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Session 3PD
Financial Services Convergence: Implications for the Actuarial Profession

Track: The Actuary of the Future

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Summary: Insurance and banking experts update financial services convergence issues since the passage of Gramm-Leach-Bliley (GLB, a.k.a. Financial Services Modernization Act). Company reaction to the passage of GLB, actuarial contributions to the process and future actuarial implications are addressed

MR. TIMOTHY J. TONGSON: Joining me today is Kristi Matus. She is the executive vice president and chief operating officer of AAL Bank & Trust. One of the areas we want to spend some time on is emerging or new, developing roles of the actuary in financial service convergence.

I will cover some background including the major drivers involved with financial service convergence. I'll give you an update regarding the main regulatory activities occurring today and their impact on the actuarial profession.

Market drivers from the consumer perspective: Consumers are essentially saying, "We want more, better, cheaper, faster." This is translated into a number of areas that have been mentioned over the last few years — things such as one-stop shopping, competitive prices, tailored financial solutions and enhanced, easy-to-use services.

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Note: The chart(s) referred to in the text can be found at the end of the manuscript.

Consumers want to be able to access accounts 24 hours a day, seven days a week. They also want to do that in a variety of ways, such as via the Internet and phone as well as face-to-face interaction. For these reasons, new products and services are being developed.

There is a number of driving forces from the financial services company's perspective. One is new growth opportunities. For a lot of companies, growth is survival. A company grows or dies. This is why companies are looking at ways that they can grow, such as cross-marketing and cross-selling.

Kristi mentioned to me that, with the intention of retaining and attracting more customers, companies are reselling to current customers. This is why customer ownership is such an important part of financial services. Financial services companies refer to insurance and securities companies and banks.

The financial management of companies is another driving force. Today, companies are trying to do more with less, so expense management is key. They are examining ways to maximize return on capital because it is a scarce resource and the market demands it.

Some companies are acquiring blocks of business to achieve economies of scale. Others are narrowing their focus so they can be more effective in a specific niche market.

Of course, competition is another driving force. Everybody seems to be getting into everybody else's business today. For example, a community bank down the street may be selling life insurance or offering insurance products. Just the idea that this is happening can create the need for another bank to want to do the same thing.

That summarizes the key drivers and background causing financial services convergence.

Convergence means opportunities for actuaries. To quote Teri Vaughn: "Actuaries are the insurance industry's foremost experts in risk assessment and risk management, and their role in this evolution will be critical." There was also a discussion by the Society president this morning, in which he talked about this importance. We will come back to this later.

Important developments on the regulatory front: I'm going to talk about four of them. This includes the Financial Services Modernization Act of 1999, also referred to as GLB, the optional federal charters, NAIC activities to modernize insurance regulations and the new Basel Capital Accord.

First, here are the key aspects of GLB. This was passed in November 1999 and essentially permitted banks, securities firms and insurance companies to affiliate

under a common ownership, also referred to as a financial holding company. This added flexibility for banks and financial services companies to interact with each other.

One of the key aspects of this act involved determining how our business will be regulated. GLB provided that functional regulation will prevail. For financial holding companies, the U.S. Federal Reserve will be the umbrella supervisor, and state regulation of insurance subsidiaries will continue.

A number of consumer protection provisions were part of the act regarding disclosure, privacy policy and bank sales of insurance.

When GLB was passed, a great deal of expectation was created in terms of what's going to happen with regard to financial service convergence, including a wave of bank-insurer affiliations and acquisitions.

There was a perception that there would be a rush to become a financial services conglomerate — the Citibank model. And, the consumer wants mentioned earlier were going to be addressed. In the two years since GLB passed, while it has only been a brief period of time, those expectations have not yet been met. There have been no radical developments. So it appears that this is going to be more of an evolutionary than a revolutionary process.

A recent survey gave the perspective of banks on taking on underwriting risk. Depending on the size, generally banks that are smaller — $1 billion in assets or less — are not interested in underwriting risk, which makes complete sense. They want to focus on their core business, which is providing banking products and services.

For banks in the range of $1 billion–$10 billion in assets, one out of four either anticipates that it will take on underwriting risk in the next three years or study whether or not they should be doing so. I think that's interesting. For banks with more than $10 billion in assets, it increases to one out of two.

So, the large banks will take the lead regarding financial services convergence.

A major development attributed to GLB is the federal charter proposals. Banks have a dual regulatory model — federal and state regulation — which has been the template for the proposed federal insurance charters. The primary driver of federal insurance charters has been the perception and realization of a number of limitations with our current 50-state system. The primary limitations cited most frequently are speed-to-market and lack of uniformity.

Banks and securities companies can get their products to market in 30-60 days. However, with insurance companies, it's measured in months or even years for some products. Furthermore, there is a lack of uniformity in what is permissible in one state versus another.

This lack of uniformity also inhibits the innovation of products so they are standardized to get them through the approval process in a reasonable period of time. This creates an un-level playing field between insurance companies, banks and securities firms. This is why there's been a lot of discussion about a federal charter system.

As I mentioned, dual regulatory oversight is the main theme; they allow the retention of a state option, if that is preferred, or federal uniformity and oversight. I'm not going to talk about the details of the various proposals; as of today there are five of them. Various Academy and industry trade groups are studying the implications of each proposal.

These are the five proposals: (1) The National Insurer Act and National Insurer Solvency Act, both sponsored by the ACLI; (2) the National Insurance Act of 2001, put together by the American Bankers Insurance Association; (3) the Optional Federal Chartering Plan for Property and Casualty Insurers, organized by the American Insurance Association; (4) the National Insurance Chartering and Supervision Act, referred to as the Schumer' Bill; and (5) the Insurance Industry Modernization and Consumer Protection Act, sponsored by John LaFalce.

In June 2002, the legislative review process is going to start. Most political processes like this take quite some time so the expectation is that we are quite a long way from seeing an optional federal charter for insurance companies enacted.

The NAIC, perhaps because of the pressure from GLB or optional federal charters, has appeared to escalate its activities to modernize state-based regulation. If there are any benefits from GLB, perhaps this is one of the most important.

The NAIC has a number of activities underway, including market conduct and speed-to-market.

The Coordinated Advertising Rate and Filing Reform Authority (CARFRA) is intended to streamline the process and get products to market faster. CARFRA was introduced a couple years ago, and the states haven't really participated in it. I won't say it's a failure, but it hasn't lived up to expectations.

As a result, a new proposal was put on the table by Commissioner Teri Vaughn to develop interstate compacts. If successful, she believes there will be no need for an optional federal charter.

The ACLI has reviewed an early draft of this compact and 'the members are generally supporters of it, but they have a number of questions, as one may expect. It's an early draft, but even this interstate compact proposal is expected to take at least a couple years to get into place, and it only envisions a limited number of products.

So, there's a lot of work, even with modernization, for speed-to-market at the NAIC level. Then there's also national treatment of companies in which the NAIC is involved.

A question for the audience: How many people here think that we will end up with some sort of federal chartering proposal in the next few years, as opposed to the other option, which is that the NAIC will be successful in modernizing their state-based regulation? Who thinks federal chartering is likely in the next few years? A third of you have raised your hands. And the other question is this: If we do adopt federal chartering, how many years will it really take to get that put into place? Most think it will be three to five years.

Now I will move on to the Basel Capital Accord, and why I think it is important to us. The Basel Capital Accord, or the 1988 Accord, is intended to apply to internationally active banks supervised by the G1O countries. It determines the framework for a bank's capital level. This also affects other domestic banks indirectly for competitive reasons. The Basel Committee on Banking Regulation and Supervisory Practices put together the 1988 Accord. It consisted of representatives of the central banks and supervisory authorities of the G10 countries, which constitute the major economic powerhouses: the United States, Japan, Germany, Switzerland, and so on. This accord established the common minimum framework for calculating the capital adequacy of banks; essentially, it requires that capital must exceed eight percent of risk-weighted assets.

This formula is straightforward with percentages applied to the assets, to risk-weight them, based upon a perceived credit recoverability rate. Then they applied 8 percent to it, and made sure the capital was at least as high.

The Basel Accord primarily addressed credit risk. But, we also have market risk and operational risk. These are two very significant risks and they are not captured in this formula. As a result, work was done on the new Basel Capital Accord, often referred to as Basel II. A couple years ago, they put together an initial consultative paper that proposed this new updated formula to provide greater flexibility and sensitivity to the risk banks have. It is based upon three pillars.

The first pillar is to establish a minimum capital requirement, with emphasis on a bank using internal methodologies to calculate how much capital they need. Now, we in the insurance industry have worked with target surplus formulas for some time. That's really what this aspect of Basel II is about. They're trying to refine it in

an area in which we, as actuaries, are generally comfortable, and have been using formulas like that for some time.

Banks that implement sophisticated risk measurement and risk management techniques and prove to the supervisory authorities and rating agencies that they have superior tools for measuring and managing risk can reduce their capital requirements.

The second pillar is the supervisory review, which essentially means the supervisors can override the minimum requirements, depending on the circumstances of the bank. So it's not a straight-up rule such as, "Here's the formula. Apply it and you're fine." Instead, the supervisors want to have the ability to come in and override that if they really need to.

The third pillar is to introduce market discipline. Essentially, this is to require that banks comply with new disclosures and make their operations more transparent than they have been in the past. That process should impact a bank's stock price, cost of capital and so on.

Those are the fundamental three pillars of the new Basel Accord. Many details are being worked out right now. The next step in this process is for the Basel committee to complete a "comprehensive impact study." Essentially, what that means is they're taking the formula and applying it to various banks to measure the impact.

They are planning to publish their next consultative paper this year. Member countries would implement the new accord in 2005 allowing a three-year time frame to transition into the new accord.

Why is this important? Because of GLB and convergence, we introduce the bank regulator. Banks, securities firms and insurance companies will get into each other's businesses. We' have capital requirements that are determined by the Basel committee, which dictates what banks must hold, and the U.S. Federal Reserve is the umbrella supervisor for financial holding companies under GLB.

In summary, there is overlap with the key drivers, convergence and GLB. They are not mutually exclusive or independent. Each on its own may not seem like it applies to the actuarial profession. However, when taking them together, one can project where this is headed. One can see these circles that overlap, converging together.

That's how I picture this. Is it going to be next year? No. Is it going to be three years from now? It will probably be more in that line. I don't know about five or ten years, but it's definitely moving in that direction.

Again quoting Teri Vaughn: "Regarding our potential contribution, the actuarial profession is looked to as the most credible source for analysis, modeling and management of financial risk." That creates tremendous opportunities for our profession.

Jim MacGinnitie touched on that today during the general session. A number of expansion opportunities are being created for our profession, which allows us to get into, and add value, in these new areas, as we have done in our past.

We are in a key position to facilitate bridging the knowledge gap between these various industries: banks, insurance companies and financial services companies. This provides continuing education for our members.

So, there are new things going on out there for the profession, but how do we take advantage of them? Various committees are studying our strengths and weaknesses. On the "strengths" side, 'we have a strong image and presence within the insurance industry. Some of the key factors that stand out are our professionalism and standards of practice. As risk management professionals, we are second to none in those areas. Those are distinguishing features for our profession. We are also experts on insurance products, risk management, financial reporting and operations.

But where are our challenges and threats? The key issues are with our image and presence. We really don't show up much on the radar screen outside the insurance industry. And many of our skills are not unique to the actuarial profession. That creates competition for us.

Then there are the exam requirements, which have probably convinced a number of people not to pursue the profession. Also, generally, our knowledge of banking and securities is weak. This involves bank products, risks, financial reporting and so on.

'We have a lot to learn, which goes back to the fact that an opportunity for us is within continuing education. What's being done about that? The general strategic initiatives are these: to increase the public's awareness of actuaries, to enhance our professional skills and standards and to expand the scope of the profession.

This was discussed in terms of what they're studying right now. Some of the candidates for president of the Society also touched on these. A number of things are being done, such as the "Big Tent" and the quantitative risk specialist (QRS). These are a bit dated, and I think there is more current information as to where the Society and CIA and the international actuarial organizations are in that regard, but I'll summarize where we are today.

The "big tent" tactic was one of the visions that Howard Bolnick had launched when he was president of the SOA. The Academy, the SOA and the CIA worked together to develop tactics to expand the profession to those practitioners using actuarial techniques in the noninsurance financial services industry (i.e., "new actuaries"). They needed to find new actuaries who are risk professionals and are employed by other financial services firms.

One of the things he pointed out was that the biggest missing piece is professionalism, which I mentioned before. In his opinion, this is the core principle that distinguishes us, and is essential to developing organizational and public trust. This is a key point for us as an organization to leverage in the development of our profession as it moves forward.

The specific tactics at that time were to look at the education and qualification system and figure out how to wrap it around the new actuaries. Also, he looked at how we could expand into noninsurance institutions by bringing those under the big tent. That would get our foot in the door. Part of that process would involve a redesign of the actuarial organizational structure so these new actuaries were accommodated.

Since that time, the QRS has been discussed, and Rob Brown had an article in the *Actuary* that talked about his vision. I think this is similar to the new actuary concept, but basically financial engineers and risk professionals didn't see much advantage in the big tent initiative.

So, this QRS process evolved, and essentially the vision was to develop a syllabus of material based on developing a core skill set, common to a number of disciplines involved in financial management, risk management and so on. As a result, one would get a QRS designation. To get that, one would have to have some core skills and pass one comprehensive exam.

I think that exam encompassed things like mathematics, probability and statistics, and numerical analysis. On those early exams, a lot of the fundamental financial risk management skills were tested.

If one chose to stay on that track, there would be a professional designation of QRS. Or, if one wanted to move on into being an FSA equivalent, he or she would take the traditional actuarial exams. It was envisioned that this point would be around course No. 5.

So that was the historical perspective, and there is a lot of discussion about where to take this now. Probably the most current information available was mentioned at this morning's general session. It'll be interesting to see what develops.

The SOA has a Finance Committee whose role is to explore and develop opportunities for actuaries to expand services to noninsurance financial service organizations. Their objectives are as follows: to understand educational needs and opportunities, to understand the linkage between actuarial approaches and best practices used by banks and financial institutions, and to increase the visibility of actuaries in the financial services industry.

They've had a change in leadership over the last year, so the committee has been dormant. Kristi and I are both on that committee and are still waiting to hear what they decide to do with that. The SOA has created a Risk Management Committee. I'm not sure if they're going to spin off part of that group to study some of the things we discussed, so right now there's nothing new to report.

At the Academy, I chair the Banking and Financial Services Task Force. Our mission is to coordinate responses to the legislative and regulatory initiatives in the financial services areas that affect the profession, to develop relationships with public policymakers, to monitor financial services convergence issues, to assess the impact of issues on the profession, and to communicate this to our members on a timely basis.

In that regard, our task force, as well as a number of other Academy committees and representatives have been involved in this area by assisting bank regulators and public policymakers to understand insurance. They are asking questions like: What are the risks? What are the products? How do they work? How is insurance regulated? Why is it different than banks?

We have had quite a few people involved in U.S. Federal Reserve presentations, giving briefings to Capitol Hill financial services staff members and getting involved in financial services. So, we're making progress in those areas, but there's still quite a bit to do. With the debate and discussion that's going to occur in the next couple months about optional federal chartering, there's an opportunity for us to provide input.

Some individuals have been working with the NAIC to develop a mapping of insurance and bank risks as a means to educate and understand each other's business. Essentially, the categories of bank risk include credit risk and market risk. Also, we are trying to match up the insurance-related risks.

As one may guess, a lot of things on the insurance side just don't fit. Jim Reiskytl is spearheading that, and he's having a fun time, but it's a big challenge. One of the challenges that we face regarding market, operational, interest rate or credit risk is that a bank does not think what we're thinking. Somehow we've got to bridge that gap if we're going to make progress in this area. The work that Jim's group is doing is one effort to bridge that gap.

Our group is monitoring the optional federal charters. The various practice areas of the Academy — life, health, casualty and employee benefits — are each individually studying what these proposals mean to them. And the Banking and Financial Services Task Force will work with them with the intention of producing a public policy monograph that not only summarizes the main points, but also addresses what it means for the actuaries.

We want to make sure that the legislators, the people who are making the laws, really understand the importance of our role in an optional federal charter. This is an opportunity for us to elevate our awareness in the process. If everything goes as scheduled, we'll have something produced in the fall of 2002.

The other thing we're working on is the new Basel Capital Accord, from the risk analysis viewpoint, as well as finding out what it means for the actuarial profession. We're monitoring the new accord because the banks may adopt this for capital requirements by the Federal Reserve. Since the U.S. Federal Reserve looks at how banks measure capital, we want to know what it means for us if we go to a national, optional federal charter environment in which the Federal Reserve is the umbrella supervisor.

Because of these questions, we want to make sure we understand what's going on there and whether or not we can provide input. Our intent is that, when the next consultative paper appears, and if it appears on schedule, we will produce a position paper with regard to that new accord.

What can people do to help? A lot of people are already involved. One can directly get involved in some of the things we've talked about here, but then there's also the professional development that each of us needs to think about continually in the process.

An article titled, "Vision of the Actuary," by Patricia Guinn, is appropriate to mention here. One of the things she concludes with is this: How do we meet the challenge?

She writes, "Other professionals are encroaching on the traditional work of actuaries. Business and government leaders are turning to nonactuaries to solve problems actuaries are well-suited to tackle. Attracting new talent has become more difficult as investment banks and fund managers successfully compete for high-caliber college graduates.

What does this mean for actuaries? It means we must change without abandoning our heritage. People will always expect actuaries to have solid technical and analytical skills, but these are merely table stakes. We need to expand beyond the traditional actuarial skill set and develop stronger business skills. We need to effectively communicate the business implications of what we do, be more creative problem solvers, and develop our abilities as leaders, managers and team players.

We also need to leverage our skills in lateral areas like investment management and banking where actuaries can add significant value. Today's fast-paced, complex environment demands that we get to the answer quicker and add greater value along the way. Finally, we must raise our profile and build bridges to other professionals.

I think that provides an excellent summary of the opportunity for our profession.

I will now introduce Kristi Matus. Kristi is the executive vice president and chief operating officer of AAL Bank & Trust. In those roles, she provides strategic leadership to the sales, marketing and operations processes of a nationwide Internet bank that also provides local retail branch services. Kristi serves on the board of directors of the bank and is also a board member of Outlook Group Corporation. She's a summa cum laude graduate in applied mathematics from the University of Wisconsin at Oshkosh, an FSA and a member of the Academy.

MS. KRISTI A. MATUS: Welcome to the case study portion of this morning's presentation. I'm going to give one person's perspective about moving from theory to practice.

The questions that I always loved on actuarial exams were the type that started out like this, "You're an actuary for ABC Company. Describe your process and how you would do (whatever the task was, whatever the material covered)."

The question that came to me from AAL about three years ago was this, "We want to expand our banking services. Right now, we have three separate banking entities. We want to bring them together, and we also want to expand what we offer to our members, nationwide.

"So your task is twofold. First of all, build the strategic context that you're going to use to support this approach with both bank regulators and the board of directors. Then, finally, create the marketing plans and the operational platform to support the aggressive growth."

I'm going to talk with you about how we got there and what we did.

Here's my general background. I started out as an actuary at AAL in 1990, and did all of the traditional actuarial things, such as mortality and morbidity studies, life and health insurance, product development, pricing and compliance.

In 1996, after working with a lot of product introductions, it became evident to me how dependent actuaries in our organization were on other areas for bringing our final products to market. So, I decided to take a step to a nontraditional role and moved to a strategic planning and process improvement role within the organization.

I did that for a couple of reasons. First, I wanted to learn more about how the rest of the organization functioned so we could bring the product to market a lot more efficiently. Second, I wanted to take some of the actuarial skills and knowledge — the analysis and decision-making processes that we learned — to other areas of the organization.

Throughout that process at AAL, I've had the opportunity to work in a wide and diverse number of areas. I've worked in everything from operations and billing to compliance and product research. So, in 1999, when GLB was passed, and we wanted to take banking further, I had a very broad background.

Part of the reason that I switched was that there is a perfect opportunity to integrate what one is doing into the rest of the organization and to take that actuarial knowledge and drive the rest of the organization forward. I'll say, though, one of the biggest lessons for me was that I did this when I was still taking exams. I recommend that anyone thinking about nontraditional opportunities carefully evaluate the timing of this decision, as study time does become a challenge.

Why banking? From a corporate perspective, the reason AAL wanted to get into banking was that it had a very strong banking heritage. As I mentioned, AAL had three banking organizations. In 1998, we opened a limited-purpose thrift; it was only engaged in fiduciary and trust services, although it was actually chartered as a bank. In addition to that, we had two credit unions; one was 65 years old, the other 14.

So, from management's perspective, we were already very heavily into these businesses. However, we hadn't structured them in a way that we could leverage them to get the best business value. To us, "best business value" meant an opportunity to grow relationships with our members through new product offerings.

This is why it's important and, specifically, why it's important to us. Deeper relationships persist. One can look at the data from *U.S. Banker*. We'll see 27 percent of individuals with one product fall off every year. By the time one gets to individuals or households with at least two product holdings, attrition rates are cut by at least a third. That's important as banks and financial services organizations begin to understand more and more the value of retaining relationships versus going out and acquiring new ones.

Wells Fargo Bank's corporate strategy has a stated goal to build eight relationships with each household with which they work. On the insurance side, more than three relationships is a pretty good indicator that one is heavily penetrated into a household.
One should think about his or her own banking relationships for a moment and try to come up with eight. I've done this for myself. If I have a debit card, a credit card,

a mortgage, a checking account, a CD and a money market account, I'm still only at six.

So my point here is that Wells Fargo recognizes the value of building deeper relationships with customers because it becomes very difficult to untangle that relationship and move somewhere else. The other thing that's evident by this strategy is that Wells Fargo is going to have to get to that eight-relationship mark with something beyond simple banking services. This means they would need to start invading the securities business (which they've already done), as well as insurance and annuity sales. There is simply no other way that they can get those numbers.

Different types of products allow us to reach different markets. This was also important to us. We essentially want to own our membership. We want to have the larger share of wallet on the financial service side with us, as most organizations do.

In the year 2000, our product suite was geared more toward higher-end service products. Property and casualty, which we offered through a brokerage relationship, were our bottom-end entry products. Then we scaled all the way up through traditional insurance and retirement planning products to very specific customized and tailored estate planning products and trust and fiduciary services. We did this through our trust company. However, there was nothing to bring new and young people into the organization, which was one of our concerted goals.

The bank adds the ability to create very low entry cost relationships with our members. It also allows us to reach out to our members with products that essentially everyone needs.

It's hard to imagine someone not operating with a checking account or any type of loan. It gives us much more leverage to get into every household. So when I look at what the bank provides in the context of our overall corporate strategy, it's really the cap on both ends, from simple products for everyone to the very highly customized trust and fiduciary services that we offer to our most valued clients. The AAL product suite of insurance and investments rounds out that middle piece and gives us something for people no matter where they are in their life and no matter what segment they're in.

Finally, the strategy was partly defensive. I talked about Wells Fargo in terms of their stated goal of eight relationships. That's not at all unusual anymore. I think everyone knows that banks are becoming more and more aggressive about selling our products.
By the end of 1998, 11 major insurers had also filed for thrift charters. They were companies like American International Group, State Farm and Principal — names

that we all know and recognize. USAA had been in banking since 1984, so it had a longer-term heritage out there.

Here are some of the data we were operating with at the time. This quote is from *National Underwriter*, going back to 2000: "Seventy-five percent of consumers purchased their most recent individual life or annuity product from an insurance company."

Well, that's great. As an industry, insurance still owns 75 percent of the market for the core products that we deliver. What was shocking to us was, when we looked at it going back just five years, the number was more like 95 percent. So in a very short period of time, banks began to capture a large share of what we felt was our market, and their customer satisfaction rates for delivering it were actually quite high. Customers were pleased by what they were getting.

Chart 1 is interesting when one starts to talk about wanting to own the wallet share for customers' financial services. The bars illustrate households that use at least one service. Commercial banks clearly outweigh all of the others, but when one gets a little bit deeper, to thrifts, credit unions and insurance companies, it's all pretty much an equal playing field. We all have a good share of the one-service type of business that we can do with customers.

But the bars on the right answer the question, "What are customers looking at as their principal institution or their primary financial institution?" Commercial banks far surpass anything else that's out there. Then look at savings institutions and credit unions — they're next — look what happens to the insurance company bar. It disappears.

We are not a primary institution for people. It's questionable whether the insurance industry will ever be able to move into that position, but without having a transactional relationship with customers, it becomes more difficult to retain their business and to grow those types of relationships. It's an uphill battle, essentially.

So where are we right now? The bank opened on June 4, 2001. At this point, in the first half of 2002, we have $320 million in assets on the banking side and approximately $200 million in assets under management on the trust side. Our growth had come entirely through acquisition of the two credit unions that we brought on. Then in 2001, about four days before we merged the credit unions into the bank, we were informed that AAL and Lutheran Brotherhood were merging, and Lutheran Brotherhood also had a bank. So we did three mergers in six months in 2001, which brought us our growth.

Internally, we find that bank customers who are also members of the parent organization have about twice the product holdings of typical members. So where

we've penetrated, we know we've been successful in terms of deepening those relationships. That's clear.

The other thing that's nice is customers don't distinguish between the bank and the parent. There's always been this question: Can one really build an umbrella brand so that customers are going to start coming to the company for all these products and services without distinguishing between businesses?

What we're finding for the customers is that they are indeed doing that. Our trust department is probably the biggest success story of the bank. It has completely blown away all of its sales goals from the last several years, and has done so through building relationships with our financial associates — essentially, our agents — who are dispersed nationwide. Our agents get compensated for referring those types of leads to us, so we've always been in a model where we're partnering with our field staff and delivering what we do.

Table 1 shows how clients really see us, with no distinction. These comments come from loan confirms. This is a bank audit process in which, after someone closes a loan, for a certain percentage of our customers, we send out a postcard that asks questions such as, "Did you receive the right paperwork? Was it done promptly?"

Table 1

Then we leave an open space for comments. This is what we get back from an audit tool and it is pretty interesting. All over the country, 80 percent of our

members don't live within driving distance of one of our retail locations. Therefore, we are primarily a distance-delivery model.

The results indicate that service was super: "Once again, AAL filled the bill for us. They are a very professional organization. I really enjoy doing business with AAL, and am a member for life." This is exactly what we are hoping to achieve with the brand that we're striving to build with the bank.

So, what are our challenges? Those of you who have been in large organizations that have merged know first-hand that a significant amount of catch-up needs to be done post-merger. Right now, we have brought together four different cultures and boards of directors, with different heritages and ideas about strategy and where we need to go.

So, there's been a significant amount of change to manage, but I think that we've been relatively successful. Also, we've done a good job of bringing those things together in a cohesive manner and continuing our movement forward.

I noticed today that my nametag says "AAL Member Credit Union." That was two names ago, and now we're going on our third. On July 1, 2002, we will have a new name and a new brand. Thrivent Financial Bank, and the parent company, which is the merged AAL/LB now, will be Thrivent Financial for Lutherans.

So that, too, has its challenges. Thinking about it from a banking perspective, when ordering checks for people, how many times does the company name change on checks, credit cards, debit cards? We've had a lot of change to manage in this way.

Given that we're in a merger situation, it's also become a challenge to engage our field associates. We feel we're doing a good job of building the brand, however, their core bread-and-butter products are still insurance and investment products. In times of great change, people go back to what they're accustomed to. So our next step is to begin to leverage that and watch it take off again and turn on our real growth — not acquisition growth, but real growth and penetration with our core customer base.

Here is a bit of history on the roles I had as we went through this process. From a nontraditional actuarial perspective, here are some of the things that I experienced. In October 1999, I was named the managing director of our largest credit union, which was nationwide and had existed since 1987. Then I was also named the project sponsor and manager for getting the bank up and going.

Finally, when the bank opened in June 2002, I was made executive vice president responsible for sales, retail, marketing and operations for the organization. It's been a diverse journey. Although I'm not necessarily doing Lotus spreadsheets or building pricing formulas, a lot of the decision making and analytics from my actuarial

training provided an extremely good background for moving us through this time of significant change.

What do I think will happen with this whole convergence issue? Tim talked about this, too. What we're seeing now is that convergence alone, or adding a bank to an existing company alone, will not move one forward. That is one piece of the strategy. Unless it is combined with other things that add value to the customer, to address their issues, one will not get there and will not grow.

I'm beginning to see that other institutions — not necessarily financial institutions — leverage the ideas of convergence, like one-stop shopping and best value, but have no financial background at all. They're trying to take things that normally people don't think of as being fun, and make them fun and easy, or save the consumer money.

One example is Yodlee. How many of you have heard of Yodlee? Yodlee is an online service for the financial services industry that does what is referred to as "screen scraping."

Essentially, one signs up with Yodlee, and gives it all of his or her passwords and all of the URLs for any financial services with which one has a relationship. What they do is build a home page for the person. So every day when one logs on, all of the financial information is consolidated in one look.

In some situations, one can even transact, transferring money back and forth. It depends on what the core systems are like behind that. But my point is, what Yodlee has done is tried to capture this idea of one-stop shopping, and, at the same time, 'combined it with the ability for consumers to still diversify their assets.

It's a neat tool, but account aggregation is more for people who like to set things up, like computer games or XBox or that sort of thing, because it's not easy to set up. Also, one has to have a great deal of trust in the organization because he or she has to turn all of his or her information over to Yodlee and have the company manage it, and 'this isn't necessarily a financial services organization.

Expense-wise, this is interesting as well. That one falls in the save-or-make-me-money category. This is an online budget and cash management service, and what they do is monitor one's spending habits.

After a certain amount of time they'll communicate with the person and say, "You're buying this product at store X. You could save X amount of money if you instead bought it at store Y. Or, instead of buying brand W, purchase brand Z." They will actually help find better deals, based on some of the logic and algorithms they have built into their system.

Then, finally, there is Progressive. Most people in the insurance industry are aware of what Progressive has done, which is basically saying, "We want you to be our customer for life. If we can't give you the best deal, we're going to find someone who can, but we want you to always come back to us."

In all of these types of situations, companies — some of them financial, some not — are leveraging the customer trends behind convergence without necessarily going the full way. Here are some things to think about from my perspective.

If one is interested in taking an actuarial background into what we would consider to be a nontraditional role, I feel very strongly that actuarial training is solid, core business training. The decision process that we use is not much different from what should be used in any business. The other advantage that actuaries have is we can learn tremendous amounts of complex material very quickly. I have seldom seen other professions that have the same capacity to learn and take on new tasks in a short period of time. By the way, our exam process does that.

The insurance background, as Tim mentioned, is very helpful for pricing and risk analysis in other industries. Even in banking, right now, one of the things that's required every year is to do a full assessment on all of the risks related to one's particular business. That's what insurance is about. Again, in just about every business right now, there's an opportunity to leverage the actuarial background to make a difference in a new way.

Moving between financial services industries changes the approach to business. I think this is a positive thing for financial services overall, while, in an insurance company, one has a certain way of looking at the financial services world because of the regulatory framework, the products offered and the customers.

If one moves into banking, insurance or investment, all of those dynamics have changed, so one will take what's good about the disciplines learned and improve the next sector of financial services. At the same time, when working in banking and investments, one will learn things about his or her view of the world that will change his or her approach about insurance. I think it strengthens financial services overall to have that sharing of process and ideas.

Sometimes we need to create an opportunity where other people don't see it. Tim and I talked about this last night. Very often when looking at nontraditional roles, the organization might turn to the accounting department or other professionals. One may actually have to take an active step in creating those opportunities where no one else sees them.

Then, finally, acknowledge that there is a learning curve. An actuarial background gives a very strong foundation to move into other businesses, but not if one goes in thinking it is not necessary to learn anything else, because the models are very

different. So, accept that there's a learning curve, accept that for awhile it will be uncomfortable and accept that one is likely to feel out of place.

Going from being the designated expert in a topic to being a learner is a daunting task. It can be humbling at times, but to be successful in making that leap, it's important to take a learner's attitude.

If one is going to do that, whatever business one is looking at, I encourage anyone upfront to study the current business and regulatory models that govern the particular industry, and constantly improve communication skills.

It is necessary to know that terminology is different between the two industries. We all have our own jargon, but if one can explain things to people in a way that makes sense without using the jargon or the buzzwords, it is possible to still be effective. One doesn't need to know all the background to move forward.

Also, create opportunities. Listen to the customers. Know where they want the business to go. Build a talented staff who understands the core business. This has been one of the extremely critical things to the success of the bank.
What we did, operationally, was brought in a group that combined several talents. I had the insurance and the parent backgrounds, so I understood where we were going from a corporate perspective, along with our strategy. I brought in agents. I brought in people who had managed branches at traditional banks. I brought in consultants, and I brought in someone from the operations area of our parent company.

That formed our team. We need to have diversity in point of view, including people who can springboard off of us by understanding the industry. To go in and think one can create something from scratch, without having that expertise, is going to be a lot more challenging.

Finally, one should use what he or she knows to redefine the way business is done in both the traditional and nontraditional roles. There is a huge opportunity there for the actuarial profession.

MR. DANIEL KUNESH: I have a couple questions for Tim. My first question is on the banks. What is the jurisdiction of the Basel Accord? Is it intended simply for the European Union banks and for application in 2005 or does it have a broader worldwide jurisdiction?

MR. TONGSON: My understanding is it applies to the G10 countries. I'm not sure exactly which ones it encompasses, but with regard to how it then affects us here in the United States, it would be a requirement for the banks that are active internationally.

MR. KUNESH: So, the United States is one of the G10 countries?
MR. TONGSON: Right.

MR. KUNESH: So the Federal Reserve would likely adhere to whatever they come out with.

MR. TONGSON: Yes, in my opinion.

MR. KUNESH: The second question is, in your view, how does this bridge to the insurance industry, which is probably the smaller child of the family of financial services companies and banks? Focus on the United States and Canada, mainly.

Do you think that any initiative for a changed capital standard in the United States for insurance would come from whatever federal authority we have, if we have a federal authority, or the NAIC. Should it remain intact? Or would it basically come through the Internal Association of Insurance Supervisors (IAIS)? And corollary to that, is the IAIS really following the Basel Accord in their thinking?

MR. TONGSON: I'm not sure I can address the latter part of that question, on whether or not they are following the Basel Accord. But, at least under the current framework that we have, the Federal Reserve will be the umbrella supervisor for financial holding companies and banks; therefore, for an insurance subsidiary of a financial holding company, the Federal Reserve really can tell that organization what their capital requirements should be.

There is some push from the bottom, since the NAIC or state-based regulatory requirements determine how much capital the insurance company' must hold. So, I don't know if there's really a clear answer at this point because of that dichotomy, that we've got something coming from the top and from the bottom for insurance companies that are financial holding companies.

If it's just an insurance organization or a bank, that is much clearer in terms of the capital requirements. But the financial holding companies are going to have insurance subsidiaries that are going to have the toughest time with that.

FROM THE FLOOR: How do you view what Citigroup did in early 2002 with Travelers in the property and casualty, taking them out from under the umbrella in this whole convergence? Is that an anomaly? What's your view on that?

MR. TONGSON: That's very interesting. It goes against the grain of what a lot of people envisioned as financial services conglomerates. I think it speaks to exactly what a lot of other people are saying, that it is not the direction that companies are going to go. There will always be companies who home in on what they are good at; it's not just about accumulating more and more.

So, it remains to be seen if we really have the financial services conglomerates that provide the one-stop shopping? My personal opinion is that there's a huge opportunity for niche market players who can provide the level of service that is needed, and there will be companies who continue to acquire and are involved in all different forms of financial services. But I think that's going to be more the exception than the rule, at least in the near-term.

MS. MATUS: I will add to that. Again, just expanding the breadth of what an organization offers is not a strategy in and of itself. It has to fit with what customers want from a company. It has to fit with how they think of the organization.

It seems like there wasn't a good strategic fit between the two in this situation. They never leveraged the strength of the two, and perhaps that's why that decision was made. So I think we will see more of this, as Tim said. Companies will come together, then split apart again as they figure out what works in their marketplace and their business strategies. That's no different from mergers and buyouts and the things that happen in any type of industry.

FROM THE FLOOR: This is a question for Kristi. How are you regulated, and what impact does the Basil Accord, risk-based capital, etc., have on your operations?

MS. MATUS: Right now the Basel Accord has absolutely no impact on our operations. We're a thrift. We're regulated by the Office of Thrift Regulation (OTS). In addition to that, the reason it's not on our radar screen is, as a startup thrift, one of the OTS requirements is to set aside a huge amount of capital. This is essentially enough to get a suitable capital ratio, which is around 8 percent for starters, plus three years of net losses. So, even if Basel were to be enacted tomorrow, it would be a significant amount of time before it would impact what we do.

FROM THE FLOOR: I just want to follow up on the questions about Basel and clarify something. My understanding of Basel is that it's supposed to be for banks operating internationally. Is that correct? Are you operating internationally?

MS. MATUS: No.

FROM THE FLOOR: So, would you even be subjected to Basel?

MS. MATUS: I don't know the answer to that. To be honest, again, we haven't been following Basel because we know it doesn't apply to us.

MR. TONGSON: That was part of Dan's question earlier. Part of that has an impact on banks that are operating internationally.

FROM THE FLOOR: Right.

MR. TONGSON: My perception is that that's also used as a benchmark for the Federal Reserve and how they look at banks operating locally.

FROM THE FLOOR: I think you're right because otherwise there is the situation where one has different capital requirements for banks operating internationally versus only domestically.

MR. TONGSON: Thanks for pointing that out.

Chart 1