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Session 100F

Bancassurance in U.S. and Canada: Before Today . . . Beyond Tomorrow

Track: Nontraditional Marketing/International/Product Development
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Summary: Bancassurance is evolving rapidly and differently in the U.S. and Canadian marketplaces.

As a follow-up to the pre-meeting Bancassurance seminar, this session provides the opportunity to join with experts and participate in a broad discussion of pertinent issues such as:

- *Convergence of financial service companies*
- *Bancassurance models*
- *Regulatory barriers and new legislative activities*
- *Segmentation of customer base*
- *Competitive environment*

Mr. James B. Smith, Jr.: The objective of this session is to give you a good feel of what financial service convergence means. It will include a legislative update of what's happening in Washington at this time and discussions on customer segmentation, on bancassurance products, and also distribution channels within a bank. This session, interestingly enough, is really a continuation of sorts from a seminar on May 3, 1999. It's the first time SOA has had a seminar like this

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immediately preceding a meeting on a Sunday afternoon. It was well attended, and we had really a great audience with a lot of questions.

I'd like to introduce the panel to you. Steve Lash is with Ernst & Young and serves as senior consulting actuary. Steve, in the context of his bancassurance background, has worked for Global Insurance Group, which was part of Chase Manhattan. Furthermore, Steve serves on AAA's bank and financial services task force. Chad Masland is senior vice-president of Citicorp Insurance Group. Chad serves as chairperson of the annuity best practice committee of the Association of Banks in Insurance (ABI) . Also joining us today is Deanne Osgood, who is a consulting actuary with Milliman & Robertson. Deanne specializes in variable and fixed life insurance and annuity marketing and product development. She works closely with the financial services practice of Milliman & Robertson.

We also have on the panel Ken Reynolds, who is the executive director of the Association of Banks in Insurance. I might mention that bankers form the membership of this association, which represent nearly 70% of the deposits in the U.S. It's really a great association in terms of having representation not only with the bankers but also with insurers and other vendors. Ken, besides being affiliated now with the ABI, was with NationsBank, and there he was credited with numerous contributions to the creation of NationsBank diversified financial service franchise. Jim Overholt is with Milliman & Robertson, and he heads the financial institutions practice in Chicago. He was previously president and CEO of Great Western Financial Corporations, three non-banking subsidiaries, which included securities, capital management, and insurance. Great Western Financial Securities Corporation was one of the five largest sellers of annuities in the bank channel and one of the ten largest sellers of investment products overall.

I am with American General Life and Accident. Up until a few months ago I was with KPMG Peat Marwick and have spent quite a few years in the Bancassurance market. I also would like to mention that David Collings is serving as our recorder today.

The way this open forum is set up, audience participation is very important. We had a lot of questions yesterday, and I'm hopeful that today will be the same because our purpose as panelists is to have some worthwhile discussion that can add value to what you do after you go back to the office. I encourage your participation in asking questions, and furthermore, offering any ideas and thoughts that you might have. One other thing in the way of background: When we speak of bancassurance we're using, at least for purposes of this open forum, a very broad definition. It would include both the perspectives of the bankers and the insurers. It would include all types of products, which could be life, annuity, and health, property and casualty, title insurance, private mortgage insurance, and so forth. Obviously, with this group the focus will be on the life, annuity, and health arena, but when we say bancassurance we are looking at the broad definition.

The driving force in my opinion for bancassurance is not so much that the insurance companies are looking at an additional distribution channel. Furthermore, it's not so much that bankers are looking for additional revenue. To me, those are by-

products of what's happening or what has happened in the U.S. insurance market. I say they're by-products because the fundamental issue, I think, is basically that we in the insurance marketplace are not reaching enough people. The most interesting statistic on this is what the ACLI publishes in their *Monitoring Attitudes of the Public* studies showing that 70% of U.S. residents do not have a personal life insurance agent. Once a banker asked a very appropriate question, and that was, "What about upper income households?" You would think that most of them would have a personal life insurance agent, but I didn't know the answer to that. I went back to the office and looked it up. Sixty per cent of households with over \$75,000 of annual income did not have a personal life insurance agent. Therefore, as I look at the issue of bancassurance, it is not so much a need for additional revenue or an additional distribution channel. The driving force is the fact that we're just not reaching enough of the public with our insurance, annuity, and health offerings.

I thought that it might be worthwhile also to ask Ken Reynolds, executive director of the Association of Banks and Insurance, to spend a couple of moments talking about the current status of bancassurance legislation in Washington. After he does that we're going to throw it out to the floor for questions either on that topic or any other topics that you might have.

Mr. Ken Reynolds: There is a move in Congress to modernize the financial services industry. H.R. 10 is the short version of that legislation in the House of Representatives. It's currently in one of the subcommittees of the House Commerce Committee. The Senate has passed a bill that is very similar to the House version. The next step is to come out of the Commerce Committee. It'll go to the Rules Committee, and it'll go then, hopefully, to the Conference Committee, and then maybe to the President's desk for signature, conceivably this year. It is designed, as they say, to modernize the financial services industry, and basically what that means is to remove some of the classic barriers between banking, insurance, and securities activities. The law of the land today separates those aspects of the financial services business and says, in effect, that banks can do banking, and securities firms can do security stuff, and insurance companies do insurance stuff, and never the twain shall meet.

It has evolved in the marketplace through very visible things and many less visible things, one of the visible being the combination of the Citibank and Travelers companies into what we today call Citigroup. Other activities have demonstrated that the marketplace is evolving despite these regulatory and legislative prohibitions, and, as is almost always the case, the legislation is trying to catch up to the realities in the marketplace. Jim touched on some of the many factors that are driving that change, and we can get into some of those if that's an area of your interest.

However, we wanted to start with just giving you a sense of what financial services modernization legislation was about because it is going to influence, some feel may even shape, the nature of the changes that will be coming over the next several years. This is because additional organizations are working together and collaborating and acquiring each other to affect the change in the distribution process for financial services in this country.

This same movement, as you might expect, is also taking place in the rest of the industrialized world, at least Europe and Canada. To some degree Canada has taken some actions that are ahead of the U.S. In most of Europe, certainly in the U.K., they have about an 8-to-10-year jump on the U.S. in terms of statutory and regulatory structure with respect to the oversight or control of the financial services business. Many years ago, banks and insurance companies and securities organizations in Europe were allowed to affiliate, that is, to own each other and operate within the same corporate structure.

From the Floor: Yesterday we talked about Europe, but we really didn't consider its success there. Has this thing helped the insurance industry and the banking industry in Europe, or what's happened?

Mr. Reynolds: Success, like beauty, is in the eye of the beholder. Generally, with that caveat, I think we can safely say that it has brought about a change in the way in which financial services are distributed in Europe. Those services are more readily and widely available to consumers, and the services are being delivered in a very different fashion today than they were 10 years ago. And that it is, I believe, more effective in terms of responding to the needs of consumers. When I made the comment that the legislation affects and may shape the changes and the way changes come about in the delivery of financial services in this country, I had in mind one of the elements of the rules in the U.K. A needs analysis, perhaps what you might call a financial plan, is required of financial services providers in the U.K. They are required to do a data gathering process to identify the needs of each individual that they're working with. The needs analysis process is subject to examination by the financial services regulatory authority, which has been known to fine and actually rescind the marketplace license of those who are found to be in violation of effective needs analysis processes.

One definition of success would be that the customer is better served as a result. I believe at least that they are better served as a result, but to some degree it came about as a result of the rules that were established. In the U.S. and in Canada we don't have the same rules structure. It might be more difficult for us to orient to success looking at the customer benefit definition. Other definitions might be more appropriate. Are what had historically been banking organizations selling any insurance? They are. In bancassurance, as the French define it (it is basically a French term), many things are included. It's not just insurance sales in a banking institution, but it's also investment sales like mutual funds. All of that is lumped together, and when you put that volume together you get very significant numbers. Virtually all of the major financial and depository institutions have a large insurance carrier affiliate devoted, in most instances, to the customers of the financial institution. They are enjoying significant volumes, not just in insurance, but the institutions are also doing a great deal in pension savings plans, which are very popular in the U.K. It's probably too long an answer to the basic question, "Is it working?" I think it is working, and I think we have an opportunity also in this country.

Mr. Smith: A question came to me as I was thinking of that same issue, which I've asked of some insurance actuaries who are in the U.K. market, and who have spent

a lot of time in the arena of bancassurance. What percentage of the bank income comes from the sale of some type of insurance—life, annuities, property and casualty, whatever? The answer was very surprising. This is not a highly accurate number, but it was more of a gut feeling that one gentleman had picked up through his experience that it was in the 25–30% range. I was shocked to hear that because here in the U.S. often a benchmark for having bancassurance is around 10% net revenues to a bank. Most banks aren't anywhere even close to that. The range of 25–30% tells me a lot. Furthermore, in France, as Ken mentioned, there are different rules they have to follow and different cultural issues as well. Over there the figure is 55%, and this is a harder statistic. Fifty-five percent of the life insurance sales are through the bank channel in some form. This again, is a huge penetration.

Mr. Chad H. Masland: Ken, in that session that you were talking about, the Reagan work that was done with ABI, they made some comparisons, as I recall, in terms of revenues as a percentage of assets, and in the U.S. it was something like 50 basis points. I think in Europe, as I recall from that study, it was close to 2.1% as a percentage of assets. There's almost four times as much revenue as a percentage of assets in a bank's ledger in my understanding.

Mr. Reynolds: There's a little bit of an apples-and-oranges problem that I hasten to point out in a room of actuaries. The definitions of the figures are a little different: the one-half percent that we talk about having achieved in this country—and the number that we're citing is in the ABI—is insurance only. The two percentage points in the European situation includes mutual funds and pension savings plans and a whole range of services generally that aren't categorized as traditional banking services. There's a little apples-and-orange difference, but I agree the magnitudes are still very different. It's a little difficult to pick out how much of the 2% is just insurance because of the differences in definitions, but still it's easily two to three times in Europe what we see in this country in insurance sales at financial institutions.

Mr. Masland: Chad, I think it's also the fastest growing segment by a fair margin also. Bancassurance, as opposed to traditional insurance company distribution, is growing at an order of magnitude larger than the insurance industry.

Mr. John S. Tillotson: I'm somewhat familiar with all arguments in favor of bancassurance and the reasons and the driving forces. What I'd like to hear a little bit about are the original reasons for the barriers—going back to the Depression or whenever, or even whatever it was they were afraid of when they put up these barriers. What sense is there today that these reasons no longer apply or could not occur again if there's another Depression?

Mr. Smith: Let me ask you this. Do you have an opinion on that or are you seeking an opinion?

Mr. Tillotson: My impression would be that there are things that we have forgotten about. Nobody living now was around back then and we may be underestimating the risks.

Mr. James H. Overholt: The barriers that have prevented banks from becoming involved in the investment business and also the insurance business over the years had their formation, as you point out, in the Depression era. The rationale was that the companies would be too powerful. In those days bankers were underwriting securities and then putting depositors' dollars in the securities, and so on and so on. There were no rules that prevented that. What came as a result were rules that prevented that and a separation of the industry. It was sort of a dual solution, and it's only part of that solution that is now being proposed to be rescinded or restructured.

There are still rules that prevent the abuses that led to the problems in the banking system back in those days. There was no Federal Reserve System. There was no FDIC insurance and so on. What has now changed is that we've been able to live in a system like that, and we are now finding that it behooves the consumer, with the protections that still exist in mind, to let the institutions back into other kinds of businesses. A good example of how that may have already been done is in the securities business, where banks were effectively tossed out of the business of underwriting securities. Again, the rationale back then was that they would underwrite them and then sell them to their depositors. They may not be the best securities in the world, but there was an economic interest in selling them. Therefore, let's not tempt banks. Let's prevent them from that.

The municipal bond industry is an example. Banks have been prevented from underwriting municipal bonds. The language of the prohibition said that they should be prevented from underwriting revenue bonds. And now that general obligation bonds are the largest share of the municipal bond industry and banks are not prohibited from underwriting general obligation bonds, they've been doing it for years without any kind of difficulty. Likewise, banks have been involved in corporate underwriting to a more limited extent through loopholes in those old laws. There are some loopholes that banks have used to get into the business, with the approval of the bank regulators and the securities regulators, I might add. But there's been no evidence of potential problems since then, because of the additional constraints on activity, of which I'm aware. Nor is that of concern to our regulators at the Federal Reserve, who are very keen to make sure that the banking problems do not recur.

I think the system seems to work pretty well, and in view of that the legislation is being offered and will likely pass. Letting banks back into the insurance business and, conversely, letting insurers and securities firms have additional powers themselves all is within the context of a whole bunch of rules and regulations that prevent the abuses that led to the original problems. They're not tossing out all of the rules. They're just letting the companies who really look very much like each other, when you get right down to it, do the things that they're already doing in just a little different way.

Mr. Steven D. Lash: I'm just going to add one other thing. One of the controversies around this legislation is whether banks can do these things we're talking about in the actual bank itself or under a bank-holding-company structure. As far as I'm aware, any of these activities would be under the bank-holding

company, which is one of the protections they're leaving in place so that it won't take down the bank necessarily if some of these activities don't go well.

Mr. Smith: I think there are two pragmatic points that I might just build on from what we've heard here. One is that it is very unlikely that major regulatory bodies will be eliminated in this financial modernization regulation. You will still probably have the state insurance commissioners and the office of comptroller of currency (OCC) involved along with the SEC for registered products. I don't see elimination of these regulatory bodies. A lot of regulation will continue, but obviously there will be certain issues to be resolved. For example, with bankers there's a matter of community reinvestment that they're required to do, and how does that translate into what happens if there are insurance subsidiaries within the bank? I think multi-regulation will continue, but there will obviously have to be some modification.

The second thing, pragmatically speaking, is that we must look at global competition. Look at the number of European banks, for example, who own U.S. life insurance companies. Although we may feel uncomfortable with merging banks, insurance companies, and stock brokerage firms together, there are issues of survival and competitiveness in a worldwide marketplace. I would say that should also be factored in. Whether we like that or not, it is a reality today.

Mr. Overholt: Further to that point, the reality today also is that U.S. banks anywhere else on the globe can and are doing this. U.S. banks underwrite and sell and are involved in these activities in foreign domiciles, but they simply can't do it here, and, conversely, banks' competitors can do it here. It's really the worst of both worlds, and the proposed changes are simply recognizing the way the entire world has grown up. Again, we're not talking about taking all the controls off. We're just talking about letting people do what they are capable of doing within the context of existing controls that have worked for a long time.

Mr. Smith: As I suspect most of you know, insurance companies can engage in the sale of traditional bank-type products by purchasing state-chartered thrifts. Well over a dozen insurance companies have done that, and the Office of Thrifts Supervision has approved it. By purchasing a state-chartered thrift they can sell bank-type products: checking accounts, savings accounts, and CDs. They can even engage in personal loans anywhere in the U.S. Thus there is an avenue today in addition to what has happened at Citigroup with Chad that insurance companies can do as they look at offering these bank retail products.

From the Floor: This is really kind of a follow-up on a comment that Jim Smith made about state regulation. The National Association of Insurance Commissioners (NAIC) has pushed hard for retaining functional regulation of the insurance activities of banks. Does your association have a position on that? Do you feel that will result in a viable regulatory environment for banks?

Mr. Smith: I think that question is directed to Ken Reynolds, as opposed to others. Ken, again, is executive director for the Association of Banks in Insurance.

Mr. Reynolds: I just came from an NAIC meeting in Kansas City last week, and they were talking about the multi-faceted regulatory reengineering process that the state insurance departments are going through right now, which automates a great deal of what had historically been very cumbersome and inefficient processes for filing license applications, filing forms for new products, getting authorization to do business in a state, a whole host of things that have to be done. And so the insurance regulatory community in the states has recognized the need to modernize their processes. But your question really goes, as I see it, a little deeper, to the viability of the state regulatory model. Having attended NAIC meetings and having met with many commissioners over the last several years, I think the jury is still out on whether or not the state regulatory model can be sufficient to deal with a fast-changing economy, technology, and operating process.

The position of the ABI is very much in support of the existing functional regulatory process being charged to the state insurance departments. We don't object to that process or to the need to provide functional regulation, which is a buzzword that basically means regulatory oversight over the function of selling and producing insurance products. It has become shorthand, though, for vesting that authority with state, as opposed to federal, regulators. There is no element—directly, at least—in the legislation regarding financial services modernization considered in the House or the Senate, which most people would interpret as eliminating state functional responsibility for insurance. There is a view, however, in the minds of the NAIC and many individual state commissioners, that the wording in the legislation, which prohibits a state from preventing or significantly interfering with the insurance activities of a national bank, is tantamount to eliminating state functional authority. They maintain that any regulation could be viewed as representing significant interference.

The NAIC has argued vehemently for modifications to that wording which, in effect, would reestablish the authority of the states to interfere significantly with or prevent a bank from being in the business. Until two years ago, when the Barnett Bank case was heard and adjudicated at the Supreme Court level, 22 states had done exactly that. That is, 22 states prohibited banks from being affiliated with an insurance company or agency. These prohibitions had been established over the years largely at the urging of the independent insurance agents, who are a very powerful lobbying force at both the state and federal levels. In many cases the state legislatures are heavily populated with insurance agents, and often the state insurance committees within the state houses are chaired by insurance agents. The insurance commissioners and legislatures in many states have been very responsive and supportive of the needs for protective legislation, which they would admit has been protective in its primary motivation for insurance agents.

The banking community believes, therefore, that any federal regulation that allows a state to reestablish those kinds of prohibitions will frustrate the very purpose of the modernization legislation and, therefore, would be violently opposed to it. I'm giving you too many words to try to explain that the ABI's position is supportive of state regulation with limitation, very clear limitation, so that the regulatory authority can't rise to the level of total prohibition or limitations, which in effect rob the venture of competitive viability.

Mr. Smith: As I said at the beginning, this open forum is to address issues that are on your mind, and regulation and legislation are obviously very important. We can continue with this if you like. There are many product and subchannel-type issues, too, that we might want to touch on, but I throw this back to the group here for another question on anything.

From the Floor: My question actually is a product and marketing question. What's the success been in selling health insurance, critical illness, and also the whole life-type products, universal life, through the bank assurers? It seems like there's a lot of success with the fixed and variable annuities and possibly term, but what's the success with some of the other products?

Mr. Lash: You mentioned success of term. I think that's probably arguably worded. I think that, generally speaking, life products have not been successful through banks. Health products are getting more press and exposure in banks, but I wouldn't say they have been successful either. Banks have yet to solve that model of how to sell life products successfully. The statistics reveal that, in total life, banks have about 1.6% of the market compared to 55% in France, as Jim mentioned. I don't think anyone would consider that successful, at least to date. The term products are generally sold through a number of different areas. The Internet, direct mail, agents, and platform personnel are generally the areas where they are sold.

The other products you mentioned, the higher premium products, such as whole life, are typically sold through trust or estate planning departments and the departments of a bank dealing with high-net-worth individuals. Again, some of the bank programs have been hit or miss, but they have generally not been successful. That's where the insurance companies can actually add a lot of value. There's one very large insurance company that is marketing to banks now with the higher premium products. They believe that success in banks is not going to be for the low premium products, like the term through platform, but the higher premium products. And I think the insurance companies need to go out and wholesale and educate the banks and really do a lot of hand-holding to make that product line successful. Some of the bigger companies have embraced that and are trying to see if they can establish a foothold in some of these banks.

Mr. Masland: At Citicorp Insurance Group, we've run a lot of credit-life-type products through the system to tie into bank loans and the credit-card-type division of the company, but from mainstream traditional kind of insurance products, we have failed miserably. We have had several attempts at financial planning-type sales, and it just hasn't connected yet. We know the clients are there. We know there's a way to do this. But we've had a tendency, at least until this merger, to focus fairly heavily on making sure the bank needs are taken care of first for these customers and then figure out what else makes sense.

We've had some success with a product called "hospital income protection" that is a related health type of product, but it's not quite what I've perceived to be what your question is. We still have an awful lot of ground to plow there. We are fairly confident that with the support of Travelers tying into the bank network we should

be able to get a much better infrastructure to achieve that process because, as we've indicated, we know the clients are there and we know the needs are there. We just haven't got the right sales process, and so our sales culture is changing radically. I think you will probably find over the next four or five years a significant shift in the way people think about selling to bank clients, at least with our company for sure. We've had some term insurance experience, and that has not been nearly as successful as we'd like either. As you've noted, our fixed and variable annuity business has been spectacular. Even there we think we've just scratched the surface. We therefore are obviously going to lean in the direction of the accumulation products, where we know we're doing well, and then, hopefully, be able to cross-sell after we get into that arena.

From the Floor: I look at the critical illness sales in the U.K., and I think the majority of them are done through the banks. That's kind of the example that I'm drawing from.

Mr. Deanne L. Osgood: Companies are looking at why it has been difficult to sell insurance, such as life, health, or some of these other products that they'd like to break into. Some of the processes they're looking at are the issue and underwriting processes. These processes are very foreign to banks, and banks haven't taken to them very quickly or very well. I'll mention Travelers, and maybe Chad has something to add here. They piloted a term insurance program last fall in three states with Fleet Bank that, I believe, went live in January of this year. It was called the Easy Care Term Program, if I'm remembering this correctly. These are term insurance sales that are done basically over the phone. The yes/no underwriting decision is given over the phone, and the contract is in the hands of the consumer within, I believe, three days. It's a very, very short process. Now, the way it works is that the customer can buy up to \$100,000 just by answering questions. It is an underwritten policy, and they use an expert underwriting system developed in Ireland that, based on the response to the prior question, decides whether to drill down and ask more questions. The whole process takes maybe 15-20 minutes over the phone. This is full underwriting. There is no blood test or saliva for \$100,000, and for a \$100,000-300,000 face amount there is a saliva test only. That's my understanding. I don't know, Chad, if you have anything else to add, but they were successful.

Mr. Masland: I'm more on the annuity side.

Ms. Osgood: That's one to watch because that's definitely been an initiative for selling term insurance in banks and an attempt to streamline the underwriting process while still having credible underwriting by using this expert underwriting system. I haven't seen any sales numbers to date, but I would say to keep your eyes open for that, because that is an area where companies are looking at how they can shorten that issue process and take the underwriting out of the hands of the bank. These are two very important things.

Mr. Smith: You can carve out the mature products that have been sold through banks. These would include credit life, credit disability, accidental death and dismemberment, and mortgage life insurance. And you then look more recently at

what's being sold, that is, the annuities (that's the low-hanging fruit; it's fairly easy to sell). The fixed annuities have a lot of similarities with the selling of CDs, so there's a real natural movement from CDs into fixed annuities. Then you ask, "What will be the next current wave of products out there?" I have seen that bank products fall into several categories, but the two major categories are life insurance and property and casualty. They see property and casualty as being a natural because they're placing personal loans that can in turn generate sales of automobile insurance or homeowners insurance, and some banks just don't want to get into life insurance. They like the P&C. Then you have others that feel the other way. It's really difficult to know in advance what their culture would tolerate.

When you look at the life insurance aspect of this—again thinking in broad terms or a macro sense—it falls into two categories, the simplified sale and the complex sale. With the simplified sale you have the middle-income market, which is a lot of the bank customers. You have simple products that may require no medical underwriting and very limited medical questions, and it becomes more of a transaction. It can be issued more quickly if it's term life insurance. And there you're creating wealth, since with term insurance you don't put in a small premium.

The other avenue on the life side is the more complex sale, and that is where you may be protecting wealth or addressing wealth transfer. Those are much more difficult types of transactions to explain to the customer, and it's also for a higher tier of customer as measured in terms of net worth or income. There you have to explain more about some of the intricacies, for example taxes. But there are many opportunities, because all of these people who have been purchasing annuities, that is, the low-hanging fruit for the bank, are also people who may in turn be generating some estate tax problems, and life insurance can help solve that for them. There may be a natural step into this estate or wealth protection component with a more complicated sale later. But, again, banks tend to gravitate toward the simple, low-touch sale, even within life, where the banker really doesn't have to get involved in a more complicated sale for their customer. I mentioned the P&C side versus life.

Mr. Lash: I would make one other comment, contrasting annuities and life insurance. On the annuity side banks are, generally speaking, cannibalizing their own assets when people have CDs coming due and the banks try to transfer them to an annuity. The pie has not therefore really been expanding on the annuity side. I probably shouldn't admit this, but I actually own a CD. In this market, I probably shouldn't. The bank has called me to give me better ideas for use of the money, and they've been trying to sell me an annuity. On the life side, as we talked about, the underserved middle market and that type of thing, they're actually trying to expand the pie to sell products to customers that don't own a product. I just wanted to make that distinction between annuities and life. One of the reasons why annuities have been so successful is that, as we've been saying, it's easy to transition from a CD or an accumulation-type product to an annuity.

Mr. Smith: I think it's very important for the bank to look at its customer base in making decisions like this, and it really has to couple the number of customers in different segments with the bank's culture, that is, its tolerance for selling

insurance as opposed to just writing out a CD application form, which is very simple. If you speak to those bankers who are dealing with retail products, they indeed think of it in terms of cannibalization of the assets because they may leave the bank. If you talk to the more financial thinkers within a bank, they'll refer to that as disintermediation, which doesn't quite have the same connotation there. Bankers are, by and large, very practical and they realize that if they don't disintermediate or cannibalize their products, the customer will go across the street. As we in the U.S. are looking at the kind of legislation that will allow us to sell insurance through banks, they're looking at it on a very personalized, micro level in terms of what they need to do.

From the Floor: I'm a couple years removed from working with banks, which is a lifetime in this era, but up until two years ago we spent a considerable amount of time trying to work with banks on alternative distribution. Can we find a way to sell the more traditional life products without agents? We were coming to the conclusion that a big barrier in doing that was the bank's relative inability to understand its customer base well enough to do anything with it. You'd come to this model that said that if you want to sell universal life, the best way would be to throw a bunch of agents at it. If you do that, the bank would have the same trouble we have, that is, not enough bodies to be able to pay for it. The conclusion we came to was that banks didn't really understand their customer base well enough to set up their marketing department to do event-based marketing and that they were either unwilling or unable to really put effort into understanding the customer base well enough to do marketing. My question to anybody on the panel is, have there been many strides over the last couple years in that? Is there more of a willingness or ability to do it? And then to leverage off this gentleman's question, are some product sales more successful overseas because U.K. banks or overseas banks have a better appreciation for their customer base and can do more with it than we can here?

Mr. Smith: With the experience that you've had, which I realize is a bit dated possibly, but did you see from GEFA's point of view that there wasn't enough customer segmentation to really allow the sale of insurance in a most opportunistic way?

From the Floor: It was an issue when you get into the more traditional high-ticket insurance products. My unit at the time was coming at it from a direct aspect. We came to the conclusion that the only way to really sell products like that on a direct basis was to understand the bank customer profile so well that you would know that the people you were calling were really the ones best suited for that type of sale. And you would expect that because of either some demographic or event in their life. When you call on behalf of the bank and say, "Mr. Smith, I'd like to talk to you about x.", there will be an openness to take it.

We were piloting some things with a small handful of banks, but in that small handful of banks they really didn't understand Mr. Smith well enough to know I could be calling Mr. Smith. I may have Mr. Smith's name because he was the last person who called, but the real account holder is Mrs. Smith. There are other things like that. We were considering term insurance, some of the simpler products.

They're simpler because you don't need as managed a sales process and can back into some of those sales without much effort. But to get into that higher ticket sale, and we were coming to the conclusion that that was the next real level of development that needed to happen, as opposed to fixing the product or correcting product sins, the platform person just isn't good enough to sell it. All these seem to be minor issues in the grand scheme of things as opposed to the real issue: who is the customer and what's the best way to get at him or her?

Mr. Overholt: I think your opening observation that the world has changed a lot in two years is accurate. In two years time you have seen a broad number of banks really begin translating what had been sort of an individual knowledge of customers held at the branch-platform-representative level into an institutional knowledge of customers by really embarking on some very significant data mining exercises.

We cited probably one-half dozen banks that have spent upwards of \$100 million each, \$30 million over the course of three years or so, to develop exactly the kinds of things that you're talking about, and it's come a long way. The examples that we looked at expect to earn upwards of \$100 million a year as a result of those kinds of efforts. They combined not only demographics of their customer base, like income and occupation, but also the psychographics of the population, such as spending patterns, buying patterns, etc. They looked at what kind of people they are, using both internal and external data, and then taking the next step into what are they going to do next. What are the triggers for certain kinds of buying behavior? Some of it is event related, as you mentioned, some related by activities in the past. In fact, we thought that there would be a fair amount of opportunity for actuarial science in beginning to look into some of those patterns and predicting them better than they are being predicted right now, but it's a very significant effort that's underway in the banking community. I would venture to say that probably one of the top three or four items on most big banks' agenda is to try to understand more about their customer base and how to approach them for these new products. This is a very significant change, with most of it occurring really within the last two or three years.

Mr. Lash: Jim, you have said that the bank's knowledge of its customer base is generally better than the insurance company's knowledge of its customer base, and I think that is very true. Furthermore, I think that you have to start with the customer before you start getting into products and distribution channels. A bank with which I worked did one of the better jobs in terms of customer segmentation. For most of their bank retail products they had 16 customer segments, and for each segment they had certain profiles. In the case of life insurance—and by that I include annuities as well—they felt that 16 was far too many, and they reduced it to six. Thus they had six buckets where they put their customers, and they were able to place over 80% of their customers into those six different bucket classifications.

When a customer would call the bank's phone center, actually appear in the bank lobby on its platform, or have some other kind of communication with the bank, the banker would be able to pull up specific information about the customer. He or she would also pull up profile information. The profile information may not be

completely accurate because some of it is based on general population statistics for a customer that falls into those categories, but it provides the banker specific and non-specific information on the customer. Then, there were certain questions that the banker could ask the customer, depending on the customer's profile. Then he or she might want to explore annuities through these questions or follow a life insurance path. I thought that was a neat system, where the banker could really focus better on what types of products to sell rather than just an across-the-board, "Here's our product offering. Which one would you like to talk about?" There were some real plusses.

Mr. Overholt: Yes, results in direct mail campaigns for folks who have been doing this are something in the 25% range, sometimes higher, with very significant upgrades in capabilities in the last couple of years. The sales culture has changed dramatically over the last couple of years, as well. That might have been another ingredient that you looked at as a reason things weren't as successful as you thought they should be at that time. A lot really has changed over two years, and folks who have attempted in years past to leverage the bank channel for the distribution of all kinds of these products should probably think about going back for another look. A lot has changed.

Mr. Masland: You're finding a lot of credit card companies, too, are having a significant opportunity to mine a database. Certainly in our case at Citigroup we have a huge database of clients, and segmentation's been part of our bloodstream for quite some time in terms of selling a variety of products, financial services, and everything else, to the card base. We've had areas in Manhattan and Long Island City that all they do is segment, and obviously Travelers is going to benefit from that as well.

Mr. Seamus Creedon: If I can comment on bank sales in the U.K.—it is true that the U.K. banks are among the major sellers of critical illness and of individual long-term disability business. I think that reflects a number of different things. First of all, banks generally know their borrowing customers or potential borrowing customers much better than the rest of their customers. A lot of those sales are to existing borrowers and to new mortgage borrowers, for example. The U.K. banks have been helped by the fact that they have invested heavily in training advisors. They selected certain staff and called them mortgage advisors but trained them in financial planning advice, and that has been a help to them. They've also been helped by the influence Ken mentioned of the regulators insisting on financial planning for customers. That's actually been a benefit in terms of selling life insurance as part of a review of a loan or of a new loan.

From the Floor: It occurred to me that the issue is not whether the banks understand their clients, but do they understand insurance? What kind of training is being done to improve the ability for the bank's people to train? The gentleman's answer here in a way ties right into that. They have people who understand insurance better, and the rules seem to reinforce that, but it seems to me if this legislation passed, then there'll be more incentive for the banks to train people, to put in agents, and to get more financial planning done. I think maybe it will be done better at the bank level because people might trust the banks more than life

insurance agents. It might be a more natural entree. But what is being done to improve the ability of the banks to sell and to understand insurance? A platform person has to be licensed to sell insurance. Is that true?

Mr. Overholt: I can address it on behalf of the banks that I'm familiar with and those that I have been involved with. Training is critical, you're absolutely right. The issue quickly becomes how many things can you be a generalist in and still be effective and serve your customer well? When do you have to stop trying to be a generalist and really import a specialist, maybe even a CLU type of individual? At some of the major banks, and we can hear from specific examples on the panel here, there are training and certification programs that go well beyond what the regulators currently require. In California where my bank was our platform, people were capable of selling almost any kind of insurance product, but we simply would not permit them to do that. We very closely circumscribed what they were able to do. We required the preparation and passing of internal testing to make sure that what they were delivering and what they understood about the products was appropriate for the customers. The motivation was not regulatory. We went way, way beyond what the regulators required. The motivation was just good business. The approach was to solve customer's problems involving insurance products, investment products, and other kinds of things, and to do that better than anyone else. That has its own requirements that go with it, and I think a lot of banks are taking that approach.

Probably you will see more rigorous state licensing with the passage of H.R. 10, I would guess. Perhaps you will see different classes, like some states do now, or a certain kind of license letting you do one thing, another kind letting you do something else, and so on. That's much the same as you have in the securities world where there's a series this and a series that and a series the other thing. I think I have six securities licenses right now, and that's probably going to be the direction I think that the regulators will also go, particularly when you're talking about a generalist kind of distribution process, which is very different than the insurance paradigm of the past. In the past, regulators were dealing primarily with specialists in insurance, and their rules were adequate. People kind of grew up and learned by osmosis, but they were specialists, and that's the key point. Now we're entering a world where you have more generalists who are selling the product and know a little bit about a lot of things, and maybe the risk is not very much about any one thing.

You also have a significant distribution channel opening up in direct market. What kind of training or information is going to get delivered to a customer through those channels, through the Internet, through the telephone, or other kinds of mechanisms? It's going to be a very difficult and sticky kind of process. In general it's self-policing right now. I think the regulators would do well to consider emulating the securities kind of structure with different kinds of licenses for different kinds of products.

From the Floor: What about training pointers? You don't have to know everything, but you have to know where to send somebody. Is that being done?

Mr. Overholt: That's a different kind of training, and, yes, that is being done, both training and the creation of expert systems that help with that technology at the platform level, in some cases at a kiosk, where a client can take himself or herself through a process like that.

More importantly, when you're dealing with a generalist, there is support for a bank platform person in the form of asking a question, getting an answer that prompts the next question, etc. The process enables you to either serve the customer at some level or it tells you at some point to turn him over to an expert. It also tells you how to make a referral. Training and expert systems come into play when you're talking about that kind of positioning. As an aside, the Internet is a whole different kettle of fish.

Mr. Smith: Just to build on a comment that Jim made, in terms of training those people who are not full-time insurance specialists who work on the platform, that is, they're an officer in the bank lobby. The issue often is not an intellectual issue of whether they understand the products. This term insurance has guaranteed premium for this long or this universal life has these kinds of guarantees and projections. On the intellectual side, these people are pretty bright, and they may have 50 or more retail products that they're selling, so they've got the capacity to understand the products. What can be most difficult is actually training them to ask the leading questions and to feel comfortable with that. I know just in the last couple of weeks we were dealing with a bank, and their issue with training was not just the products. It was how to get the platform people to feel comfortable with even bringing the subject up and then asking the right questions.

From the Floor: Well, that's really sales training, and it falls into the same category. Incentive is another issue there. Agents are motivated by commissions. What motivates the platform people? What turns them on in terms of even getting into this area?

Mr. Smith: Does anybody want to comment on incentives, platform incentives? By platform, again, just to clarify, we're talking about people who are selling insurance part time. They're full-time employees of the bank, but they're selling insurance along with other traditional retail bank products.

Mr. Reynolds: Most of the banks do have incentive programs for so-called platform personnel. I was in a bank in Washington, D.C. in the last two weeks talking to a person who was opening a checking account for me. She said that she had been with the bank for about a year and a half, but was leaving. She seemed quite capable, so I asked why she was leaving. She said, "Well, I can't stand the sales pressure." After having spent many years in a bank's marketing division, I wanted to leap for joy that the banking industry had gotten to the place where it was exerting sales pressure on the banking reps who are opening the checking accounts. I think that speaks volumes about at least an aspect of the evolution, but they do have an incentive program, and that pressure is a part of, "Gee, Julie, why do Jane here and John there have 47 points accumulated so far this week, and you have three points? What's the deal?" That program is an important part of the process, but I'd like to segue into a comment echoing or keying off of some of the

points that Jim was making about the level of sophistication. A lot of the organizations that Jim and Milliman & Robertson work with are state-of-the-art kinds of companies. Otherwise they wouldn't have the good brains to hire folks at Milliman & Robertson. There are many organizations that aren't that far along in my view. I didn't want you to come away with the feeling that in the last couple of years they've come from the stone ages to rocket science.

You pretty much have to categorize organizations in the form of big ones, middle size, and small ones because they're very different environments. The big organizations that have the size of customer bases, which make investments in data mining pay off, or have the potential to pay off, are the very ones that have the greatest difficulty in making those things come about. They're struggling with practical issues arising out of their acquisitions. They're still wrestling with just trying to make computer A talk to computer B, so that when the customer goes into a Fleet office that was a customer of Bank of Boston, they recognize him and cash a check. This is basic stuff, not to mention Y2K. They're concerned that all their lights are going to go out on January 1, and it's a big concern. Thus there are basic day-to-day system inhibitors that make it difficult for the very largest institutions with the greatest opportunity to take advantage of that opportunity.

It's very unfortunate, but it has caused me to feel better and better about the prospects of the community bank, because even if the lights did go out, they could continue to operate. Bank of America cannot; if that computer goes down, they're out of gas. But if you go into the community bank, John behind the counter knows who you are. He knows you've got money in the bank and will cash your check.

Mr. Smith: He may not be able to find it.

Mr. Reynolds: He may not be able to find it or get the vault open. But as to your question about training and incentives, the banks have a good sense of what needs to be done, and they are moving in that direction, but it's due to several factors: other kinds of resources and competitive pressure and the relentless demands of the securities analysts for continued earnings growth. It's very difficult for them to make the kinds of investments in a long-term project necessary to reconfigure the organization, and a lot of them haven't come to grips with that. They're still torn between, a) Should we put our resources on the Internet where we can, in effect, establish an electronic presence with our 8 million customers more readily and less expensively than we can train 6,000 employees to have that same kind of relationship? or b) Should we stick with the branch platform and train our branch personnel and put branch personnel in there to be generalists? There's still much of that kind of head scratching going on, and that slows things up as well.

Jim made a quick comment about actuarial science and the place of actuaries in all of this thing. When financial institutions are allowed to invest in and enjoy parts of risk income, one of the things that is going to detract from the effect of financial services modernization legislation is the fact that they're going to be very selective in the kinds of risks that they choose to participate in. They'll be more comfortable with programs like annuities, certainly title insurance, programs that they are familiar with and where the risk can be quantified, which means that actuarial

science is going to come to the fore as an important part of their selective involvement in underwriting income. I think these things bode well for actuarial science.

Ms. Osgood: I just wanted to add a couple of comments on the motivations for platform staff. It would be another seminar in itself just to talk about the platform staff and how things work. It ties into some of the silo concepts we talked about yesterday that still exist in the banks. I started working in the bank insurance industry in 1991 and worked with a very large platform program where the platform reps were not paid anything to sell insurance or annuity products. Taking a test and passing it was almost like a promotion for them. These were people who were accustomed to being at the head of the class or the best performers, and now they were being singled out to take this test and be able to offer new products. The reps of this particular bank, by the way, told me they have 600 products they could sell between bank products and other things. Now they were being singled out to start selling annuities. That made them proud, and they wanted to do it. They were really selling the annuities, not just one or two. They wanted to be at the top of the list of the people in terms of sales. They wanted to see their name up there in lights, perhaps to be invited to a due diligence meeting or something. They are now paid some incentive compensation. When the competing institution across the street started cherry-picking these top producers, the producers in the platform staff learned that people outside of their world are paid to sell this stuff.

I would be hard-pressed to find an institution out there that isn't paying some kind of incentive, usually in compensation. The challenge is making it comprehensible. There's one program I know that is so complicated that when the insurance services group quizzes the platform staff on how much compensation they should get, they can't figure it out. There's too much energy being spent trying to figure that out. But what also happens in platform programs is (this can happen in the silo-type situations), if the bank is changing goals or having special programs and CD goals or IRA goals that take the attention away from the annuities or investment products, you'll see huge fluctuations in volume. If the bank isn't talking to itself, and if the insurance product goals aren't integrated with other bank goals, you're going to have a much more volatile program. The platform distribution methodology is a very interesting animal. There has been a very large trend moving in that direction. If bancassurance is going to succeed here, there's a huge culture change that needs to take place inside banks in terms of how they look at all their products and also how the platform staff fits in.

Mr. Masland: I would agree. Citigroup is going through a tremendous change that's going to have a combination of ecstatic people and very upset people in the business, some of whom will share the sentiments of Ken's teller that there's too much sales pressure, while people from the sales side think there's not enough. We're also starting to talk in terms of solutions for clients instead of products for clients. As we described in our earlier session yesterday, banks are moving from the idea of being product purveyors to being solution providers, and, therefore, training has to occur. What's going on currently with the Travelers and Citicorp merger is that we have a lot of people getting licensed within the branches who weren't even thinking about being licensed in the past. We're rolling out a new

financial needs analysis program that has a focus on client needs. There's been a strong sense that we have not hit the vast majority of our clients in that middle-income marketplace to support their needs. The banks are supposed to be able to do that more effectively, but we're discovering we haven't done it as well as we'd like in terms of providing real value to them on a cost-effective basis, both for the client and also for the bank branch.

Mr. Smith: As we talk about incentives for results, we often think in terms of the licensed agent, but within banks there are some incentives for referrals. Someone who can be paid—it's generally a flat dollar amount—for a referral can also be an effective source. They have to be paid for every referral, not just where there's an insurance sale that follows. This can be a very effective program. It also simplifies things because it's generally thought that if they're paid for every referral as opposed to every sale, then they don't have to be licensed. The incentives can be very important, not just from the sales but also from the referral aspect as well.

From the Floor: We've talked about U.S. markets. We've talked about the U.K. market a little bit. Ken, you and I talked a little bit last night about the Canadian market, but does anybody else in the forum have any comments on the Canadian banking and insurance situation?

Mr. Smith: Given that you work with an insurance company that's part of a bank in Toronto, would you like to share for the benefit of this group what your experiences are?

From the Floor: The situation is a little bit different in Canada. There are some similarities, but banks for the last couple of years have been allowed to own insurance companies. They're allowed to distribute term products, travel products, accidental death, universal life, whole life-type products, We use a platform as well. We also use call centers. However, there are real restrictions in the branches in selling insurance. What I gather here is that in the U.S. the branch employees can sell insurance if they're properly trained and have their licenses. In Canada, that can't happen. They can hand out a card, which references an 800 number, that you can call within the insurance operation, but any other form of advertising is strictly prohibited.

From the Floor: You can't do a referral to another rep?

From the Floor: You can do a referral to the call center, but there are no true reps that sit in the branches.

From the Floor: It is therefore fairly passive, heavily dependent on somebody to do something. That person may not want to do it or may forget. The government polices it.

From the Floor: I guess my question is whether it is legitimate in Canada for the person not only to give the card to the potential client but also to pass that name back to the call center so they could do an outbound call?

From the Floor: Right now that can't happen.

From the Floor: Their sales are reflecting that, of course.

From the Floor: Yes. That's why I asked the earlier question about the success. So, I think Internet marketing and outbound call centers are popular, but there are some restrictions.

Mr. Smith: I do have just a broad-based question for the panel. From your perspective in working with this market, do you think that banks are looking for highly competitive products versus high-commission products?

Mr. Masland: I think I can answer that from a Citigroup standpoint. One of the things I find most amusing about my role is that I'm actually working with a bona fide, fully empowered, insurance company called Citicorp Life. For a while it was a fairly well-kept secret that Citicorp owned something that could actually blow up the financial services industry and just chose not to for mostly return-on-assets reasons. Those of you who are on the valuation side of the fence know what I'm talking about. I had a painful experience with these. The return on insurance products is not as immediate as banks like to see. That brings it back to that trade-off issue because Citicorp Life has created products as a normal insurance company, and yet it's part of a bank. The bank is making demands, but you only have so much compensation built into the product before you start deteriorating its competitiveness. Like most insurance agents, I've discovered, the bank wants both of those things—high compensation, high competitiveness—and can't understand why the people in this room and others can't figure out how to do that.

So we end up walking that compromise position most of the time or trying to create the smoke and mirrors that we're all familiar with so that it looks like it's more competitive than maybe it really is. But we have found that incentive comp does drive it a lot, particularly in a bank environment, because the banks actually don't have the same breadth of products being sold through the environment that, for example, a broker does. An insurance broker, even a career broker or a career agent, will call his home office and tell them that if they don't deliver this product, he's going to sell XYZ's company across the street while he's at it. He's still meeting his minimum requirements to be a career agent with them. He's not that bold to say it that way, but that's exactly what's going on. I ran into it continually before I joined the bank. Within the bank network, however, the bank screens vary carefully which products are going to show up and which insurance companies are going to be able to deliver products to their network, and, consequently, you may have three to five products of a certain type, and that's it. Therefore, it doesn't have to be as pristinely competitive all the time, particularly if they're spinning off the bank relationship. The client's there already.

Let's talk about not only the mutual funds that we're dealing with here, but how about some of the other retirement needs he or she might have, or estate planning needs? I think particularly in the annuity line it does not have to be as pristinely competitive as we'd like, although that pressure is now building, but I'd be

interested to hear some of the comments of the folks who have been consulting with banks on this.

Mr. Overholt: The easy answer is, you're absolutely right. You want the most competitive product and the most commission you can possibly get without deteriorating service, and if that means you have to accept a much lower rate of return than you already have, then that's fine. The more thoughtful banks, I think, would ideally like to see a product that is competitive—not the best price in the marketplace but one that is competitive.

Banks have a lot of stock in their brands and have spent a lot of time developing them. They think that they have significant competitive advantages in the markets that they serve, and they want to leverage those competitive advantages, which include brand strength. They can be competitive to the extent that they can leverage their brand, maybe not the best product priced in the market but a competitive one. So they maintain their credibility and their trust and so on and take the rest of it, I think, in commission, in effect being paid for the brand that they have established in the marketplace. I think that's kind of the approach that they are taking, or at least that the thoughtful ones are taking. Don't try to be the best price in the market all the time. You're not going to gain anything, and you're not going to be able to develop a long-term relationship with the purveyors of those products if you take that approach. And you'll be all over the ball park because the best price is going to change from day to day, from week to week. But if you stay competitive, and if you then leverage your brand to achieve the economies that you can get, that's a good approach to take.

The second point would be this notion of relationship pricing. That is pricing products that recognize that there are other products involved in the relationship, which also have earnings that follow along with the relationship with the client, which also, in reality, is a part of the brand strength of the company. I think you'll see a fair amount of relationship pricing involved in insurance, just like you have seen it in the case of trust products, banking products, and even to some extent with mutual funds. It's very difficult. Sometimes you have to be very aware of the tying laws, which prohibit the coercive sale of a product in return for the purchase or some other benefit in other banking products. But there are ways to accomplish it, and I think people will be very creative in terms of giving their best customers a better deal than they might otherwise get.