation is expected to function the way a bank does, with your insurance products being sold through the bank during banking hours. Thus, you must have a committed distribution system and a committed set of branch bankers. There are not a lot of experienced individuals who have sold insurance activity in a bank. If you want to talk to somebody who has been directly involved, you've got to go to those 16 "grandfather" banks in the Midwest, e.g., First Bank Systems in Minneapolis and Norwest. Ask them how they set up their operation. Outside of those 15-16 banks, you're going to find that it's a limited environment, and you're essentially starting from scratch.

MR. JOHN S. MARR: Change in our business has been constant over the past few years. In reflecting on this, I had a hard time defining any significant change that occurred during the first 15 years that I was in the business. I think it was the Employee Retirement Income Security Act of 1974 (ERISA) that got things rolling, and the tempo has continually increased and intensified over the past few years. In my opinion, we haven't seen anything yet. And in this regard, I think it would be in your own self interest to do some serious, clear-minded thinking about how these forces of change are going to impact your companies, our business, and you personally within the near future.

One manifestation of this change curve is the sale of insurance through banks, savings and loans, and other financial institutions. Actually, beyond the positive financial impact on the sponsors of seminars on this subject, to my knowledge there is little meaningful, large-scale activity underway, as far as the sale of insurance through banks is concerned. Certainly these high-profile ventures between major banks and large insurance companies to sell mainstream insurance products have had lackluster results to date, and most would have to be labeled failures, at least from a profitability standpoint.

I don't think we should be surprised at this. These generally appear to be experiments, and in the context of experimentation, they don't make a lot of sense to me. The idea that we can somehow take the traditional agent and move his desk and chair out of the agency and into a bank lobby is beyond me. The very idea that this capitalizes on an opportunity, or addresses the more fundamental issue of distribution overhead, is also beyond me, particularly when we recognize that most of the banks are moving aggressively to reduce lobby traffic!

Each time I learn of one of these ventures between a large insurance company and a major bank, I envision two heavyweight boxers in the first round. They're sizing each other up, measuring each other's strengths and weaknesses, with each hoping to be in a better position to deliver a knockout blow later in the bout. Let's face it, the banks and the insurance companies are fundamentally competitors. Now, don't misunderstand me. I believe that banks are going to sell insurance of all kinds, and they're going to sell a lot of it. It's inevitable. But they're not going to be merchandising insurance in large volumes under the types of highly publicized agent-based ventures we see today.

In the final analysis, there will be a wide variety of successful approaches ranging from bank-owned insurance companies selling proprietary products, perhaps under private labeling deals with major insurers, to independent specialty service companies that will be formed by successful independent agents to sell marketing services to banks in support of bank-sponsored, bank-controlled programs, with every possible variation in between.

There are ventures underway today where companies have been formed as specialty marketing organizations specifically designed to support the insurance marketing needs of the larger regional bank holding companies. These are true joint ventures with a commonality of financial interests throughout which attempt to realistically address the individual needs of all the various parties: consumer, bank, marketing entity, and (manufacturing) insurance company. Further, most of these ventures are based on state-of-the-art direct response marketing systems, which is the heart of the merchandising methodology, and they have the potential to point the way in realizing the mutual opportunity that the sale of insurance through banks represents. These new programs should start operating early next year, and by the last half of 1986, we should start seeing some very interesting initial results, indicative of the opportunity potential. We should, however, make no mistake about this area of opportunity. At best, it's one of a mixed blessing for the insurance industry for the simple reason that it is the banks that have the customer relationship; they recognize the value of that relationship, and in these joint ventures, the banks are always going to be the dominant, controlling partner.

I believe the banks will sell a lot of mainstream products; i.e., life, health, disability income, homeowner's, and auto. They're going to sell them directly to the consumers, and through employer access gained via the commercial side of the bank. But, inherent in this belief is the conviction that the marketing (and, ultimately, the underwriting of insurance by banks) is simply one facet of a larger and more profound change already underway that will culminate in the creation of what is generally termed an integrated financial services industry.

Certainly not every insurance company, bank or other financial services provider will become a fully integrated financial services institution. However, a major segment, led by the megastars--i.e., American Express, Prudential-Bache, Sears, and a number of others--will continue to move toward becoming fully integrated structures, will collectively become market-dominant, and will forever change the historical product-segmented approach. This is going to impact the way that all financial products, including insurance, are sold and supported.

In my travels, I have found that a good many people, including many in the life insurance industry, doubt that we'll ever see a fully integrated financial services industry. Some say the pioneers in this fully integrated financial services concept are all having trouble with their newly acquired stock brokerage "children." They won't play nice with their other members of the family. The implication was that the cultures, styles, and compensation expectations were so totally foreign that they could never be integrated into the family, and that you can't have an integrated financial services company without a stock brokerage component. Therefore, no financial services industry. Then there are the frequent articles commenting specifically on the bank and insurance company ventures, such as one in a recent issue of The American Banker. Here we have bankers who thought the road to increased profitability was paved with fee income from the sale of insurance, and insurance executives, on the other hand, who thought they'd found a bird nest on the ground, i.e., all those bank customers. Now they're all disillusioned! It costs more, it's harder and you don't make as much money! The implied conclusion is to forget about selling insurance through banks or banks providing fully integrated financial services to their customers.

Well, I don't buy it. I become more convinced each day that the catalytic forces that guarantee an integrated financial services industry have already consumated that reality. Contrary to what many in our industry seem to be waiting for, the integrated financial services industry is not going to come into being with some dramatic legislative event. The legislation is always the last event in the process of change. There isn't going to be any revolution or watershed event to signal the change. Rather, it's going to be an evolved transition over a good many years with lots of bumps and dips along the way, just like those we're seeing reported in the media today. The banks are ultimately going to invest the time and effort needed to understand the financial realities of insurance. They're going to sell it, and they're going to sell plenty of it, but probably not with traditional agents sitting in the bank branches.

Note that I'm not one that believes in the imminent demise of the American agency system. It certainly will go through dramatic changes, as will the rest of our industry, but it's not about to disappear. In fact, I believe it's going to be the successful agents, today's winners, who will form marketing companies to service the insurance distribution needs of many banks.

Integration will happen over time, and I think Mark Twain's advice should be the order of the day: "Habit is habit, and not to be flung out of the window by any man but coaxed downstairs a step at a time." To do otherwise wouldn't be desirable or responsible from anybody's perspective, particularly the consumer's.

My purpose today is not to convince you as to the certainty of an integrated financial services industry, or even whether or not banks are going to sell insurance, or how this threatens the historical independence of our industry. (In fact we're talking about the survival of some companies.) I would like to share my vision of the marketing theme that will be dominant among the survivors, whether they're integrated or not. This is more than a marketing perspective; I believe this will be the basis of the fundamental business relationship that successful financial product providers will have with their customers in the new marketplace.

Certainly from the most fundamental perspective, no company can expect to make a successful transition into the new marketplace unless it clearly understands what its targeted consumers want and need, and unless it has a realistic measure of its competition. That includes the banks and all the other significant financial providers. The underlying strategy must be to focus, then, on the marketplace, and not merely on what the regulatory structure permits. (Again, the regulations will be the last to change.) Focus not on what is possible in terms of existing product or administrative capabilities, but rather, on a continuing assessment of consumer needs.

Assuming that we do accept that a fundamental market-drive perspective is the foundation of the strategic plan, the framework for implementing that strategy involves the concept of what I call "tar baby marketing," (analogous to the tales of Uncle Remus, Br'er Fox, and Br'er Rabbit). Tar baby marketing addresses the inadequacies inherent in our historical approach of dealing with our customers. The predominant approach processes the customer in an assembly-line fashion (slide I) over the course of the relationship with our companies. Suffice it to say that in a new marketplace this won't get the job done. We're trying to develop a relationship with a client, and we can't even identify who's responsible throughout for managing that relationship and providing continuity of service. The successful providers of financial products and services in the new marketplace will know who's responsible.

SLIDE I

Marketing	= Plans Sale
Sales	= Makes Sale
New Business	= "Manufactures" the "Product"
Customer Service	= Services the "Product"

Who's Responsible???

Tar baby marketing is predicated on two essential concepts: (1) The purpose of any business is to get a customer and to keep him. (As those responsible for pricing in our business, I know actuaries can relate very well to the issue of keeping a customer.) (2) A customer is an asset, the most important and valuable asset that a company has. That asset must be carefully managed so it will flourish and grow over the years.

Defined another way, tar baby marketing is based on the concept of coordinated management of the customer relationship, beginning with product development, through distribution, and then continuing with ongoing service in order to support that product over the life cycle of the customer. Customer management is the essence of tar baby marketing, and this integrated approach can be segmented into two logical components: (1) how a company positions itself to form new customer relationships; i.e., customer acquisition. (2) how it sets itself up to keep that customer, to nurture the relationship so it will grow, flourish, and generate increased profitability over the years. In fact, the acquisition and maintenance strategy must be integrated so that, as you focus on the two pieces, you must always keep the overall concept of customer management clearly in mind.

The purpose of business is to get and keep a customer. Focusing on the former, let's examine the elements of customer acquisition (marketing and sales in the current vernacular) as I have defined them.

With regard to sales systems, there aren't any absolutes. How each company goes about doing business from a sales standpoint will be for it to decide, based on its target market, its strengths and weaknesses, and all the other variables. But there are some guidelines.

For the most part, selling will have to employ a leveraged, cost effective sales systems. One on one, whether it's across the kitchen table or in the bank lobby, isn't going to get the job done. Even seven sales a week, as the margins continue to shrink, aren't going to get the job done. Even in the agency companies, direct response techniques are going to become essential sales support tools, if not the selling system itself for certain market segments. I don't mean to imply that direct response is a panacea; it's not. I just used it as an example of one leveraging technique. The point is that, if your company is going to be a serious and successful player in this new marketplace, your selling system, whatever it may be, had better be good.

Next, unless you're a highly specialized niche company, (which may be a viable approach in the new marketplace depending upon the market, competition, and so forth), a diversified, multiproduct portfolio is going to be important in acquiring customers, and it will be essential in managing the ongoing customer relationship for increased profitability.

Consumer based market research is a ubiquitous, contemporary, marketing, buzz-word phrase. It's essential, and only the best and the most successful are going to employ it effectively. The consumer based market research must be continuously updated, and certainly an important part of it will be feedback from the most important asset that a company has, its current customers. The successful companies will invest heavily in defining their target markets, and they'll understand these consumers and their needs very well before they put the product design pen to paper, or do any sort of pricing.

Last but not least, the successful companies are going to make the necessary investment in technology to provide accurate, timely sales support. Customers are going to expect answers to their "What if?" questions, and they're going to expect them immediately. I don't care whether they're tax questions or financial planning; customers simply want to see ledger alternatives. The idea that you can get back to the customer in a couple of days won't work; it'll be too late. The competition will have already addressed the question and made the sale.

In the context of tar baby marketing, the acquisition phase is simply the beginning; keeping the customers happy, and meeting their ongoing needs quickly and professionally will be essential to profitable results. Knowledgeable customers and greater access to products are going to shrink margins further, and keeping the customer will be more important than ever, so the area of customer management will require the greatest effort from company management, and the majority of the capital investment.

Senior management will have to make a strategic commitment to an integrated customer-management strategy, and to develop, within that strategy the tactical plans to implement it. Moreover, it's essential that the entire organization, including the actuaries, become inoculated with this strategy of managing customers, the company's most important asset. The customer-management strategy must become a bedrock corporate value. An automated system must be put in place to support the relationship management process, and this is where the big dollars are involved. We're not talking about product administration systems, although they could be integrated, but rather the systems that will provide the universal, on-line access to the entire customer relationship. The company's focus in the marketplace must be directed toward the total customer relationship and a state-of-the-art support system will be absolutely essential, not only in properly managing the all-important relationship but also for future marketing productivity purposes.

Finally, the keystone of the strategy will be those individuals charged with managing the customer relationship, the customer representatives --not sales nor service representatives, but customer representatives. These must be skilled professionals who will function in support of both the sales acquisition system and ongoing customer service, and who can be accessed via toll-free lines. They should have instant access to the total status of the customer relationship at any point in time via the customer-management system. Contrary to the current assembly-line approach, where the customer is handed off from unit to unit, the new support system will monitor the relationship with the customer at a sophisticated level, with on-line access to the quote systems, administration systems, issue systems, claims systems, and so on. The successful players in the new marketplace are going to invest whatever is necessary to attract qualified individuals to fill this customer representative role, and no longer will those responsible for post-sale servicing of the customer essentially be clerical personnel. Customer representatives will need to be well-educated, well-paid, motivated individuals who understand the corporate mission from the "big picture" perspective. Not only are they going to support the sales and customer acquisition process, they will also manage the ongoing relationship aspect by providing prompt, professional customer service, including upgrading and cross-selling, as circumstances warrant, due to the changing needs as the customer moves through his or her life cycles. If properly structured, the customer representative role will not only be key to managing the customer relationship, but it will generate a handsome pay-off in the form of increased margins generated from the cross-selling and upgrading process. The customer representative role will have to be uniquely defined in each company based on its individual characteristics, acquisition system, target markets, and product mix, but it's an essential component for survival and success in the new marketplace.

What I've described is a tall order indeed; it's quite a challenge to make it happen. Theodore Levitt hit the nail on the head in the quotation shown in Slide II and, while his reference here is to the complex issues facing the science-based industries, I think that the issues in execution that face the insurance industry are every bit as complex. In the final analysis, it's going to be up to you and the other key individuals in your organizations to do the planning, tinkering, managing,...the tough jobs to make it happen.

MR. TILLER: Would each of you expand on Mr. Marr's comment that insurance people do not believe in the immediacy of integrated financial services?

MR. MARR: Many in the insurance business (and I deal mostly with marketing people) seem to have an insular perspective; there is a recognition that change is evolving and that it is going to impact the business, but they don't perceive most insurance companies participating directly, particularly from a distribution viewpoint, in a full range of financial products and services.

MR. SWEENEY: Not only would I agree with Mr. Marr for the most part, but I would say that the banks, who talk a good game in this area, also have little commitment and don't quite understand what it is that they're talking about, when they talk about it. Outside of the major companies, (Sears, American Express, Prudential-Bache) for the most part there's been only the back burner type of activity. Everybody's a little afraid to get involved in a major way.

MR. GARY W. HERTEL: Mr. Sweeney, when you spoke of integrated company services, you made the statement that you saw the larger companies integrating financial services with a broad insurance product portfolio. You mentioned somewhat under your breath that there may still be room for the specialized niche companies. I'd like you to address what you see for those specialized niche companies, since, being from a smaller company, I see no way we can play in that full portfolio of products.

SLIDE II

"Thinking things up is not the same as making things happen. It is not merely that there are a lot of slips between the cup and the lip. It is simply that though science-based industries may begin with theoretical knowledge, they do not end with it. Translation of knowledge into results is almost purely a matter of "tinkering" and, more importantly, a matter of management."

"The Marketing Imagination" by Theodore Levitt

MR. SWEENEY: That's when we start thinking in terms of survival time, and it's a serious problem. It's the most serious problem for the mid-sized companies, not the very smallest. The little guys can carve out an opportunity for themselves that's tied to a particular marketing concept, but the middle-range companies are between a rock and a hard place. Now a niche market is, by definition, small. It is the smaller companies that will identify those specialty markets based on a concept of marketing to that particular market, and they'll be able to address it profitably. Of course, depending on how big a market is and how many people are identifying it, it can't last forever.

A lot of banks, as they move into insurance, are not going to want to underwrite certain risks. They'll want to underwrite all the life business they can, but they won't want any auto. While that doesn't relate to your specific interest, auto is a risk they'll want to handle by entering into private labeling deals with major insurers. I think that a lot of independent agents will divorce themselves totally from insurance companies and form structured marketing companies, and I think that some companies are going to make a living as manufacturers for these specialty marketing organizations. In terms of identifying specific niche opportunities, you have to look at the matrix of a given company to answer that.

MR. EDWARD L. ASTRACHAN: It seems that up to now the longstanding experiments with banks and insurance have been in credit insurance, where for the most part the banks seem to charge a rather high price and generate high fees, more or less because they've got the convenience of the transaction. They don't feel they have to be that competitive. The savings bank life insurance systems, which have been in existence for a large number of years in Massachusetts, New York, and Connecticut, have extremely price-competitive products and try to sell insurance based upon their reputation. In terms of pricing, is there room for both types of pricing strategies, or are we going to be moving toward only extremely competitive pricing from the banks?

MR. SWEENEY: I don't disagree with your comments that there are a couple of states right now where you can buy very competitive products. We've had a problem in the life insurance industry that, due to the costly distribution system, we tend to have everyone congeal up in one price level and, therefore, one pricing structure. It's hard to get some idea of how the cost curve would look if you were to move outside of that general distribution system. My view is that the banks are going to have to do that as they get into underwriting, whether or not they develop a relationship with an underwriter and have the underwriter produce the product for them. One way or the other, they're going to move down this theoretical cost curve and actually undercut.

In Australia, one of the strategies we had worked on with a bank was to knock the underpinnings out of the insurance industry--to revolutionize the industry. The way they were going to do it was exactly that--price down the experience curve, move down the cost curve, come up with a very price-competitive product and, on the basis of (1) their reputation as a bank, and (2) their distribution system, offer a highly competitive product and pull the underpinnings out of the industry. Of course, that sounds fine in theory, and the strategic planners among us would probably support the idea. You've got to implement it, and it takes some doing, but I believe that the banks' real strategic advantage is going to be in cost and pricing of those products.

The biggest problem right now in the U.S. is finding a company that's willing to produce that product. Incidentally, they exist, especially if the bank is willing to take the cost cut in its commission. If you've got the distribution base and the overhead in place, you don't need quite the commission to make a good profit on your product. We did it on the P&C side; we cut our own commission, cut the pricing, put value back into the product, and went out on the marketplace in a specific targeted market. Initially, we had 6 percent of the market, and three months later with a highly competitive automobile policy, we had 60 percent of the market. Sure, it's difficult to compare to a life insurance operation because automobile insurance is a commodity, but to give you some idea of the price sensitivity in P&C, going from 6 to 60 percent is an enormous gain in market share. You could do the same thing, maybe not to the same extent, in the life insurance industry.

MR. MARR: You observed that the banks have been in the insurance business for a good many years. They make a lot of money on it, and they own a lot of insurance companies. The opportunity here represents a big cultural change, a transition from where they are at this time. In dealing with banks, you can see that they have ambivalent feelings. They don't want to give this up, but they know that they must if they're going to move to this pricing methodology. The banks want to get involved with the mainstream products, but they don't want to give up the credit-related coverages that they're selling today. That's a corporate glitch they have to cross over.

MR. CHARLES E. MOES, JR.: Our agent friends are always making the assertion that insurance is sold and not bought. Do you gentlemen disagree with that statement, or are you just talking about different ways of selling?

MR. SWEENEY: Having started out each of three presentations in Australia with the observation that life insurance is sold and not bought, I would have to agree 100 percent. In my opinion, the strategy for a bank that wishes to implement a life insurance marketing strategy revolves around the use of a sales force to distribute the product for the bank. Direct marketing can support it by coming up with leads and referrals, but I think you need a trained insurance sales force who understand the more complex products, such as universal life, to explain things. This sales force would be salaried. I don't believe that banks will be able to direct market (or use the branch network to sell) the life insurance products at levels comparable to those attainable by a trained insurance sales force.

MR. MARR: I agree that insurance is definitely sold and not bought, at least the products that we're interested in, in the life industry. Commodity products like auto and homeowners insurance will be bought; anybody who has had anything to do with the property/liability business knows that the P&C operations are not really sales oriented. I'm not saying that agents will not be involved. I don't think traditional agents and the methodology that we have employed historically will be used. Each organization will have to develop a matrix of sales capabilities to merchandise its own individual products, whether that be banks or insurance companies. The company is going to have to use systems that have been established for purposes other than selling life insurance products, one at a time. You've got to figure out some way to mass merchandise either through seminar selling, direct response, or a combination of all. Certainly in certain circumstances, in certain hub branches of banks, for example, you could employ an agent productively and get by with him or her doing a good job from a productivity standpoint. But when you think of the branch network, you've got branches spread all over, and the bankers are really worried about controlling their image, integrity, and the quality of what's distributed. Thinking of having a distribution network of hundreds of agents spread across these branch networks where the branch managers don't know or care about insurance, it's going to be hard to think you can deliver through people on-site. They're commission driven, which is inconsistent with the quality and consistency that the bankers will be looking for. I don't think it can happen. But it will have to be sold, and you're going to have to develop efficient systems to do it.

MR. PHILIP J. T. CERNANEC: At the risk of being perceived as an actuary, I did want to ask for some explanation of one of the statistics quoted. Mr. Sweeney, you indicated that the productivity by representatives associated with banks (or selling bank sponsored products) has increased to a level three to seven times that of a representative operating independently. What types of products are these representatives marketing, and what type of ratios might you expect?

MR. SWEENEY: This experience is based upon two particular instances, one in the U.S. and one in the U.K. In the U.S., the experiment involved primarily universal life, with some whole life products, but no annuities and no other types of esoteric products. In any event, that experiment produced a three to one productivity increase. In the U.K. experiment, there was a seven-fold increase and involved what they would call unit link products, which are comparable to our universal life product. I honestly couldn't estimate how fast or how much of a productivity increase you'd get on the annuity side, other than to mention that it is fairly easy to sell annuities in a banking environment. In my limited personal experiences with annuities (not with my bank), they had dramatic results with their annuity products using a direct marketing operation through direct mail.

I agree that you can't put an insurance agent in every branch; it just wouldn't be efficient. I look for the branch banking system to evolve toward regional operation centers. In the case of Australia, as well as several that I can think of here in the U.S., you're going to find insurance specialists set up in a regional office, each with responsibility for maybe 20 branches. That's what the bank did, that achieved the three to one increase in productivity. The agent sat in the office and took phone calls from the bankers who had arranged the appointments.

MR. TILLER: We've concentrated primarily on individual life insurance sales, and touched briefly on the property and casualty line. Some of my colleagues in the major insurance companies claim that they're not that concerned about the individual sale, which will probably still require an individual agent. They are concerned about the "tie-in," what I would call corporate nondiscretionary sales; i.e., group benefits, employee benefits, pension funds, and corporate property and casualty type coverages.

MR. MARR: The employer access market probably represents one of the most dramatic opportunities as far as the sale of insurance from the banking perspective. They have enjoyed tremendous leverageable relationships with corporations of all kinds, and I think that the idea of using the employer as a conduit to sell all kinds of financial products and services is one of the greatest opportunities available to the life industry, the banks, and all providers of financial services. I think it will become one area of enormous growth, whether we look at the qualified business in terms of life, health, major medical, qualified pension, or deferred compensation of all sorts. But more specifically I think that the real opportunity lies in the voluntary programs that will be accessed through the employer conduit and the convenience of payroll deduction, in the sale of all forms of insurance and financial products and services.

MR. SWEENEY: From a bank's perspective, when you move into that particular market, you encounter some of the toughest competition in the business from the big brokerage firms. It's not an easy market to break into. When you put a regional banking operation up against a big brokerage firm, you've got some real heavyweights going against some lightweights. A second consideration is the politics of a bank. When you move into the corporate environment, you're no longer selling one-to-one on a retail basis. You've actually moved into the commercial base, and the banking environment is very protective of the corporate base. In fact, the corporate base tends to be the purview of the trust department, and trying to get an insurance operation to work with a bank trust department is a little like mixing fire and water. The potential is enormous, but the politics are staggering. I'm not sure how much of an in-road the banks are going to make in this area for that reason.

MR. ROBERT L. WHITNEY: I'm interested in your comments on product design, from two viewpoints: (1) what are the Australians using or planning, and (2) you commented that, on an experimental basis, universal life had been used in this country. Is this the product that you see as preeminent? Is this the product that the bankers should plan on using? Obviously, we have term insurance, annuities, and various bundled and unbundled combinations, and I just wondered if you had any thoughts on the ideal product design for the bank-marketed insurance product?

MR. SWEENEY: If you take the general view that a bank is selling a financial service, I certainly have a preference for universal life; it covers the entire ground. Note that the politics of insurance in banking manifest themselves again. Banks are protective of their deposit base; when you sell a lot of universal life (unless there is a payback in terms of certificates of deposit or reinvestment of the funds), the bank may feel as though you're raiding their deposit base by selling that particular product. It's a sensitive issue within a bank, especially one that's growing rapidly. Quite frankly, in the operations that are in existence today, the sales are not yet substantial enough to make an impact. Two or three years from now, you may see the banks moving away from the universal life product and more towards a term product. When retailing a product through a bank distribution system, you're looking for commissions as much as the next guy, and that is a plus for universal life since that's where the commissions are. Of course, an agent will always sell term life rather than lose the sale. The agents marketing through banks sold a lot of term as well, in the experiment to which I've been referring. The product being used in Australia was similar to a universal life product.

MR. MARR: I find enormous interest on the part of bankers with regard to universal life, but I think for it to be ultimately successful, it must address the issue that Mr. Sweeney brought up. One possibility is the opportunity of variable universal life or some derivation that will enable the bank to actually have a proprietary product, not only from an overall standpoint, but specifically with regard to the investment element.

MR. TILLER: The large S&Ls in California have the enabling legislation, if they structure themselves properly, to own a broad range of insurance companies and are experimenting with it. Some have been active in it for some time. In working with them to develop interest-sensitive products, we found a sort of corporate mental block; the banker says, "I understand interest rates. These insurance people don't. How can they possibly be guaranteeing 12 percent? I can't earn that!" Bankers don't understand surrender charges, mortality loadings, and their interrelationship. This is a serious cultural problem. They're also probably a little ahead of us in some asset/liability matching ideas. Bankers have been making mortgage loans for some time, but they've been packaging these mortgages and reselling them in a secondary market. One of the things with which they're currently experimenting is bringing the mortgages back into the insurance company. If so, they could use the insurance company cash to fund the mortgages. There's a lot of potential there in immunizing the risk and starting to understand the investment side of the insurance business a little better.

MR. STEPHEN P. MILES: First, I was interested in your comment on the Australian bank and the universal life product. I had some discussions with the Australian Life Insurance Commissioner along this line, and he was concerned that the life company should maintain control of the assets and not be controlled by a bank. In this case, what's proposed to be invested directly in bank assets? Probably he has a different point of view if the bank and the bank life insurance company are basically the same owner. My other question is that, between Mr. Sweeney and Mr. Marr, there seem to be two different approaches; one of Mr. Marr with basically direct marketing, and one of Mr. Sweeney with some form of in-house selling. Is that a difference between casualty business and life business, or is it a real difference in approach? It might be easy to say that you can combine the two; that's a fairly glib answer, but when you go into a bank, you have to push for just one thing because as you say, there's a culture difference. If you must choose between direct marketing and a regional agency distribution, which do you choose?

MR. MARR: Incidentally, there was a political problem involved in the investment management and we never solved that one; i.e., who ran the money since the insurance company may have a different money manager. When you talk about direct marketing and you have a direct sales force or ownership of a sales force of some type, you've got to be judicious and cautious about the way you use direct marketing. If direct marketing is not used to generate leads, you have a problem of alienating the sales force by encroaching on their territory. Although that's their view of it, it may not be true. In fact, you don't even sell the same products through a direct marketing approach. Low distribution costs require low margin products which are different types of products. But when an agency field force comes up against a direct marketing approach, they tend to feel as though you're undercutting them, so you've got a case of not quite supporting the field force. My view of it is if you do direct marketing, you do it to support the field force, generate leads for them, turn it over to them, and let them handle the closing.

MR. SWEENEY: I guess you've finally smoked out a definitive difference between us. My conviction would be to come at it from the opposite direction, the point being that the basic system would involve the methodology of direct response but not direct response as we know it today. Heretofore, the idea was to go out and do full file mailings and hope that one-tenth of 1 percent (or one-half of 1 percent if it's really great) would result from a high perceived value product, such as accidental death products. To justify it, your product must have tremendous margins to support the distribution cost of those expensive full file mailings. Alternatively, as Mr. Marr pointed out, the banks have a tremendous wealth of information in their data base about their clients and their target markets. Through segmentation scoring systems and the preliminary screening for a direct response campaign, you can research the data, analyze files, and essentially preselect those groups of buyers who will have the highest propensity to buy. You support that system with a customer service system that not only sells the product but provides service on an ongoing basis and that thinks in terms of forming relationships, not just making sales. By forming relationships and extending additional coverages in the normal course of the customer's life cycle, over a period of years, you will form multiple product relationships with those clients. I'd chose the methodology of the telemarketing center staffed by professional, well-paid, capable people, and supported by direct mail, media, and other lead stimulation techniques.

MR. TILLER: I would like to thank Mr. R. Larry Warnock, who worked behind the scenes and actually made the two contacts with Mr. Sweeney and Mr. Marr. I appreciate his efforts in helping us put together this session.