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Financial Services Modernization Law

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Summary: Prior to 1999, Glass-Steagall legally separated banking, brokerage, and insurance activities. Enactment of the Gramm-Leach-Bliley Financial Modernization Act brings "down the walls," separating these financial industries. Market forces are already reshaping the financial services industry, notably the Citicorp merger of CitiBank and Travelers.

Does the future portend a race to the finish line of consolidation for all insurers, or will pockets of specialization and excellence remain in certain market niches as an alternative model to the huge financial services conglomerate?

MR. TED JOHNSON: I'm director of marketing for financial institutions at the Life Insurance Marketing and Research Association (LIMRA) International, and with me is Kent Jamison, also from LIMRA. Kent is the assistant vice president and research scientist. We're going to be doing a session on financial services modernization. I'll be talking about the new law, new legislation, and some of the business implications. Kent will be talking about some research that he did relative to consumer acceptance to the concept of one-source shopping and buying all your products from one institution.

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I'm going to talk about business implications of financial services modernization. In a nutshell, the law is pretty simple. It just basically allows banks, securities firms, and insurers to enter each others' businesses. In fact, that is the entire purpose of the new law. Interestingly, the barriers between the different industries were already eroding anyway. Banks were already getting into securities business. They're already distributing insurance. A lot of it was already going on. The legislation provided a little bit more catalyst for change at a more macro level, which we'll get into. It laid a secure foundation, so if a bank wanted to get into the insurance business, there really was no question about their ability to do that anymore. Of course, in legislation, nothing is simple, so there are many challenges ahead. There are many provisions to the act. I'm going to talk about the key insurance provisions. There are a lot of others. For example, there's a provision on the use of automatic teller machines (ATMs). You have to be told that you're being charged for taking money out. It's very specific to the banking industry. The ones I'm going to discuss are for the insurance. Primary areas that were affected, or provisions that are important to us and the industry, include the concept of a financial holding company. National banks can establish financial subsidiaries which provides for a real broad array of financial activities. There's a set of safe harbors that we'll go into as well.

Another key factor is functional regulation, which provides for regulation, in essence, industry by industry, based on existing regulatory structures. There's a multistate licensing provision for sales reps and agents. The privacy policy is another important thing that I'll probably not spend too much time on, but it is very critical to how well this will play out over the long term, at least from a marketing standpoint.

First is the financial holding company. The new entity or structure that's put into code by the law provides for a broad range of activities by a bank or any other kind of financial institution. It allows them to sell banking products and services, insurance sales and underwriting, and that's an important thing because most of the banks were ready to do insurance sales. It does help them to do the underwriting and manufacture the insurance products. In fact, if anyone is interested in bank employment, I can tell you of several banks that are looking for actuaries. It also provides the opportunity for doing security sales and underwriting as well. That barrier had already been breached pretty substantially. So there are a lot of changes relative to this one structure.

There is the financial holding company. In fact, I went to the Federal Reserve Board Website and printed off the list of banks that have requested financial holding companies status. There are over 400. Obviously the banks are taking this whole thing fairly seriously. The reality is that some of the banks really do have serious plans to acquire insurance companies. I haven't seen a lot of activity in there yet, but they do have plans to do that. Many of the others just applied for financial holding company status because providing future flexibility seemed like a good thing to do. So they really haven't had any specific plans to use it. The Federal Reserve made it so easy to get a financial holding company status. You've got an awful lot of companies that went ahead and just did it.

One of the requirements is that the firm be well capitalized, well managed, and have a satisfactory community renewal activity (CRA) rating so that the Federal Reserve Board can be assured that this firm is on strong financial footing. Of course, they already know all these firms are strong anyway, so there was very fast approval.

National Banks are also given some additional functionality. They can do an awful lot of new financial activities. Many of them were already selling insurance; this provides an even stronger foundation, and it allows them to get into other financial activities as well. They can do this by establishing financial subsidiaries, whereas a financial holding company has to have a set of affiliates under the holding company umbrella. For national banks, that's not the case. Basically, the bank can just have a subsidiary within the bank that provides for those other financial services.

Another factor that many people don't know exists in the first place, is it allows the national banks to sell insurance without the "place of 5,000" condition. What that meant previously was a national bank could sell insurance as long as the place they were selling it from had less than 5,000 people. There was never a clear definition on what a place of 5,000 was. Generally, it could mean a town, but what's a place. It could be some place out in the middle of the county. There wasn't necessarily even a town. As long as it had less than 5,000 people, a bank could sell insurance in that location.

Because of some court tests, they could also do that nationally. That was an imposition on some of the banks, particularly, if their primary locations were in a large city environment. Their branches were not in good locations as well. So what the new act did was just remove that as a provision. The bank can continue to sell from there. They just don't have to do that anymore. An important distinction between this and a financial holding company is that a financial holding company cannot only sell insurance but it can underwrite it. A national bank can sell insurance but not underwrite. There is a key difference that depends on how far they want to go with insurance capabilities.

As I mentioned, there are also a variety of what are called safe harbors, and this really came from agency associations making sure that the legislation didn't allow a bank to have too strong of a position relative to selling insurance. As you know, independent agents have fought financial services modernization for many decades. It puts in the law the provision that allows the states to set up safe harbors, and it helps protect the insurance agents from banks having too tight a control over the customer. There are actually 13 of them. Several of them are obvious. One is the bank can't reject a policy because it wasn't written through their insurance operation. So the customer, if they need to get insurance, can go anywhere to get that. The bank can't use misleading advertising. Nobody should be able to do that. They can't tie products and services, so if you want a loan, they can't require you to get a life policy from them or a credit life policy.

Disclosure requirements are things that the banks were subject to already. You have to indicate in all the marketing materials that it's not FDIC insured, and it's not a bank product. Banks had to do that before. You can't merge your books and records and tie referral fees to a sale. The safe harbors were there for a specific purpose. That was to protect the insurance agents, or at least what they thought would protect the insurance agents.

Functional regulation is going to be very interesting, particularly if you work with various regulators. States regulate insurance activities, as always. An important distinction is they can't discriminate against the bank. Many states were doing that, and obviously the banks were not exactly thrilled with it, so one of the provisions is that they can't discriminate against the bank.

They have to deal with the bank the same way they deal with the insurance companies and the agents.

The SEC continues to oversee securities activities; one new consideration, because of the new existence of financial holding companies, is the Federal Reserve, the umbrella supervisor for financial holding companies. You can see where this might get interesting. The Federal Reserve oversees the financial holding company. The state insurance regulators oversee the insurance operation. The SEC oversees the securities firm and either the Office of the Comptroller of the Currency (OCC) or the Office of the Thrift Supervision (OTS), depending on the type of bank. The estate bank regulator oversees the banking operation. If you're a financial holding company, you could be dealing with four regulators. That hasn't proven to be a major problem, but when you get to the point that there's starting to be disputes, even over what kind of product this is, then we might see some interesting activities among the regulators. The Federal Reserve is going to be the primary arbitrator. That's yet to be utilized, but it probably will be used soon. They allowed the Department of Treasury to prove new financial activities. Interestingly, this action made it subject to Federal Reserve Board concurrent.

Multistate licensing is to everybody's benefit. Because of the way a provision is written, it establishes a regulatory framework that really requires the majority of states to either enact uniform laws or regulations for licensing or provide for reciprocity. If you have an agent in the State of New Jersey, and that agent wants to get licensed in a variety of other states, that used to be quite a challenge because all of the states have different requirements. Depending on the state the person was in, they might not meet the requirements of another state. To the extent that all the states have to provide reciprocity, that agent can license in one state and then virtually anywhere else he or she wants to. I suspect that what will happen is it won't be done through uniform laws and regulations. It will be done through reciprocity because that's the easiest way to do it. Basically, the National Association of Registered Agents and Brokers (NARB) is created if it's not done within three years of the passage of the law.

The NARB will provide a federal level licensing body. So an agent would go there and just get a license at that level and not have to worry about the state level. Many insurance regulators are worried that this could potentially transfer state powers up to the federal level.

There are several considerations in the law that provide for state versus federal rights in a couple of different fashions. Either states do it or regulators take it over. The NAIC is already working on it. It was one of its key concerns because it didn't want to lose that authority.

The law establishes a privacy policy floor. This is a very contentious area of the law. Many lobbying groups are lobbying every which way on this. They are going all the way from no privacy provisions to making it very strict. As you all know, privacy is a very hot issue at the moment. The privacy provision requires a financial institution to provide information on their private policy at the initial customer relationship contact and then annually provide a policy statement. Let everyone know what his or her privacy provisions are. It's also required that the policy statement be on their websites. In fact, the FDIC did some research prior to the act taking effect, and it found that almost nobody would have been in compliance with the privacy floor that was being established. We're not too far away, but there are a lot of challenges there for everybody.

Another important thing I want to make sure I mention is this just doesn't supply the bank. It also supplies all your insurance carriers as well. So it's very important that the privacy policy is very clear at point of sale, in all the communications, and ultimately in any of the databases that are used to contact clients. This is especially true because it provides the opportunity for a customer to opt out. Right now it only allows a customer to opt out if you use a third-party marketing or a third-party administrator firm. If you're sending your customer data to somebody outside the firm, it let's the customer opt out of any contact based on any of the financial information or any of their privacy information that might be resident on that file. So that's going to be a challenge for everybody to manage. All of federal regulators and state regulators have been working on it and have put a hold on it going into approval until next July because they recognize how complicated it is for most of their firms to do this.

Here's another interesting spin. The state law would preempt the federal law because it's a very rare provision. Very seldom do you see that kind of thing happening in federal legislation. It only does it if it's stricter. That is why I suggested establishing a floor. The challenge here, of course, is every state can pass different legislation as long as it was stricter than the federal legislation. You might have 50 or more privacy rights to deal with, so it will be messy.

What are some of the business implications? I'm sure everybody can think of even more than I'm going to go over. First, there are mergers and acquisitions. This was considered to be one of the primary provisions but we really haven't seen too much yet in that regard. Citigroup is probably the classic example, or at least is a classic example of a financial holding company. They actually did it before the legislation was passed. The interesting thing was that, since then, not an awful lot of activity has occurred in this arena. Many banks are buying other banks. Many insurance companies are buying other insurance companies, but we're not seeing too much in the way of cross industry activity as yet. One of the areas where it has already starting to happen is in the banking industry, where banks are buying regional broker dealers and securities firms. We've already seen a lot of that. Chase bought J. P. Morgan. There is a lot of that kind of activity that's going to go on but we haven't seen too much cross-industry activity between the banks and the insurance companies. Depending on whether you're an investment banking firm or not, you would have different viewpoints on that. Many investment banking firms see that it makes a lot of sense, but a lot of analysts don't see where it makes a lot of sense because the insurance companies don't have as high a return on investment (ROIs) as banks, so why would banks buy one? They wouldn't want to lower their earnings profile, and it could affect their ratings. It will be interesting to see how that plays out in the future.

What I see happening more than that is strategic partnerships forming between banks and insurance companies. It has already been happening, so this isn't a major announcement. We're going to see more and more banks and insurance companies aligning more closely, trying to work together so that they can learn more about each other's businesses. That's pretty much what the banks have done relative to distributing insurance products. They try to align very closely with an insurer and try to understand exactly what function that insurer is going to perform versus what function they're going to perform. They learn about the products. When banks first started

selling insurance, they used third-party marketers because they didn't know anything about selling insurance so they figured they would get somebody else who does.

Over time, what has been a real challenge for the third-party marketers is that the banks, once they learned how to sell insurance, basically threw the third-party marketer out and brought those functions inside. They do that because now they don't have to share any of the commission revenue with the third party marketer. They can bring that all in-house. For some firms, that can be a lot of money. Last year, First Union Bank wrote $2.6 billion in annuities. Generally, when they strike a partnership deal with insurance carriers, they even get more than the standard 6%, but it takes 6% times $2.6 billion and then they do okay. They're getting a pretty good revenue stream out of that. So there is a lot of money in the business for the banks. They need alternative sources of income, which, of course, is why they're doing it.

One of the other implications which, again, we're not sure where it's going to head, is annuity and life insurance underwriting. I can see where a bank might be more interested in doing the annuity underwriting because there really isn't much underwriting involved in an annuity. Banks, by their very nature, are asset managers. After all, what is an annuity? I can see it happening more quickly in the banking industry than in life insurance underwriting. That is one area where most of the banks really throw up their hands because they don't understand this. To the extent that they were going to get into the underwriting end of the business, they would actually go ahead and buy an insurance carrier. As I said, a lot of the banks do hire actuaries. First Union, for example, has actuaries that it uses to help evaluate the insurance carrier products. First Union is careful in its due diligence. It wants to make sure that it really understands what it is bringing on board in terms of the company relationship as well as the products.

I think we're going to see a lot of cross-fertilization of cultures. That has already started to happen. In fact, this was happening before any of the legislation was passed. Aetna brought in a guy with a banking background to head up the firm. That had been happening in a lot of different situations where the insurance company would bring in a banker. The insurance company assumed that they really understood the financials and the capitalization requirements better. So we're going to see more and more of that as time goes on. Of course, banks, right

now, if they want to set up an insurance operation, go out and hire a variety of insurance people. The key difference might be at what levels these start to occur.

Another important implication is the use of thrifts. I'd assume that, in most cases, all the firms you work for have applied for a thrift charter. It is a very common practice these days. In a lot of cases, the insurance company will apply for a thrift charter even though they're not sure what they should do with it. They wanted to take advantage of the window of opportunity, similar to how the banks apply for financial holding company status. There are numerous insurers who now have thrift charters, and they're going to be used all the way from just setting up the ability to trust operations to actually full-fledged banks. For example, State Farm already has, in essence, a virtual bank that it allows its agents to use to sell bank products as well.

We're going to see more and more of that over time, even at a lot of the smaller companies like Shelter. It is selling regular bank products as well. So there are lot of different ways that the industries are going to start to cross-compete. We've seen more thrift charters in the last three-and-a-half years. I'm not sure what that suggests in terms of numbers other than there's a lot of activity in this area. There are some examples of companies that have thrift charters, and they're all using them differently. This applies all the way from full banking services to just trust services. This is obviously only a partial list.

There are some other implications that are perhaps a little bit further extended from the major provisions of the law. I think we're going to see an increase in private label and proprietary products. Proprietary products are very common in Europe where the bank owns the insurance company and, of course, they just sell their own product. Private label products are products that are manufactured by the insurer, but the bank will put its own name on that. We'll see more and more of that, particularly as the partnerships start to merge. When I was at Aetna, we had a private-label, product-fixed annuity that we distributed through AmSouth Bank. We were initially a little skeptical about doing it. How much value can that add? In reality, most of the customers were bank employees because the bank selected the name and because it was pushing this product. It felt much more ownership of that product. The bottom line is they sold $85

million at a fixed annuity in their first year so that made me a believer that a private label product could really work quite well.

Proprietary products get a lot more complicated because the variable annuity uses some of the bank's funds. However, there are other ways of structure for proprietary products, including profit sharing and a variety of things like a bank managing the assets and so forth. Most companies aren't too thrilled with that. Some, like American General, are very active in that area.

I think we're going to also see a lot of new product development as the industries start to understand each other better and the opportunity is there for a little bit more in the way of mix and match on products. Mix and match products will fall back into the issues of functional regulation as it pertains to who gets the authority to approve or disapprove this product, similar to the securities type of insurance product of a variable life.

I think we'll see a lot of reinsurance issues. Many reinsurers were much more on the front-end of trying to evaluate the implications of the new law. Obviously, one of the things they were trying to evaluate is a bank buying an insurance company. What does that mean to us as reinsurers? Is it going to make it more of a challenge? Exactly what's going to transpire here? I don't know if there are going to be any real major challenges here, but the reinsurance companies have already been very active in trying to evaluate the implication. This is particularly true in a life insurance area where a bank might start to try to influence an insurance company and lower its underwriting requirements. Banks have been very challenged in selling life insurance by the underwriting component. They don't like the time frames. It takes too long. Most of the products they sell (other than perhaps loans) are fulfilled right then and there. So everything has a pretty short time line, whereas insurance underwriting, of course, does not. So many of the insurance companies that are active in the bank channel have been trying to do things such as setting up simplified underwriting for single premium type products, which are more transaction oriented. They do teller underwriting or take any underwriting out of the hands of the bank reps.

I mentioned multistate licensing, which should make it easier for all the different financial institutions in moving forward.

Over time, the regulatory environment is going to get much more complicated before it gets easier. That is because, as we know, there will be occasional turf battles across the different regulatory bodies. This provides the opportunity, even though each supposedly has a distinct area of responsibility consistent with what they had before. When new products start coming out and questions arise as to the proprietary or particular aspect of a product or what have you, there are going to be a lot of turf battles that could occur there as well. If the Federal Reserve is going to play the role of arbitrator across all these different regulators, it will be interesting to see how much of their authority they will use or whether they are going to let things play out without intervening.

There are some additional implications. I think there's going to be an impact on sales reps, particularly over time. Right now, if a bank is distributing insurance products, it is going to be doing it in a variety of ways. It is going to be doing it through the platform staff and through insurance specialists. Basically, it will hire insurance agents. It can do it by direct response or telemarketing approaches. Some of them are doing it over the Internet, and one of the things they're going to want to do is make sure that the reps have the broadest capability to sell the broadest array of products possible. Obviously, that's a two-edged sword. In one sense, you're getting more efficiency out of that distribution entity, whatever it is.

On the other side, there are too many people who can handle that broad array of products. As you go down to the specialization chain, or hierarchy, you're going to get simpler products. In other words, take a more generalist type of person, like a platform sales person who sells CDs. He opens checking accounts, sells fixed annuities, and perhaps sells a simple life product like term insurance. You have to make it as simple as possible for that individual because he is going to have the broadest range of products. I think there's going to be a lot of pressure on sales reps that sell more and more in the context of a broader array of products.

The industry has already been headed toward structuring financial planners, and many of the banks try to do this as well. Kent isn't going to be talking about it but he just did some research in the summer of 2000 on consumer perceptions of financial planners and advisors. It will be interesting to see how that plays out in terms of people's understanding of it. What I've heard so far is there is not a strong understanding. On the other hand, the financial landscape is getting so complicated that more people are going to go to financial planners or at least people who suggest they're financial planners. That will be one of the challenges for the consumer.

One-stop shopping was a very important implication within the law. It was thought that the federal government was enabling consumers to do one-stop shopping. Kent's presentation will be on the consumers' perspective of one-stop shopping and whether they think that's something they'd like to do. From a federal level, that was one of their key points in structuring a law. The law was to provide the opportunity for a consumer to buy all their financial products from one source.

Privacy, as I mentioned briefly, is going to be very challenging. If each state or any state starts to pass more restrictive legislation than the federal legislation, each firm that does business in that state is going to obviously have to deal with that different level of legislation. To the extent that all the states start setting their privacy bars at different levels, it's going to make it very complicated for banks and insurance companies to try to operate in that marketplace.

The only thing that we can hope for is an industry in which that doesn't occur too frequently. That is because it will take down a lot of firm's capabilities in cross-marketing, to the extent that, for example, a state might provide the opportunity for an opt-in instead of an opt-out. So I, as a consumer, actually would have to sign something saying it's okay for you to use my private information to contact me for other product sales. So if you're doing any cross-selling from one affiliate to another, even within your insurance company, you might not be able to do that in that state where there's an opt-in provision. That is because not many customers say it's okay to contact them about the gazillion products you have. So that will be a major challenge, should that occur. Right now, the law provides only for opt-out to third-party marketers, the third-party administrators. It doesn't do it for cross-affiliates. The state could do that as well. In fact, there

is a lot of discussion at the federal level because they didn't think they went far enough in that realm as well. So there is potentially a real challenge in that area.

The other important things that the Federal Reserve thought it was doing was establishing and focusing on consumer benefits. It thought there would be a lot of benefits to the consumer from the law over time, particularly in the area of competitive pricing. To the extent you have a better purview of financial institutions providing more and more products ostensibly that's going to end up creating a more competitive environment. That will, therefore, lower prices. Of course, nobody knows exactly how that's going to play out, but the bottom line is that was what the feds thought was going to play out. They wanted to see prices generally go down.

What do I see as the key challenges? How is an organization going to be able to put all these different pieces together? First of all, I think every firm has got to take a hard look at its organizational strategy. If you haven't already, you have to do it on an ongoing basis because the long and short of it is, you want to remain a nitch player. You want to focus on some kind of specialty. Do you want to constrain yourself to certain methods of distribution, or do you want to go the full boat and provide all types of financial services across the spectrum? It seems what's happening so far, which isn't a big surprise, is the larger the firm, the broader a perspective it is taking. There are many large firms (obviously insurance companies) getting thrift charters. Many of the larger banks are already distributing insurance and are taking a look at broader applications within there as well. But every firm has to consider it.

Let's assume that one-stop shopping starts to work from a consumer perspective. What kind of bearing does that have on your firm? Is it going to help or is it going to hinder your current strategy? Distribution is also going to be a major factor. Many companies have already had to establish bank channels. Many companies don't, but the bottom line is many insurers certainly distribute through multiple channels. I think we're going to see more of that. Banks are going to start distributing through many more methods as well. Many people think a bank is a single monolithic channel. In fact, most insurance companies, if they have a different channel differentiation, would call the bank channel. The bank itself distributes through a variety of methods. There are already a variety of distribution methodologies in place. I think the financial

service modernization is just going to make that even more of a challenge in providing distributors with additional products, as I mentioned earlier.

We already talked about products. I think we'll start to see some innovative products. If a bank owns its own insurance company, at some point, they are going to start questioning a lot of the insurance products and how they're built. When I was working with First Union and at Aetna, they questioned everything we did in terms of their product structure. They wanted us to open that black box so they could understand the pricing, the underwriting implications, and the functional breakdowns of how the things were priced. So if they owned an insurance company, they would even be more fastidious as to how they approach that. So I think we'll see more of that in the future.

Infrastructure, of course, is very important as well. How are we going to be able to deal with all these different product lines? How are you going to set up your customer service operation? Are you going to set up customer service operations that are distinct by product, or are you going to have to have different ones per product? When I was with Aetna, we had one customer service operation for annuities, and another for life insurance. At one point, there was the effort to bring those together. It didn't work. Life products were too complicated for a lot of the folks that were on the annuity side, so it never did transpire. Everybody is going to have to look at his or her infrastructure. How much support can you provide for this vast array of products that you are distributing? Obviously, it's a challenge now. I think it will become more so as we move forward.

Ultimately, the key issue is consumer acceptance. That's what Kent is going to talk about. He did some one-on-one research and took a look at what consumers think about one-stop shopping.

MR. KENT S. JAMISON: LIMRA has issued two white papers. One just came out recently on privacy, and the other is on my subject, financial integration. It is based on these in-depth interviews I did with people. If you want to follow up on any of those papers, go to www.LIMRA.com.

Let's do a little bit of a flashback. I joined LIMRA in 1980 and I head up the consumer research department there. At the time I arrived, there was a big piece of research that had just come out the year before. It was done in 1978, by SRI (Stanford Research Institute). It did a survey of affluent households and found that *affluent* back then meant an income of $50,000 or more. They found that the average household had 20 different financial products and services from 12 different providers. This kind of shook people up, and it got a lot of play with our companies and other financial institutions. There was a big drumbeat back then as a result of this study. This means the affluent really want to get things together. They're spread out all over the place. But as we all know, that didn't exactly take place.

In 1986, the Federal Reserve did a study and found that 75% of people would prefer to consolidate their financial services in one organization, preferably a bank. However, during the 1980s, we all know that things didn't exactly work out the way some institutions thought. We had the Sears, Dean Witter, Reynolds, Coldwell Banker merger. There were all these great thoughts of consolidation, but that just didn't play out.

Some of you young people might not remember the Baldwin United fiasco. Anyone remember Baldwin Pianos? It acquired an annuity writer, United, that went defunct. We don't have United Annuities, and we don't have Baldwin Pianos. Garn-St. Germaine was a piece of legislation that greatly loosened up savings and loan powers. It allowed them to branch off into different things, and we ended up with a savings and loan collapse a few years later. Linking databases for cross-selling was just not there yet. I remember seeing some platform presentations at big conferences of how Sears, Dean Witter, Reynolds, and Coldwell Banker were going to merge all this stuff together. I was skeptical myself at the time because I know our own insurance companies, and our own members back in the early 1980s were having a great deal of trouble just getting consolidated customer files out of their own policy files. I think that's just coming to fruition for a lot of life insurance companies. Our own members couldn't get all those policy files together in one customer file. In 1987, the stock market collapsed, and that kind of shook everything up.

Things are different today. We have automatic teller machines (ATMs) everywhere. We didn't have that back then. We just got results from last month, and our figure shows that 63% of

adults are now connected to the Internet. So that continues to climb. The 401(k) has changed things. People are much more involved in managing their own money, and they invest it in mutual funds more often than they did 20 years ago. Baby Boomers are now facing retirement, and they're much more involved in their finances. Customer files are much more common now, not only with life insurance companies but with other companies as well. Cross-marketing and database marketing is a thing that has come of age. We now have a financial service modernization act that lowers a lot of the barriers and hurdles that we had before. I can't overemphasize enough the economic boom that we've been through. I've been doing focus groups on other subjects, including financial planning. This boom tremendously colored the way people are thinking about their finances.

So things are different now. Will consumers consolidate? In 1998, the American Council of Life Insurers (ACLI) did its annual MAP survey (Monitoring Attitudes of the Public). They found 42% would be interested in consolidating their transactions with one of the institutions that they already are dealing with. Banks, by far, came out as the primary institution that comes to people's minds.

In 1999, Forrester did a survey which showed that 16% of consumers are likely or very likely to switch financial providers for one-stop shopping. So we're going from 42% acceptance down to 16%. This is one of the reasons I was skeptical about doing a full-blown quantitative survey, a survey of a couple of thousand people, which is more typical of what LIMRA and a lot of financial institutions or companies would do. They would just write a few questions, and send out the survey and get some results. I felt that kind of approach would be suspect. I really believed that this was a complicated enough subject. I couldn't even do it in a focus group because I really needed to sit down and understand why you bank where you bank. Why do you deal with the insurance company you deal with? Why do you deal with the stockbroker you deal with? How would you feel about getting that all together?

The ACLI survey said that some of the positive reasons people saw about integrating their finances at one place was that they expected that they might get reduced fees. They might have more tailored offerings, and they would get a consolidated account statement and perhaps a more

comprehensive range of products would be offered to them. They wanted the best products in specific categories. Some of the negative reasons they were fearful of one institution holding all their assets is because, if they got everything from one place, they might kind of get a vanilla folder product, and they might get a better product through a separate institution.

We did our own survey in January of 2000 after the act was passed. The interviews I did were done a year ago this summer, so it was actually a couple months before the act was passed and before there was much publicity about it. In our survey, we found 35% liked the idea of one institution handling all their financial needs, but a little over half didn't like the idea. We found, as some of the other surveys showed, that the percentage who like the idea was skewed to the upper income and also skewed to younger people. I would like to point out those two demographics don't usually go together. Income is usually related to age. The older you get the more income that you have. There's a snippet here of a major finding that I found in my interviews. It appeared that this concept appealed to younger, more affluent people. In our survey, 35% believed no one company could have all the best products and services. About a quarter didn't want to give up their existing relationships, and 22% were afraid of having everything in one place.

So let me turn now to some of what I found. Like I said, the interview was divided in half. I literally spent a half an hour talking to people, in a fair amount of depth, about what their existing relationships were before I even sprung the concept of putting it all together in one place (which then occupied the second half of the interview). As you saw from the lead slide, most of the respondents were dealing with four or five different institutions. That's not counting their credit cards. Americans tended to have at least a couple of credit cards from two different institutions if not more. So that ups it even more.

I want to walk through the pluses and minuses of what people saw with each institution. The banks' primary advantage is everyone has a relationship with a bank. We're all connected. That might not be true with life insurance. Not everyone has a stock brokerage account, but everybody has a bank. Banks have an advantage in that they've already been cross-selling. They are more readily perceived as being a possible provider of insurance, of mutual funds, or of some

of these things because many of the banks have already started doing this for the last several years, that is not the case with some of the other financial institutions. Of course, a big advantage is the local branch. That's sort of a mixed thing at this point because, with ATMs and banking by phone and now on-line banking, the branch bank is becoming less and less important.

In terms of negatives, people overwhelmingly talked about all the bank mergers, and they were fed up. Almost everybody, either personally or through colleagues, had experienced their bank being gobbled up by somebody else or their bank gobbling somebody else up. Accounts change, and if they hadn't experienced some sort of problem themselves, they knew somebody that did. That might be reflective of local markets. I did these interviews in Atlanta, Philadelphia, Hartford and Toronto. Maybe you won't see this in Des Moines, but I think most of us understand that there has been a lot of widespread turmoil in the banking industry. The other thing people complained about over and over was all the fees. I heard, "The banks are nickel and diming me to death."

When I talked to them about consolidating everything, their response was, "Why should I put my stuff with a bank? They're just going to nickel and dime me, and not only on my checking account like they do now, but now they will be able to nickel and dime me on my insurance and stock brokerage account." They were very, very cynical about their banks. They were also cynical because they had lost their personal relationship with their banks. People spoke nostalgically about that person in the branch bank that used to recognize their face and know who they were. Either because of mergers or because the bank has now started rotating their branch personnel from one branch to another, nobody in the branch knows customers anymore. Banks use to have an edge up here in terms of their personal connection with their customers. They've lost that. That was an advantage they lost.

Credit unions are, of course, not widespread but I will say this is one of the few institutions or the only institution that people were intensely loyal about. They felt very good about their credit union. They felt they got a good deal. It was personal. They had been treated right. Of course, the drawbacks with credit unions is they typically don't have a wide product range. They're not even widely available. Quite often the credit union is near where you work, but it might not be

near where your spouse works so your spouse doesn't have access to it. I guess some of the larger credit unions might be hooked up to ATM machines, and that helps, but there are certainly some drawbacks to credit unions, and credit unions just don't have the breadth of products that banks typically do.

Lenders by the way, we're just not seen as players. Lenders are lenders. They are viewed as a person from which to get mortgages.

My auto loan might be with a bank. Quite often the auto loan wasn't necessarily at the bank where a person has their checking or savings. People would say they got their auto loan where they could get the best deal, but that wasn't necessarily where they did their banking. Again, they think, why consolidate? The bank doesn't do anything special for them.

Credit cards, like lenders, were not seen as a player. The credit card companies are thought of as institutions that issue a credit card. They might give me frequent flyer miles. They might do this or that. They offer things from time to time, but I don't see them offering banking or checking, savings, or that kind of thing.

Property and casualty insurers have an advantage in that, generally, there's a local presence if people are dealing with an agent or an agency. Obviously, some people might be dealing direct, like with Geico, but if it's State Farm or Allstate or a brokerage, there's a local presence there. They often deal with a local agent, which is an advantage. They too, like the credit card companies, are seen as too specialized. They just aren't perceived as being the kind of institution that's going to offer everything.

The other thing I ran into was when I talked to people about auto and homeowners insurance, there were a lot of idiosyncrasies about underwriting. There was one person in Philadelphia that lived within the city limits, but his neighborhood was counted as being suburban by this one particular insurance company. As a result, his whole neighborhood had lower rates with this one company. All the other companies considered the neighborhood as being in the city and the rates were higher. There's no way he's going to move his homeowner's insurance to his local bank

unless they get the same kind of specialized underwriting. I stumble on that kind of thing from time-to-time.

The disadvantage of life insurance is not everybody, particularly older people, has individual life insurance. Sometimes that market is missed. The advantage is that there is a local presence with an agent, if there is an agent, and if there is a connection there, which was not always the case.

Mutual funds are not widely held by everyone. However, they are in an attractive market with people that have more money. Again, most of them are seen in a narrow product range of just offering mutual funds or just investments, but typically not getting into insurance. There is usually a direct relationship unless it's purchased through a financial advisor or stockbroker.

Stock brokerage firms are seen positively, but all the positive vibes that you get with people are not through the firm but through the stockbrokers themselves that they deal with. Of course, this is also reflective of the economic good times. Who of us doesn't have a stockbroker that we don't love given what the stock market has done over the past five or six years? Who could have gone wrong?

Existing relationships. About half the people had a tax accountant and felt very good about him or her. Half had ties to at least two financial professionals. A third had a financial planner that they felt good about. With a stockbroker, it was more of a personal relationship. About one-third had a personal tie at the bank. What I learned was when they talk about their existing relationships, loyalty was nonexistent across the board, whether you were talking life insurance, auto insurance, homeowners insurance, banks, or whatever. The only exception I would say is the credit union. This is one area where people felt any kind of real attachment. There were sort of idiosyncratic attachments of a homeowner's company giving a good rate because a neighborhood is counted differently. There was a woman in Philadelphia who liked her bank because she had a place on the Jersey Shore. The bank had ATMs in New Jersey, and they didn't charge her any fees, so she felt particularly loyal to that bank. So there were those kinds of idiosyncratic exceptions. In terms of loyalty or personal connection, it was very nonexistent.

Personalized service was also virtually nonexistent. Again, when you're talking banks and insurance, or what have you, banks were definitely on shakier ground than other institutions because of the mergers and because of the fees.

When I finished the 60 interviews, about one-third of the people were positive about it. Eight of those people thought that it sounded really great. There were another 16. I'd describe them as the "yes, but" group. Yes, they like the idea but you could almost see on their face that, as they thought about it, they started seeing the problems and the implications. Thirteen were unsure and then about another third were what I call a piece of puff pastry. They were just very skeptical. They wanted nothing to do with it.

I had people sort of fill a sheet on various advantages and disadvantages of consolidating. This kind of splits the people that were really in favor of it against the people that rejected it. The people that liked the idea saw consolidating the records in one place as a real advantage. They also liked the idea of one contact. They wanted a 1-800 number or one person to deal with. The rejecters weren't seen as a particular advantage. The supporters believed in the concept. They thought this could work. The rejecters thought it couldn't. There's no way one company can do all these things. In terms of the best price or product, the supporters were kind of neutral, but price was a real reason why people rejected this. I should turn that around. Price was a key reason for those who rejected it. By the way, when I positioned this with the respondents after talking to them about all their existing relationships, I asked about bringing all this together. They said, "Yes if it was a better deal." I said, "Let's assume that it's all your existing relationships. The price is no better. The fees are no less." I tried to keep price neutral in the discussions with these people. One reason I did that was because loyalty was so tenuous. If I said there was a better deal, I think I'd have 100% say yes. I would consolidate or I'd consider it. Once I removed price, people were back to being skeptical.

Interestingly, openness, the willingness to sort of share my finances with one institution and one place was seen as something positive for people who liked the idea. People who didn't like the idea were kind of more private. They were more guarded. They didn't want one person having that big a picture of their finances. So there was a real attitudinal difference. The rejecters really

wanted the flexibility. I remember one person I interviewed in Hartford was absolutely adamant. I can get a better auto price if I shop it myself. If I put it all together in one place, I'm not going to get the best price.

Size, interestingly, was not particularly a cutting edge kind of thing between supporters or rejecters. The risk of putting all their eggs in one basket was not a problem for the supporters, but it was for the rejecters.

My conclusion is the case against consolidation is stronger than the case for consolidation. The case against consolidation reflects the threat of mergers, not only among banks, but among insurance companies and among the whole financial services industry. People would say, "Why should I put all my stuff with one bank when six months from now they're going to get bought out by somebody else? All those accounts are going to get changed. I'm going to leave it alone." They don't rock the boat. That's probably one of the biggest things out there. It's a lot of trouble to move everything. People said, "If I'm going to do this, the one time I want some personal help is at the start." I have a lot of paperwork. I'm not going to pick up the phone and move everything to one institution. I know I'm going to have a lot of forms to fill out, questions to answer, account numbers to give and all that kind of stuff. As I said before, people repeatedly had unique ties to an institution, just as the Jersey Shore example. In another case, a man might have dealt with a bank in Philadelphia ever since he got out of World War II. That bank gave him his first car loan when loans were hard to get.

All institutions have to deal with the fact that they are seen in a narrow image. Insurance companies are not seen as offering checking and savings. They're going to have to overcome that image but that is true for every financial institution. Every financial institution is seen as having its own specialty, and it's going to take a while before people will accept the fact that they can do other things. Certainly, there's skepticism that one company could do it all. Let's not forget that there's a lot of economic disadvantages. You're not going to move your mortgage because you're probably going to have to go through closing costs again. You're not going to move your life insurance or your annuity. There might be surrender charges. You might be 50 years old now and no longer qualify. Even if you do qualify, the rates are going to be higher, so

why would you move your life insurance. Everyone, almost without exception, even those who liked the idea, were hesitant about putting all their eggs in one basket. Convenience alone is not enough. The one exception is the young affluent. It's a very important exception, and it was suggested by some of those survey research findings. These are younger people with higher incomes. The typical case was a dentist that I talked to whose wife was a professional. They had two young kids, were very busy, and very financially sophisticated. They are aware, confident, and willing to share their information with one person. They were pressed for time, and they didn't necessarily want the best deal, or the lowest price. This concept appealed to a good chunk of them. This is a key market that almost every financial institution wants to pay attention to.

We'll make a case for consolidation. Most people want to simplify their lives. People talked about the computer and the Internet and how that would facilitate bringing this about.

If people saw some genuine perceived value, beyond just convenience, a significant portion of the market might have some appeal to the concept. Notwithstanding that, I am very hesitant. I think what's going to happen, as in the last two decades, is this is just going to continue to evolve and evolve slowly.

The white paper does get into other issues. There are issues about private labeling. One of the strategies here is that if people are so concerned with having all their eggs in one basket, you might not want to label all your products under one umbrella. You might want to divide them.