RECORD OF SOCIETY OF ACTUARIES
1993 VOL. 19 NO. 3

BANKS SELLING INSURANCE: PRACTICES AROUND THE WORLD

Moderator:	KEITH GUBBAY
Panelists:	GERALD G. CUNNINGHAM*
	DOUGLAS A. FRENCH
Recorder:	RACHEL M. HANCOCK

- Products
- Market share
- Business strategies
- Distribution
- Successes and failures
- Lessons to be learned
- Implications for the U.S. life insurance industry

MR. KEITH GUBBAY: We were going to have three speakers. Unfortunately, Jeremy Goford, who was going to come over from the U.K., could not make it. We are very fortunate to have Gerry Cunningham from California. He's going to be our first speaker. Gerry started out in insurance in 1981, where he was a founding member of Great Northern Annuity (GNA). GNA was very successful selling annuities through financial institutions. He was general counsel at GNA. In 1986, he joined Integrated Resources and headed up the marketing of Integrated's financial products. In 1989, he moved to Essex Corporation, where he now is president. Essex is a third-party marketing company that distributes financial products through financial institutions. It's the largest in the U.S. It sells about $1.8 billion of single-premiums and is the largest by quite an order of magnitude. We are very fortunate to have Gerry on the panel.

Doug French is a principal of Tillinghast, based in Stamford, Connecticut. He has spent the last three years in Australia, managing the Melbourne office there. As you may know, the Australian banks have been quite successful selling insurance. So it'll be interesting to hear what experiences Doug can share with us. Rachel Hancock is our recorder.

MR. GERALD G. CUNNINGHAM: As Keith mentioned, I'm an attorney by background. My subject is insurance sold through banks in the United States. I was going to give you some industry-wide figures on the sale of life insurance and homeowner's insurance, as well as annuities, but I was only able to come up with numbers for annuities, because the market for the other products is so small at this point that no one bothers to gather the information. The insurance market through banks is almost, at this point, exclusively an annuity market. This total bank annuity sales in 1992, broken down between fixed and variable annuities is $12.2 billion. I came up with a rough estimate of bank life insurance sales, which is not terribly reliable, of $375 million in 1992. It's primarily an annuity market.

* Mr. Cunningham, not a member of the sponsoring organizations, is President of Essex Corporation in Napa, California.

The total annuity market in the United States is about $50-60 billion; therefore, the banks now have something on the order of 20-25% of the market. That's an amazing number if you consider that the whole business of selling annuities through banks only started in 1981, and that it started with sales through institutions, most of which no longer exist. It's really only in the last four or five years that the commercial banks began to sell annuities. Dr. Kenneth Kehrer, who is the source of this information and the leading consultant to banks selling insurance products, estimates that in five years, bank annuity sales will be up to $40 billion. Obviously, a huge market.

I was asked, why there is an emphasis on annuity products, and not on insurance products. I don't know that I really understand the answer, except that there are some clues. Many efforts have been made to sell life insurance through banks so far, none of which are particularly successful. Annuities have been successful because the product is sold as a pure investment product. It's usually sold by individuals, whether they're full-time or part-time, that have no prior life insurance background. Their prior background is in the sale of mutual funds or individual securities, or merely as bank employees. The product is sold as an alternative to a certificate of deposit (CD) or a money market account. It's a product that, put side by side with bank products, as a pure investment, looks more attractive to many investors. And that's the secret of its success.

As banks have attempted to diversify beyond annuity products, they have not diversified into life insurance successfully. What they have done is diversify into other investment-type products, specifically, mutual funds. Now in 1993, banks are expected to sell something on the order of $50 billion in mutual funds. That represents probably 15-20%, of the rapidly growing and immense mutual fund market. So, the niche that the banks have carved out so far is the niche for pure investment-oriented products. That's their natural constituency. They have customers that have money in the bank that they're interested in investing. I think that life insurance sales will come eventually, but it's so much easier and so much more lucrative to make the easy sale of fixed annuities and mutual funds. Neither the banks nor the marketing companies servicing the banks, so far, have been willing to devote the effort necessary to figure out how to successfully sell life insurance products through banks.

Who are the players in the marketplace? Table 1 breaks down total annuity premium sales for the top 20 companies for the last four years. And what I think you'll find fascinating is that the leading seller of annuities through banks is the Dutch company, Aegon. Why is that? It distributes through six or so marketing representatives or exclusive general agents. One advantage they had is that they were one of the first companies in the marketplace. They have provided marketing support to the banks, but the marketing support has been at a fairly modest level. They've succeeded primarily by having the very best products, by being close to the market, being very innovative, and simply putting out products with features and benefits that are better than anything else being offered.

The mystery to me, and to every actuary I've ever talked to about the Aegon products, is how the company underwrites this product and makes a profit. I was in Holland recently, and if you're over there, the world looks pretty flat. Maybe there is this sort of Dutch Ptolemaic actuarial science that produces different numbers than we come up with in the United States.

TABLE 1
Top 20 Underwriters of Annuities
Distributed Through Banks and Thrifts
Ranked by 1992 Financial Institution Premium

Company	Premium ($ million)				
	1992	1991	1990	1989	1988
Aegon	1,170	1,228	990	650	700
Great Northern Annuity	913	900	815	825	682
Conseco	802	1,120	875	430	250
Keyport	795	541	437	475	228
Lincoln National	700	400	200	175	n/a
Ford Life	700	39	0	0	0
Hartford	673	350	91	n/a	n/a
Financial Horizons	608	648	500	115	n/a
American Enterprise	520	210	125	100	n/a
AIG	450	300	150	85	175
USLIFE	435	279	n/a	0	0
Alexander Hamilton	410	275	246	235	320
National Home	307	r/c	r/c	r/c	r/c
American General	300	59	n/a	0	0
Safeco	280	150	125	85	n/a
Kemper Investors	266	250	255	190	n/a
Jackson National	267	200	200	130	n/a
Central National	220	110	77	12	0
Principal Mutual	190	120	70	n/a	n/a
North American L&C	187	80	n/a	n/a	n/a

n/a -- Not ascertained
r/c -- Requested confidentiality

They have products with ridiculously low surrender charges and other features and benefits that any American actuary would look at and say doesn't work. However, they have succeeded, and in fact, you can see that their sales in 1991 were just a shade lower than 1992, and that's because they have admitted that they are at their capacity. About August or September of 1992 rates plummeted, and they've dropped back out of the market. They took their $1.2 billion and quit. They could be at $2.0 billion if they wanted to.

The number two player, GNA is a totally different story. It's a start-up company set up just to sell annuities through thrifts, and then banks. They succeeded not with good products, but by providing an intense amount of customized marketing support, providing just the kind of marketing support banks need to succeed – it's a diametrically different approach to the business. This is the company that was recently acquired by General Electric (GE), who, shortly thereafter, purchased United Pacific. I don't think United Pacific is even on the list anymore. It used to be in the top four or five, but the flight towards quality and its reputation as a junk-bond player caused it to virtually drop out of the market. But GE recently paid a total of almost $1 billion to buy these two companies, and announced that it thinks that there's a huge potential market for the sale of insurance and mutual fund products to bank customers; it voted with a billion-dollar investment. GNA's sales have been flat, however, for almost four years. GNA would say that that's probably because it just hasn't had the capital. The real reason is because its products haven't been very competitive because of the very high cost of the marketing support it provides. It really has not had very competitive products.

Conseco was one of the major players, at $1.1 billion in 1991, dropping to $800 million in 1992. Conseco will be even lower this year because of this flight toward quality and concern about safety. Conseco is a fine company, but there's been some controversy surrounding it. It was highly leveraged. There have been some articles in *Barron's* questioning its accounting. And that's just enough to scare off a number of the banks, and cause Conseco problems.

Ford Life, I think, is one that is worth talking about, if you represent an insurance company and might be interested in the marketplace. How did they go from 0 to $700 million? It's a client of ours, that we represent exclusively. We approached Ford Life one-and-a-half years ago, when we discovered that they had a sleepy little life insurance company with $2 billion in assets, $650 million in capital and surplus, a 35% or 40% ratio that any other insurance company would die for, and another $150-200 million in statutory profits rolling in every year. It had a very strong, financially clean balance sheet. It was able to underwrite a very competitive product by out-sourcing everything. I think there are only three employees at Ford Life. The people at Conseco manage the money and administer the policies. It has Essex market it. By out-sourcing, it was able to put out a very competitive product, backed up by the Ford Life balance sheet. It went to $700 million in a year, and this year it'll probably be $1 billion. If there's a moral in that story, it tells you very clearly, that this is an easy market to enter if you have financial strength, if you're willing to underwrite competitive products, and if you take the right approach to distribution. I mean, there are no real barriers to entry if you have those ingredients.

How does it distribute its products? Does it go direct, or does it distribute through marketing companies? The first big decision an insurance company has to make when it decides to get into the bank marketplace is, what is it going to do? Is it going to set up its own internal operation, like GNA did, and provide turnkey programs and so forth? Are we going to just deal direct, and let the bank provide all the marketing support and just hand the product off? Are we going to give the product to a third-party marketing company? Or, are we going to use all three approaches? There are different approaches that people have taken. There's no one way that works. The banks really do have to have a fairly high level of marketing support to succeed in this business. They're still learning to be sales organizations. They've got thousands of employees, but they're not sales-oriented people. The job of training and supporting those people is a big job, and it's very rare that a bank is able to really do it successfully themselves. The support has to be provided, and so the insurance company can either, like GNA, build its own internal support operation, or it can deal with a third party. Most of the business, except for GNA with its own internal marketing company, is being done through third parties.

Table 2 shows the leading marketing companies, and their primary carriers on the right. One of the things that we're proud of is the fact that we're now the largest by far, and four years ago, we were at $400 million.

TABLE 2
Largest Markets of Annuities through Banks
($ millions)

Marketing Organization	1992 Premium	1991 Premium	1990 Premium	Primary Insurers
Essex	1,800	1,087	790	Ford AllLife
Marketing One	914	749	609	Lincoln National Alexander Hamilton
GNA	913	940	815	GNA
Financial Horizons	656	647	600	Nationwide
BANKMARK	621	460	175	USLife Western National
James Mitchell (JMC)	580	300	256	Keyport Life of Virginia Aegon
FIMCO	490	440	300	Aegon
Planco	455	320	140	Hartford United of Omaha
AMCorp	440	423	390	Aegon
Liberty	400	352	260	Keyport
INVEST	389	290	267	Kemper Investors Lincoln Benefit Keyport
Talbot	370	150		Safeco
Compulife	300	200	135	Western National Alexander Hamilton
Jackson National	267	200	200	Jackson National

I think one of the reasons that we've been fortunate to do so well is because we're the only company on that list, at least in the top five, that is privately owned, and has multiple relationships with a number of major carriers. That allows us to tout our independence, which has become very important as the banks have become more concerned about the financial safety and strength of the insurance companies. A few years ago, an insurance company could come in and say, "Deal with us. We'll give you the insurance products, we'll put you in the business." But if the bank does that, it is really getting into bed with a single insurance company, and they don't know what's going to happen to that insurance company in two or three years. Is it going to continue a conservative investment policy, or is it going to continue to maintain high capital surplus levels? Is it going to continue to provide a competitive product with competitive renewal rates? We're able to say, "We represent Principal Mutual, Ford, AIG, John Hancock, and Allstate, and you can spread your money around and not be tied to any one." That has given us a huge advantage.

While I think in the insurance end of the business there's growing opportunity for insurance companies (as we grow from $10 billion in sales to $40 billion) all of us in the business see a shortage of a product or a capacity problem developing. If you have the right credentials and the capital, it's an easy market to enter. The reverse, I think, is happening with marketing companies, because over a period of years there have been a number of marketing companies that have dropped out of the business. There's a consolidation occurring here because the established companies have had ten years to build up expertise. So they have marketing departments and training departments and customer service units, so they have critical mass that allows them to provide a wide range of services. Four or five years ago, you could start up a marketing company and sign up a few banks easily. The business is almost all going to one of these established players. And the other thing that's happening is the marketing companies that are privately owned are being acquired by insurance companies. Bankmark, for example, was a privately-owned company until about six months ago. Financial Horizons was a private company that was acquired by Nationwide a couple of years ago. What is now described as Liberty used to be a company called Pamco, and Invest is now owned by Kemper, and so forth. So, there is a consolidation of the marketing companies occurring, and you have a gradual acquisition of those companies by insurance companies that are trying to vertically integrate to provide that kind of marketing support that they haven't been able to provide directly themselves.

Table 3 shows some information from a survey of 44 banks that has, I think, some interesting information. It was provided by Bank Insurance Market Research Group. The banks it surveyed included, three banks under $1 billion in size, 21 that were $1-10 billion in size, 13 that were $10-40 billion and seven that were over $40 billion. Broken down they are 68% commercial banks, 32% thrifts. You see their average asset size. These were basically on the high end. We're dealing here, obviously, with large institutions.

TABLE 3
Responses from a 44 Bank Survey
Which surrender-charge schedule best describes your best-selling annuity?

	Banks	% of Banks
More than 7 years	2	4.8%
7 years	14	34.1
6 years	6	14.6
5 years	16	39.0
Less than 5 years	3	7.3

Rough Average: 5.9 years
Source: Bank Insurance Market Research Group

What kind of sales force do they use? One of the big issues that still has not been resolved in the bank marketplace in the United States is what has been the best way to sell the product? Should you license customer service representatives, tellers, or branch managers, and have them sell the annuity product along with all the other products they're selling? Or should you employ a professional, dedicated sales force? The banks were asked, how many have a platform sales force, how many have dedicated? Almost half had platform and 86% had a dedicated sales force. That adds up to more than 100%, right? The reason is because many banks have evolved toward what we call hybrid programs that are a combination. There were a lot of thrift banks that started out, just licensing platform people to sell annuities only.

Then, somewhere else in the bank, they started a dedicated sales force to sell mutual funds and securities and maybe insurance products and annuities. Then they tried to figure out what do you do with the two? People try various ways to try to develop a hybrid sales force that can work together, rather than in competition.

The bulk of the big banks, at this stage, are primarily relying upon dedicated sales forces that sell the full range of mutual funds and probably some individual securities, (although that's a very small market in the banks) as well as fixed and variable annuities. Citicorp, Bank of America, Chase, Wells Fargo, Chemical, and now Nations Bank, through a joint venture with Dean Witter, have all gone solely with dedicated sales forces and are not using platform people. Except for Nations Bank, these are big money center banks. Some of the large thrifts and some of the super regionals, however, have gone the other way. Bank One has had a platform annuity program. One of our clients, First Union, which has had a dedicated sales force like Chase and Citicorp, just recently decided to license 2,500 platform people to sell both their proprietary mutual funds and fixed annuities. Bank of New York, a client of ours, has just decided to license several hundred platform people to sell annuities and their no-load proprietary funds, which is something no one has tried to do yet, and I think this has some interesting possibilities. U.S. A.M. Corp, the biggest bank in the northwest, has always had a dedicated sales force. They've just decided to license several hundred platform people to sell fixed annuities, and probably eventually mutual funds. And one of the things that has prompted many of the banks to begin to experiment with this kind of hybrid program, where you license platform people to sell some of the products, either just annuities, or annuities and a limited menu of mutual funds, is the tremendous success that a large savings and loan, California Federal, has had with this approach. Banks are very reluctant to take their lead from thrifts, and particularly a sick one like Cal Fed that has been on the endangered species list for a number of years; but, in the end, results talk. Cal Fed started out with a dedicated sales force, then added platform people selling mutual funds and annuities. This year they will have total sales of mutual funds and annuities of about a billion dollars, using that approach. That's gotten a lot of attention.

Even after some ten years of experimenting with different approaches to distribution, interestingly enough, the jury is really still out. There are those who say you need the full-time professional who can really do a quality job, maybe do some financial planning or at least some needs assessment, sell a full range of products and go head to head with that Merrill Lynch person. There are those that say go dedicated, but you can't put one person in each branch; there's not enough business, generally, unless it's a huge branch, so they have to circuit ride. Each sales person may cover two, three, four, or five branches.

The other school of thought says, we have hundreds of people sitting in our branches already. They know the customers. They know how the bank works. We want 100% coverage. If people walk into a branch, we think it's important that someone who could sell these products be right there when they walk in. We're going to take our existing people and equip them to sell the full range of products. I actually think that in the long run, the latter strategy is probably the right one. It's just a matter of adapting the institution and developing the level of expertise in the institution, so that the people within all these branches are salespeople and can sell the products of the bank. They probably won't be able to sell everything. The Merrill Lynch stockbroker doesn't sell life insurance, they gave up on that. There are only so many things any one person can do. So you'll probably have a salesperson in the lobby that will sell a fairly wide range of products, but then there will be specialists, and that's how life insurance will be sold. Life insurance will be sold by the platform person in the lobby, recognizing the opportunity to make a life insurance sale, and then being sent in to make the referral to the specialist who sells life insurance, and probably nothing but life insurance.

Let's discuss some annuity sales for different sizes of banks from the survey of 44 banks, to give you some idea of the kind of numbers that can be done. I think Citicorp is up to $800 million. It has a huge dedicated sales force. It was one of the first banks in the market. It has been really dedicated in this market, and it has had tremendous success. It sells a Nationwide product, and an Aegon product. But rumor has it that it is one of the few insurance companies that has that grandfather power to underwrite, and it is doing its homework and getting ready to begin underwriting its own proprietary products. So it will probably be the first commercial bank to actually underwrite its own fixed annuities. A typical rule of thumb is that a successful annuity program should capture about 2% of the core retail deposit base. In some of the smaller institutions, those in the $2-5 billion range, where they're able to bring a little more focus to the program than these big banks, we've seen results as high as 5-7% or 8% of that. We have some thrift institutions that have $2 or $3 billion in deposits, sell over a $100 million a year in annuities, and generate over $4 or $5 million a year in net revenue. We have some thrifts that are just hanging on and surviving with the money they're making selling annuities. They're making much more money selling annuities than they are at their core bank business.

I want to switch from methods of distribution to products, for a moment, because I thought you might be interested in knowing what it takes to compete successfully. If an insurance company wanted to enter this market, what does it need to have? Because of the Executive Life debacle, the Mutual Benefit failure, the problems with MONY, and a number of other companies, the banks have become extraordinarily conservative in their selection of insurance companies. Now, you, as actuaries, know the kind of changes that have been occurring to kind of rein in the investment strategies of the insurance industry. It really hasn't been necessary in the bank marketplace. The market has done it for you. You just can't do business with a bank anymore unless you meet certain criteria. The first thing you must have, at an absolute minimum, is an A rating from Best. But that, in itself, really doesn't mean very much. As you know, most of the big failures were AAA companies. Probably the biggest loser in this whole debacle was A.M. Best, who has been totally discredited by the marketplace as qualified to judge the credit worthiness, or safety of insurance companies issuing annuities.

The Standard & Poor's (S&P) or Moody's rating are the most respected. Table 4 shows the lowest-rated annuity on the menu, not the average or the highest, but the lowest-rated annuity that any of these companies sold. It's very hard to do business these days unless you're rated at least AA. If you're on this table and you're single A, there's probably more to the story. For example, Ford Life is single A, but its parent company, American Road, is A plus, and it guarantees the liabilities of the subsidiary. So you'll generally find a AA somewhere in the equation.

TABLE 4
S&P Rating
Responses from a 44 Company Survey
Lowest Rated Annuity

	Companies	% of Companies
AAA	3	7.7%
AA	21	53.8
A	13	33.3
BBB	1	2.6
B or lower	1	2.6

What does the product look like? About three or four years ago, the yield curve inverted, and for the first time, or maybe the second time since this market developed, short- term CD rates were actually equal to or higher than the one-year guarantee on annuities. That really hammered annuity sales at the time, and the innovation that was developed in response to that event was the so-called bonus rate annuity, which, in most cases, was designed by merely lopping 1% off of the commission and putting it on the first-year rate. It would be clearly disclosed to the customer that it was a bonus, and that the base rate was 1% lower, and if the interest rate environment didn't change, customers could expect a renewal that would be 1% lower. This differs radically from the practice that many insurance companies engaged in (and some still do) of giving people a bonus rate and not telling them it was a bonus rate, the so-called teaser rates. Some insurance companies and marketing companies and banks engaged in that practice. Some still do. It's a short-term strategy that eventually blows up. It's one that we, as a marketing company, will have nothing to do with. We require a blood oath from all our carriers that they use what we call level-spread pricing. If interest rates stay the same, that renewal will be the same. And if it isn't, we won't continue to do business with them. But you can see what the bonus rate did. It was an innovation that took over 70% of the marketplace. There are still some holdouts. I don't think Citicorp sells a bonus rate, but whenever a bank puts a bonus rate on the menu with other products, the bonus rate gets nearly all the business.

Rate is the most important factor in an annuity sale, whether we would like it to be or not. The second most important factor is surrender charges. You really can't have more than seven years of surrender charges, and the most successful products are at five or six years. When we started GNA we thought that liquidity would really be important. We started out with a product that had five, four, three, two, one surrender charges. That was nice, but it caused incredible surplus strain and risk, and that all had to be reflected in substantially lower rates. What I've learned over the years is that while the length of the surrender charges is very important, the size of the surrender charges isn't. The average superconservative bank customers don't plan on paying a surrender charge, whether it's 1% or 2%. So for the products that we design with our insurance companies, we say we want them short, and if they've got to be high to get them short, then that's the way we'll take them. So our flagship Ford product has surrender charges of 9%, 8%, 7%, 6%, 5% or something like that. They are very high, but short. Better than the more traditional surrender charge schedule, which was 7%, 6%, 5%, 4%, 3%, 2%, 1%. Make them big and get them over with.

So, in terms of what kind of product you must have, if you really want to enter the bank marketplace, you need an AA S&P rating. You need a strong parent too. You might have a life insurance company that's strong on paper, but if there's some controversy surrounding the parent, that could mean death in this marketplace. And then you simply need to put a product out there that has a competitive interest rate built around a spread of no more than 175 basis points, a surrender charge period of five to six years, there probably needs to be a bonus rate, and probably total acquisition costs of no more than 6.5%. The banks want to get 5-5.5%. If you use a marketing company, they need about 1%.

Another feature that's become very important is cumulative withdrawals of interest, if you can do it, rather than just 10% a year which is standard. One other feature that's become very important in this interest rate environment is systematic withdrawals. It's not an immediate annuity, it's just systematic withdrawals. They're really not buying tax deferral. These are for people who want income, and it's just sold in competition with a CD on the basis of a superior rate and the fact that the principal is guaranteed. Right now, in this interest rate environment, in the bank marketplace, maybe 25-30% of the business is being done with systematic withdrawals. Instant issue is also an important feature.

I mentioned that the market right now is about 90% fixed annuities and 10% variable (that is in the broker-dealer community). In the Merrill Lynches of the world, interestingly enough, it's the other way around. It's probably 90% variable. If a stockbroker sells a fixed annuity, he or she sells the fixed annuity bucket inside the variable annuity. I believe that the bank marketplace is moving in that direction. Variable annuity sales are up dramatically. We expect them to continue to rise as the marketplace matures and becomes more sophisticated. In addition, probably the biggest thing that's happening in terms of product in the bank marketplace right now is the development of bank proprietary mutual funds. Every big bank is coming out with proprietary mutual funds, and as soon as they have any success, the next thing they will want to do is wrap the proprietary funds in a proprietary variable annuity. The Fleet and Great Western have just done it. We're talking to Wells Fargo, NBD and other banks about doing it. In the end, that allows the banks to retain control of the assets. Up until now they've been willing to give the assets up to the insurance companies or the mutual fund companies because they saw no alternative. But once they see a way to control the assets through proprietary product that's going to be their preference, no matter if they are proprietary mutual funds or proprietary variable annuities. Instead of just earning a one-time fee up front and giving up the assets, they can keep those assets under their control and continue to earn annual fees.

Finally, where do I see the market going for products? Wrapped variable annuities is one. In the fixed annuity area, I think the opportunity lies with insurance companies that are willing to accommodate the desire of banks to control the assets. By that I mean, find ways to let the bank manage the money. Wells Fargo manages $150 billion a year; it has sophisticated people. They can manage money. Design a product that gives them the power to manage the money, and pay them a fee for managing it. Design products that allow them to share in the profit stream based on the persistency of the product, or the actual spreads or profitability earned. Instead of just paying them a commission for selling the product, find a way to cut them in on the product. That's where we'll see the industry going. Ten years from now, I think that banks will either be selling their own products or, if they're selling through insurance companies, they will have a proprietary stake in those products.

MR. DOUGLAS A. FRENCH: I'm going to concentrate on bank assurance in Australia and Southeast Asia. However, I want to warn you up front that most of the presentation will address Australia. That's where most of the bank assurance activity is taking place right now, and that's where we can learn many lessons. We will discuss the players and their business strategies, the market shares that they've obtained to date, what types of products they sell, the distribution methods they use to sell those products, and then briefly we'll touch on some results, lessons and implications.

As a result of deregulation in the late 1970s and early 1980s, Australian banks can distribute life insurance products to their client base and can own life insurance companies. Until 1978, Australia had separate banking and life insurance industries and, for the most part, the federal government regulated both of these. The banks were regulated through the reserve bank, and life insurance companies were regulated by the life insurance commissioner through the Life Act of 1945. In 1979, the federal government appointed a committee of inquiry into Australia's financial system. The committee was a response to a number of changes in the market, including the diversification of financial instruments and the development of new financial institutions. After this committee's inquiry, it had the following recommendations: level the playing field, remove barriers to ownerships of banks and other financial institutions, and reduce regulation and control. The committee presented its final report in 1981, and this report led, in due course, to the establishment of life insurance subsidiaries by the four major retail banks in Australia.

That's a bit of history of how we got to where we are now. Let me deviate for a minute and fill you in on the current situation for banks in Australia. It's not a good time to be a banker in Australia. Profits are down. They have huge corporate loan problems, and they have huge real estate exposures in Australia. Central business district property is down 50-60% in value, those values that were at their height in 1989 and 1990. Since 1990, Australia has been in a recession. In spite of the Prime Minister, we're still in a recession. We're not pulling out quickly. Australia will not pull out of its recession until the economy in America gets revved up. In Australia, we have invested a lot of time and money in building a very large branch distribution structure. What I mean by that is bricks and mortar -- lots of buildings. I work on Collins Street in Melbourne and if you walk from the beginning to the end of Collins Street, and you banked with a major retail banker, you could run into a branch every block-and-a-half to two blocks. This is costly. Of course, this is the main street of Melbourne. You would see the same thing on the streets on either side of Collins Street.

Australians use automated teller machines (ATMs) more than other people in the world. However, there is a cost to using ATMs. Currently, it costs $1 per transaction. Doesn't sound like a lot, unless you're like my actuarial students, who take $10 out at a time. That does tend to add up. The banks are realizing that it's costing money to provide this convenience to their customers. Finally, their culture is a bit under attack, in Australia. Up until now, when you became a branch manager in a bank, you were trained to lend money to consumers. The bank is geared around lending. It doesn't know how to sell things. People walk in, they take out loans.

The bank branch managers have been taught that when they give loans to people, the banks make money. We'll touch more on this later in my presentation.

I've divided up the major players in Australia into three groups. First tier, second tier and then some agency agreements. In the first tier are our four major retail banks. Again, all four are selling insurance through their bank branches to their clients. Westpac Bank has a strategic alliance with AMP. AMP is the largest insurance company in Australia. It sells products through a subsidiary called Ampac Life to Westpac Bank customers. The Commonwealth Bank has been extremely successful in selling life insurance. They're half government owned. There is a rumor, in a couple years, that the rest of the bank will be floated. Then we have ANZ Bank, and finally National Australia Bank. ANZ Bank owns ANZ Life and National Australia Bank owns a life company they call National Australia Financial Management. Advance Life and Citicorp, in Australia, are smaller, regional retail banks. They sell a limited range of products. Bankers Trust and Macquarie operate in Australia as funds managers rather than retail banks. Both of these life companies are relatively new, and the major reason for establishing them is regulatory, rather than because of market pressures. There are less regulations to sell single-premium products for life companies in Australia than to sell unit trusts, or what you call mutual funds. A way to get around doing nasty things like filing prospectuses is to set up a life company and sell the exact same type of product through it.

There are two large agency agreements worth mentioning. There are others, but they're with fairly small regional banks. MLC has an agency agreement with the Bank of New South Wales. New South Wales is the state where Sydney's located. MLC is the third-largest insurance company in Australia. And we have another agency agreement that has been formed recently with Armstrong Jones Life and Challenge Bank. Challenge Bank is in several states in Australia, however, they're based in western Australia, where Perth is.

There are really three business strategies worth discussing when you have a look at these banks. First, their entry into the market. Second, their relationship to the bank. And finally, the pricing of products. With regard to entering the market, we've seen four routes. Buying an existing operation, starting from scratch, doing a joint venture, and agency agreements. The ANZ Bank chose the acquisition route, and purchased a small existing operation to get started. The Commonwealth Bank and National Australia Bank established life insurance subsidiaries from scratch. Westpac Bank, which was the first to jump into life insurance, started from scratch in 1985, and in 1991, sold Westpac Life to AMP and set up a strategic alliance. AMP changed the name to Ampac Life. We discussed the two major agency agreements. It's important to realize that at the time of deregulation, the four major banks did have existing life insurance arrangements, and they offered products that revolved around lending. They also had fairly significant mutual fund or unit trust operations. When they got their life companies, these insurance arrangements and mutual fund operations were integrated into the new life insurance subsidiary.

With regard to the relationship to the bank, it's important to note that generally life subsidiaries work along side of, and are not part of, the branch office structure. The head of the life company does not have control over bank branch managers. He might think he does, but he doesn't. Usually he reports to a general manager in the bank who is head of subsidiaries, and he queues up, just like all the other subsidiaries, to get attention. I can tell you from experience, it does no good to be the CEO of a life company and send a memo to branch managers and ask for more leads. It doesn't work. What happens is the life insurance company competes for business with other companies in the branch, similar to other divisions. This relationship is important, and we'll discuss some of the problems of that relationship later on in my presentation.

In terms of pricing, most of the products in Australia are sold through sales consultants, or a dedicated field force. Now, the acquisition costs are lower due to the warm leads that are provided to the sales consultant. These negate the cost of prospecting. You don't have to prospect when you're a sales consultant, somebody feeds you leads. Your job is to convert leads into sales. Now, in theory, this prospecting savings cost should be distributed between the shareholder and the customer, and I think some textbooks would say evenly. However, in practice, what we're seeing in Australia is that this savings is being skewed towards the shareholder. The products are competitive in the market, but they're not clear winners. They will all be in the top quartile, but they won't be number one on anybody's product list. The exception to this is the Commonwealth Bank. The Commonwealth Bank, when they started a few years ago, primarily sold a single-premium, tax-advantaged pension product with no front-end or back-end load; instead, they take 100-basis points from you a year. Those 100-basis points are extremely competitive in Australia. You most commonly see something up around 150 basis points. I think it's safe to say, with what they're selling, they're creaming the market right now.

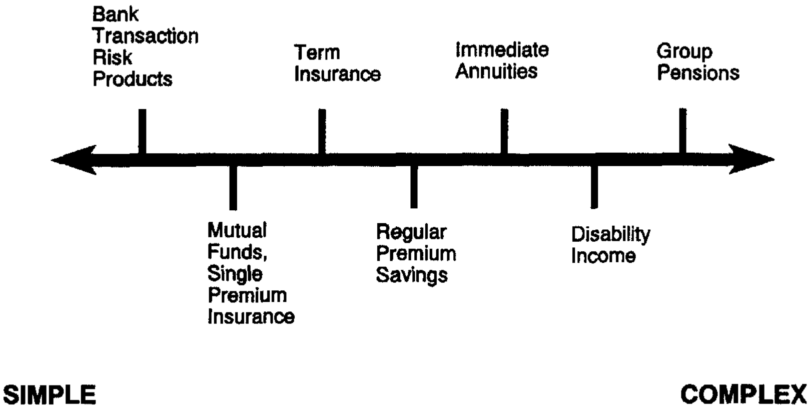
Last thing in pricing, I just want to touch on micro versus macro pricing, and try to explain to you how bankers think. With life insurance in Australia, actuaries typically use micro pricing or they price on a per-unit or a per-product basis. Bankers do not think this way. Bankers price on a macro basis. They have a big distribution system that they've built up over 100 years. Their job is to put as much product through that distribution system as they can in a year. Their profit is shareholder profit and contribution to company overhead. They don't think like insurance people. Now, some insurance people say the banks misprice their life insurance products. I don't think they misprice them; they just think of their pricing a little bit differently. Some people do price in the cost of a lead. They do take into account that if they are provided a lead from the bank branch they have to pay for that. I would think it's safe to say that though the life insurance subsidiaries do not price in the cost of this distribution structure, that is, the cost of the bricks and mortar, they're not forced to do that because bankers think in macro pricing terms and they don't do it.

What's their market share by new annual premium by single premium? For regular premium, they control about 5% of the market. That's primarily due to Westpac Bank's universal life product. Westpac Bank concentrates on selling an unbundled universal life product through their bank branch. Five percent might not sound like a lot to people in North America; however, in Australia, 50% of the market is dom. nated by two players. They both happen to be mutuals: AMP and National Mutual. So if somebody can walk in and take 10% of the remainder, the industry is going to take notice.

The other players have followed a single-premium strategy. The four major retail banks in Australia currently control about 35% of the market. The Commonwealth has been the most successful, but they've all had success to varying degrees. Most products sold in Australia are unbundled, and the bank-owned life companies follow suit in this area. They have exploited the retail end of products. They do not or have not, to date, concentrated on wholesale pension products. Because of current pension legislation, single-premium products or recurring single-premium products are popular. They sell variable products. Banks in Australia do not like book-value guarantees. They typically set up their life insurance subsidiary to be very capital efficient. They don't like to pour capital into a bank. Why would you hold reserves for asset mismatching, and things like that? Insurance companies in Australia lost a lot of money in the late 1980s and early 1990s on book-value guaranteed products, or what we called capital-guaranteed business. Capital-guaranteed business currently is not the flavor of the month with the low interest rate environment. Everybody's hooked on variable, or what we call unit-linked products, and that's what the banks sell.

Chart 1 is a product complexity spectrum, starting on the left with simple products and the right shows complex products. We see that banks are selling bank transaction risk products that they've always sold. They're selling mutual funds and single-premium products. Term insurance is sold in their bank branches. It's basically ART or yearly renewable term or annually renewable term. They sell regular-premium savings, primarily Westpac Bank. Banks are starting to get into immediate annuities. Immediate annuities are not popular in Australia.

CHART 1
Product Complexity Spectrum



Pension legislation to date has meant that when you retire, you get a lump-sum payout. You take your money, and you pay off your mortgage. You use the remainder for your around-the-world trip. You come back having exhausted all your funds and you go on the old-age pension. That's the way you retire in Australia. Pension legislation is changing, encouraging people to take immediate annuities. There is a lot of capital strain on immediate annuities, banks are a bit nervous about it. Some of them have it in their portfolio. I can tell you, nobody's selling a whole lot of it. They do sell disability income through bank branches. One chief executive officer told me he regretted the day he ever allowed disability income to be sold. You have to train your sales consultants a little bit differently to sell this product as compared to single-premium products.

At the beginning, there was some pain, but I think they've sorted it out. They do sell the product in bank branches. We're just beginning to look at the group pension market and see how the banks can attack it. Again, expense loadings on all these products are lower than industry averages, but they're not clear winners.

We use four types of distribution: sales consultants, over-the-counter sales, independent agents, multi agents or financial planners, and direct marketing. All four of the major banks use sales consultants to varying degrees. This is by far the most popular form of distribution amongst the majors. Sales consultants are provided warm leads. One bank allows the sales consultant to go out and generate his own leads. I believe this is extremely dangerous, but the bank does allow somebody to go and knock on doors and represent their bank and say, "I'd like to sell you some insurance." For these banks, independence is always an issue. They bend over backwards to do the best for their customer. They want to show the customers that what they're buying has value. They've all developed different ways to deal with independence. One bank allows you to sell a product from a different funds manager or a different insurance company, to prove that you're independent. Another bank requires independence for big clients. If you come into this bank with more than $50,000, you get shuttled off to the side to an independent consultant who will encourage you to spread your money over many players in the market, and tell you all the benefits of doing that. That's how they deal with their independence. Sales consultants are currently remunerated with salary and incentive bonuses.

The Commonwealth Bank, although they're now selling through sales consultants, has started with an over-the-counter product, that simple product I described before. You just walk in, and ask for a pamphlet. You get a nice glossy pamphlet with an application on the back, you fill it in, and give your check. It's extremely successful. Two major banks, and the majority of the second-tier banks, do allow their products to be sold by independent agents or financial planners. I believe, long-term, this will be a distraction for the banks, because it removes their eyes from their primary distribution channel. However, I must say, in the short term they've been successful with it. And then, of course, all the banks use direct marketing to sell insurance. It's used to generate leads, either through bank statements or credit card statements. It's a way for the life insurance company to build up a customer database, because legislation prohibits banks from passing names over to the life insurance company.

The biggest issue when you're a bank and you own a life insurance company is distribution. This issue receives constant attention by everybody. And generating leads is where you make it or break it. Again, legislation prohibits direct access to the database, and you need to develop ways to work around it. For instance, there's training. It's difficult to train 19-year-olds who work behind counters of banks to recognize somebody with a lot of money, but they try to do it. If somebody comes in who has a large sum of money, the bank employee should ask, "Do you want to see one of our financial planners?" There are lots of redundancy payments coming into Australia because of the economy, and these should be passed onto a financial consultant.

We have direct marketing to encourage leads. Bank subsidiaries generally work alongside the branch office structure. We have the product companies at the top and they feed into customers. This is the way we've historically done it in Australia. Now, in this structure, each company has a marketing department, and they're in charge of distribution. However, banks are starting to find problems with the way they're doing this. First, the customer base is becoming fragmented as each marketing department markets to a subgroup of the client base. There is a definite lack of cooperation, and it does stifle the organization's ability to increase the knowledge of the client base. To get insurance sales through, you must understand the client and his needs and provide solutions. Over time, this type of system will probably lead to a dry-up of leads.

What are people looking at? A new proposed structure. Banks in the 1990s want to look out for their customers. They understand the importance of a customer. Studies show that most people in Australia use more than two major retail banks to do their banking. In the old days, if you could get someone's mortgage, you had the guy's banking business for life. It doesn't work that way anymore. People go out and shop. It's extremely expensive to gain a new customer, therefore they're concentrating on keeping the customers they have. Service to the customer, they believe, is enhanced when knowledge is gained. When you have a better knowledge of the client, you have a better understanding of his needs and you can provide appropriate solutions. This translates into having one marketing department that is physically in the bank. So the product companies become product suppliers. The marketing department is in the bank. It reports to somebody in the bank. It determines the needs of the customers. It determines what product or company will provide for those needs. It's a different look. However, this is going to require a retooling and a retraining in the bank which gets back to a lending focus. These guys don't know how to sell in banks. They're not used to asking customers, "What do you want? What do you need?" They're used to giving loans to make money. This will happen over time, but it's going to take time for the banks in Australia.

They've all been successful. A 30% market share in Australia equals success. The bank subsidiaries are all relatively profitable, based on published accounts. They do make money selling life insurance. They do have built-in advantages. They have a large client base. Insurance companies in Australia are starting to realize that the agent owns the client, not them, and it's difficult to get around that. They have the ability to gain knowledge on that client base.

However, there are barriers to success. Lack of coordination with bank branches is a problem. There is a culture clash between bankers and insurance people. Oftentimes, when they start up these companies, they hire life insurance people to run the life insurance subsidiary. Sometimes that's a problem, because they treat it like another life insurance company. They don't treat it as providing a product through the bank branch for bank clients. Sometimes we see that our objectives between the bank and the insurance company are unclear. Again, sometimes the bank insurance companies have problems with complex products, which is what they've learned with disability income. It requires more training of sales consultants to sell that type of a product. It can be done. Westpac Bank has done it, but it takes more effort to do that than to just hand somebody a no-load, single-premium product.

Let's discuss the Australian situation. If you're a life insurance executive in Australia, life is not good right now. You're under attack from all angles. There's a recession that's been going on since 1990. We're in a low interest rate environment. We are getting simplified pension legislation in Australia which is going to threaten a lot of defined-benefit plans. They're pushing defined-contribution and portability. The Trade Practices Commission in Australia has done a nice little investigation on the insurance industry, with regard to its costs, the way it discloses these costs to customers, and the way that it sells products. The report was not very favorable. Now it is pushing for disclosure of commissions for agents. That's going to hurt the life insurance industry. Consumerism is growing. When I went to Australia in 1989, nobody ever talked about consumers. It wasn't an issue. Now we see consumer groups popping up all the time, questioning life insurance products and the value that they add.

Tax is always a threat. We see new entrants from the banks. I think it's safe to say that bank assurance in Australia is here to stay. The life insurance industry is under attack. All these banks have started, and they've set up bank insurance companies. And they've all done it differently. Some have bought, some started from scratch. They could have all done it a little bit better. However, they've still captured about 30-35% of the market share, so they think they're doing a wonderful job. These guys are real competition. In order to survive, the life insurance industry must re-think its strategies. What we're trying to do in Australia, as life companies, is put commodity products through the wrong distribution system, an expensive distribution system, and it's starting to catch up with us and break down. The life insurance industry needs to think about distribution and what products should be put through that distribution system.

That's it on Australia. I want to touch on southeast Asia. There are five countries I'd like to mention, Hong Kong, Singapore, Indonesia, Thailand, and Malaysia. In Hong Kong, we know that East Asia Aetna has a 50% joint venture between the Bank of East Asia and Aetna. The distribution of life products, however, through the Bank of East Asia has not been explored. Carlingford Swire is partly owned by the Hong Kong and Shanghai Banks. They sell group pension and medical business through a salary-direct sales force taking leads from those banks. However, to date, they've not sold any life insurance. Cigna does sell some business in Hong Kong through credit cards, but it's safe to say most of bank assurance is primarily revolving around lending. Singapore has only about 5% of life insurance business which is sold through banks. However, four out of the thirteen companies licensed to operate in Singapore do have a link or a connection with a bank. We are anticipating more activity in Singapore in the future with regard to bank assurance.

In Indonesia, there are a number of small companies that are wholly or partly owned by banking groups. So far, they're getting insurance based on lending transactions. However, legislation has changed there recently, and they're looking for ways to sell pension products through the banks. It's interesting to note, in Indonesia, that it's pretty easy to start a bank. Almost anybody can do it. And when anybody can do it, that means they tend to collapse a lot. In Indonesia, putting your money with a bank is not as safe as putting your money with an insurance company. Insurance companies are viewed as more secure. This is going to stifle bank assurance for a little while in Indonesia.

In Indonesia, there's lots of activity going on with regard to life insurance. Any multi-national looking at southeast Asia should take a trip down to Jakarta and have a look. There are 250 million people in Indonesia. They have the same annualized premium in force as Fiji. Fiji is about four hours out of Australia. All the Australians vacation there. There are two million people there. So the insurance in force, in the two countries, is the same. One has two million people, one has 250 million. There's a lot of multinationals walking through Jakarta right now. You need a joint venture partner. You need one that has not been thrown in jail or is not corrupt. You need to be careful when you're down there. In Thailand and Malaysia, there are some links beginning to start between life companies and banks. However, they're just beginning to explore possibilities. Malaysia is probably going to be an interesting place in the next five years.

In conclusion, in southeast Asia, life insurance, for the most part, is being sold by tied agents, who build a personal relationship with their customers. Currently, there's little activity in the bank assurance area. However, we're watching the situation because the current legislative conditions may change, and southeast Asia is definitely one of the go-go places in the world; it is a very interesting place to do business.

MR. PAUL H. LEFEVRE: I have a question for Gerry. When you went through the product specifications, you talked about penalties and rates. From our experience, I've found that the policyholders in the bank market are quite old. I'm curious if you're finding in any of your relationships, that you're reaching younger people with either a variable annuity or fixed annuity, or whether it just comes with the market because that's who's walking into banks. We find that one of the biggest issues with marketers and companies is, what the maximum age is, and will policies be issued to 90-year-olds?

MR. CUNNINGHAM: That's exactly right. I think the average age of a fixed-annuity purchaser who goes through a bank is 65, 66, or 67. Most of the insurance companies ratchet the commission down, if they issue to those over age 75, which you almost have to do to compete. Generally we do it by reducing the commission by at least a point, or even more. The variable annuity buyer is younger. The average age of a variable annuity buyer is probably between 50 and 59. We are still grappling to come up with an insurance product that can be sold to people under 50, but we really haven't been able to do it. I talked about how we've had no success so far selling real life insurance products. I mean, it's probably those products that ultimately will be sold to younger individuals. Right now if they're under 50, we sell them on the mutual fund. If they're in their 50s, we'd probably try to sell them a variable annuity. If they're in their 60s, they're super risk averse and conservative, and have probably bought only a CD in their life, so the only thing we can get them to buy is a fixed annuity.

MR. TODD L. LASZEWSKI: I was just curious when considering selling different life insurance products, it seems that there might be a lot of opportunity, at least in the United States, to sell estate planning vehicles or second-to-die products, etc. to the older population. Is that being pursued at all?

MR. CUNNINGHAM: Just recently everybody sees that opportunity. Mostly these programs I'm talking about are retail programs with simple products geared to grey-haired ladies -- mom and pop stuff. "You had a CD; would you like an annuity? It's a little better." And we really haven't had any successful strategies for capturing more of the upscale market or the business market or the high-end market. We are just gearing up a couple of tests ourselves to sell second-to-die life insurance as an estate planning vehicle through the trust department. I've seen the studies; it's a very compelling case. If you've got a net worth of more than $2 or $3 million, you really ought to buy second-to-die life insurance. I think that is going to happen. That's an obvious market, as well as business-related insurance of other kinds. In fact, one of our closest relationships is with John Hancock.

You may have noticed, I listed all the companies that are in the business, but you may have noticed who isn't on the list; where's Prudential, New York Life, where are all the big names you're used to seeing? None of them are in the bank marketplace now because either they're afraid to alienate their agents, or if they're willing to get in, they find that they're just simply not willing to underwrite the kind of products that will be competitive in the bank marketplace. Some, like Prudential, tried but folded its tent and left, because it thought it could sell the same products it was selling through its agents based on its name. It couldn't sell them and it gave up. John Hancock is really the first company that has had any success, and that was only after starting with a product that really wasn't competitive. It can only be successful if it is willing to separately price it. Distribution is less expensive through marketing companies or through direct relations with the banks than it is through general agents. Companies just can't look at their average cost structure; they have to isolate it and design a product specifically for the bank marketplace. With acquisition costs of 6-7%, they must figure out where to go from there. And if you can put a competitive product out there, you can compete.

John Hancock is now successfully competing, and I think it is the first of the big players, with a general agency sales force, to do that. Hancock has all these other products, second-to-die life and so forth, and we're working on some tests with it, trying to draw upon the expertise of its general agents to help us sell those products. What I think we're really lacking here, and this is sort of similar to the comment that was made about selling disability insurance, is companies like ours because the banks really don't know how to sell insurance. We know how to work the bank system to sell an investment product, but we don't know how to sell insurance. So we're trying to find ways to draw upon the expertise of people like the John Hancock independent agents, or general agents, to combine their product sales skills with our knowledge of the bank marketplace to see if we can put that together and begin to sell some of these other products.

MR. LEO J. HERBERS: In some of your closing comments, you mentioned that you expect things to get very interesting in Malaysia over the next five years. I just wondered if you'd elaborate on that.

MR. FRENCH: You can't get into Singapore right now. There are only 13 licenses, and they're not giving out any more. So that market is closed. We think the next logical place to go is Malaysia, and that's why we're watching it. There has been a big merger between a bank and a large insurance company in Malaysia in the last six months, and we're waiting to see what they're going to do. Malaysia can be used as a jumping point, just as Singapore can. I mean, I don't think you can get rich just selling in Malaysia, but you can use it as a jumping point.

MR. CUNNINGHAM: We've been doing some research on foreign markets, like Mexico, for example. When you do the research the first thing you learn is that there are an enormous number of people in Mexico, 85 million, but the life insurance market, in terms of premiums, is minute. Probably more premium is generated in Cedar Rapids than in Mexico. And there are two ways of looking at that. Either there's no market there, or there's enormous opportunity. It depends on whether you see the glass half empty or half full -- are you an optimist or a pessimist? Some of these markets have an emerging middle class; the standard of living is rising rapidly. Most likely, there is going to be a huge market there eventually. Some of these markets are wide open right now, there isn't anybody in there. One of the markets that we're doing research on now, and probably the first foreign market that we will try to enter will be the Mexican market.

MR. GUBBAY: Gerry, regarding the due diligence that you do on the companies whose products you write, what kind of guidelines and procedures do you put in place to monitor the assets and liabilities?

MR. CUNNINGHAM: When I talked about what you needed I talked about Best's rating. I didn't really touch on investment strategies. Most of the companies that got in trouble were companies that either had a big real estate exposure or a big junk bond exposure. You simply can't be in the junk bond market and sell your products through banks today. You clearly must have well under 10% junk or even less than 5% to be acceptable, and you can't have a heavy real estate exposure. We have retained the services of Dr. Kehrer, who I mentioned. Dr. Kehrer has a Ph.D. in economics from Yale. He's not an actuary. He specialized in this marketplace, and he performs a semiannual due diligence for us with all of our carriers. He sends them all a questionnaire that's basically designed to monitor their investment portfolio, the quality of their investment portfolio, and their capital and surplus ratios. We also monitor the financial condition of their parent, if they have a parent. Some of our larger banks are now asking for something additional from an actuarial firm. So we're now just kind of trying to sort out a strategy as to exactly how we would plug an actuarial review into this process. It basically comes down to how we can afford to pay the preposterous fees for the services you provide.

MR. DANIEL J. MCCARTHY: I was interested in your answer to Keith's question, because it seems to me, particularly with the way risk-based capital ratios are going today, companies have been backing out as fast as they can from junk real estate. But what they're in fact doing is taking a lot less quality risk, but a lot more duration risk. With the products you're talking about, that would scare me. Do you have any thoughts on that?

MR. CUNNINGHAM: That's a really good point. I don't know that anyone right now is zeroing in on the interest rate risk that's being taken. Clearly, the typical company to compete needs to be out there with something like a 6% rate right now, and they need a 150-200-basis-point spread, but you don't get that in a one-year instrument.

MR. MCCARTHY: Or even a five-year instrument.

MR. CUNNINGHAM: Yes. So, there is a mismatch there, and that does concern me. I think the companies we're dealing with have fairly high surrender charges that run for at least five years. From their standpoint, I think they believe that gives them adequate protection. I don't have the expertise to say whether they're right or wrong. I actually worry more about what's going to happen to renewal rates, and the effect on sales and on the marketplace when rates inevitably go back up, and renewals start coming in below market.

MR. CUNNINGHAM: It's a real concern. It's an equally big concern, on the mutual fund side, for banks who primarily sell bond funds. And it's going to be even worse there, because at least you have a guarantee of principal with the annuity. The customers can get a slightly lower interest rate, but their principal is still guaranteed and they can kind of ride it out. But what's going to happen when they wake up two years from now, when interest rates shoot up and the net asset value of their mutual fund has dropped by 40%?

MR. MCCARTHY: That's the customer perspective. My question was from the point of view of the institution, which is a little different.

MR. CUNNINGHAM: It is from the point of view of the insurance company. One of the companies that has had a great run is Conseco. Their stock has outperformed every other company, even AIG, over the last five years, by a big margin. Lately, it took a big dip, I read, based primarily on speculation that they had exactly that risk. I mean, they've got $10 or $12 billion in assets, and they've got a squeaky-clean portfolio, no junk, no real estate. But they're out there on the curve. They've been reaping these enormous windfall statutory profits, as interest rates have gone down, but obviously it's going to go the other way at some point.

FROM THE FLOOR: On that same subject, we do business with an awful lot of bank marketing companies and it isn't until a Tillinghast or a Milliman & Robertson or somebody is brought in, that this issue even comes up. It doesn't come up with Kehrer. A lot of due diligence is a phone call; how much junk do you have? Every now and then it's how much junk did you keep and can you give us higher rates, because it's been the highest performing part of the portfolio. That has always amazed me, and it has worked to our benefit only a couple of times. We are a successful A-plus S&P company in the bank market, and we are getting worried about that, because more AA and AAA players are coming into the market

The thing that amazes me is when BBB bank, is the one that's giving you trouble. I do believe that this interest rate environment is the worst time to be mismatched long. It is not the time to be sitting with long assets. It's better to cut your margins than to extend your maturities out, and a lot of people believe that the bank market is different than the terrible stock brokerage market, where the stockbroker is going to move the business at the end of the penalty period. My belief is that we've seen much higher surrender rates during the penalty period in the bank market than we have in any other market. And part of that is because a bank customer controls his or her actions more than he or she does in the stockbroker's market. In the stockbroker's market, the broker keeps the policy he sold. The customers do not really know what they have. In the bank market, they think they have a CD, and if CD rates increase to 7%, while their annuity rate is 5%, the people might move the money into a CD or IRA right away. We don't have any experience yet in that marketplace.