RECORD, Volume 25, No. 1*

Atlanta Spring Meeting
May 24–25, 1999

Session 86PD
Trends and Issues in Financial Institution Convergence

Track: Financial Reporting
Key Words: Financial Reporting, Marketing

Moderator: STEVEN D. LASH
Panelists: DAVID HOLTON†
MARK OLSEN‡
JOE PICARELLO§
Recorder: STEVEN D. LASH

Summary: Banks are buying life insurers, life insurers are marketing through banks, mutual fund companies are taking over the retirement product area, and insurers are acquiring thrifts. Diverse sectors of the financial services industry are melding together at increasingly rapid rates.

In this session a panel of experts discusses the major issues and trends, including:
- *Underlying causes of consolidation and convergence*
- *Competing interests of banks and insurers*
- *Banking vs. insurance products*
- *The Citicorp-Travelers experience*
- *The regulatory environment and lessons learned from HR-10*
- *Accounting differences*
- *The outlook for the future*

Mr. Steven D. Lash: I think you're attending a very important session today, and if you paid attention to the agenda of the Society meeting in Atlanta, this is the third session related to financial services convergence and bancassurance. The Society obviously has recognized that bancassurance and financial services convergence is a topic that's going to be important to all of us going forward. We're particularly lucky, and I'm particularly grateful, for the panel that we have today. What's good for me is that I'm the only actuary on this panel, which is probably good for all of us.

---

*Copyright © 2000, Society of Actuaries

†Mr. Holton, not a member of the sponsoring organizations, is President of Wachouvia Insurance Services in Winston-Salem, NC.

‡Mr. Olsen, not a member of the sponsoring organizations, is a Partner at Ernst & Young LLP in Washington, DC.

§Mr. Picarello, not a member of the sponsoring organizations, is Vice President of Chase Insurance Agency, Inc. in New York, NY.

Let me take a moment to introduce the panel in the order they'll be speaking. First is Mark Olsen. Mark is a Partner in Ernst & Young's (E&Y's) risk management and regulatory consulting group for the financial services industry, which is based in Washington, DC. In this capacity he works with senior management of financial institutions in anticipating, interpreting, and implementing federal regulations. Mark has spent more than 30 years following industry issues as a banker, congressional assistant, and regulatory consultant. His experience includes working with E&Y professionals and financial institutions in understanding and implementing changes in laws and regulations and evaluating new product opportunities allowed by those changes. With the convergence of banking, securities, and insurance industries he has assisted in the development of controls and procedures for ensuring compliance with investment product suitability guidelines and state and federal guidelines on insurance sales, and evaluating the regulatory permissibility of other nontraditional banking products. Prior to joining E&Y, Mark spent 16 years as a commercial banker, including 12 years as a bank president, CEO, and board member. He was also president of the American Bankers Association. Additionally, Mark served for five years on the congressional staff of former Representative Bill Frenzel (R-MN), including two years as a legislative assistant when Frenzel served on the House Banking and Currency Committee.

After Mark will be Joe Picarello. Joe is a vice president and director of business development for Chase Insurance Group at Chase Manhattan. He manages a group responsible for product development, product sourcing, and insurance carrier management across all channels. The group is responsible for all annuity, life, health, and credit products at Chase. Joe joined Chase in 1994 as vice president and senior business line manager with responsibility for the credit life, credit property & casualty (P&C), and direct response businesses. Joe came to Chase with more than 20 years of insurance industry experience in business development, product development, product management, and strategic planning with the American Bankers Insurance Group, the Beneficial Life Insurance Corporation, and the Crum & Forster Insurance Group.

And last, but not least, is David Holton. David is a senior vice president and group executive of Wachovia Corporation and president of Wachovia Insurance Services based in Winston-Salem, North Carolina. David joined Wachovia's management training program in 1973 and became a branch manager with Wachovia Bank of North Carolina. In 1976 he was named manager of retail branch operations for the Personal Banker Program. In 1980, he moved to Kuwait, where he was a banking consultant to the Bank of Kuwait in the Middle East. In 1982 he returned to Wachovia, and in 1985 became the regional manager responsible for correspondent bank relationships in New England, the Midwest, and the West Coast. David moved to Atlanta in 1987 and had responsibility for implementing personal banking in Georgia. He was named senior vice president and head of retail banking administrative services in 1989. In 1991 he was named regional manager of Metro Atlanta Branch Banking and in 1992 was elected senior vice president and group executive. He became the manager of insurance services for Wachovia's member banks in 1994 and assumed his current position in 1996. David also serves on the board and is treasurer of the Association of Banks and Insurance. He

also serves on the board of the American Bankers Insurance Association (ABIA) and has served on the faculty and advisory board of the American Bankers Association's National School of Retail & Branch Banking and Graduate School of Banking in Madison, Wisconsin.

Last, I'm a senior consulting actuary at E&Y in its national actuarial practice. Bancassurance is a particular focus of mine. I've worked on numerous engagements with both banks and insurance companies in dealing with bancassurance strategies. With that, I'm going to just make a few opening remarks to set the stage before we let the panel go forward.

The bancassurance marketplace. Annuities by far are the success story as far as bancassurance sales go, with approximately $18.8 billion in 1998. The personal life side sales of $1.4 billion I would say by all accounts have been disappointing. This area represents about a 1.6% market share on the life side of sales through banks, and I know that's an area where banks would like to do a much better job. Also, there's a lot of controversy around that $1.4 billion number. There are many different studies that have been outputting the life sales at $2.4 billion; another that I've read puts it at about $260 million. It's hard to get a handle on what the actual sales are in the industry, and there's a lot of controversy about that.

A survey of what products banks offer was done by Datamonitor in 1997. Annuities, fixed annuities in particular, are the most offered product through banks, with variable annuities not being far behind. Life products also are not totally left behind. It was 63% for whole life, and I would expect that the life side has grown dramatically over the last few years.

In the third quarter of 1998 banks had a 32.4% market share in fixed annuities, which by all accounts is a successful and substantial portion of the market (per the Kehrer Report). The year 1998 will also be the first year that variable sales will exceed fixed sales in banks. You also see in 1995 a pretty huge drop in market share from 32% down to 23%, and I am still unclear on the understanding of that number. I spoke to the Kehrer people about that, and they said it had to do with the relationship between CD rates and annuity yields, but I find that a little hard to believe to be responsible for such a huge drop back in 1995. According to their data, at least it's taken until the third quarter of 1998 to get back to that same level.

Some further statistics on bank sales of life insurance; market share is less than 2%. It's actually 1.6%. Simplified issue term life is really the way that many banks want to go, and that's something that we will talk about later on. What are going to be some of the success stories going forward? Make products simplified. The underwriting process right now takes, I think, way too long, particularly for banks and the bank customer. For the higher premium sales you typically are going to see that more through trust departments, estate planning, and high net worth areas of banks where those sales, as we know, are a little bit harder to come by. And you're going to deal with more of the higher net worth individuals. Third-party marketers (TPMs), I believe at least on the life side, will continue to play a very

significant role. That role has come down a great deal on the annuity side as banks have gotten more and more comfortable with that product, but on the life side TPMs are still going to play a significant role.

Here are a few last pieces of information to put things in perspective. Datamonitor did a survey back in 1997 asking people why they would make a purchase of insurance through a bank. The number one reason mentioned was trust in a bank, which in my mind wasn't totally a surprise. Banks have what I like to call a "halo effect" where they have the too-big-to-fail phenomenon, the FDIC insurance phenomenon, which clearly has nothing to do with insurance, but I think the branding of a bank and the brand name and the trust that people have in a bank are going to be a big influence on whether they're going to buy insurance through a bank. What's more interesting is the least-mentioned reason, price, which is something we should think about, and I think we'll see that service capabilities are a very important thing to meet; you don't necessarily have to be the cheapest place on the block for products.

What about the factors that encourage banks to get into insurance? Again, I don't think there are any surprises here. Increasing revenue is the most named reason. Banks are looking to increase revenue and move away from interest-based income and move more towards fee-based income. Clearly that was the number one reason. Moving next to the factors that discourage bank entry into insurance, the number one reason stated was lack of knowledge and expertise in the insurance business, which I think is a common theme out there. Secondly, the expense, as we know, of getting into the insurance business is quite high.

In 1996, Conning & Company surveyed 500 insurers and asked them if they used banks as a distribution channel or planned to use banks as a distribution channel by 2001. In every line of business there's the drive that insurers plan to use banks more often. I think the most interesting one is on the life side—term life (48% to 74%) and permanent life. At least with permanent life we're talking almost a doubling of insurance companies (from 30% to 60%) that are going to use banks and a significant increase on the term life side. And if you remember a couple of years ago when this whole bank and insurance thing started, people were out there publicly saying—or at least insurers were out there saying—that they didn't want to use or didn't need to use banks. But I think what was going on behind the scenes was many insurance companies were running to their local bank and saying, "Please, will you give us shelf space for our product?"

Mr. Mark Olsen: Doing legislative updates on banking, insurance, and securities issues can become a career. I had an interesting discussion the other day with a long-time lobbyist for the securities industry who has been fighting to retain the Glass-Steagall Act. The joke around Washington was that people have educated children and now occasionally grandchildren either fighting for or against the repeal of the Glass-Steagall Act, and this lobbyist, who has been on the securities industry side for a long time, approached one of the senior members of the Commerce Committee and said, "I have a son considering grad school. What's the likelihood

of us continuing this a few more years?" That senior member of Congress said, "Awfully good. I think you're going to make it."

Having said it, though, there's also a good possibility, for reasons that we'll talk about, that this is the year that there will be a major change in the Glass-Steagall Act. What is not clear is what the Glass-Steagall Act does or doesn't do and its impact on the insurance industry. I keep hearing people say that with the repeal of Glass-Steagall banks will be able to do more in the insurance field, but that is not precisely accurate. The Glass-Steagall Act is the portion of the National Banking Act that separates banking from securities, and it really has little to do with insurance. If this bill passes in its present form, financial services companies will be able to have common ownership. You could have banks, insurance companies, and securities firms all owned by the same parent within what is called a financial services holding company, and that's how it affects insurance.

With specific respect to insurance, when HR-10 started to move as a potential legislative vehicle in the last Congress, there were no insurance provisions in the bill. The insurance provisions were added only because there were certain elements of the insurance industry that were anxious to see federal legislation amended to define what banks could and could not do. Basically, the focal point for those efforts were the independent insurance agents and the NAIC. While you've seen the statistics, which have indicated that banks have dramatically increased their presence in the insurance industry, there really has been no change in the law authorizing it.

What I'm about to say I think is old news for many of you, so bear with me, but for those of you who may not recall, the key drivers that expanded the banking industry's interest in insurance have been two Supreme Court decisions. One was the VALIC decision, which essentially determined that annuity products for purposes of national banks were not classified as an insurance product but were separately classified as an annuity, not insurance; therefore, the national bank regulator, the Comptroller of the Currency, could authorize that power, and it was outside of the jurisdiction of the insurance industry. The Barnett decision followed VALIC fairly closely. It determined that a state insurance commissioner could not override federal law with respect to whether or not national banks could be in the insurance business and how they could do business in the insurance agency. The provisions relative to insurance really relate to those two Supreme Court decisions, which vastly opened up the opportunities for insurance for banks. And with that in mind, let's look at the two bills.

There really are two bills. HR-10 is the bill that's moving in the House of Representatives, and S-90 is in the Senate; they are pretty much companion bills. The Banking Committee passed HR-10 on March 11, 1999. The specific provisions relating to insurance are as follows: Title insurance sales and underwriting are not permitted in this bill, whereas they are in the Senate bill. The bill specifically defines insurance as those products regulated as insurance as of January 1, 1997. That really relates back to the VALIC decision, in which the court made a determination as to what is or is not insurance. The NAIC is saying you need to give us some

ground rules. Let's decide what is and what isn't insurance. If it walks like insurance, quacks like insurance, and swims like insurance, is it insurance? The current bill in the House Banking Committee says, yes, if it was as of January 1, 1997, it is an insurance product. And regulated as such, it will be considered to be the case.

The next provision is even more obtuse, but it's critically important because in terms of those two Supreme Court decisions, what the Supreme Court also said was that with respect to future decisions we will defer to the opinion of the Comptroller of the Currency because there is a provision, a federal law, that allows deference in those cases to the federal law. What the insurance industry and particularly the insurance commissioners are saying is, "Let's level the playing field on deference." Now, unless you're a lawyer you probably never thought of deference, but that's another area where the insurance regulators are saying we need to be able to get our arms around what the Comptroller of the Currency is doing. In terms of product definition and how far the courts can go prospectively, we want to put some parameters around it. That's basically what those two provisions do.

The next part is 13 types of state insurance laws that are protected from federal preemption. Are any of you from Illinois? One. Illinois passed an insurance provision at the Illinois State Legislature that allowed 13 different types of regulations to be imposed. It was an agreement that was decided on by the banks and the insurance industry, and that basically has become the standard. That is what is included in the law, and they are very basic things. You have to be licensed. They have to be clearly identified as insurance personnel. The flip side of that is that it preempts the state law that would ban an affiliation between depository, insurance institutions, and insurance firms. That's the pro for the quid.

In the House of Representatives, unlike the Senate, there is something called sequential jurisdiction. The Banking Committee has jurisdiction over banking, but the Commerce Committee has jurisdiction over securities and insurance. In order to get a bill through the House of Representatives you have to go through both committees. Now, literally as we are sitting here the Commerce Committee is getting ready to act on that bill. In fact, as I drove to the airport this morning I heard an ad on the radio sponsored by the National Insurance Commissioners Group urging people associated with this bill to look very carefully at modifying the bill to provide additional protections in the bill for consumers. The mock-up session probably is going to be held on Thursday and Friday of this week, and it is expected that the full Commerce Committee will vote on a bill as soon as they get back from the Memorial Day recess. Now, one of the things that's very important here is that the Commerce Committee is the most friendly venue for both the securities and the insurance industry. It's likely that the bill we get is going to be the one that emerges from the Commerce Committee, and it is expected, therefore, that the full House probably will vote on the bill even before the Fourth of July recess.

The Senate Banking Committee has moved, and that's quite a change this year. For the last several years the chairman of the Senate Banking Committee, Senator

Alfonse D'Amato, always took a different philosophy. He let the House of Representatives do its will for a couple of years if necessary, and only after all the hard battles were fought did he want to take up the bill. Chairman Phil Gramm has an altogether different approach. He started moving legislation from the first day, and they passed S-90 on March 4, actually even before the House Banking Committee passed a bill. And Chairman Gramm has an altogether different view. He has much more of a free market view with respect to insurance and banking. The active insurance lobbyists have had less success with Gramm. Some of those same provisions have been watered down. Title insurance, for example, is permitted. They've moved the insurance product definition to January 1999, and they've softened slightly the deference position as well. Now that bill has already passed the full Senate. We may get to the point where we'll see the Senate and House coming together in conference as early as this summer. It's very rare for a banking bill to have passed both the House and the Senate in the first year of a new congressional session, and if you're betting on whether or not there will be banking legislation this year, there could well be.

There are a couple of things that you may want to keep in mind. The President is still threatening to veto the bill, but that has nothing to do with the insurance provisions. There is a disagreement between the Federal Reserve Board and the Comptroller of the Currency on operating subsidiaries, and there have been some efforts to weaken the Community Reinvestment Act, which has some of the people in Washington concerned. The other thing that is particularly interesting about it is that the banking industry has demonstrated minimal interest in the outcome of this bill. Most of what this bill would authorize, banks can already do. The bill would streamline it, but it would also add another layer of regulation, so the banks are not taking as active an interest in the repeal of Glass-Steagall as they had as recently as two and three years ago, with some notable exceptions—one that we're about to talk about, Citicorp.

We keep getting the question, "If a bill hasn't passed, how can Citicorp and Travelers merge, and what does all of this mean?" You might recall that Citicorp and Travelers merged into Citigroup without the benefit of legislation. The application was made to the Federal Reserve Board to create Citigroup. Of the two entities, Travelers and Citicorp, guess which one of them made the application? The insurance company. Travelers made the application to form a bank holding company. The significance of that application was if Citicorp had made the application, it would have had to divest of all non-approved activities on the spot, but when Travelers made the request for the holding company, there was a five-year period of time with which it was able to comply. There is the expectation that this legislation over the course of the next five years will allow the merger to be fully completed, and HR-10 essentially would do that.

Citicorp, as Citigroup now, is one of the most active proponents of seeing it passed. If the bill should not pass, there are still other things that are available to Citigroup and perhaps the only activity that is at risk under current interpretation of law would be the underwriting that it does. It is possible that some of that underwriting, if not all of it, could be conducted offshore should it choose to go that

way. But I think when Citicorp made the application it was its full expectation to implement the bill with the completion of HR-10.

There have been no other similar kinds of mergers at this level. There have been mergers of banks with securities firms, which has been allowed now for some time as a result of another change in regulation, but you can expect to see more similar kinds of applications if, for whatever reason, this legislation is derailed. But nobody's doing it now until there is a sense of what's going to happen with HR-10.

Mr. Joe Picarello: At Chase we have a very broad insurance program, and, as a result, we do work extensively with many of the companies that you represent. I'm usually talking to all your sales and marketing people. I don't get an opportunity like this often.

I know you don't need me to tell you that the industry's changing. Technology and new entrants are really transforming the insurance business. Your customers can source products not only from your traditional distribution networks but also from direct marketers, from the Internet, and, yes, even from banks. The changes are really forcing the industry to become more efficient, to be faster, and to rethink the strategy for how we develop products and how products are developed for this channel. Manufacturers are all vying to try and meet the specific needs of these new distributors. All this change means, and should mean, better value for the consumer. It can also mean a better process for developing products and better information for those who are developing products.

Facilitating the development process within the bank is really a multifaceted opportunity and challenge. It means working with diverse units within the bank such as the branch distribution network, the mortgage bank, the credit card bank, the commercial bank, and the private bank. We have very diverse interests within the bank. What's worked for us is to partner within the bank to jointly develop strategies with each of these lines of business. Each business has its own business model. It has customer segmentation strategies that can differ. It has intimate proprietary knowledge of its interactions with that customer.

To reap the benefit of that we have to be able to work with the bank closely and to integrate seamlessly into its process. It's important to use the bank's expertise in using technology in that sales and service and transaction processing mode. That's a core competency that I think we need to take advantage of from the insurance business. When we get to that point, when we're working on this partnering within the bank, we don't save a seat at the table for vendors, but we will save a seat when we have a strategic partner. And that's the kind of relationship we're really looking for.

We really do make extensive use of data mining. I think Steve said that some individuals in different sessions didn't think that banks are really out there and taking advantage of that. I think we've spent a lot of time developing links between the Chase Insurance Group data-mining capability and that of each line of business. We do develop segmented insurance offers. We overlay the insurance segmentation

with that of the individual bank unit. We've developed plenty of sequential offers and think that there's opportunity for leveraging the distribution. The specific proprietary response models and profitability models that have been developed are tailored to each sales channel and to each market segment. We've been very successful with them, but we've also modeled revenue potential. For example, at the bank branch level we go in and take a look at what the propensity to buy different insurance products is within that entire base, and we have developed sales goals and revenue goals. "Have developed" means to allocate the sales resource, which is an expensive resource, and really produce targeted customer lists for those salespeople to go out and use in their efforts.

An example of some business synergy that we really had with some of those efforts to overlay our segmentation with a business's segmentation is in the credit card company. It uses a risk-based segmentation scheme based primarily on credit risk. Where the insurance needs-based model was overlaid we were able to find opportunities where segments in the card business marked for exit would be ones you would focus a lot more attention on when you overlay the insurance opportunity.

If I look a little deeper, I really believe that the opportunity in the bank is to leverage distribution channels. If we really do that, we can improve the delivery economics, and we have to use technology as that enabler. We have an active project going on; we're bringing those partners to the table to implement a straight-through process, a process where it's entered at the point of sale, and the distributor and the manufacturer are like one, at least through this electronic means.

In addition to information, another competitive advantage that I think we have is frequent contact with a lot of customers. We also have a privileged entree into their lives at the time when there are some major life cycle events taking place. We can connect insurance to an event. We sell homeowners at mortgage origination. We sell automobile insurance at the point where a customer has purchased a new vehicle. There are some natural extensions to this process and other opportunities within the bank where we are offering floor plan insurance through those same auto dealers within Chase Auto Finance. We can be there with the customer with the right product at the right time. We do have some significant opportunities. We can fit a product into the bank process and design a product to fit their specific needs and existing sales process. If you look at another opportunity where we're talking about leveraging the branch distribution, the results from traditional sales methods should be very dramatically improved. With some of the experimentation we've done on sales methods, we've seen results that indicate that we can achieve a 95–98% placement rate in situations where you might have expected a placement rate of 50% under more traditional methods. And we don't think we've taken this as far as can go. If we can reengineer the process, I believe it will be a more proactive sales process that will strip out a lot of expense and produce a better spread of risks. We'd like to get to something that will have a more favorable loss experience result.

But we certainly have some major challenges. The underwriting process is way too complex. I was involved early on with the insurance business in the more traditional lines of business, in life and health insurance, and had a long respite from the business, much more into direct market and specialty-type products. When I came back, I didn't see anything that had changed, I guess, significantly over that period of 15–20 years. We looked beyond the underwriting process in our product array. Many others are too difficult to manage and we have too many partners, but it's also hard to bring all those products to the table with one partner or with a small group of partners.

If you look beyond that, you also have a cycle time that's extremely long. If we're going to deliver on the bank promise to bring some good value in insurance products to this underinsured—I guess I would say the high end or maybe the low end of the mass market—we need to find better ways to complete that underwriting process. We need to develop surrogates for the information that's coming from sources now such as the attending physician's statement. We need to do drill-down questioning, which will be a lot better. But we have to go a lot further; there has to be a joint effort in the development process. We don't want a pure trade of convenience for price. There's a lot of work that has to be done. This is not an easy equation to solve.

We think that a solution is integration. We have to turn it into just another bank product when we're selling insurance; it should be a product that's integrated into the selling process and the training and systems. We have to have a simplified issue process and a product designed to serve that lower end of the huge mass market. We need to make use of that low-cost distribution and change the delivery economics. We have to use data that we have or data that we can capture easily. We need partners that are favorably inclined to providing data to us so that we don't have to go out to unwilling partners to collect that information. We also need to embrace alternative distribution.

Right now direct response is working for us. We do a good deal of business on homeowners, auto, and life insurance products, but we can do a lot more, for instance, voice authorization. If we could just bring some real effort to making that work, it could have a dramatic impact on the results and change the dynamics of the direct-response business. A devoted and dedicated salesforce still has a place, but we're going to migrate that dedicated sales resource to cover the more complex needs that exist within the private bank, the commercial bank, the small business areas, and the Internet. It's going to happen. We're looking for partners to help us make the Internet a true channel, to get it beyond the point of being an information source that we use to direct individuals to another sales channel.

I guess again I would say the solution for us is integration. Our development and reengineering focus will be fewer and simpler products, extending the bank brand, taking advantage of the fact that we have all these opportunities to contact the customer and to be there at important points in their life, to leverage that existing distribution and change the delivery economics, and to fully integrate into the bank's selling process. That's where we think the real opportunity is. To do that

we're going to try to abandon and avoid the vendor concept and select strategic partners to bring them to the table as part of this process.

Mr. David Holton: It's a pleasure for me to do this. As you heard from my introduction, I've been a banker for 25 years, and I've been trying to learn the insurance business just for the last 4 years. I do believe I share a common goal with you today, and that is to develop and deliver soundly built, market-receptive, profitable insurance products for both individuals and businesses. Working together, banks and insurance companies can provide customers better product availability and at the same time generate excellent returns for our policyholders and our shareholders. With the time I have with you today I'd like to just share with you some of my thoughts as a banker over the last 25 years, and how I think the landscape of banking has changed. Maybe there are some parallels for you to understand what's going on with the insurance industry.

Banks offer insurance companies broad access to customers. Here are a few examples. Banks communicate with 55% of their customers every month and with nearly everyone annually despite ATMs, online banking, direct deposit, and even some banks in the New York area that chose to charge people who line up for a teller. Branch activity and branch transactions are doubling every year. Even though we see Internet activity growing by leaps and bounds, for 99% of the banks across the country the number one place to get new business activity for a bank is, by far, inside a branch, and I think it'll be that way for a while. Banks are also aware of the many events that happen in their customers' lives. We see the name changes when they get married. They change their account names. We help them with major purchases and their loans. We help them with savings accounts for their minor children. All of these are examples and opportunities where we can enter into discussions about risk and investment products.

Banks have information on all their customers as well, such as income, age, location, and the financial products that they hold. Through modeling this information and, I might add, following the various laws and rules and regulations we have about sharing that information so we don't do anything wrong, banks can identify prospects and people who might be likely candidates for their investment and insurance products. Well, that sounds like a great marriage, doesn't it? You have the products. We have the customers. But banks are not going to accept the standard processes and products that you have. They're going to want products and services that suit their distribution channels and distribution systems, not the agency system that many of you serve today.

Let me explain how sales and distribution systems with a bank have changed in the last 25 years since I've been a banker. Maybe you'll understand why banks won't and cannot turn back any other way and why only those insurance companies that understand this will enjoy what I think is going to an explosive growth of insurance opportunities that will be available to them. When I joined Wachovia in 1973, I was a branch manager. My asset accumulation products consisted of a 30-, 60-, 90-, and 180-day CD and a 1-, 3-, and 5-year CD. That was it. Misplace your renewal notice, and your maturing CD went into a passbook savings account, so you

remembered it. Need your money before the maturity? Too bad. Most of the penalties would come out, and you'd lose all the interest that you accumulated. Interest rates were capped by the Federal Reserve. All banks were the same. The customer was basically trapped. Once deregulation occurred, however, the consumer became king. They could now vote with their feet, and they could leave you for a better offer. It was their money, and they wanted to control it. Investment vehicles were changing as well. Even people like my dad who would never voluntarily put any money in the stock market found some of his 401(k) retirement funds in the stock market. Banks had to begin to offer non-FDIC-insured products. Disintermediation was a very difficult pill for banks to swallow, but eventually every bank took the pill.

Today, banks have build-your-own CDs. We feature guaranteed rates on additional deposits in the future. We have withdrawal features with no penalties for certain CDs in certain situations. We now have money market and sweep accounts that allow you to earn interest on idle money that's lying around. And today banks, as you heard, distribute over 30% of annuities, while several years ago they did zero.

Lending was quite different, too. Installment loans under $5,000 carried an interest rate of 15%, and you could do those for 24 months. If it was $5,000 and over, the interest rate was 12%, and you could go up to 36 months. Thirty-year mortgage loans were made by the mortgage subsidiary but not in the bank itself. A second mortgage lien was usually only taken in work-out situations and often considered to be a useless piece of collateral by the bank. Probably the most telling example of credit, though, revolves around credit cards and overdraft protection. Both of those products came to fruition in the 1960s and met extremely high resistance among traditional bankers. I'll give you an example. My credit authority for an installment loan was $15,000. My credit approval authority for a VISA or Master Card or overdraft protection was $200. Credit cards and overdraft protection were to be used only in emergencies.

Well, now you know the story today. Installment loan volumes at banks are decreasing and giving way to large lines of credit with interest-only payments, in other words a virtual loan for all time. Lenders today offer simultaneous closings of equity bank lines when you close your first mortgage, offering 100% of the equity. There are credit card solicitations, too many for you to count when you get back after being gone for two days, offering $10,000, $20,000, even sometimes $50,000 through the mail or the phone. Today, people use credit cards to charge things like college tuition, frequent flyer points (like I do), groceries, and, effective since last year, even to pay the IRS. Loans that once took days to review and discuss are now turned around on the spot. Where bankers once called lenders and department stores to get the update information on how you were handling your credit in the local markets, today a Beacon score-off of your credit bureau report tells you whether or not you get the loan and what your interest rate will be. We model your risk profile and predict the likelihood of default on a loan and make upward adjustments to variable rate credit cards by many banks around the country.

I remember on one of the first days of my job I went to my loan administration officer, a guy named Merle Stone. He told me two things about lending. First, loans were meant to be repaid. Second, don't ever lend money to something that you have to feed or clean up behind because you may have to repossess something one day. Now, the logic behind the feeding and the cleaning up might be good counsel for new lenders coming in, but I would also tell you that those older bankers could not see what the market wanted. They could not see how new products could be developed, built soundly, underwritten soundly, and marketed over time so that they would make a lot of money for the bank. The definition of lending and the terms under which we lend and expect to be repaid, how we issue credit, and how we continue to monitor the loan continue to change, and for most banks, we've learned how to soundly and profitably manage through that period.

At the core of all of this is the customer. Again and again they've proven if you provide a valuable product that's fairly priced, easy to get, and serviced appropriately, they will buy it and use it. Now, some of you may be saying—I can see it in your eyes—that it looks like the banks lost control. Well, there are even some bankers around today who say we did. Even if you're right, it's irrelevant because we can't go back. The process will not turn back. If a bank chooses to offer insurance, it wants the insurance experience to parallel the banking experience; that is, a series of seamless systems that can identify prospects, aid in the selling, and speed the issuing process. The consumer will expect that the bank which provides an insurance product will provide the same degree of speed to issue and servicing that they've come to expect from a bank. They will not see the insurance sale disconnected from the other products and services they buy from the bank. If a bank is going to be successful in representing your companies, and if your company's going to be successful being in the bank channel, we need to begin learning from each other what kinds of changes in the process we might want to look at.

For discussion, I'd like to offer a couple things for you to consider. I realize that some of the things I will tell you you've heard before. They're not original necessarily. I also will tell you that what I do know is what I don't know, and I don't know the intricacies of your business of underwriting. Some of these thoughts I think will challenge those processes that have been very successful for you in your companies, but just as deregulation and demographics forced the banks to change their products and processes, I'm going to submit that the swell of distribution that's going to be happening by alternative channels will put pressure on your industry and will force you to change some of your processes as well.

Let me begin at the national level, and let me also say, since I'm being recorded, that I'm not necessarily against state regulation per se. What I am opposed to, however, are the numerous individual, sometimes meaningless, regulations that are imposed by states. And you should be, too. Recently, my office sent 52 applications to register staff to be licensed in a particular state. The form says clearly at the top—type or print neatly. We typed them, as we have for the past four years. This time they were returned, unaccepted, with a note that was handwritten: "We no longer accept typewritten applications. Please handwrite and

resubmit." Honest, it happened. They had a logic there that would defy logic. The fact I'm getting to is that a universal license process would simplify and speed up the process, and it'll be beneficial to you as well as us.

Another issue is when you return home and pull out one of those credit card applications that you got while you were away, look at the back of it and the three inches of the smallest print possible, and down there you're going to read something like this: "In Alaska coverage ends at 62." In Missouri it'll say 70. And it'll say it's not available somewhere else. Trying to remain compliant in each and every state on each of these types of issues is very time-consuming and costly to you, me, and the consumer. Can't we get these state regulators to agree on some of the more mundane issues at a national level that will not interrupt or undermine the core issue they're trying to address, which is to protect the insurance soundness in their states?

Let me move on to sales support. Most banks have platforms that are automated. Rates, product profiles, sales tools, applications, forms, printing, and access to customer information are just a fingertip away. For your products to compete and prosper they're going to have to be woven into the bank through automation, which means more industry standardization in both the forms and underwriting criteria. Sales illustrations can no longer arrive by U.S. mail the day before or the day of an effective change. Banks simply can't, with their distribution system, have their agents pop those little babies in the machine the day they arrive. We have processes and virus controls and things of that nature. Y2K compliance and viruses are probably not much of a concern to your small independent agency, but it takes me three weeks to get through the virus operations at our bank. Now, that's a problem for the bank, but what I'm telling you is that it's a backlog. It's a process that we have to work on, too, but we have to work together to find ways to get that directly fed, and I would submit that Internet access and direct feeding from insurance companies to banks very shortly will be a requirement in order to do business in the bank channel.

Underwriting risk. We'll need to move closer to the customer, and we'll have to become more automated. I've seen a branch system in the U.K. where it's a simplified product with five questions. If you answer negative to one of the five questions, it trips out into another sequence of three or four questions. Depending on how you answer those, you can be underwritten or rated, but underwritten, and you can move through the process and pick up another 20% of the accounts that you typically would reject in a simplified issue. The use of technology like this, I think, will be one of the top distinguishing characteristics of companies that can figure out how to work in the bank channel.

Product and product marketing is another area that needs to undergo change. Designing products and promoting products that will make the banking product perform better will be the key. If your marketing people can figure out how to take an insurance product and make a banking product perform better, then there will be a greater likelihood of making the sale. Let me give you an example. If you go into almost any bank in the country and open up a checking account, the very next

service that it offers you is the overdraft protection. And why? This makes a nice link. I talk with the customer and I say, "you just opened up this checking account, and I have another service in case you make a small math error or something like that. We can keep your checks from the checking account from being returned and save you some money." What do you think? It makes a logical connection to the customer. Suppose the discussion went like this: "Thanks for opening your checking account. What I'd like to talk to you now about is a loan." There's no connectivity, but the fact of the matter is overdraft protection is a loan. It performs the function of a loan when it acts, but it's sold in the context of a performance enhancer to the checking account. How it actually performs is immaterial. You don't have to worry about it being a loan. You have to worry about what it does for the customer. Mutual funds with guaranteed minimum death benefits is an example of what I'm talking about here. While life insurance is used to offset the prescribed return of a mutual fund, it's not positioned as a life insurance product. It just happens that the life insurance is the underlying way in which that particular feature becomes a reality if needed.

What other types of products and services for life and disability could be developed and marketed around CDs, IRAs, 401(k) contributions, and other core products the banks sell? Most banks are different from most insurance agents in that banks don't necessarily need 100% of the commission to survive. Banks with trust departments, proprietary mutual funds, retirement planning, and administration services can benefit from other fees and services that they get other than just the commission on sales. Knowing this, a whole new array of products and structures and pricing, different from your traditional product lines, could be made available to the bank channel.

I trust that these few remarks will stimulate a discussion on the panel. I believe banks can help educate their customers. I think we can use our relationship to make strong recommendations to our customers about what coverages they might need, and I think we will do a good job following up with our customers and increasing the persistency. Those insurance carriers and banks that can get this joint vision, I think, will have a very successful future.

Mr. Lash: Dave and Joe, you both talked about partnerships and venturing. How important are insurance company ratings to you in picking your partners and picking your products that you deal with?

Mr. Picarello: We certainly have stated rating categories from the different rating agencies that we won't go below, but that's not been the most critical factor. There are plenty of potential partners out there with the appropriate ratings. Making a decision to select partners that goes beyond identifying solid companies with solid financials is the much more difficult part of that process for me.

Mr. Holton: The ratings are important. We do have a risk committee that we have to go through. But, just as Joe said, it's really the commitment that the insurer would have to the bank channel—its willingness to work with us—that is most

important. But certainly financial stability is the first cut for us. However, there are enough that are inside that cut that we can work with.

Mr. Lash: Would you say, therefore, that if a company has an A- versus an A, that this is not going to be a big driving force whether you deal with one company or another? That is, would an A- be acceptable?

Mr. Holton: A- would not be a problem for us.

Mr. Picarello: I think, depending on the business, we could also do business on an A-, although certainly not if we're selling annuities through financial consultants. But with other products that we have, and we have some pretty broad-based offers, we have done business at any A rating level.

From the Floor: Regarding the various product sales, in all cases it appears that the banks are just acting like agents collecting a fee and passing the premiums or the deposits on to an insurance company. Is the bank taking any risk in these things or accumulating deposits?

Mr. Picarello: I can tell you that we're pretty selective, but we're taking risk in some of the products that have been, more traditionally, bank products on the credit side. We're taking every risk associated with these types of products, ranging from the insurance risk and the investment risk to the marketing risk. And we're buying services. With other lines we've been a lot more selective. But we still do have interest in taking risk and participating on the manufacturing side. We're taking risk through a reinsurance basis on our program. We're buying services from another party to make filings and manage the claims process, but for all intents and purposes we have every other risk associated with the program. We have several insurance companies within the Chase group for both life and P&C.

Mr. Holton: We have two reinsurance companies. Banks, as you know, historically have been allowed to reinsure what they do through their customer base. If you're making loans when you have credit life or disability, you can do that through an insurance captive. Wachovia as a national bank is not a grandfathered bank. It is 1 of 13. We're not allowed to take any life insurance underwriting risk there. Our risk is totally in the credit insurance area.

Mr. Lash: The other thing I'll add is that there are things in the works out in the marketplace where banks are becoming more willing to take on more risk, particularly on the accumulation product-type side, and some banks are implementing that. Another item of interest is a survey that was done by the ABIA asking banks about their willingness to underwrite. Only 16% of banks said they would not be interested in underwriting; 84% are interested in underwriting insurance products or might be interested down the road. It's my opinion that market forces will drive that change, and we will see more banks exploring different ways to underwrite risk, whether it be through contingent commission or through reinsurance or those types of avenues. One area that's often discussed is the distribution system and the costs that are involved in a distribution system.

From the Floor: Could you comment on how you compensate your salesforce and how you provide incentives to your salesforce, particularly in light of all the discussions of licensing platform personnel? Who are the personnel who are really on salary? How do you add incentive-compensation to those types of people?

Mr. Holton: We currently do not have a platform program where the personal banker or the customer service representative, depending on the part of the bank you come from, will be the one who sells. Chase has a broader program in that regard. But as it relates to what we do have, we have insurance advisors who have 12–15 years of experience, and they're working the up markets, a lot of affluent markets; that is, second-to-die and estate-planning work. We have 170 people with Series 6 licenses who sell investment products, annuities, mutual funds, and insurance. With our recent acquisition of Interstate Johnson Lane, we have 470 stockbrokers who are licensed for mutual funds and annuities, as well as insurance. We're all over the board. The Wachovia part is basically a combination of base salary plus a multiple that you have to validate based on the gross commission revenue you generate. That multiple will go between two and three times what your core base salary is, depending on the salary level. Then from that point there's a grid that has additional revenues that are coming in. You earn a percentage of that commission going up. It's a combination there. With the Interstate Johnson Lane people it's straight commission. They get a percentage of what is sold on each and every sale. And the only really interesting nuance that we have that I haven't heard any other bank have is that our insurance advisors are actually part of a core team of people with four disciplines. There's a private banker, an investment officer, a trust and fiduciary sales officer, and an insurance officer, and those four disciplines have x number of customers they serve out of a portfolio. There is also a bonus situation that's over and above what I just described that's tied to how well that team of people does in penetrating the multiple disciplines through that core customer base that they're assigned.

Mr. Picarello: I would say our programs are very, very similar to what David described. The only thing I would say is that in our platform program, much to my own dismay at least, we do not directly compensate branch platform individuals per sale. There is a contribution that's a weighted revenue value that feeds into a bank incentive plan. It is across all products. In the respect that you'd always like to have your particular product or business favored, it doesn't work. It certainly works from the consumer perspective where something feeds into that plan. But it doesn't happen as quickly as we would like. Typically you have producers who sell and are immediately rewarded for the sale. For us, this happens at the end of a quarter or at the end of a six-month period. We've tried to deal with this situation in other ways in order to keep their successes in front of them, but that's really the only difference from the type of setup that David described.