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Success in Bancassurance: A Coin Toss?

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Summary: Different models are used in what is known as the "bancassurance market." Which models are successful and why? Bancassurance is increasingly being considered by many insurers in North America and regulations are facilitating its use. This session will tell how bancassurance has been implemented by insurers in other countries in this case study format.

Ms. Lori A. Truelove: I work for BMA Reinsurance, and I've read quite a bit about bancassurance. I'm book smart but I have no actual practice in this area. We have two speakers who do have experience in the bancassurance area.

I'd like to introduce our first speaker, Ian Robinson. Ian is a consultant with Tillinghast-Towers Perrin Financial Services, and practices in Sydney, Australia. He joined the firm in January 1997. However, prior to joining Tillinghast, Ian held the position of chief manager of risk management within the financial services division of the Commonwealth Bank, one of the four major banks in Australia. The Commonwealth Bank was the last major bank to enter the bancassurance arena in the late 1980s; nevertheless, it developed a highly successful formula. Ian played a key role in the establishment of the life company subsidiary of the bank in 1988 and held the position of appointed actuary since 1990. He was responsible for all actuarial functions as well as heading the compliance function for the division. Ian

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Note: The charts referred to in the text can be found at the end of the manuscript.

is a Fellow of the Institute of Actuaries of Australia, a Fellow of the Institute of Actuaries of London, and an Associate of the Securities Institute of Australia.

Mr. Ian N. Robinson: Unlike other areas where the U.S. and Europe lead the world, I think Australia can probably teach a few lessons, perhaps not to the world, but to those countries that are looking at getting into bancassurance. From the little I know about what's happening in the U.S., the Glass-Steagall Act inhibited what banks wanted to do for right or wrong reasons. From your perspective, you might consider the case study of Australia. Think of it as a scouting party that has gone out and blazed a few trials and made a few mistakes on the way. Maybe the U.S. can avoid making the same types of mistakes.

I'm going to be talking about who we are and how to find us on the world map. I'm going to be talking a little bit about the nature of bancassurance and how we see it operating. In particular, we'll look at things in the context of Australia. I'll have some of those for you as well. Then I'll go on to talk a bit about what I believe works and what probably doesn't work or doesn't work so well. I'll discuss some of the key components of bancassurance and what sort of things are needed to make it work. There will be a couple of examples of specific companies as well, and then I'll close with a little bit of prognostication about what I think will be happening.

So who are we? As you know, Australia has quite a large land mass. In fact, if you were to superimpose a map of Australia on a map of the continental United States, Australia substantially dominates the U.S. land mass. In fact, there are many similarities to the U.S. Based on the geography, most of that landscape would be flat, like the U.S. Much of it is grazing land or desert. People do live there, but population is concentrated on the eastern seaboard. Like the U.S., it's a multicultural society. It's heritage goes back to the U.K. and Continental Europe; after the war, Southeast Asians settled in Australia.

It has a population of approximately 19 million. That's less than 10% of the U.S. The population is highly concentrated along the coast, particularly the eastern coast in the major capital cities like Sydney, Melbourne, and Brisbane, which accounts for only 1% of Australia's land mass. Inflation is low and we have typically high unemployment. When Americans come to Australia they feel quite comfortable. There's a lot of things that would be familiar to you. The same would apply to people coming from the U.K.

We are technology addicts. We love technology, especially the Internet, mobile phones, automatic tellers, and direct deposit into bank accounts. Banks only have to introduce any new technology like that and we grab it. I'm not sure of the reasons why, but it might have something to do with our remoteness from the rest of the world. It might have something to do with the sparsity of the population across the land mass.

The bank industry is a reasonably concentrated industry. Of the five largest banks, four are national. These banks have 63% of the deposit base in Australia. There are 56 banking licenses or branches in Australia, so that should give you an idea of how dominant they are. Many of those are foreign banks.

In terms of life insurance, the four national banks established life insurance company arms back in the mid-1980s as a result of deregulation of the banking industry that the government was pushing. The four major banks were very quick to establish a life office. National Australia Bank was the first in 1985, followed very quickly by ANZ, Westpac, and then Commonwealth Bank in 1988. Three of them established life companies from scratch. ANZ was the exception. It bought an existing middle order top life company. They all, except for Commonwealth Bank, established the sales force and the management and staff within the life company area, generally from the industry.

There was probably a mix of bank people and life company specialists, particularly those from the agency forces. They thought that, at that time, they needed to have salespeople who knew the products well, so they came from the life insurance industry. The one exception was the Commonwealth Bank, which decided from the outset that it wasn't going to do anything like that. It decided it was just going to use its own paper, its own products, its own systems, and do everything its own way. It believed that by using life insurance agents, it was going to get off the path of repeating many of the mistakes the life insurance industry had made. As I said, it started in 1988, and a good part of the success was due to that formula it kept religiously over the years. It hasn't changed. It still uses its own products, its own product manufacturing design, and its own salespeople. In fact, it has become the largest bancassurance in Australia even though it was the last to start.

In terms of the traditional life companies, the five largest are AMP, Prudential, Colonial, MLC and National Mutual. As of yesterday, the AMP, after a demutualization process, is now listed on the stock market, and hereby became the last life office in Australia to demutualize. There's one little company that is still a mutual. For all practical purposes, there are no longer any mutual life offices in Australia. The five largest life offices, excluding the banks, are selling at the rate of 56% of the market share of single premium and 67% of the new regular premium.

In terms of funds management, the five largest fund managers would have about 40% of funds under management. There are about 100 fund managers and, more recently, we've seen the entry of U.S. joints such as Vanguard and Fidelity. There are quite a few company CEOs in Australia with shaky knees at the moment.

So what is bancassurance? You might think that it's simply banks selling life insurance, and I suppose that is true to some degree. In fact, if that's all it was, then these banks have been doing that for a long time. They certainly have in Australia. It's much more than that. It's about the distribution and manufacturing of banking insurance products. One must consider the whole set. That's essential in order to be cost effective and it is essential to the bank's own customer base. Another way to look at it is that bancassurance is exercising proactively and leveraging the bank's own strengths. A natural and obvious strength, which any particular bank has, is its brand. It must leverage up the brand and the goodwill that's inherent in that customer base. There is its branch network and existing activities. It could be argued, in the final analysis, that any institution, certainly a large institution, will have all those features in place. At the end of the day, it comes down to brands. I believe that banks probably see it that way as well. They recognize the threats that exist around them. All they have is the brand to stand on.

An example of leveraging that I can talk about, that I have a lot of familiarity with, is Commonwealth Bank leveraging off the high mortgages by selling or packaging a life insurance product with those mortgages. The branch loan officer might be called at the end of the interview process for a home loan and say, "By the way, would you like some life insurance on that?" There might be, as in the case of Commonwealth, one yes or no health question, although it tends to have three or four parts to it. The trick, of course, is trying to come up with a question that clearly knocks out those who are on their death beds or those who are in the high-risk category, and at the same time, not to end up with a strike rate that is so low that you don't have any support of the branch personnel who are trying to sell this product. This product turned out to be a highly successful product for the bank. You might wonder about the claims experience. It turned out to be quite light, and it has been going for quite a few years. Nobody knows why, but the evidence is there.

Now my focus is on banks. Of course, the term bancassurance implies a preeminent position that banks would hold. AMP, the largest life office in Australia, recently obtained a banking license. It felt that there were many advantages to being able to have the word *bank* in its name. When times are difficult and customers are looking for a place in which to have trust and confidence, banks still have that comforting advantage. On the other hand, National Mutual, another large life office, has stated publicly that it has no intention of getting a banking license because it believes it can do everything that a bank can do, with a few exceptions. Those exceptions are not worth having, and there is no value added to the company.

From the Floor: Does that mean that there's no relationship between the bank and the insurance company, or is it like two people working together?

Mr. Robinson: When I say the bank, I should be talking about the life insurance company itself within the bank. The life insurance companies actually don't employ any people. It's just a legal entity. There might be a division within a bank to market the financial services division. The bank, as you would normally understand it, can't access that customer base. If the branch manager wants to market a product, he can do that, and he can provide information about the life insurance company product, but he can't actually access the customer base. If someone is interested in the life company, the application is completed, it will go through, and then that customer also becomes a customer of the life insurance company, in legal terms.

So what's in it for the customer? I think there are pretty obvious benefits from the customer's perspective. They have the broad array of products that they can choose from one financial services provider The banks believe that they're in a good position to advise customers on what their needs are and be able to tell them that they have a full range of products. Of course, a bank can't force customers to choose its own particular products. They are naturally in the obvious position of having some marking power. Clearly an objective is to achieve an outstanding global service. You have to follow that up. Customers are looking for fair value for money, so that's very important to them as well.

What's driving this change? There are a number of factors. They're not unique to Australia. The global driving forces can be seen everywhere, and Australia can't avoid the tides of change lapping at its shores, so to speak. Other drivers are rising consumerism, rapid technological change, continuing globalization, free movement of capital, increasing fear of worldwide systemic risks, and a new wave of competitors.

The May 1998, Vol. 32, No. 5 issue of *The Actuary* had a few articles on reinventing the life insurance industry, and there was one in there titled, "Navigating the Technology Course," by Ronald J. Helow. I'd like to read a short quote from it: "Technology will switch from a defensive to offensive tool—aimed principally at driving revenues." I totally agree with that. Technology used to be very much a back room exercise, but it's now one of the major keys to success.

Let's discuss the new wave of competitors. I'm sure most of you would have heard of Virgin in the U.K. It was a record retailer. It was highly successful in a number of areas and now has success in financial services. That's what I mean by new wave competitors. There are threats from software houses, so I won't talk about that to this audience. You would know about it better than I would. There are all sorts of things that are driving the changes worldwide.

There are three phases of change that I can think of that are clearly delineated in Australia. I've already mentioned that in the mid-1980s the banks started to establish life insurance companies. They also established at that time their advisor network and got into the mutual funds business. We call it unit trust, but it is mutual funds business. Then subsequently, in the very late 1980s and early 1990s, they realized that organic growth just wasn't going to be good enough for them. So the MNA started there as well creating various alliances, most of which have never worked. Alliances just don't seem to work. It also established what some have called personal bankers, which are people who are trained and authorized to sell and give advice on a limited range of products. If the situation was such that the customer was of high enough worth, or the situation was too complex for them, then the personal banker was to send the person up the line to the fully fledged investment advisor.

We've recently seen the life insurance companies wake from their slumber. They had all sorts of problems with legacy systems, outmoded forms of distribution, and they had to make some decisions. So we now see life insurance companies getting into retail banking with or without a license. They can do that in Australia, but they have a much greater customer focus and look much more at new technologies and new delivery techniques. So they're rapidly catching up, and the field is pretty level now.

I have some numbers that reflect the percentage of the bank's group profit from all sources. These would be the percentage of profit derived from the company's financial service group, which could include mutual fund business as well. It's too hard to isolate the life insurance company itself. National Australia Bank is the largest corporation in Australia, and it's share of bank group profits is 3%. It is not enough to be the largest corporation, and it has, of course, a low percentage there. So from the bank's perspective, the numbers don't look great, but I assure you they're important and the banks want to see increasing value from most sources, in fact, all sources of fee income whether it's financial services or not. For comparison ANZ is at 9%, CBA is 6%, and Westpac is 5%.

When one looks at it from the life insurance company perspective in Australia, it looks a bit more threatening, and the regular premiums are still not fantastic. It is one area where the banks have had some difficulty, but it's something to make them concerned. The area where the banks have had the greatest impact though is on single premium business, and I think I can draw a parallel here to the U.S. market. But most of that single premium business has come from deferred annuities, which I think you just simply call annuities. That's what the banks are selling now. So it's an investment product that is almost always unit linked, investment linked, or market linked. It's called a deferred annuity. What happens at the age of 65 is they can cash in the annuity and take the money and run. They might convert it to a lifetime annuity, or they may convert it to some other form of unit-linked annuity. There's no obligation to actually take it. There could be tax consequences, so they had a reasonably significant impact there.

It's almost impossible to get information about their own customer base, but my own estimate suggests they're probably getting around 5% of their total customer base at this point of time.

There are more efforts to segment the market. They certainly have a big focus on the retired market, or those who might be approaching retirement.

From the Floor: Has the interest of the banks also produced an increase in the total business or has it just taken away from the old?

Mr. Robinson: You jumped right ahead. That was one of my conclusions. In fact, I was going to end on a positive note for the life insurance companies. I was saying focus on the market. It is 5% of the customer base, but the effective customer base would be much less, of course. There are a lot of people in that customer base. The banks would clearly strike out. There's no point in trying to market to them. But if you cut it in half, you could say maybe they've reached 10% of the effective customer base in ten years, which is good for a ten-year period or a little bit more. Life insurance companies are estimating that they will have about 40% of the potential life insurance market base after 150–200 years. So the banks are not doing too badly. Clearly, the next 5–10% is going to be that much harder.

There has been the growth from the regular premium market (Chart 1). There has been a steady incline, which is not bad. As I said, the single premium market has shown substantial improvements. That's the share of the total sales across the life insurance industry, including the bank's own sales through the life insurance company's subsidiaries. A large part of the new single premium, shown by the dark bars, has come from the Commonwealth Bank which was highly successful in the deferred annuity market. I think they timed it really well. There was a recession going on and people were walking up the street with their investment money in hand, and asking the branch manager what to do with it. They just put it here because there was no entry or exit fee. Of course, they had to get volume just like the banking product, and they did.

The story of funds management is not so great. It is recognized as being much harder. Chart 2 shows wholesale funds management business. It is a completely different market. The area that had the most success is the retail market, mainly due to the retired end of the sector and those who are 10 or 20 years out from retirement. Personal pension plans have also been successful, particularly in the markets that are represented by low-to-middle net worth customers. They've had a number of less-than-successful areas. One is the pensions market. It is a complex area, but it holds a lot of potential and they are continuing to work on it. They are attempting to focus on those customers with high net worth, but it's very, very difficult. They recognize that those customers do want a highly customized form of service. I'm sure if the banks decided they really wanted to attack that market, they would do it well, but they have so much to do already with their current customer base, which is predominantly for customers with low-to-middle net worth.

Pure risk business doesn't have great numbers, but they've been highly successful running off the back of their banking products, particularly the mortgage loans. There is a lot of business there. Another problem market with mutual funds is that the competition is so fierce. There are hundreds or thousands of mutual funds, and they're all trying to get a bit of the action. Of course, you must have outstanding investment performance, and the banks have been constantly struggling to get that. We call property and casualty general insurance. I don't think the banks have been interested in that area. It's an area that tends to have commodity volatile profits. It just seems riskier to them, I suspect. Life insurance seems to be a more natural fit. When I say life insurance, I mean savings products as well, not just pure life insurance.

Electronic areas should be terrific for distributing products, especially through areas like the Internet. It's something that has recently happened, and it has started to gear up in recent times. It is distracted by other things, but they are starting to work hard on it.

What advantages do banks hold? I think most of these should be pretty evident. They have a large customer base, a large branch network with access to customers. Of course, customer loyalty can't be taken for granted in these days. Customers in Australia are prepared to shop around for the best deal. It's easy for customers to move because there are no exit or entry fees on products. Brands are naturally important, and I've already mentioned that. Access is also another important advantage. So banks have the three major components: the customer, the brand, and the way to bring the brand to the customer. They have the so-called many moments of truth with customers and the transactional activity that traditional banking business generates. It leads to many opportunities for cross-selling other products if banks want to do so. It has been said that banks are pretty good in the back office as well. I think that's somewhat questionable, but I'll add it for completeness.

Banks do get high productivity. Remember that the financial services advisors actually get fed warm leads from the bank. They are told about someone who has indicated an interest in a particular product or has a certain type of problem. The productivity would be three to four times higher than what a traditional life agent would expect to get. The downside is there's lower remuneration. I could have said lower commissions, but they don't really get commissions. You are actually better off if you put higher productivity and lower commissions together.

The banks are able to run at lower unit costs. If you put all of that together, the life insurance advisor or the financial advisor is better off, and so is the customer and the bank. The products may have lower margins, and they might choose to price their products more competitively. They're in a position to do that but they end up with enhanced overall aggregate profits. The bank could cross the product in the same way the life insurance company does and keep the extra margin if they so wished, but it does lead to higher value added.

So what have the life insurance companies been doing about it all this time? As I said, they were in a bit of a slumber for a while, but they were distracted. They had all the systems. They had very high costs they had to get down, and frankly, they didn't think the banks could do it, so they weren't worried about it. There has been a bit of a shakeup. I'd like to question whether it's a fair game. I think it has been said that it's easier for banks to go into life insurance today. To them, it's a matter of adding on another product. However, for life insurance companies to get into banking, it would be like getting into a new form of business, which I've heard they wouldn't know the first thing about. I don't think it's a symmetrical game because it is not fair to both sides. I think the life insurance companies, as I indicated in one example, have come to the realization that they don't even need a banking license. There have been some factors in Australia that have led some companies to that conclusion.

And so what sort of responses have they had? They can stimulate banking. They can, of course, obtain a banking license if they want. They've tried to forge alliances. Where it has worked, most of those alliances have fallen apart, but they continue to form alliances with a different type of partner rather than a life insurance company bank. The alliance might be with a communications company or an energy company. They've been cross-cutting and rationalizing their products.

One company reduced its product set from what was 80 products down to about five or six, which made it so much simpler. So that dramatically reduces cost.

They've also been cutting their agency force dramatically. I'm not sure of the number, but at least half of the agents that were there ten years ago are no longer there. What they have left is an agency force that is much more professional, much more highly skilled, and able to sell a broader range of products. The AMP has life insurance agents knocking on doors and, in some instances, selling home mortgages. So bank and life insurance companies do not see themselves as bancassurers, but as financial services providers. The distinction between the two is effectively gone.

What sort of problems have there been? There have been a number of problems. It's important that they all recognize what functional components are necessary for bancassurance, but the trick is to get those functional components working together.

For example, they realize the need to be organized on functional lines, not company/legal entity lines. The Commonwealth Bank, National Australia Bank, and I think the ANZ have all moved to organize themselves on functional lines so you won't find a financial services division within those banks. There's a life company there, of course, but it's just a legal entity. You have to have a legal entity to sell the product and the tax laws require that legal entities to be established. You won't find any people working for life companies. All the staff are disbursed throughout the bank. I think it follows a model that is pretty popular in France. There's a company in France that had this idea that all the executives of the bank are responsible for selling all the products of the bank, however you might classify those products. It seems the banks in Australia are taking the same approach.

There has to be a common approach to training, to sales culture targets, compliance culture, product packaging (color coding). They must be consistent throughout the whole bank. At least that's the theory. The banks are still trying to sort that out. They know where they need to get to, but they're still working on that. There must be alignment with the competencies of the bank and the bank office and front office. There clearly can be opportunities for a conflict there if they're not aligned. Again, there has been great success there, mainly because the developments have been happening so rapidly for them. There are so many different areas they need to focus on at the same time.

One of the things that they learned is they need to understand customer relationships and that a financial services customer or a life insurance customer is most probably a bank customer. If they upset the life insurance customer or if the customer dies and for some reason the claim isn't paid, relatives will not be too happy and the bank might lose five or ten bank accounts just like that. So banks have to be very, very careful about the relationships.

Banks need to understand constraints. They have privacy laws just as the U.S. does, and they need to work through that. They need to understand the business. Banks and the life insurance companies understand that they're in the financial services business. Banks are not in banking business. That's a product focus. Life insurance companies are not in life insurance business. That's a product focus. They're all in the financial services industry, which is more of a customer focus. The focus is on delivering to the customer. And whether you start as a bank or as a life insurance company, it seems, at least in Australia, it doesn't really matter. It really has merged together.

The other area that can create problems is channel conflicts. It is something the banks had to address very early on. They had advisors selling products and they had branch staff also selling products. The branch staff, of course, is only being paid a salary, and the advisors were getting a base salary, and they would also get volume bonuses as well. It was not a great deal of money, but at least they had the opportunity to get bonuses, and bonuses were a new idea to the bank. They had a great deal of trouble getting their minds around that concept, but they needed to. You can't use the possibility of conflicts between channels as an excuse for not creating those alternative channels. You have to meet it head on.

You must spend a lot of time on that. Banks in Australia simply are not used to this idea of selling these products. There is potential for all sorts of cultural clashes. They have to design and align their reward systems to line the product up with the distribution method and with the market. They have to spend a lot of time in that area and they have. It has been a long process, and has taken them many years. It is experimental and there is a lot of change. They must manage the branch and selling cultures. Traditional agents tend to learn very quickly that trying to get people from the life insurance industry to sell these products just doesn't work. They have a completely different culture. They don't understand how banks work, or how the branch network works. The branch networks are not interested in trying to serve their needs.

Commonwealth Bank markets its house brand. As far as I know, it doesn't try to sell anybody else's product. As I said, it recently integrated its functional lines. It is sorting out those areas of its business that it doesn't believe are adding any value. Commonwealth Bank has outsourced its information technology, printing, and those types of areas. It does this if it finds it is not adding value or is not part of the core business. Seeking scale is absolutely essential in this day and age (at least it is by acquisition as far as domestics go). All the banks are pursuing increases in their fee revenue and reductions in their cost base.

National Australia Bank is also integrated on functional lines, but it has much more focus on a global scale for acquisition. It is also pursuing revenue increases from fees and reducing its cost.

Is bancassurance the right term? I think I've indicated enough to suggest that the concept really doesn't have any meaning anymore. It really has reached its "use by date." A better term that's used in Germany is financial service conglomerates. I'm just about to combine all those indexes into one. I recognize that it's too hard a job to try and distinguish between the types of legal entities.

I'm going to try something a little provocative. Has life insurance died? Some people think so, but what they mean is death of pure life insurance risk business as a stand-alone product. It is fine if you try to package it with something else, but as a stand-alone product, it's not worth it because of the margins that it generates. For those who are in the business for wealth generation, life insurance just does not produce the dollar margins that they want to see.

There certainly have been major changes in face-to-face selling. It has been said that the banks don't know anything about face-to-face to selling and that it is still necessary. I think that's right. As I said, the life insurance agency force has been somewhat disseminated, but there's still a strong call there. It's going through a period of rejuvenation, and those who are left there have a much better job than they ever had.

My concluding comment is that bancassurance is, in fact, not a threat. I would suggest though that it's hard to point to any particular evidence, but I would suggest that banks have raised customer awareness for the need for life insurance and for savings. I think there is good reason to believe that everybody has benefitted. The concept of banks and life insurance is gone forever. There will be banking business and life insurance business, but not banks doing banking and life insurance companies doing life insurance. That idea is gone. Life insurance companies in Australia need to understand the business they're in. They're not in the life insurance business. They're in the financial services business. Likewise, banks are thinking the same way. The banks are addressing this issue of capital alignment and pricing alignment. The way banks price products is different from the way that life insurance companies price products. Capital allocation, performance measurement, and price all need to be aligned. The model is still evolving.

Ms. Truelove: Our next speaker is Bob Proehl, and he is vice president and chief strategy officer of Cybertek Corporation. Cybertek Corporation is a wholly- owned subsidiary of Policy Management Systems Corporation, and these firms, together, are the largest providers of solutions for the worldwide insurance and financial services industries. They service a client base in excess of 1,000 companies. The company has long enjoyed the reputation within the industry of being innovative. Among these innovations are support of the first virtual life insurance company, the creation of the industry's first electronic commerce platform, and most recently, the establishment of the insurance connect forum designed to maximize the effectiveness of banks as a distribution channel for insurance products in the U.S.

Mr. Proehl joined Cybertek in 1995 in his role as chief strategy officer. He acts as a futurist with the responsibility for developing business unit strategies and defining future directions. In addition, he oversees the marketing programs of the various organization elements to ensure consistency of focus. These organizational units include those focused on insurance, banking, electronic enterprise, information solutions, and outsourcing. He is a fellow in the Life Management Institute and has served on the board of directors of numerous corporations, industry advisory groups, and professional societies.

Mr. Robert Proehl: This is obviously not going to be a case study, since I'm going to be talking about domestic bancassurance, and it really does not exist yet.

The change that we've experienced within our industry has been interesting. In the traditional business model, we had the agent generating the demand, companies manufacturing the product, processing it, and then distributing it to the agent. I would venture to say that tomorrow's business model is already today's business model.

Tillinghast does a survey every two years of the CEOs within the life insurance industry. For the first time, and regardless of size of company or type of company, or structure of company, the number one issue among all of the companies was distribution channel productivity. They are also concerned about competition, the changing market, and customer demands because the consumer has become king. Sales practices and compliance issues are also important because nobody can afford to ignore them with some of the awards that have been given out.

The next question is, what are they going to do about those issues? How are they responding to them? They are responding through the increased use of technology by implementing alternative distribution methods, such as bancassurance, and by strengthening their compliance procedures and processes. They are basically employing all the processes and tools that were embodied in something we called our insurance connect forum. It is an organization that we created about a year ago. It's an organization that was made up of banks that distribute insurance products and insurance companies who distribute their products through banks. We brought these groups together and said, "If Barnett has opened the flood gates, where's this deluge of new business?" It hasn't happened yet due to many cultural and other types of reasons. This forum was the only place where the two parties could come together to have some meaningful discussion. There were other groups like banks and insurance companies and things of that nature, but those are primarily lobbying organizations. They want the playing field tilted in their direction. So we brought this group together and said, "We're a technology company. We want you to define the vision of how this ought to work, and then we will provide the technology to help you substantiate that vision."

So why did we create it? We recognized a couple of other things, too. First was that the consumer is really dictating how they're going to buy your products, what they're going to buy from you, and how they want to do business with you. I've been to these meetings and had people discussing whether to go on the Internet or other things. The truth of the matter is you have to do all of those things. You have to be able to support all of those distribution channels. If you don't, what you're really saying is, "I'm going to forego the opportunity to capture business in that channel." That's all you're doing because somebody else will offer it. So that's part of it. The other is this whole idea of a consolidated financial services industry or one-stop shopping. That's not new when you look back a few years at Sears and some other failures. What's new is now it's a model that can be achieved, and the reason it can be achieved is primarily because of the technology.

So why was this forum unique? As I said, we brought together the actual players where the rubber meets the road, and we got to talk to them. We focused on a more tactical approach. Strategically, everybody recognized that the convergence of the financial services industry is pretty much a given. But tactically, how is this going to work? There are a lot of issues. We started this a year ago, so there's a lot of regulatory uncertainty. What's the Office of the Comptroller of the Currency (OCC) going to do next to usurp something?

When Citicorp and Travelers merged, that was viewed as a transforming event. That really says that the game has changed, and companies are not waiting for the regulation. Ian talked about insurance companies in Australia doing business as banks without charters. Look at what Citicorp did. It said, "We can do this for three years under the banking law, so we'll do that, and then we can probably extend it a couple of more years. By that time, maybe you'll have your act together and we can regulate this business and compete on a fair footing with everybody else." It created a whole new kind of organization for the cross-selling opportunities. I don't know how many of you have read the announcements or listened to the press sessions on this. It didn't talk about the synergies or the kinds of things you'd expect when you have mega organizations merging. That wasn't the conversation. What was said was, "We're going to have 100 million consumers and we're going to be able to cross-sell to those consumers." The one reason they're going to be able to do this is because there's an opportunity to be successful now because of technology.

So as the industry has evolved and changed, we've also changed our insurance connection offering where we used to get together and share ideas. Then we jointly developed a vision of how the process could work and should work. It's mainly a matter of some cultural things and just thinking about changes. The processes are there, and the technology is there. There's no magic to any of this stuff.

Then we put together a solution set in this group. We're going to continue to keep the forum. We have some standing committees that focus on products and things of that nature. We are also addressing the technological aspects of it. We tried to create a bancassurance pack with all the products and services that anybody that wanted to get into this business would need, with the exception of legal advice. We're a software company. Obviously, we can't do all those things, and we would never be positioned to do them.

What we were able to do was define a vision that described how the process could work well. So it was a new business model based on new products and new ways of doing business. It was a broad functional support. Banks are focused on this to increase their fee income. They view it as fee income. They really don't want to take on an additional infrastructure to deal with it. They'd be more than happy to partner with someone to do that, provided that someone wouldn't damage their relationship with the client because that is the key factor for the banks in this process. Technology is a key element, as is the issue of standards and these sales channels, which can reduce cost and give more control.

We went into it with some sort of basic premises. The first of those is that we're going to have to change the way we've traditionally done business. I think Ian alluded to the fact that you can't really take the agency system and the existing products and just put that in a new distribution channel and expect it to work any better than it did where it was created. The fact of the matter is that the basic process has worked well. I mentioned control of the client relationship and technology. You'll hear me say that more than once. So what was defined within this group as some key elements for success, were some channel-specific products and standards.

As the banks start to sell insurance products, they're going to begin with the commodity products, but they're not going to be satisfied with that. Products are going to have be simple. They're going to have be created and defined in such a way that 100% of the bank's customers can buy the product, and I'll get into how that might occur.

We think that underwriting is going to have to become proactive. This is going to sound a little funny coming from people who have a strategic alliance with Lincoln Reinsurance underwriting. The idea of taking four to six weeks to underwrite a life policy is just not going to play in the banking environment where loans are underwritten in a day.

There is the ultimate knowledge worker. I'm talking about someone beyond the wired consumer. It's the wired consumers that would prefer to do the work themselves. In other words, they would prefer to serve themselves right up to the point they can, and you have to allow them to be able to do that. They have a netcentric approach to the whole process. Take the example of the fax machine. One fax machine is worthless; two is better; 2,000 is a lot better, not only because of the amount of connectivity you can get, but also because of the other people that contribute to the process and add things like auto dialers and all of the other kinds of products. We think the model for this has to work in the same way. So this is what we put together as a solution set, and we felt it addressed the entire state of the process. These processes need to be addressed.

Now, if you look at that, there are some of those things that we obviously don't do. We don't do product design. In order to be able to offer ourselves as a solution provider to the insurance industry, which is what we do, you have to be able to provide a complete solution. People don't want to buy a system. They don't want to have a business process reengineered. They want their problems solved. If you can't do those things, or you don't do some things, you should align with people who you feel are the best of the breed and who have the most talent for doing these things. Act as a general contractor and bring the whole process together. Some of the people we've aligned with in the product design area are Lincoln Reinsurance and Tillinghast-Towers Perrin. We have some other initiatives going on there, but I'm not going to talk about those.

What's going on in the industry and why is it necessary? If everyone within the life insurance segment of our business would be honest with themselves in terms of where we fit in relation to other financial services institutions, I think we would have to say that we're probably harder to do business with than most. Our products might tend to be high cost simply because the traditional distribution system is flawed and adds to that cost. If I called your home office and said I wanted to buy an insurance policy, could I do that, or would I get transferred to 16 different departments? Would an agent call three or four days later and try to sell me that policy? Would I even want it then?

How do we explain this as an industry? I can go out and get a $300,000 mortgage and a mortgage protection policy the same day. If I want to get a $300,000 life insurance policy, I have to undergo some very intrusive procedures, and that's going to take four to six weeks. That's not a viable model going forward. This is how we kind of describe that model, and I know a little about this. If you look at the traditional underwriting process, you would see that it's a very paper-intensive process. Until just recently, we owned the largest provider of attending physician statements in the country. It was a great, high-volume business, with a lot of revenue associated with it. The only companies that were making any money in that business were shippers like Federal Express that was getting the paper back and forth for us.

So when you look to the new model, you might ask what is it going to take to be successful? The successful companies will be those that are the easiest to do business with. They're going to have to offer low-cost products. Now, I didn't say they have to have the lowest cost, but they're going to have to be low-cost products. They're going to have to provide value. This gets back to the discussion of the agents and how they will survive and prosper if they provide value in the sales process. To the extent they don't, they will be history. Our vision includes how we think that agent can play specifically in this market.

We used a different term for life event marketing. I forget what it is, but it's obviously key. One of the key advantages banks have above a life insurance company is more opportunities to interact with the consumer. To the extent they can leverage those in the cross-selling opportunities, the better off they'll be. Obviously, there are creative new products and channels. They have to be responsive to the marketplace. They must support multiple products and companies, and there have to be nonproprietary solutions, which, coming from an environment where proprietary software was the name of the game, this is kind of a radical change. The people who will be the losers in the model are those who are unwilling to change and say, "This is how we distribute product," or "These are the products we've created. Make them fit in your channel." That's not going to work.

We're obviously entering a networked world. I talked about why you would want a netcentric model for this, and basically, it's a way to achieve more widespread success. In that model, you have people that are very closely aligned. As I mentioned, we have some that are specifically aligned with us in our bancassurance efforts, and we have others who are more loosely connected, but everybody can play. It's not a closed system. The advantage for those who are taking the lead and doing this is that they get to define the standards. Standards are the key to this process. You won't have 15 different applications even if you want to deal with 15 different companies. You'll have one application much like the property and casualty side of the business does now.

Banks invested a ton of money in the branch banking network because they recognized the value of controlling the relationship with the consumer. Is that a good investment in today's world? Chances are it is not a good investment for the traditional bank branches because the interactions with the consumer are becoming virtual. What we see is an increase in the online or virtual kinds of interaction. In the last six months of 1998, online banking was up 30%. So we see a change in the way products are sold and in point-of-sale evolution. You'll have agents in a bank that are marginally supported with technology maybe on the left end of the spectrum. In the middle of the spectrum, you have some pretty sophisticated data mining and bank marketing kinds of programs, and then what we call proactive underwriting, which is marrying the technology to maximize your cross-selling opportunities.

The Web site for the Home Banking Network shows a physical representation of a bank-lobby, and at first, I thought it was a good idea. Then I thought about more carefully, I decided it's probably not a good idea because not many people actually go into a bank anymore? Do you physically go into your banks anymore? I mean we're going to have a whole generation of kids that wouldn't know what that graphical representation is. I guess it tries to give an image of trust and relationship.

The word processing evolution. We've gone from assembly worker teams to knowledge worker to the ultimate knowledge worker. A perfect example of this is the automatic teller machines (ATMs) in the banking industry. You do the work for the bank because you enter the information. You can do a better job because who knows more about what you want to do. You're less apt to make a mistake, you know your address and everything. So you do the data entry for them, you include it, and you pay them a fee for the privilege. The remarkable thing is it increases customer loyalty. Why does it increase customer loyalty? Because they cared enough about their customers to make it convenient. In other words, you can do it when you want to do it. There have been numerous studies on the proclivity of people wanting self-service until they get stuck, and then they want to be able to just branch out and get some help.

In terms of risk underwriting, two things have to occur. One is we need to become more proactive. We have an alliance with Lincoln Reinsurance. I've gone into the lion's den at Lincoln and said, "We have to change life insurance underwriting from its traditional role as sales prevention to one of a more active role of creating sales opportunities." What we're talking about is data mining. Who's a likely prospect to buy this particular product? Except we're talking about doing it in a real time basis while we are interacting with the consumer.

To achieve that, and to be able to underwrite and deliver a life policy, we're going to have to change the way the actual evidentiary information is gathered. The way to think about it is kind of taking the old homily (a good credit risk is a good insurance risk) to its logical extension. What if you could gather all of the information about a consumer that was already available on electronic databases today? I'm talking about the health care claims databases, the prescription drug databases, and the motor vehicle records. You could gather a fair amount of information, particularly when you couple that with the information you would gather as a result of that life event interaction.

We talked about mortgages. Once you've gone in and applied for a mortgage, or applied for it over the Internet, or however you did it, they already know a fair amount about you. They know everything about the medical information. That's all well and good, but to make it happen, technology was clearly lacking, but now technology makes it possible.

As I said, we want to make underwriting proactive, but you can't do that by adding additional underwriters in the process or your costs go through the roof and you will not be competitive. What you must do is render those decisions electronically by simply adding additional decision legs to an electronic capability. You must be able to deliver the materials instantaneously because there's no point in doing it otherwise.

Mass personalization pertains to the banks' ability to deal with trading partners they can rely on, who are not going to mess up their relationship. They don't want you to go out and say, "Give me a quote for term insurance," and pick the lowest provider. They want a quote for term insurance from somebody who is going to provide service, and pay the claims, and things of that nature. The technology that was developed primarily as a result of the Internet allows mass personalization, and it also allows branding (like private branding annuities, for example) to deliver.

Bank insurance systems are no easier to modify or mess with than traditional legacy life insurance systems. As a matter of fact, they might be worse because they tend to be stovepipe systems. In other words, they are line-of-business systems like property and casualty more than a consolidated system like life. This new technology has afforded the ability to grab whatever information you need and massage it. By using technology that's very easy to work with, you can deliver the information to these legacy systems in the form that those systems are expecting, so you don't have to go in and change information. Those are key. The technology is just adding legs to the decision making.

Let's discuss proactive underwriting in real time marketing. Suppose there is a bank officer's desktop on the Internet. We've gotten an application for a mortgage loan. This is such a perfect example of how much easier things are with new technology and the Internet-related technology. We go to the proactive underwriting aspect. It says, "Congratulations, Mr. Jones. You've gotten your mortgage from us and, by the way, since you're such a valued customer, you're also preapproved for all of these things." If you think about it, that's a real paradigm shift. It's similar to credit cards. You used to apply for credit cards and they would underwrite. Today they just mail them to you because they've already underwritten them based on the information they know about you. Let's take homeowner's insurance. I'll use it as an example because it's an obvious affinity product. If I'm going to sell you the mortgage, I might as well as sell you the homeowner's insurance at the same time. I can give you a quote from the people who are my alliance partners. These are just standard things.

There's another key aspect of it. You or a clerk has already entered the information. There's no reason for us to have to recapture it. We have the applicant's information already.

Electronic signature is approved in 11 states and 12 or 13 other states are considering it.

The potential insured will go ahead and sign the application. The application has been sent. At this point, this is an application that has been sent that already has everything that old legacy system behind it needs to have in the form it's expecting it. It's just going to turn around. We could buy the policy, but the fact of the matter is we could actually issue the policy on the spot.

You obviously wouldn't guarantee issue every life in life insurance. But if you think about the intellectual aspect of it, you have to look at in the same way you look at group underwriting. This person didn't come to buy life insurance; he or she came to get a mortgage, a car loan, or some other bank product. So that's one thing it protects. You can say, "Up to *x* amount, we're not going to do any underwriting. We're just going to take that with the mortality risk side, and we will guarantee issue or find a partner who will guarantee issue everything up to $100,000, as long as these people are members of the group. That's fine. That satisfies the bank's requirement of not telling its people that they can't buy the policy because you can't be selective when you're dealing with it.

What you can do is commit to issuing $150,000 guaranteed issue policies and charge what you can, and then say, "If the customers would be willing to submit to licking the cotton swab and having a paramed come out, they would be eligible for a $250,000 policy and it will be cheaper. If customers want to submit to full medical underwriting, then the insurance company can give the customer the best deal possible. In this way, we've satisfied the bank's requirement for meeting their consumer's needs, and it's a way to deliver life products.

I said earlier that banks would get into selling products on the commodity side, but they won't be happy with it for the same reason agents aren't happy with it—there's no money in it. There is another key aspect. Controlling the customer is the most important thing to the banks. The customers they covet the most—their private banking customers and their trust department customers—are the customers that they are least qualified to serve because those people aren't going to buy commodity products. They're going to say, "The term stuff is nice but why don't you tell me about this variable universal life. Isn't that a better deal for me?"

There is a way to address that type of consumer, and there are ways it can happen. First, there is the underwriting aspect, and I've talked about it a number of times. This is where we see the agent coming back into play, but not the agent as we know him or her today. How do banks handle these types of inquiries today? They subcontract it to an agent, which raises the immediate question, "Whose customer is this? The bank's customer or the agent's customer?" What if that agent was virtual? What if that agent was sitting in a video call center somewhere with collaborative technology that lets him do a needs analysis on a video? That technology is there. There's no reason it can't work. We think that's the role where the agent will get reintroduced into this process.

The other thing that we're working on with Lincoln is to come up with a way to develop a risk score that's analogous to a fair credit reporting score. It will be a standard risk score that will mean one thing to one company, and another thing to another. So what we're looking at is nothing less than the emergence of a new industry or a consolidation of other industries.

If we look at it from an insurer's viewpoint, we see that 15% of the annuities are now sold by banks. It's obvious that products can be sold. We also see what's happening in terms of individual life sales that are declining over the years. The Life Insurance Marketing and Research Association conducted a survey to see how people feel about their life insurance coverage. There's a whole underserved market, and it's an underserved market because of our distribution channels. You simply can't afford to go sell $200,000 term policies face to face. If banks can put an advertisement on the back of bank statements or your ATM receipts, that would be a way to do it.

The truth of the matter is a lot of them already sell insurance. There are some success stories to be had. Here's the real reason. Noninterest income is becoming much more important to the banks. How do we plan ahead for that? We must develop products suited to that channel and streamline the fulfillment process. Bankers want to broaden their financial services. They want to have the complete offering to deepen the customer relationship. They also want increased fee income. Bankers have never lost sight of what business they're in. They haven't changed over the centuries. The idea is that they feel they're better suited to do this for these reasons.

One of the major philosophy differences is they can't pick customers. Think about a bank's best customers. They're also its worst insurance risks, even on the property and casualty side. Who owns those homes that are right on the water? It's the bank's best customers, who probably would tend to be a poor life insurance risk. But you have to address them on that customer basis.

Who are the customers? Somebody asked where they come from. Seventy-one percent of them come from credit cards. They just see insurance as a logical other piece of the puzzle fitting. Banks have recognized the importance of technology as a competitive tool. We, as an industry, need to recognize that productivity has to increase or face the alternative to that. The first step is you have to digitize the enterprise. You can't keep doing this stuff with paper.

The insurance industry has been slow in getting on the Internet. A couple of years ago, the Life Office Management Association resource magazine listed all of the insurance Web sites, and it took about a half page. Is it important? Banks know how important it is. That's the cost of a teller-served transaction versus an Internet transaction. So clearly, that's the direction we are moving. The pace of change is increasing dramatically. If you look at the major things that have been discovered, like electricity, you realize that it took 50 years after it was discovered to become ubiquitous because there had to be a network for it. The digital revolution occurred a whole lot faster. Computer chips are a thousand times more powerful than they were in 1971. The same thing is happening in the image area. You used to send one page a second over copy telephone lines, and today you can send 90,000 pages and encyclopedia volumes in that same time frame. Major advances pale in comparison when you compare them to the Internet. It took radio 38 years before it had 50 million users; it took television 13 years to get that many viewers; and it took personal computers 16 years from the first PC kit before they had 50 million users. It took the Internet four years to get that many users.

What will enable bancassurance is what will enable financial services consolidation. We must factor in globalization and the other things. It's going to be the air that the companies in the future are going to breathe to survive. Welcome to the new millennium.

From the Floor: I work for AIG and I work in the United Arab Emirates. I've been working with bancassurance for the last five months. We have a reaction from the field force. When you come up with a product that is sold through the banks, what's the reaction of the field force?

Second, the banks are somehow going to have an input in the design of the product; therefore, you may come up with a product that competes against your own existing products. What's your view about that?

Mr. Proehl: On the first question, I would quote the president of your life companies, who indicated that your strategy was to sell through all available channels and not be held hostage by one. I mean you can look to the Prudential example. It started Pru Direct, and it said, "That's not going to happen. Pick the one you want. We provide 99% of the business, and these guys provide 1%."

The truth of the matter is that the consumer is the one that's going to make that decision. It's not going to be the company or the bank. We've got to provide it the way they want it, however they want it, whenever they want it.

Mr. Robinson: In the case of Australia, it was recognized right from the onset, and it has been mentioned in a variety of ways. There is the need to align products with your markets and the distribution channels. In a simplistic form, the banks would typically keep the simple products they would buy off the shelf. The customer could walk in and almost take it. But other more complex products would have to be referred to advisors, and they know that. The banks can't sell them. In fact, there are laws that restrict that. The laws in Australia now are very strict about giving advice and the process an advisor has to use in order to give advice. Supporting documentation has to be used to follow that up. It has proved to be not as difficult a job as one might imagine from the onset. It almost seems to take care of itself, at least in the Australian context.

From the Floor: What's happening in life insurance pricing in the U.S.? Let me preface that by saying that life insurance prices have been coming down very rapidly over the years. Part of that is just the secular improvement in mortality, but a big part of it comes from all the information that we had been gathering on people, on their blood chemistry, and on other things done in the area of heavy duty underwriting that takes four to six weeks. What kind of products are you selling in Australia? What are we proposing for this new bancassurance model that doesn't have that type of underwriting compared to the lowest priced products being sold in the U.S. today?

Mr. Robinson: The banks are selling traditional life insurance products. Nobody sells whole life endowment business anymore. Banks never sell that. I'm talking about protection business in its pure sense; it's pure risk business. All the banks have products that need to be fully underwritten for mortality, for morbidity cover and disability income insurance. It stands up almost exactly like a traditional life product. The consumer wouldn't really see any difference. The underwriting process is the same, and so is the price. Bank's prices are not any more competitive than those of the life insurance companies.

The banks have been successful in an area. I trust the customer has convenience in operating through the bank. The way the banks have been most successful in life insurance has been through their products which they can piggyback off their core banking business such as home loan mortgages. They keep the product extremely simple, and it's almost immediately declined. They have been hugely successful with direct mail business.

They've been very successful with telemarketing. As a matter of fact, I can piggyback that on top of the direct marketing as well. I think the tricks that we're using in Australia, or the banks are using are new to the industry, and certainly not new to what happens in the U.S. I think there's a difference that the banks are playing that game now, and taking some of that market share.

Mr. Proehl: One of the things that became fairly clear in our early discussions in this insurance group forum was that the banks didn't want to deal with just a single insurer. They deal with multiple insurers. So the way I would answer your question is, the features that make your company's particular products competitive in a market segment today, are the same features that will make it competitive in this market. If you're a low-cost term provider, you would be one of the early companies that will be in it. If you tend to specialize in annuities, you're already there.

From the Floor: Let me just see if I can sum up. Ian, in Australia, the bank product and the traditional insurance company products are the same product and are essentially priced the same.

Mr. Robinson: They are comparable.

From the Floor: Do you have any idea how that compares with the multiple class? We have superpreferred, preferred, smoker, and nonsmoker delineations here in the U.S. Do you have the same thing in Australia, or is it just standard and substandard?

Mr. Robinson: No, we have the same delineations. Smoker and nonsmoker classifications have been in effect for many, many years. The preferred lines delineation is only just coming in. We tend to follow trends as they arise; we do not lead them. I guess that's another example where we've done that. The banks and the traditional life insurance companies are doing pretty much the same sort of thing in that area. So the banks are not offering a particularly low-priced product or a product with any more features. That's not the area where they're trying to make their revenue. They're more complacent. We don't want to have to refer to someone else. So a number of those products are there to ensure gaps. They don't expect to turn a lot of revenue from that source.

Mr. Robert Hart: I'd like your reaction to Bob's presentation because part of what you said is that strategic alliances between the banks and the insurers have not worked in Australia.

Mr. Robinson: I suppose the classic example was the AMP and Westpac. Some years ago, Westpac had a capital shortage, and it could have sold its life insurance company. It had been very successful up until that point in time. Instead, it decided make an alliance with the AMP, the largest mutual office at that point in time. It went on for a number of years.

The company was renamed Ampek instead of AMP Peck. It was meant to be an alliance. It was run by AMP staff, but its products were being distributed through the bank. The AMP was effectively acting as a manufacturer, and Westpac was acting as a distributor. In the end, it fell over. Westpac had an option to buy back the life company, which it did, and it solved their capital problems. The alliance didn't work for a number of reasons. The primary reason was that AMP was still attempting to use agents through the Westpac branch network. It was hard enough to do it while Westpac was selling. Once Westpac got into an alliance with AMP, it found that AMP was one step further removed. So the branch staff of Westpac had probably even less reason to support the concept. That's my own personal view. I think it's one of the reasons it fell over.

Alliances have been attempted and there was a recent case where the merger between two major life insurance companies in Australia failed because, for a number of reasons, they couldn't agree on who was going out of the deal, but they knew they probably would want to sooner or later. So that's why a company like

AMP is looking to alliances with companies that have unique customer bases such as Nortel or a major communications company. Energy companies are other companies that can be considered for alliances, but I think this is unique to Australia. This sort of thing is happening in the U.S., isn't it?

Mr. Robinson: If you're planning a trip to Australia to see what it's like, by the time you get there, it will have changed. It's constantly evolving and discarding and trying new models.

From the Floor: The other thing about the overseas market, where the model has worked and been very successful, is the products they sell work a whole lot more like financial instruments than life insurance policies. Everyone points to the success of bancassurance, and how, in five years, banks have come to have 50% of the market. Look at the products they're selling. They're more like annuities than they are life policies.

Mr. Robinson: Yes.

From the Floor: There is also a tax break.

CHART 1
THE GOING GETS TOUGHER

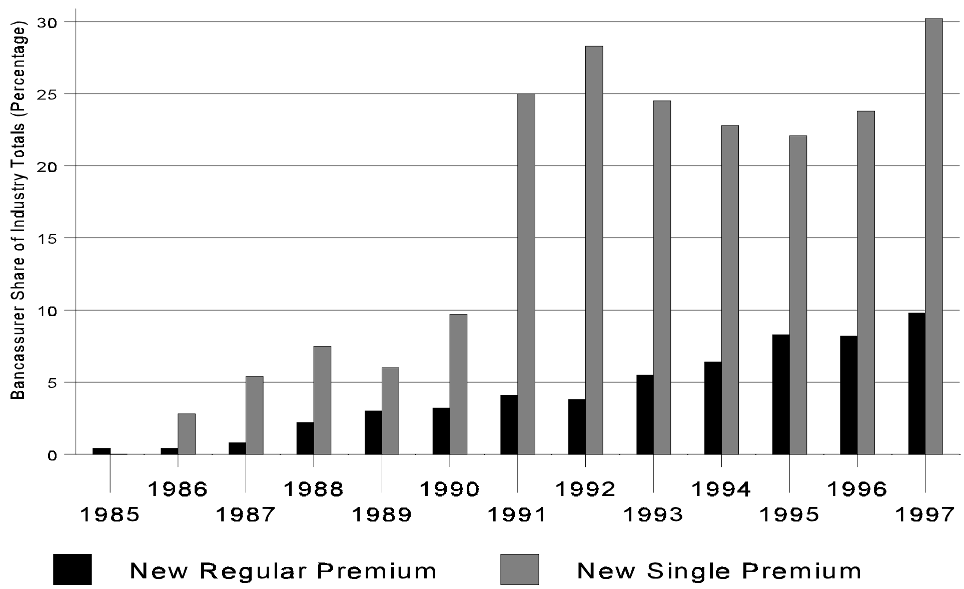

CHART 2
FUNDS MANAGEMENT SUCCESS