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BANKS: SUCCESSFUL ENTRY INTO THE INSURANCE INDUSTRY ON A WORLDWIDE BASIS

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Recorder: GEOFFREY WESTALL

- o Bank ownership/control of insurance companies
- o Special factors:
  - -- Educating the bankers
  - -- Educating the life assurance staff
  - -- Understanding risk
- o Bank insurance products in Europe, America and Australia
  - -- Products
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  - -- Relationship between banks and life assurance company
  - -- Client information systems

MR. GEOFFREY WESTALL: I work in London, and I've done a considerable amount of work with U.K. and one of the Republic of Ireland banks. I also know something about Europe, but the U.K. and the Republic of Ireland are my speciality.

We are very fortunate to have two distinguished practitioners on the panel. Ken Boag has a wealth of experience in Australia with AMP and then Munich Reinsurance and is currently with Westpac. Westpac in Australia is by far the most successful banking life insurance operation, and I'm sure he will give us some insights into the situation there.

Peter Wilde spent 30 years with Connecticut General followed that with three and a half years with The Equitable and helped it in their formation of the Japanese subsidiary. He is now with Citibank and has been divisional executive for two years for global consumer insurance efforts and U.S. operations. He is responsible for the overseas strategic initiatives. As far as the U.S. is concerned, I think it is fair to say that Citicorp is streets ahead of the other banks in life insurance operations.

To contrast this Society meeting with the first meeting of American actuaries that I attended, one of the topics then was called "Offshore," and "Offshore" consisted of everything that wasn't American. When it came to my turn to talk I started by saying that some of us considered America to be offshore. That went down like the proverbial lead balloon, and people looked absolutely blank. Well, it's interesting that this meeting is not concerned with offshore matters. It is actually concerned with international matters, and I believe the change in title is an indication of the way that the Society of Actuaries has changed its thinking over the past few years.

If you look at Europe, and starting with the United Kingdom, it is an interesting market in that it is probably one of the most sophisticated insurance markets and, as far as banking insurance operations, it is the most mature. There are five national banks, a situation that you do not have in the U.S., and there are four regional banks.

The TSB which grew out of a trustee savings bank environment is both a distributor and an underwriter and is generally thought to be one of the most, if not the most, successful banking life insurance operations in the world. It distributes by means of a very active -- some people would say aggressive -- agency force, and it was at one time averaging 40 sales per man, per month. This is a staggering figure when you contrast it with the normal agency operation.

Barclays has had a life company subsidiary for a long time, but it was treated as a completely separate operation from the bank. We understand it is now being integrated more. It has a sales force of about 1,000, and it is going to enjoy some real challenges, putting a prospecting sales force together with a bank client base.

The National Westminster Abbey is the only large, national bank that has stayed independent. It does not have a life insurance company subsidiary. It does write a lot of life insurance business, but it places it with companies around the market like any typical broker.

Lloyd's has an in-house underwriting capacity. It merged with Abbey, and we'll discuss that a little later on.

Midland has an underwriting capacity. It started this as a joint venture with the Commercial Union. It really has not gotten off the ground yet because the distribution has not been sorted out.

The Royal Bank of Scotland also has just started. It has a joint venture operation with the Scottish Equitable. It is too early to say what is happening. The Bank of Scotland is one of the few that does not have an underwriting capacity, and that may be because it is 30% owned by Standard Life Insurance Company.

Yorkshire and Caledonian are owned by one of the Australian banks. They do not have an underwriting capacity.

Citibank does have a life insurance operation in the U.K. I know it went to considerable trouble to get authorization from the U.S. authorities so that this could happen. Citibank purchased a life company in 1986. It does not have a wide and active client base in the U.K., so its subsidiary is slightly different from the other bank situations.

Moving to Italy, like most banks in Europe, all of the banks are distributors of life insurance. The Italian situation is much more fragmented. The banks tend to be regional rather than national. There always seem to be problems with the Italian authorities, but there is an increasing interest by banks in getting into the underwriting of life insurance. We will see more banks moving into underwriting in the near future.

Holland is a relatively small country with a few national banks. They all distribute, and they are starting to move into life insurance underwriting. One of the problems they have is with the employment law -- it is not possible to have self-employed life insurance agents, and it is not possible to get rid of people quickly. This may inhibit progress in the development of agency forces with banks.

Banks in France have comprehensive coverage. Almost all banks are both distributors and underwriters. The banks in France have made the greatest headway of all countries. In the U.K. the banks' market share is about 10% of life insurance. We estimate in France that it is around the 30% mark. However, when looking at the banks' penetration of life insurance, it is necessary to break down the type of products, and whereas in most markets the banks are distributing a wide array of life products, in France they are mainly selling the equivalent of the deferred annuities sold over here; they are deposit banking-type contracts. Very little regular premium life insurance is sold by French banks.

In Spain, once again, there is comprehensive coverage, but the Spanish market is extremely fragmented. Banks are small and the historic position was that banks, life insurance and general insurance companies tended to be grouped together. They have not yet really started to exploit their client base as effectively as they might, but they are, theoretically at least, well positioned to do so.

Germany is the major economy in Europe and has enormous banks. The German market is probably the most highly regulated in Europe. We shall have to wait and see whether 1992 will have any impact on that. There has been less movement in the German market than any. It is nevertheless a very interesting market. The banks have very good connections with their client bases, and our information leads us to believe that there will be a lot more interest in banks getting into insurance in Germany. They do have one or two problems however. The data protection laws are quite strict in Germany which may mean structuring things in a peculiar way. They also have labor laws which are unusual. Apparently employers are not allowed to monitor people's performance individually and assess them on an individual basis. Interestingly, the Dresdner Bank has an arrangement with Allianz, the largest insurance company. It is believed that Allianz was disappointed when Deutsche Bank set up its own underwriting capacity.

Switzerland is a market about which I know very little. The banks tend to be very secretive. So far there's been no interest, but our information is that Credit Suisse is soon to become both a distributor and an underwriter.

The Republic of Ireland has a sophisticated insurance market, probably one of the most sophisticated in the world, and a domination of the banking market by two banks: the Bank of Ireland and Allied Irish Banks. Bank of Ireland has managed to develop a very effective life insurance operation. It has been in operation for a couple of years and is already a major company. Allied Irish Banks is at the moment seeking its license. We would expect the banks in the Republic of Ireland to be major players.

That is the situation in Europe, and you can see that almost all banks in all territories are distributors. There has never been any regulation that has stopped banks from distributing life insurance. We have a much more benign regulatory position in Europe than you do over here, and I'd like to return to that in a moment.

Turning now to some of the problems that have occurred between banks and life insurance, most of these on examination turn out to be psychological or cultural. Some of these are so great that some banks do not even get to the starting line and never manage to penetrate the life insurance potential at all. Bankers sometimes can be summed up by the attitude that given the choice between life insurance and losing money with dignity, they would rather do the latter. There is also a feeling on the part of the bankers that if they get into life insurance, one of the things that will happen is life insurance will be a replacement of their deposit monies. They view life insurance as competition rather than as complementary products and services.

The product range is interesting. To some extent the demand-type products, simple products which range from credit insurance through other loan-related insurance, produce no problems. Bankers can take this type of product on as just another additional product, and in many ways it isn't life insurance in the true sense. They are able to do so with not too many problems because they still control the relationship. The greatest success seems to have been on the deposit-type products and credit insurance. Deposit-type products are very similar to banking products. In the case of long-term regular premium products, banks have failed significantly in being able to distribute these through their own networks.

It has been found, certainly in the territories where I've looked, that an active, dedicated sales force is necessary. For that active and dedicated sales force to be successful, active endorsement by the bank is needed, and this is not always forthcoming. One wonders why banks move into life insurance if they are not prepared to endorse it. If a sales force is used, the bank is into the problems of the banking relationship being interfered with. This causes enormous problems for the bankers who do not take kindly to the banking relationship being threatened in any way. Irrespective of the relative profitability of products, the banking relationship is deemed to be sacrosanct. With more complex products and a sales force, there will be more problems.

As far as the life insurance element is concerned, the problems are that life assurance people tend to think of the bankers as being less aggressive, less vigorous, and rather sleepy. They think there are enormous missed opportunities, but this is a learning process, and life insurance people are beginning to learn to cooperate with the bank. The way that this has had to happen is that life assurance has had to move a long way towards accommodating the bankers. It has had to take on board a lot of the constraints the bankers want them to take on board, and without exception, success depends upon cooperation from the top management level right down to the branch operations between both the life insurance and the banking operations.

The banks have had a go at almost every distribution system -- direct marketing through the bank branches, dedicated sales forces and financial planners -- and simple products have been able to be distributed reasonably successfully through the branch bank with

bank staff doing the distribution and also by using direct mail. Other loan-related products -- in some territories these are more important than they are in the U.S. -- have been able to be distributed from the bank branches. No one has been successful with complex products -- and "complex" means in this term straightforward endowments, whole life, nonloan-related -- unless they have introduced a dedicated sales force.

Other problems include the attitude towards risk. The banks tend to think of risk in two terms: interest rate or default. They feel these are an integral part of their business, and they understand them, although their past history leads one to believe that they do not even understand these very well. It is interesting that they lent money to LDCs, and in the U.K., they keep lending money to people who seem to be extremely poor risks.

Actuaries are used to dealing with mortality and morbidity, expenses, interest rate and inflation. We understand the mortality and morbidity very well. In certain countries interest rate is understood because of the matching problems, and it is gaining greater understanding throughout the world. Most of us would consider the greatest risk to come from the expenses, especially renewal expenses with inflation. However, the banks tend to be worried about mortality and morbidity risks, and one of the things that the life insurance people have tended to do to address these problems, is to be more conservative than they normally would be. This has led to lower reinsurance retention limits.

Because the banks have been able to save considerably on their distribution costs, they have the opportunity in pricing to do one of three things. They can offer lower prices, they can take high profits, or they can have a combination of the two. France is the only country that I know that has systematically chosen the first. It has gone in for an aggressive pricing strategy. This is the basis on which the rest of the industry is now trying to compete, and it is not very well placed to do so. In the U.K., the Republic of Ireland and elsewhere, the standard practice is to use market rates and for the bank to take higher profits. There is some indication that in some markets this is coming under pressure, and the move is to take lower profits. Banks will start to be price competitive but will still have higher profits than life insurance companies. In the long term this poses an enormous potential threat to the life companies because making higher profits at the moment is a competitive advantage. In the future banks can cut their prices which is an even bigger threat.

Looking at regulations, and I will touch on other areas of the world, the European community is extremely tolerant. It is going to be a long time before Eastern Europe matters. Financial services in Eastern Europe are decades away from consideration. The Pacific Rim is generally quite tolerant. The problem is that though it may be tolerant, the authorities and the companies tend to be much closer than in the other advanced economies. The rest of the world tends to be tolerant. The one glaring exception to this toleration is the U.S. In view of Mr. Schlesinger's comments earlier, and speaking as an outsider, I think that the U.S. attitude towards regulations is going to be a severe inhibition on your ability to compete outside of the U.S. Your legal system and your attitude towards consumer protection is an enormous inhibition. I have my own personal law of consumer protection legislation which is basically that it always ends up to the disadvantage of the consumer, particularly with life insurance. Unless the U.S. is able to do something about this -- and I do not believe that the insurance and banking

legislation, as I understand it, is really in the consumer's interest here -- it certainly will inhibit your ability to compete outside the U.S.

I would like to just finish with three interesting cases. The first is Lloyd's and Abbey Life in the U.K. Abbey is a company that was formed in the 1960s, and was for a long time, owned by ITT. ITT sold it, and it went public four years ago and is now quoted on the London Stock Exchange. It was the first U.K. company to develop a large and successful sales force; previously, U.K. companies had not used that method of distributing policies. Lloyd's is one of the big five banks and had a small life insurance company which had been in existence for about 15 years. Lloyd's started to market its customer base aggressively with this life company in 1988. Two years ago these two companies got together in a complex deal in which Lloyd's put its life insurance subsidiary, some real estate agencies and a credit company into the pot, and Abbey put itself into the pot. Lloyd's Bank finished up owning 57% of the joint company, so a banking operation has one of the largest life insurance operations in the country, part of which is operating independently and part of which is selling to the bank customer base.

Cardif is a company in France and is one of the few companies that has been able to exploit banking opportunities without being swallowed up by the bank. It provides services to banks by underwriting policies and has a good working relationship with them. It shows that in some areas it may be possible to do quite well working with the banks without being swallowed by them.

Allianz in Germany is interesting mainly because of the potential. Allianz is an enormous company, and it was thought that it might do something with the Deutsche Bank. However Deutsche Bank went off and did it themselves. Allianz retaliated with an arrangement with Dresdner Bank. The interesting thing will be what the future holds and what Allianz, with all its resources, might do in the German market.

In a tolerant regulatory environment, the banks must be the winners in financial services. There will be problems in the U.K., the Republic of Ireland, France and Holland as the bank life insurance companies will comprise 25% of the insurance market. That is a lot of the market. Why should this be so? Is it that the bankers have this unique understanding of how to sell life insurance? Is it that the bankers are brilliant masterminds of financial services? The answer is none of those. The answer is that they have a client base, and they have, in spite of everything, a good relationship with that client base. The significant weakness of almost every life insurance company in the world is that it does not have a client base. The customer base is either the client of an independent operation or, if there is a sales force, it is the client of the salesperson. The relationship is with the salesperson, not with the company. It is this relationship which makes bankers such a potential threat to the rest of the insurance industry, and the reason it is such a threat is that a client and a relationship saves on the prospecting time.

There are various estimates of what prospecting time an agent spends, but it is likely to be about 75-80%. If this time can be saved, productivity can be increased enormously. TSB is probably the most dramatic, increasing agent productivity to 10 cases a month. All of the other banking operations are aiming for productivity of four to five cases per man, per week. These are productivity gains of 300-400% over normal agency

operations. As a result, salespersons can be paid far less commission. The going rates tend to be about 30% of the normal commission rates, and that is why banks are so enormously profitable. If life insurance companies could cut commissions to 30% of their current level, most of the actuaries here would be smiling. The other thing banks have done is that they have tended to charge correctly by bringing in the expertise to do it correctly. They are now very profitable. They are in a position where they're going to be able to pose even greater competition in the markets in which they operate.

The final thing, before I hand it over to Ken, is that if they ever manage to get their client information systems in good working order, and they are many years away from this, but if they ever do, they could penetrate as much as 50% of the life insurance market, which means there is only the balance left for the rest of the industry. On that happy note I would like to hand it over to Ken who will tell us all about Australia and the lessons we can learn from there.

MR. KENNETH A. BOAG: The subject of this session is one which I've been closely involved with for the last four years, since it was just about four years ago that the life subsidiary of the bank that I work for was born. In fact, it was the first of October 1986, when it started. The subject of banks and insurance is one of those great waves of change, and over the last four years much has happened in many markets. My comments will focus on Australia and very briefly on New Zealand, although I'm not that familiar with the New Zealand market. I hope you'll excuse a certain bias towards Westpack.

Where did it all start? In Australia banks have always been allowed to own insurance companies, but it wasn't until the mid-1980s that life companies could own banks. Deregulation of the banking industry changed all this. As both groups attempted to get into each other, I think for fairly obvious reasons, life companies have not had the same success entering banking as banks have had entering life business. There are now seven banks in life business in Australia, with two more, at least, right on the brink of entering. In fact, I think one of those should just about have its license right now. Four major domestic banks dominate banking, and have now entered the life business, and I think all have had their successes. Of the other three current players, Citicorp is by far the most successful. It includes investment-style, single premium products.

Just as an aside, Westpack owned a life company some time ago. The early company was very small and not particularly successful and it was sold in the early 1970s. Westpack reentered in October 1986, as I mentioned, with the Greenfields operation that has as of now assets of over $830 million. Until recently it has claimed to be the fastest-growing life company in the world, but I think it has probably been passed by some of the new European bank life companies.

There's been a range of strategies in terms of entry, and you've seen some of these strategies change even within the relatively short time frame since the first real bank entry into life insurance. Two major banks adopted the Greenfield strategy and commenced with simple risk on investment products over the counter. One of these has since developed its own advisory force and is selling some quite traditional, regular premium products with relatively high commission sales and termination penalties. The

most competitive advantage seems in this instance to be shared between the bank shareholders and the sales force. The other bank has recently introduced a low-cost range of regular premium products, currently being sold over the counter but with announced intentions of building a sales force. In this instance the customer will benefit but the bank shareholders or salespeople or perhaps both groups miss out.

Another of the four major banks entered through purchasing an existing company and concentrated on selling products initially through brokers. It then began to use direct mail and over-the-counter methods for offering simpler products. This company strategy now seems to have two distinct strands to it as it looks more and more at developing sales off the bank customer base.

The other major bank has adopted a strategy of developing its own tied field force with responsibility for completing sales off the back of leads provided by the bank. This is basically the Westpack strategy, and these leads are provided by the bankers after an initial interview with customers in which they agree to talk to a life insurance consultant. Direct mail or other strategies have also been used quite successfully by Westpack for different market segments.

Before moving on it's probably relevant to mention the attempt by the second-largest bank, Lonzid, to merge with the second largest life insurance company, National Mutual. This marriage of convenience, as our federal treasurer who has a delightful way with words calls it, was vetoed by him on the grounds of being contrary to the national interest. It's an interesting and debatable decision and one which some believe is only a temporary delay in the eventual marriage between these two, fairly large companies. In any event, watching some interesting cultural clashes has been put off for a while.

In New Zealand there are only two bank-owned life companies, Westpack and the Bank of New Zealand. Each has started with over-the-counter sales, and it is only now that Westpack in New Zealand is starting to develop a direct sales force. It has gone a different entry route than the Australian operation. It is separately managed and the two only come together at a fairly high level in the banking structure.

There has been no legislative control on production costs in Australia and New Zealand, and by world standards these costs have been high. Therefore, there's been ample opportunity for lower-cost, higher-productivity distribution to be developed. Until the banks entered life insurance, the industry had not been subjected to any effective alternative distribution strategy. Aside from high selling costs, there are other weaknesses in the traditional industry. There is a need for time-consuming prospecting and Geoff touched on that before. There is low productivity of sales forces, a low public image of traditional life salespeople, fast geographic spread and relatively few people -- that's an Australian comment more than anywhere else -- and a distribution-driven approach to product design. The strengths of banks with a retail customer base include lots of customers, reasonable consumer trust, relationships with clients, and a large network of branches. Westpack's has 3,850 branches throughout Australia, and the other three major companies have similar numbers of branches. Also, there are highly-developed computer systems. Of course, not only banks have such features, but

so far banks are the organizations to make the most from these advantages. There's no reason why motorist associations or other organizations can't do similar things.

Again, Geoff touched on the cultural issues. Bankers and life people have different cultures. It's a great challenge to ensure that they work together, rather than one for the other. Bankers tend to be more conservative, and within our place they've always regarded life people as having white shoes, yellow flashing bow ties, and driving expensive cars. Life people, on the other hand, think of bankers as being essentially boring. It's quite interesting to sort of get the blend. Stereotypes are in practice just that. They do have some basic truth in them. It's like mixing oil and water. Each bank insurance company makes these issues, and all I can say is how we approach it at Westpack.

First, it is accepted that each has strengths and weaknesses. The bank can go in generally with sales skills. The life operation can go in with attention to customers' needs. Each year over the last four years we've seen an improvement in relationships. We've always had the support within Westpack of the top general management. Where it's worked, it's worked exceedingly well. Each year it improves and spreads. Our strategy needs acceptance by the bank. Our message has been that your first sale is always to the bank whom you depend on for your leads. No leads, no sales. No sales, no job. And the last thought makes bankers who are used to a career environment in Australia sit up and take a bit of notice. They realize that some of these people actually might not have a job next week if they don't give them leads. We talk of partnership. We work at working together. We've been at it for four years, and I think we'll be at it for a long while. We recruit largely from the bank itself, and this has proved pretty successful.

The products in Australia vary from bank operation to bank operation. It depends a lot on the strategy they've chosen. Also, the relative newness of companies has meant that the product range is developed as they push into different markets. At Westpack we have virtually no capital-guaranteed business. Our approach has led us to develop a range of single and regular premium, unit-linked products, plus some risk products. The products have been designed to fit the market segment needs, suit the distribution approach we've selected to access that particular market and avoid handing out scarce resources through traditional capital-guaranteed approaches.

If the bank has adopted a distribution approach that allows it to save distribution costs, then this advantage has been translated into benefits for the customer through low prices, and high profits for the shareholders, or a mix of these. At one extreme there seems to be an evolution towards an approach very much involving lower prices. The life subsidiary of the government-owned bank is presumably using this strategy. Equally, it has so far at least chosen to distribute largely over the counter, but this shows some signs of changing. It won't, unless it privatizes, have much access to capital, however, so that might slow it down. At the other extreme Lonzid, the second largest bank, started as largely a traditional approach. It bought a company that had been running for some time. Time will tell whether this results in higher profits or a failure to blend cultures and, therefore, lower sales. At Westpack our approach has been centered around a higher productivity formula resulting in a sharing of the spoils between the customer via

good value but not necessarily the cheapest products, the bank as shareholder, and the sales force via achievement of the higher productivity.

The traditional sales formula is something that varies a bit from market to market, I imagine, but 15 prospects lead to about five interviews and one sale for the week. Our approach is very simply that the bank takes on the responsibility for prospecting. It generates the leads. Our responsibility is to turn those leads into sales. The closing responsibility is accepted. Therefore, we, among other things, need a different sort of salesperson. They wear out a lot less shoes. And so far our experience has been that they have attained that sort of productivity level. Our products have roughly a one-third the market average level of commission. If our salespeople sell four contracts a week, then they get roughly four-thirds of the market average remuneration. If our salesperson sell three, they might survive. If they sell less than that over a period of time, they get to go and work elsewhere. Some of the sales figures that have been achieved have been quite astonishing. At some stages in the year, typically leading up to the end of our tax year, we've had situations where people have written 200 cases in two months. I think the highest productivity was achieved by one person who sold 190 in the month of June. All around, however, the customer benefits from lower prices. The bank also benefits because it gains extra profits because we don't pass it all back.

The life companies do not have access to the bank data files due to privacy laws, and we have to find, therefore, ways to gain access to the customer base. That's why we have the bank do the prospecting. It basically works from its customer base, and we don't get involved unless a client wants to see us. The single biggest hassle that we've had under our system is getting the bank to officially accept us, to provide the leads we need to support the sales base. Even despite the legal barriers, we think that's probably in the end going to be an advantage because it protects the bankers from the idea that we're out there raping and pillaging their customers. We don't get involved until they say so.

Essentially distribution is the core of the whole process. There are many approaches, and I believe no single correct answer in all circumstances. Having said this, I think there are some givens. If a bank wants to develop a significant life market share, it must use a more active sales approach. The distribution approach must fit culturally within the bank. The distribution approach must suit the market segment. And the sales force, if one is used, must be able to make a living. We tend not to sell much term insurance through our sales force. We tend to use direct mail techniques for that. Otherwise, we'd find that our people starved.

While we've been reasonably successful, the October 1987 crash did affect us. The National Australia Bank has distributed more single premium product than Westpack. I think some of that is internally generated by reinvestment of the bank's own stock pension fund, but I'm not sure of that.

Just to give you some idea of Westpack's size, it has about 40,000 staff worldwide, assets of about A$130 billion, and 1,350 branches. The group that I work for, Westpack Financial Services, manages about $10.5 billion of assets, only some of which are life insurance. The balance is in mutual funds, as you would call them, in a trust we call them, and pension business, wholesale and retail. So, it's quite a mixture, and the

bank's been in that business for 30 years. It's only recently added the life insurance string to it.

MR. PETER R. WILDE: What I'm going to do is talk a little bit about the U.S. but also about some overseas activities. Citibank, perhaps to your surprise, owns six life insurance companies overseas: three in Europe, two in South America, and one in Australia, as well as an ACLI-member company with the nonthreatening name of Family Guardian Life in St. Louis. This principally involves itself in selling credit-related life insurance principally on mortgages covering both death and disability. U.S. national banks, as some of you may be aware, are only able to sell those kinds of coverages. We cannot sell level premium, accumulative-type products. We can't even use universal life, for instance, on the sale alongside of a mortgage. Because of that, when we go overseas we must plead the case with the U.S. Federal Reserve Board, not simply with the local jurisdiction, to be given permission to act in a normal fashion in the various countries in which we'd like to do business, using the logic that it is normal practice in that market for the insurance companies and the banks to be cozy. That is how we have gotten into business in the U.K., Germany, Belgium, South America (Argentina and Brazil), and Australia.

We didn't like that very much. It seemed a bit confining. So, we tried to get some legislation in Delaware, and some of you probably followed that a little bit and know that by the skin of our teeth we got the required two-thirds vote, first in the House and then in the Senate in Delaware, and the governor signed the bill on May 30. Some of your noble agents complained to the Federal Reserve Board about the obvious raping and pillaging that would occur henceforth, and the Federal Reserve on September 5 said we should cease and desist. Within 30 days, which was the maximum time allowed, we decided to go to court. So, we're now in the midst of a lawsuit. I have learned more nabout the banking regulations and laws than I ever wanted to. There's a lot of regulation in the banking industry. So, if you think it's complex in the insurance business, come on over, and you can start fresh and learn all over again.

Some of the banks in the U.S., principally in the Midwest, as you know, have grandfathering powers for agency purposes only, and I won't spend a lot of time on that. Most of the banks and the thrifts have used the sale of single premium, deferred annuities as their primary product activity, largely by using an outside sales force to distribute that product to their consumer base. The agent in the kiosk didn't work. Some of you probably tried that yourselves. I think every one of them was an unmitigated disaster. The problem was that nobody explained to the agent that it was really an easy sale because it was a warm lead, and nobody explained to the bank that it couldn't sell its way out of a wet paper bag. Each thought they were entitled to 80% of the total commission, and somehow it doesn't add up to 100 when you add 80 and 80.

Out of that turmoil involving our industry, the insurance business is probably going to count on political pressure to broaden the base of market and capital. If you're following at all the caper in New Jersey and Pennsylvania, it is one of the more bizarre stories on the East Coast in terms of the way the automobile insurance problem is being solved. As you well know, nobody distinguishes between life insurance and automobile insurance. It's all insurance, as we say in the Midwest, and it's a problem.

I had the fun of getting a variable life insurance product into Japan in 1986. It's an interesting market; there are a lot of parallels, by the way, between Japan and Germany. Both of them are semicartels in the way they are managed and regulated; they are very closely controlled by the Ministry of Finance or its counterpart in Germany. You can have any color you'd like as long as it's black and any number of doors as long as it's two, and there's very little product and pricing flexibility in Germany. Basically you get to follow the lead of the industry, and the competition is based on how many salespersons you have and the percentage above 90% of profits that you're willing to return to the policyholder. That doesn't make for a lot of profit margins if you're a stock-owned company.

In Japan lot of sales are made at the place of employment through what they would call corporate agents. There have been very few successes on the part of the Americans in trying to do business over there. By far, the greatest success, I think, has been American Family selling their dread disease, better known as cancer, insurance in that marketplace. There are a lot of barriers, though, to banks and insurance and securities firms getting together. Although you all know that underneath the skin there are a lot of relationships among the major institutions, but no official involvement by the banks. So, we cannot at Citibank, for instance, go into the marketplace there and be in the insurance business.

In Asia, the Korean and Taiwanese markets are very similar in some respects to Japan. They copied, in large measure, not surprisingly, some of the regulatory techniques used by Japan. They both have a Ministry of Finance and follow not dissimilar patterns, and so far there has been very little activity between the banks and the insurance companies in those two markets.

Of course, Hong Kong is very liberal in the way it approaches things, with all the uncertainties that we've heard about for 1997.

Citibank is very strong in Southeast Asia. It is probably the most well-known foreign bank in those markets. We are tightly controlled. I'll give you an example. In Thailand we're allowed to have one location for the entire Citibank operations, in Bangkok. So, that's the branch. That's where the automated teller machines (ATM) are, etc. In Malaysia we have two branches. In Indonesia we have three. In India we have six. We happen to be fairly flexible fellows to try and compete with the domestic banks on the basis of that kind of constraint. They are incredible markets. I've been to some of those markets three times. Twenty years from now, if we don't blow the place apart, it's going to be awesome in this world. The growth and the dynamics of the middle class, the work ethic, their commitment to save -- it's incredible. You should, if you have not begun, read some of the theories that explain some of this logic and understand a little bit about the Confucian ethic. I think it helps a great deal to understand why they do what they do and why they think the way they do about savings and family and education and things of that nature.

Finally, Latin America is a tough market. We sell insurance in both Argentina and Brazil and are considering doing it in Chile; in the latter case because Chile has basically privatized the retirement benefits and has encouraged the public to save on their own account for their retirement. When you get to retirement age you must be given three

options in terms of single premium annuity, if you will, purchase rights, and that's one of the reasons it's appealing to us. We're a fairly large bank and have the largest finance company in Chile as well. So, it is an intriguing market.

There is huge cultural confusion and puzzlement. I would caution you to not leap too quickly to the assumption that bankers, however, don't understand riskbearing because they do some rather interesting things in appraising credit risks. I think there are more parallels there with some of the things we do in our actuarial activity than we probably give it credit for. So, bear in mind that while they think the mortality and morbidity is alien, I think they will overcome that dilemma before long and be a little bit less nervous. One other key point that is important is that the banks fundamentally do not invest in assets with long durations. In my conversations with bankers they have said, they ought to be able to handle the investment of annuity assets, and I've told them it's a little harder than that in asset/liability matching. But they do believe that they're pretty good at managing assets which I believe in many respects are largely in long-term trust accounts, a rather different investment vehicle.

I'll mention the growth of the annuity asset. Cannibalization is the banker's term for eating up the assets that are in CDs and other instruments and moving them over into single premium deferred annuities (SPDAs). I think that is overblown. We have some experience in the New York division of Citibank, which is present on most street corners if you've been in Manhattan, and less than half of the monies flowing into an outside, single premium annuity are coming from our own CDs, which means we are rescuing more than half from other fellows' pants' pockets to invest in the single premium, deferred annuity. We don't think that's a bad deal. So, I think cannibalization is a worry, but I think the facts will demonstrate that it is overblown.

Those of you who deal with independent property/casualty agents will recognize the 12 arguments as to why they don't want you to come talk to their customer. You could write down the same list for the banker and it is eerily similar. They don't like the disturbing and the upsetting of their customer base. So, if you're going to work with bankers on this issue, just get out your old notes on what you had to do to try to convince the property/casualty people to sell insurance. That will work just fine going forward.

I think the banks are clearly going to have to make a decision whether they want to be in the savings-oriented products, single-pay kinds of products (and, of course, the single premium, deferred annuity is the epitome of that) or whether they're willing to deal with the recurring-pay products. I've had a lot of fun at Citibank trying to talk through that concern because Citibank is fairly comfortable redirecting existing assets from one account to another and converting it, if you will, into a single premium annuity. Citibank is petrified at the thought of having to talk to people about diverting a portion of a stream of income to buy the typical recurring premium products that all of us know and love, and it thinks that is a huge psychological hurdle, at least in the United States, before it will be very effective in making that fly.

We've tried all of the different distribution techniques in the United States and Citibank as well. We have a TPA in Nashville that handles direct marketing products, principally

to our 30 million credit cardholders, through the mail. I call it affectionately the pots and pans business. This month it's a Cross pen. Next month it's a Casio watch. The month after that it's term insurance, accident insurance or a $40-a-day hospital indemnity policy (HIP). We've found that as soon as the premium rises very much above that kind of level of pain, the consumers do not want to sign up for the product because it's too heavy a drag on their credit card monthly balance.

We also are offering, as I indicated to you, decreasing term mortgage life insurance through Family Guardian. It is fully underwritten, male and female specific, smoker/nonsmoker. It's a very competitive and honorable product, unlike some that upset people when we offer the up-front, single pay, indiscriminate product that attracts all of the flies and concerns and critiques.

We have a bank in Germany with 300 branches. We sell a full array of life insurance products through the bank employees. We have about a million and a half accounts. Some people have both an asset account, if you will, a deposit, and a liability kind of loan. We are fairly successful in selling there. We pay absolutely no incentive compensation, not even a chocolate on the pillow or a single rose, if you do nicely. When I ask why, they say it's part of their job, and if you understand the German culture, you know that they would adhere to that quite nicely. As far as I know that is precisely the way Deutsche Bank is proceeding with the 2,000+ branches that it operates, and it is already the fourth or fifth largest life insurance company in Germany. That would explain why Allianz is a little bothered by the fact that Deutsche Bank started on its own.

Whose customer is it? The bankers, as has been said rather vigorously, believe it to be their customer, and that's going to be a major challenge as we develop the technique for marketing insurance products to their customer base, to not confuse the customer and not upset the banker by trying to steal that customer away. Of course, in classic, career agent fashion the agent goes for the throat and wants to control the customer posthaste.

So far in the United States we don't have a lot of choices about our pricing methodology because we can't sell at full, traditional lines. I think the reality is, having done some analysis, however, that clearly the banks can enjoy higher profits, as has been said, and enjoy a better price for the consumer if they so choose, and, therefore, I think that's a latent threat. They're going to be happy for the moment to charge market rates because that improves their earnings, and, heaven knows, these days the banks could certainly benefit from that. They do clearly have warm leads. I have spent 35 years in the life insurance industry, and we all know that despite our attempts to twist the questions in the Monitoring Attitudes of the Public (MAP) surveys, people still, to a significant extent, say they would be willing to deal with their banker for insurance products. For those of you who say more than half would just as soon not deal with the banks, I invite you to consider the flip-flop of that, which is a significant minority, who are willing to talk to banks, and that's by far the greater threat.

And, finally, on technology, I would just invite your attention to the fact that on each Monday in Sioux Falls, South Dakota, we get over 100,000 phone calls from our 30 million credit cardholders who want to talk about their accounts. I don't know how many of your companies get 100,000 phone calls a week, but the technology to handle

those calls reasonably skillfully suggests that the banks do have some technology that might be applicable to the insurance business.

Also, if any of you have a Citibank card in the city of Manhattan, and you walk up to the ATM, it is all touch screen. We can have 12 languages on the machine. We choose only to bring up three in most of our markets. In New York it's English, Spanish and Chinese. (We have a fairly significant Chinese market in the city of New York.) Customers can do 55 transactions on that ATM. Seventy percent of the retail transactions in the city of New York for Citibank are done on the ATMs, and 30% of 70% is done when the bank is closed. So, I just leave you with those two tidbits as to whether or not technology may have a role to play. I think the former speakers made some reference to that.

The whole issue, I think, both in the U.S. and overseas, about the tax treatment for retirement offerings is a hot potato. I have needled a few of my associates in the business and said that if we cling to this inside build-up speech too long and don't segregate life insurance coverages from the retirement savings kind of coverages, we may drown in that argument. I think before long we may have to "fess up" to the reality that the products being offered as pure sort of savings devices like that may have to be given up, if you will, in the better interest of the inside build-up. I know that's not a popular statement, but I suggest to you that continuing to cling to the idea that we will give up nothing may make us end up in the same place where we have ended up on the federal tax for life insurance companies which is not exactly a comfortable spot.

I enjoy the coercion issue. People love to throw that out. When we were in Delaware they kept throwing up that argument. Ladies and gentlemen, if you have a mortgage with us, I would suggest that you are more vulnerable to being coerced in your mind than probably at any other single time in your financial activity, and we have been selling life insurance on mortgages for many years. So, I really encourage you, when you get your spokesmen up there, don't use the coercion tie-in set-up because that's yesterday's newspaper. We've got to find a better argument than coercion to debate together in the halls of Congress or wherever it's going to be because that's really a nonstarter. It's emotional, and we love to use it like apple pie and motherhood and the demise of the independent agent system, but it doesn't really sell for the regulators in my opinion.

FROM THE FLOOR: Technology seems to be driving clients away from the bank counters. Because of the personal touch that is needed, how will that affect life insurance sales?

MR. WESTALL: If I can jump in first, I don't think it will affect them at all, really, because most of the selling is not done, certainly in the U.K., in the bank branch itself by the branch staff. As Ken suggested, the bank provides leads, and the relationship the bank has with the customer makes that a warm lead. A dedicated salesforce goes to sell to that customer maybe in the bank branch, maybe in a separate office, and often in their home. So, I don't really think the nonattendance of people at the bank branch to do banking transactions will make much difference.

FROM THE FLOOR: So, it will not affect the generation of the leads either.

MR. WESTALL: In my view, no.

MR. BOAG: Perhaps I could comment on the way we go about generating the leads, at least at Westpack. About 40% of them come off the back of mortgages, and the others come off the back of other transactions. We could see the nature of how those leads actually get generated changing, but at some point in most people's lives they do go through a banking face-to-face encounter. I think we will start to use some of the technological things that Peter touched on as well. We haven't used screens to generate leads yet, but I can see that happening, too. But the sales process itself, once the lead is generated, takes place on a face-to-face-interview basis, in our case, often in the bank branch, sometimes after hours in a home or an office, but often in a bank branch.

MR. WILDE: About half of our mortgage sales are made through telemarketing as follow-up after the loan has been approved and before it gets closed. The telemarketing people are quite successful. They're housed hundreds of miles away from where the actual loan was processed. A lot of Citibank's mortgages are through independent mortgage brokers, and the sales success is quite interesting, I think. They have anywhere from 15-30 screens that they flow through. They fill out the application over the phone with the prospect and simply mail it to the prospect to sign and send back, and it's proven to be quite successful from our standpoint.

FROM THE FLOOR: Are most of the bank-championed life insurance sales replacement sales of existing business, or is it new money coming into the industry?

MR. BOAG: From our perspective it's not replacement business by and large. Out of, say, 23-24 cases we wouldn't even meet a competitor on a completely new sale. So, there's not much replacement business.

MR. WILDE: I think that's true also. The industry is doing a terrible job in the downscale market, and I think that banks will be able to deal very well with the downscale market because they have a very strong customer relationship there, and we're not replacing business. They don't have any to speak of beyond their group benefits.

MR. JAMES R. THOMPSON: Mr. Wilde, do you find that using the platform person in the bank is superior to using the tellers?

MR. WILDE: Well, the thing that I think killed the agent in the kiosk is there was never any relationship, built between the agent and the location. What's happening now for us at Citibank in the New York division is that the individual who is offering single premium annuities, though not an employee, has a very close relationship in that locale and gets referrals in that branch because in New York City, as some of you know, there's a lot of bank branch traffic. There is a lot of personal contact, and it is a very different relationship and attitude between that rep and the bank personnel as contrasted with the classic agent in the kiosk.

MR. MICHAEL E. MATEJA: There's a great deal of concern in this country now about solvency and financial strength, and I wonder to what extent the entry of banks

into the life insurance company has affected capital structures of those organizations and to what extent that is regulated in those countries.

MR. WESTALL: Do you mean the solvency of the bank or the insurance company?

MR. MATEJA: To the extent that they are written through sister organizations is there any impact on the overall, say, capital base, surplus levels and such? I think of banks as traditionally having a somewhat different level of risk. Traditionally, it should be lower, all things considered, absent the insurance risk, although that could certainly be debated in recent years, given the results in the real estate markets. But all other things being equal, if a bank enters into an insurance market, you would think of an addition of another risk. I would expect that ultimately they should approach the capital structures of life insurance companies, and I just wonder whether you have any observations on that general subject.

MR. WESTALL: In the European community we have statutory solvency reserves we have to hold, but the structure is usually done on such a basis as to keep the banking and the insurance operation separate. So, the banking operation conforms to its own regulations and solvency requirements and the insurance operation to its own solvency requirements. So, they don't have any impact on each other.

MR. WILDE: There is a worldwide risk-adjusted capital effort underway which I wouldn't begin to try and cover lucidly, but I think, Mike, that the reality's going to be that banks worldwide are going to strengthen their balance sheet, but, again, as was inferred by Geoff, I think that they will be required to set up very clear, separate capital for the underlying insurance business. I think the inference in your question may be that some of the banks would go into the more dicey insurance businesses. As a long-time neighbor of yours in Hartford, I think it'll be a long time before the banks want to go into third-party liability offered on commercial risks. Second, the Federal Reserve Board in the U.S. is very hostile to the idea of banks being in the property/casualty business at all. That even includes the nice, placid, first-party liability coverage offered by a homeowner's policy. So, we're still trying to climb up the hill to be allowed to participate even on the low-risk coverages of that kind.

MR. BOAG: In the Australian scene they are quite separate and governed by regulations for both parts separately. It might only be in the case where a bank's subsidiary wants to offer capital guaranteed business where the reserve bank would want to see some sort of increase in the solvency requirements on the bank itself. Otherwise, it's just traded as any other investment by the bank.

MR. LAWRENCE A. SELLER: If I interpreted Mr. Schlesinger's comments correctly, I heard him say we're ridiculously protective of our market share and have been too unwilling to try to compete on a quality basis. Putting that in this context, I'm of the opinion that our real fear of banks entering the insurance business is we are too damn afraid that a bank can do a better job giving a better package of product and service than we can. I think the experiences of the gentlemen on our panel show that there are ways that banks can do insurance business. It can benefit them. It can benefit us. And

we've been too unwilling to try to work hard enough to improve our stature in this respect.

MR. WILDE: Let me respond as the U.S. spokesman. I think it is ludicrous for us to continue fighting the way we are on the premise that most banks will go into underwriting. The numbers of banks, I will bet you, that will be underwriters in the next five years that are U.S. based you can count on less than two hands, perhaps only on one hand. Part of it is because they are capital constrained even as we speak, and, therefore, all of you who are representing insurance manufacturers have a new outlet to be pursued if you will simply screw up your courage and not be bamboozled by your current kind of sales organizations, including the career system that I came to know and love in over 20 years, first at CG and then at The Equitable. I think there are opportunities there that have just begun to be scratched, and we are very myopic, generally speaking, in this country because we won't deal with this. Is that subtle enough?

MR. CHARLES C. MCLEOD: I think all actuaries pricing life products would estimate the expected profitability of those sales, and many life companies would try to calculate the value added by sales of life insurance products during a year. I'm wondering if any of the panelists know of cases of banks that have gone into the life insurance business that have tried to compare the value added by sales of life insurance products with the value of sales traditional bank products or services provided by banks, and are there any interesting findings about the relative profitability of the two types of services and products?

MR. BOAG: The bank that I work for is right in the middle of doing just that sort of exercise. I haven't yet been privy to the results, but the only thing I have heard is that all the products that we offer through the financial services group of Westpack, stack up pretty well by comparison with banking products. They're right up there near the more profitable ones, if not actually leading. They're in the first two or three in every area.

MR. WESTALL: I'm not an expert on banking profits, but I did have a meeting with some people from a leading bank, and we discussed this very issue about life insurance profitability, etc. They said there was no way they had any idea of what the profits of any of their individual products were.

FROM THE FLOOR: You seem to have covered the world, but there's one gaping hole, and that's Canada. Are there any comments about banks and insurance?

MR. WILDE: I really have very little familiarity with it. The Royal, as you know, has been quite aggressive in Canada. I've forgotten how many branches it has, but I think it's like 2,000 branches in Canada. My impression is that in very recent times the continued drop in the barriers between the various financial institutions means that there's going to be a continued blurring of distinctions between what banks are and what insurance companies are and what trust companies are? I think it's an interesting market to watch from the U.S., to see what really does come because they appear to be well ahead of us in getting rid of some regulatory restrictions.

MR. JOSEPH COLM FAGAN: I have a question for Geoff Westall on the remuneration of the branch in a bank-owned life insurance environment. In our situation we are wholly-owned by the Bank of Ireland. So, it doesn't matter too much how much commission we give to the branch because the profit is going to come either through the profits of the life insurance company or in the commission outlay. Now, it is important, obviously, for internal management accounting purposes, but I was wondering in the situation of Lloyd's/Abbey Life where there are two separate, publicly held companies, and referrals are being provided by the bank to the life insurance company, how does the life insurance company remunerate the bank for the sales of life insurance policies in that situation?

MR. WESTALL: Perhaps I had better expand a bit on Lloyd's/Abbey. The old Abbey Life sales force does not have anything to do with the bank customers. I think it's an interesting case, and I think it made the right decision, that it needed a special, dedicated sales force for the bank client base which is not the same as a prospecting sales force. As I understand it, what it is doing is actually making payments to the bank, not to the bank branch. How do you get the profits through to the bank? It's okay if you're all one company, but if you're a separate company, you have to make a payment, and then on top of that you have to incentives the branch itself, and that's really a management accounting issue, not in transfer of money, but they are actually transferring money from the life company to the bank which is part of the commission that they're saving.

MR. WILDE: The branch managers, at least at Citibank, are very carefully measured on the flow of what we'll call revenues into their operations. So what you and I would probably characterize as commissions is a crucially important measure. They really are getting credit in their financial reports for how they're doing, and if you do not succeed in getting down below the national level and you give the credit to the national manager but not the branches, they will kill you in much the same way that the local people in the property/casualty business killed you if they didn't get credit for a life insurance sale made in their locale.

MR. HOAG: Essentially, we've gone through about three or four different iterations on how to reward the bank and to reflect it in our management accounts. The latest version is to reward for their part of the job which is basically the generation of the lead, but that's in management accounting terms. In terms of actual transfer of profit, much is just done through dividend.

MR. WESTALL: The experience seems to be that you've got two things. One is to reward the local bank branch, and the other key feature which is absolutely crucial is that the local agent who is servicing that branch must have a good working relationship with that branch so that the bankers trust him to go and see their customers. So, those two are really key features.

MR. JOHN DUANE DAWSON: As banks move into the insurance market, the focus has been on life insurance and annuity type products, and I think that makes sense because those products compete for the same dollars that banks traditionally have sought. But one of the advantages that banks enjoy is their close ties to the

client base, and from a marketing point of view this advantage could carry over to health insurance such as major medical or disability income. Is there real potential for banks in health insurance? Are banks selling and/or underwriting medical and disability income insurance at this time? And what are some of the roadblocks to banks entering the health insurance market?

MR. BOAG: Just one or two comments on that. We actually do underwrite disability income at this stage, but we're not in the health insurance business. But certainly I think the potential is there for some time in the future. One thing that banks and life insurance companies connected with them are not short of is potential. You can just turn around and scratch the surface anywhere, and there is potential for tapping that customer base. So, I can see long-term care as being a market that we'll be in at some stage in the future.

MR. WILDE: You're over into, of course, the needs-selling area, and somewhat surprising to me, at least going into the banking side of this world, is that they're product sellers just like the insurance business has product sellers. So, they sell CDs and home equity loans and things of that nature. The interesting question I think you pose is, when will the bank get around the corner of the table to talk more about needs-based selling and talk about solutions of the kind you described which almost inevitably have to come out of a future stream of income payments? And that's going to require, and we're now being repetitive, a different kind of sales representative than the banks have ever had to have in the past. I think it's a nifty opportunity because we know a lot about the customer, but we have a long way to go in most locations before that is going to occur.

MR. WESTALL: I think there's one other point, and that is that the bankers are moving into areas in which they have no expertise and knowledge, and I think they are still wary of expanding too quickly. When they take on board the fact that they can general providers of financial services, then they can distribute almost anything in this area. They will be into these products, but I think, quite naturally, they feel a bit nervous about going too far because it's an area they don't know much about.

FROM THE FLOOR: Banks are in a very strong position in terms of distributing life products and other insurance products, and they recently realized that they want to go into underwriting such services. There are two main ways they've been doing that, either setting up their own life company or going into a joint venture with a life company. Do you think such joint ventures will actually survive, or is it just a case of the bank taking advantage of the insurance company's expertise in the short term and then deciding to go it alone?

MR. WESTALL: In my view there is no such thing as a long-term joint venture. I think they are doomed to be of short duration from the start, and the bank is providing all of the key elements except administration. I think the insurance company should make the most of it because it's not going to last very long.

MR. WILDE: I wouldn't quarrel with that.