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Session 56PD
Managing Alternative Distribution Systems

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Moderator: DOUGLAS A. FRENCH
Panelists: ROBERT HATTON†
DENNIS R. KOSAVAC‡
ANTHONY VESPA§
Recorder: MARLENE VAN DEN HOOGEN

Summary: The landscape of the financial services business is changing dramatically. Consumers are looking to their financial advisors to provide assistance with a broad range of financial products. Life insurance companies are facing increasing competition from other financial institutions for savings dollars. This session looks at financial products distribution systems used by noninsurance financial institutions.

Mr. Douglas A. French: The purpose of this session is to take a look at the financial product distribution systems used by noninsurance financial institutions. I'm currently with Tillinghast-Towers Perrin in New York. All the presenters are individuals outside the traditional life insurance arena. They will spend time discussing their particular organizations and their particular distribution systems. I think you'll agree that they are all very unique distribution systems.

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†Mr. Hatton, not a member of the sponsoring organizations, is Vice President & Chief Operating Officer of IDS Life Insurance Company of New York in Albany, NY.

‡Mr. Kosavac, not a member of the sponsoring organizations, is President and Chief Executive Officer (CEO) of Chase Insurance Agency, Inc. in New York, NY.

§Mr. Vespa, not a member of the sponsoring organizations, is President and CEO of Merrill Lynch Insurance Group, Inc. in Plainsboro, NJ.

Robert Hatton is the vice president and chief operating officer of IDS Life New York. Dennis Kosavac is the president and CEO of Chase Insurance Agency. Anthony Vespa is the president and CEO of the Merrill Lynch Insurance Group. Their resumes are very impressive and, while I'm not going to go through them because we only have an hour and a half, I have added up their experience. These three individuals have more than 75 years of experience in the financial services industry, so I think they have a lot of good information to share with us.

Mr. Robert Hatton: IDS Life of New York is a wholly-owned subsidiary of IDS Life, which is owned by American Express Financial Advisors, which is owned by American Express. I'd like to talk to you about our distribution channels. We have three channels. The primary channel is our advisor channel. Our advisors are fairly different from other advisors, so I want to cover that in detail. In addition, we have what we call financial direct, which is going directly to clients. Finally, we have our financial institutions, which deal with banks and other institutions.

Our primary channel is financial advisors. An executive vice president handles all our distribution channels. Under that, seven or eight senior vice presidents run the sales force nationwide. There are 45 market groups within the company and all the senior vice presidents have from five to ten of those working for them. Under that are field vice presidents—probably four to seven in each of the market groups, and then district managers and finally, advisors.

Our advisors reach clients through financial planning, and we believe that this is a key strategy to our company. Our customer loyalty is fairly high, and our lapse rates are fairly low. It's the way we want to approach every client. To give a few examples of the types of financial planning that we do, some computer plans cost in the low couple of hundred dollars, and advanced plans, written by attorneys, cost in multiples of $10 thousand. It depends on the client's needs, the net worth, and other such variables.

In their first year, the advisors are employees, and we think that is critical. They lead a very structured life that first year. They're trained for ten days in Minnesota. They have about 20 hours of training every week and they are required to do specific activities. After the first year they become independent contractors. However, they are a closed sales force. They basically sell for us and require approval to sell other products that we may not have yet.

Because we're a financial planning company, they have an incentive to become Certified Financial Planners (CFPs), Chartered Life Underwriters (CLUs), or Chartered Financial Consultants (CFCs). They cannot receive the top compensation from our company unless they obtain at least one of these designations.

Our advisors are multiproduct sellers. They sell all the insurance products, such as variable universal life, universal life, term, long-term care, disability insurance, and variable second-to-die annuities. In addition to that standard set of products, they also sell 401(k) plans, certificates, limited partnerships, mutual funds, cafeteria plans, stocks, bonds, etc. This is not an inclusive list, but I at least want you to get an idea of what they sell.

If we step back and think about this philosophically, we think clients fit along the following continuum. At one end are advisor adverse clients, and at the other end advisor receptive. The same client can be in both those positions. For example, a small business owner, who is now 48, has been investing for 25 years and is very comfortable managing his or her own portfolio—looking at it and making decisions. All the client wants out of the insurer is to execute an order quickly, efficiently, accurately, and at low cost.

On the other end of the continuum is the gentleman who has two small businesses and his net worth is $3 million. He has three children, one of whom is going to join his business. This child has been working for him for a couple years, yet he has many issues to deal with. How is the child going to pay for the business when he buys it? How is he going to set his wife up if he dies before she does? How is he going to equalize the estate for his children? One of the children is coming into the business, yet he has two others, and the business is worth $2 million of his $3 million net worth. How is he going to be fair to all three of them? All these are very complicated issues. This client on the financial direct side just wants somebody to execute orders on sales. The other client may need a very advanced plan. He needs to deal with an estate-planning attorney who will set up his estate. We want to migrate these clients across both sides, depending on how they come into the institution.

The second channel is called financial direct. This is aimed at clients who normally do not have an advisor. We solicit business through cardholder solicitations and the Internet. One of the ways we do this is through cardholder statements of the American Express card. We invite cardholders to purchase an annuity. They can fund it through the card on a monthly basis. This has been a nice business for us, and it has shown consistent growth. We think that we provide a very high-quality service to the cardholder without having a great deal of actual contact with the client.

We also advertise, and this is somewhat of a new direction for us, in *The Wall Street Journal* and through various journals. Clients can purchase packages of services through an 800 number. For example, they can get a jumbo mortgage, they can get annuities, or they can get no-load funds. We do not give advice over this channel.

We just take orders. Again, we think we provide a high-quality service, and high-quality service, through all the channels, is very important to IDS.

The financial institution is the final way we approach the marketplace, and we actually have two different ways we do this. The first is through the Financial Institutions Groups (FIG). Basically, we take advisors and put them in an institution, such as a bank, and they get referrals from personal bankers. They then help the client and sell our products. We approach the clients with financial planning. We also sell the bank's products. For example, if the bank wants a series of annuities sold, the advisor would sell them rather than ours. We have had some fairly good success in this market.

The other is called the Institutional Products Group (IPG). Here we deal with the financial institution and we sell our products through its sales force. An example of this would be a bank. We normally share the distribution channel with other insurance companies, so we're generally not the only one in that bank. There is high competition here, and a lot of the competition is based on rate as well as on quality of service. This can be fairly hot money, depending on the rates when the client comes up for renewal. But again, it's been a reasonable business to us.

From the Floor: Based on the earlier example that you gave with respect to the planner dealing with the small business owner, does the advisor get compensated for financial direct sales?

Mr. Hatton: If the client doesn't go through the advisor—for example, if he or she called that 800 number—then the answer is no. But the client could use a brokerage service through the advisor, and if it is through the advisor, he or she normally gets compensated.

Mr. G. Kevin Gough: How do you mine for business through the financial advisor channel? How do the financial advisors actually go out and find that small business owner?

Mr. Hatton: Well, they do it a number of ways. They hold seminars that might be of interest to the small business owner. They also hold estate-planning seminars for people with net worths of $1 million and up. Referrals are also a key part of the business.

From the Floor: Do you use the same products across the different channels?

Mr. Hatton: No, generally, we don't use the same products. They are priced differently, and we think that each channel deserves a special product designed for that channel.

Mr. Dennis R. Kosavac: I'm president and CEO of Chase's legal vehicles for distributing and reinsuring insurance—there are about eight or ten of them. We're all aware of the debates going on in the U.S., at least, over banks entering the insurance distribution and now the underwriting business. Historically, that debate focused on whether the banks should enter at all, and now the debate is more likely to focus on the issues of how we will regulate the entry of banks and the terms under which commercial entities, insurers, and banks will merge.

However, whether the issue at hand is distribution, ownership, or regulatory oversight, the world in my view divides into basically two relevant camps. One camp says the glass is half full. The market is not fully served by the current distribution system, and the banks entering the market will help all realize a greater opportunity. The second camp says that the glass is half empty, and the market for insurance is a finite opportunity. As soon as banks enter the market, it will take bread out of the mouths of the distributors who are captive of certain companies, and the pie will only be divided into smaller pieces.

I guess to be fair I should complete the picture and say that there is a third point of view. This third view is that it doesn’t matter whether the glass is half full or half empty, but independent agents believe that the size of the opportunity and the right to compete should be defined by and limited to those entities that they and their political associates deem approvable. But that latter point of view notwithstanding, I think a body of empirical evidence is building that will help the industries broadly establish a consensus point of view as to the overall effect of banks entering the life insurance marketplace. I say it's building because if you look at the statistics, in terms of how much premium volume is really being generated by banks, the volume is negligible, perhaps less than 1% of the industry's premium, outside of annuities. From my point of view, I believe the glass is half full, but with a number of obstacles to filling it beyond that. I think the potential is there to fill it to overflowing, but I think we have to overcome certain obstacles.

Before I begin, I'll spare you the description of Chase Manhattan, which is big, global—lots of markets with lots of customers. I tell you that only to say that if anyone is at scale in the business to compete in most marketplaces for most types of insurance, among U.S. banks, it's Chase. Our experience to some degree may be the largest opportunity that the industries confront when it comes to banks and insurance.

On the insurance distribution front, Chase Manhattan is engaged in the distribution of general lines of insurance: health, life, annuities, personal, and commercial property and casualty coverages. We distribute domestically. We also distribute internationally, primarily to the customers of the various Chase entities, including the mass markets (the so-called middle market of consumers), the affluent consumer, the super affluent consumer, small commercial enterprises, and middle-market commercial entities whose sales are typically $200 million or less. We began to pursue the insurance business with a vengeance and with a strategic focus when I took over the business in 1993. At that time, the Chemical Insurance Agency, the Chase Insurance Agency, and the Heritage Bank Insurance Agencies had combined about $12 million of commission income.

In 1997, we will generate between $800 million and $1 billion of premium, with pretax commission income between $100 million and $150 million. Our five-year business plan has us basically quadrupling this year's performance. We distribute life insurance through four primary channels. The first channel is a mass market channel. It's in the tristate New York, New Jersey area, and it focuses on selling life insurance face to face across bank branch desks, as well as kitchen counters, to the customers of a 500-branch network in that area. Nearly 100 licensed life insurance agents distribute fully underwritten term, whole life, and universal life. They do not distribute any annuities or investment-related products. This channel is being supplemented as we speak with an increasing number of bank employees who will be duly licensed. To date, we have about 200 in that marketplace to sell life insurance, and we'll probably grow that number to about 800.

Our second channel is a direct market channel, distributing term life insurance nationwide, be it by mail or telephone. It currently employs fewer than ten agents in a comprehensive one-year market test of distributing these products to the customers of the various major banking affiliates—mortgage banking, credit cards, consumer finance branch, etc.

The third channel is an affluent channel that distributes all forms of life-insurance-based products to meet the protection, estate, and business planning needs of the affluent and super affluent Chase customers. Chase is the largest private bank in the country and has lots of business overseas as well. We have the largest middle-market presence in the New York, New Jersey, Connecticut area, and depending upon the market, the first or second largest in Texas. Focused on that market, we have approximately 15 full-time employees. They've been in business now about a year distributing the product.

Our fourth channel is the Internet, which opened last month. To date, about 25 applications have come in over the Internet. This is a two-step process by design, whereby the customer logs on to the site, asks for information, and requests a time to get a quote. We're doing it deliberately in a two-step process to avoid a great deal of traffic that doesn't result in business. Once the independent agents get over the novelty of visiting our site, then we'll turn it around to a different mode of gathering business, which will be online.

All four channels are emerging—one channel has been around for about three years, and the others have been around all combined under two years. However, combined, we will generate about $17 million in life insurance premium in 1997. Our back-of-the-envelope calculations indicate that's less than 10% of what we think that will be at maturity. Basically, of that $17 million in premium, 70% of it will come from the mass market field force, about 25% from the affluent channels, and about 5% from the mail, telephone, and the Internet combined. Three years ago that volume was zero in all channels.

I would like to also talk about natural markets—natural markets, as opposed to forced markets, or markets that we dictate. In essence, in approaching this business, we were naive in a sense, and perhaps wonderfully so in retrospect, in that we just put things out there and sold them. It had an appeal really from the top of the market all the way down. What we tried to do was not determine who would buy from us and go after them, but we tried to determine who actually would come to us naturally.

When I was on the banking side of the house, one of the things I did for both Citicorp and for Chemical Bank was to plan markets around the U.S. for distribution. The concept we worked on was basically natural markets in which your share in a given marketplace of the basic banking business, checking accounts, etc., was really a function of your share of the distribution relative to the other competitors. If you had a relatively low share of the distribution relative to others, you would get a disproportionately low share. As you went up the curve, getting more distribution relative to others, there's a point at which you actually outperform your share of distribution to gain share of the market. Finally, you peak at some point. The trick was always trying to define the relevant marketplace and determine how much distribution you should put in place. Most people went around using zip codes or territories. We decided to build a model that looked at how customers actually used the network available to them—automated teller machines (ATMs), point of sale, branch bank—and look for clusters, or concentrations of customers, using distributions throughout a system, which may have been noncontiguous distribution. So by doing that, we let the customers tell us how they use the marketplace, including shared ATMs and shared terminals, and then we planned our distribution and market definition around that. At the end of the day, we think we spent less money building out markets than other competitors did by defining the market in the customer's terms.

Well, that was before I was an insurance czar. I decided to apply that same trick to the insurance business. What we learned by just putting the insurance counselors out in the New York marketplace is that we had a natural market. Ninety percent of the premium that Chase generates derives from clients with incomes of less than $50,000. I think that is in stark contrast to IDS or perhaps Merrill Lynch, which we'll hear about later. According to the Life Insurance Marketing and Research Association (LIMRA), 45% of the premium generated nationwide comes from clients with incomes less than $50,000. Seventy percent of our premium comes from clients younger than 44, versus 51% nationwide. Thirty-eight percent of our premium comes from clients younger than 34, versus 17% nationwide. Fifty-one percent of our premium comes from female clients versus 35% nationwide on average, according to LIMRA statistics. Essentially, we got what the LIMRA clients, by and large, didn't want.

LIMRA's annual fact book starts out with some onerous language that says individual life sales have been mediocre, at best, for more than a decade, annualized new premiums have been flat at about $10 billion per year, and new face amount has increased slowly. The number of new policies has declined 12 years in a row. In addition to flat sales, ownership has declined over the decade. In 1984, 62% of households owned individual life insurance. By 1992, only 55% of households owned individual life insurance, and that has dipped again. Although individual ownership has decreased, higher-income households—those over $50,000—have shown an increase in ownership. At the same time, ownership by lower-income households, particularly those with incomes under $25,000, has shown a decline. The industry has moved upscale. Well, that's not where we went. Even though we tried to go there initially, that's not what we got.

You might say that the pattern of buying through people who are in essence branch based may be skewed in and of itself, because those people are not about to see upscale people walking through branches every day. So maybe we should look at another channel to see if that natural market is natural or, again, skewed.

To evaluate the natural market through the mail and by telephone, we issued direct mail to broad groups of customers, selecting them only on the basis that they had a banking relationship with Chase. Chase's demographics across the country reflect the country. They are a tad bit skewed upward, if anything, but only a tad. These are people who received a direct-mail package and either called in or sent in a reply card requesting a quote. So these aren't buyers, these are responders.

At a minimum, these people are willing to consider us, based upon a piece of mail, as a source to get insurance information and possibly an insurance quotation. Subsequently, a number of them did buy. We mailed to the checking account, mortgage loan, and credit card portfolios selectively.

Now the general findings indicate that the older the prospects, the more likely they were to respond. Those who were not professional or managerial were more likely to respond. People with a lower 12-month checking account balance or a lower FICO score (meaning a lower creditworthiness score), were more likely to respond. Prospects with lower annual incomes were more likely to respond. Some of those are obviously positively correlated. Prospects with children of 12–15 years of age were more likely to respond. Those who visited the branches regularly with a higher number of teller transactions were even more likely to respond to the direct mail. Again, you can basically get a portrait of customers who are middle income and aspiring middle-income customers—blue collar as opposed to white collar.

Now I guess what I'm trying to include here is that Chase has entered the insurance distribution market, its natural market, I'd argue, at a point where others have disengaged by and large over time. So there's a void. People talk about the void and the big question has been, will banks fill the void? I think based upon a couple years of experience the answer is, we can quite well fill the void in the sense that we can deliver the customer. As we go back to that New York experience, we don't advertise. We don't have differentiated products. We don't do promotions. This is basically walk-in traffic. We walk up to someone and say, "You're alive. You might need life insurance some day. Would you like to talk to me?"

When we saw this, we basically said, if that's our market, we have to look at basic issues of product, price, compensation, channel, etc., and have some effect on those. Well, that's when we decided we'd take the dedicated life counselors, 100 of them, and move them somewhat up market—not to wealth, but to certainly middle class and slightly above middle class. We decided to license our branch staff and have them sell to the mass market—those people whose incomes are $50,000 or less, mostly less. So we started to license large numbers of bank platform staff. The commission structure there is obviously different. We moved those other folks up market slightly. We're in a process of doing that. We have started to build links to selected carriers that will allow us to process business electronically as opposed to the sea of papers involved these days for relatively simple products. We have started to introduce simplified products—underwritten on face amounts of less than $100,000 for branch sales. In fact, you can get it with a five-question questionnaire. If you answer no to any of the five questions, then you get a background Medical Information Bureau (MIB) check and if that checks out, the policy is issued. The issue rate on applications is 99.99%—all within five business days.

Well, that's what we did. However, I think that really just allows us to keep the glass half full. In a sense, yes, we are selling it and, yes, we are making money and, yes, it will continue to grow, and yes, it's an interesting business, but it will not get into the annual report and cause the share price of Chase's stock to get to its rightful multiple.

I also think that to truly realize the potential of the bank market, the people here and the people who are just after you in the chain, as it were, of product design and product performance, will matter to banks a great deal. We can deliver to clients at relatively low cost because we spend nothing in advertising to get the market to our door. Our expenses start as soon as we try to actually get the customer to fill out an application and process it.

I think we have to start doing things substantially differently, and my model for this is the credit card business. For the market we're going after I think that you should draw your next junior colleague from the credit card business to see how the credit card business actually generates pricing, product, and distribution efficiencies.

I think the insurance industry basically started to move away from the industry while the technology was advancing for the credit card industry, allowing the credit card industry to go after large numbers of customers inexpensively, on a per-active basis. During the last 20 years a huge explosion of credit cards has occurred. In the early days, you used to have to give three pay stubs, fill out an application, and then be rejected eight of ten times to get a credit card. Now it's just the opposite. You have to shut the door, close the mailbox, and throw those mailings away to not get a credit card. There's been different degrees of profitability in the industry over time, but the industry itself has generated hundreds of millions of dollars of profits for credit card companies. At the same time, these companies have helped the economy grow tremendously.

I think that years of avoiding the mass market and tracking the agents as the agents move up market in terms of bigger premiums, one a week, 1.2 a week—we're selling 3.5 a week right now, per agent, without any direct mail—has left the industry without the mindset and perhaps the will to actually penetrate the mass market. I guess if we're going to move from Lutece—which is what largely the industry has gone to, and I watch it every day—to McDonald's, we have to make several changes. This is my generic solution. We have to come up with a product design that allows for single-session selling and delivery—the ability to sell the product and deliver it in the same session. You have to have an immediate—to be read as real time—underwriting decision and confirmation of the price to the customer. You have to have a firm effective date of insurance. You will have an answer that the effective date of insurance is guaranteed to be in place by *x* date. It has to be a relatively near-term date. It has to be paperless, other than what's required to document the synopsis of the terms—price, term, beneficiary. It also has to be an industry standard for price disclosures. It won't work any other way, in my view.

For the average person, the current life insurance distribution processes are fraught with uncertainties. They're geared to dissuade all but the unflappable and very purposeful from buying insurance—certainly among the mass market. If we can make them simple, understandable, and encouraging, we will have a chance of overflowing that glass well over the top, and there will be an opportunity for our combined industries to serve what is an easily delivered natural market.

Mr. Anthony Vespa: Microsoft, Intuit, Fidelity, the Internet, Schwab, IDS, Chase Manhattan, Merrill Lynch. If you conducted a consumer survey today, few people would equate these companies with insurance distribution or manufacturing. But I'm willing to bet that if you take that same survey five years from now, things will have changed dramatically, especially after listening to some of the strategies today.

Many of these institutions will have meaningful insurance distribution and manufacturing, frankly, as Merrill Lynch does today. The reason I believe this is happening is because of the continuing revolution in the financial services business. The revolution, as everyone I'm sure is aware, is moving forward with incredible speed, and it's changing the financial services business forever. I see four dynamics that are changing our business. I call it the four Cs: convergence, consolidation, competition, and commoditization.

Now the revolution is creating great opportunities as well as great challenges—again, is the cup half full or half empty? I truly believe that the winners, the leaders in the financial services in the years to come, will be big, global institutions, fully integrated, broad-based financial services firms. They'll operate on both the retail and the wholesale levels. They'll have capabilities in banking, securities, insurance, money management, mergers and acquisitions (M&As), advisory, and investment banking, just to name a few. In my view—the Merrill Lynch view—you can't look at insurance as a stand-alone business, because insurance manufacturing as well as distribution, which becomes even more critical, must be viewed in the context of total financial services capability. Also, the distribution must be provided by the most efficient method that's preferred by the target markets that you are going after, whether it's through personal service, direct marketing, technology or some combination of the above.

I'd like to talk to you about insurance distribution, but I'd like to step back from solely talking about it in the meaning of product distribution and talk about it in the broader context of overall financial services. This has to do with the changes that we foresee and that we currently see in overall financial services. I'm sure many of us can remember a time not so long ago when there was a banking industry, a securities industry, and an insurance industry. They were rigidly defined, functional organizations, and there were impenetrable walls among all these organizations.

Well, I think everybody recognizes that these days are gone forever. We have a financial services industry in which the lines are blurred, the walls are coming down, and competition exists for similar clients. For us at Merrill Lynch, the broader context we'll discuss has a lot to do with the way we as a firm, over the years, have responded to these changes and with the way we have helped, I believe, create some of these changes, and how our strategy over the last 20 years has evolved to where we are today.

From there, I want to focus on some of the specifics of what we are doing. More importantly, I want to share with you some of our viewpoints about the future. Merrill Lynch has been in the insurance business for more than 15 years. We're a manufacturer and distributor. We manufacture our own variable annuities and variable life products. In addition, we distribute numerous products of other carriers—life products, annuity products, and long-term-care products, as examples.

Our total client assets in annuity products total more than $17 billion. In 1997, we should see more than $2 billion in annuity volume—half of this volume will be our own products. Interestingly, in 1996, we were the second largest distributor and underwriter of variable life. Our average face value of second-to-die survivorship, which is our estate-planning market, is approaching $2 million. The fact is that we have been fairly successful in the business—not because we're in the insurance business, but because it's an integral part of what we do as an organization.

Frankly, I think having insurance as part of our portfolio adds significant value to the markets we target and the relationships that we're building. As most of you know, Merrill Lynch really made its name over the years as a big retail securities firm. That changed dramatically in 1996. The securities industry had its own case of the "Big Bang." Fixed commissions went by the wayside, and it started the revolution in the securities business. At that time, Don Regan, who was our chairman, actually decided to reinvent who we were as an organization. We truly went from a transaction securities organization to what we consider to be a marketing organization. Selling, as you know, focuses on the needs of the seller, the need to sell to whomever you can. Marketing really focuses on specific target markets and the needs within those markets. Marketing also focuses on the best means of distributing to those target markets. Marketing organizations focus on long-term client relationships and on earnings that are relatively predictable and grow consistently over time.

Now, what we do ask—and we're quite serious about it—is what is the client need that we're targeting? What does the client want to achieve and how can we help him or her achieve it? These questions have helped us discover a number of things. It really helped us discover that what clients really wanted from us was convenience. They wanted a full array of products and services and not just those of Merrill Lynch. They wanted a point of sale that was oblivious to whose product it was. They did want expert advice and personal service. High-quality, world-class personal service is just as important to the relationship as the products and services. Over the years, we've had a clearly defined, yet evolving business strategy that focused our researchers on meeting the needs of specific target clients.

I'd like to briefly walk you through this evolution. It will give you a perspective of where we've come from, where we are, and where I hope we're going. You may recall, back in the late 1970s, we developed the cash management account (CMA) which, at that time, was a revolutionary new idea in product and account design. The CMA was where you could put your investments in, write checks from, have low-cost credit, high-yield money market funds, and credit cards all in one account. Indeed, we started the revolution in that type of product, account, and relationship with our clients. That evolved into the next step.

By the early 1980s, somewhere around 1982 or 1983, we moved to the next step, which we called asset gathering. We started to recognize that the more assets that clients gave to us, the broader the relationship with the clients evolved. In 1983, we had about $100 billion of client assets in our accounts. We started to focus on asset gathering as our core strategy. That evolved into the next step because as more and more clients gave us more and more money, we found that they wanted more and more from us, which we were more than happy to deliver if we could do it in a quality way. We found that they wanted not only to give us their assets, but also they wanted us to allocate them and manage them properly for a long-term relationship. That evolved into what we called affectionately at the time, the "Triple A" strategy—asset gathering, asset allocation, and asset management—which means get the money, do something with it that's right for the client, manage it long term, and develop long-term relationships with the client.

As a result of this strategy, we now have $900 billion of client assets in accounts at Merrill Lynch. As you know, as things evolved and as more and more clients gave us more and more of their assets, we recognized that if we really wanted to be value added to the clients, we had to know more about them. We had to define what their long-term financial objectives were. We had to understand clearly what they wanted from us and what they were trying to accomplish. This led to the next evolution of our strategy, which we called financial planning. As you know, IDS is also very big in financial planning.

As part of the financial planning process, we have three steps: profile, plan and performance. Profile is simply, but yet importantly, asking the right questions and getting to understand everything there is about what our client wants to achieve today and tomorrow. The plan provides a road map for the client to follow—recommendations to implement to achieve the client goals. It's an internal financial plan that was ranked one of the best in the financial planning industry. It's a very comprehensive plan. We only charge $250 for it. Contained within that plan are numerous recommendations based on the needs of the client.

Based on the plan, we hope to implement those recommendations with our clients. The third leg is performance. Performance is that the products we provide must perform as we say they will so that there are no surprises for our client.

The last step is the service. World-class service is critical to the relationship because we can win or lose clients as much with service as we can with products.

Our goal is to have a financial plan for every client and to implement these plans. It is within the context of each plan that we provide the insurance. Our approach does reflect our strong view about the distribution model for all financial services and products from banking, mutual funds, trust services, credit cards, securities, and insurance. In the segment of the market that we target, which is interestingly different than what Chase targets, banks, insurance companies and securities dealers in some cases are all focusing on and competing for the same client. If everyone is focusing on that market, what will make the difference in the marketplace?

To compete successfully, we believe you have to know who your clients are, what they want, and be able to deliver what they want. A general idea is clearly not enough. Because clients are unique, their needs are also unique, and you must be able to provide service to the uniqueness of the individual.

Currently, we provide this personal service through Merrill Lynch and its 13,000 financial consultants. As I think most people recognize, we have our own captive sales force—13,000 plus right now and growing. These 13,000 financial consultants, who are spread worldwide (most domestically), are also supported by specialists in different disciplines. For instance, the Merrill Lynch Insurance Group has approximately 115 specialists throughout the country working with our 13,000 financial consultants. Our specialists are estate planners—insurance, as well as annuity—and these specialists are growing as well. We also have specialists in other disciplines and from other business units who work with our financial consultants to provide value to the overall client relationship.

Through the financial planning process, we recognize that clients' needs break down into three areas—asset management, liability management, and transition management. Let me explain the resources that we have to deliver these needs.

In asset management, we offer a range of investment products, equities, fixed incomes, mutual funds, cash management, private portfolio, and on and on. We have business units in place—subsidiaries such as Merrill Lynch Asset Management, the Private Portfolio Group, and Merrill Lynch Consults—as well as others that focus on asset management in the form that the client really wants.

On the liability management side we offer traditional and unique credit products, mortgages, and personal and corporate lending. We do that through subsidiaries such as Merrill Lynch Credit Corporation, Merrill Lynch Bank and Trust, Merrill Lynch International Bank, and Merrill Lynch Business Financial Services.

Finally, transition management, as we call it, is managing assets across the life cycle of clients. Through the Merrill Lynch Insurance Group, as I mentioned before, we offer life, annuities, and long-term care. We do not offer any property and casualty right now. We also offer trust services through Merrill Lynch Trust Company. In essence, we look at the products and the services in the context of the client's needs and the total financial plan. Insurance is no exception.

As we have bet the firm on this strategy, we do a lot of market research to see if this strategy really does work. Let me tell you what the market research says. We do market research every year on client attitudes and prospective client attitudes. We have found that the clients believe very strongly that the financial planning process, if implemented, adds value and creates a high level of confidence in their ability to meet their financial needs. The process has a very positive effect on securing the long-term relationship with our clients. It eliminates the need to go to another financial service provider.

In fact, we found that when we do financial plans for clients, the clients invariably bring more and more of their assets to us. Let me give you an example. In 1996, we did 150,000 financial plans. There were 117,000 insurance recommendations alone that came out of the financial plan. You can see how the process of financial planning drives all the other businesses that we are in to service the needs of the individual clients.

Our challenge moving forward is to make sure that we deliver on the promise of planning and that we have a real, very positive impact, on the long-term value to our clients. We believe that's how we're going to create value. That's how we're going to create a distinctiveness in what we do as an organization.

A few other points are worth mentioning. We talked about commoditization. In an industry such as financial services, where everything is changing so rapidly, commoditization and how you respond to it becomes an issue. It used to be that information was a unique value. Currently, we believe information is a commodity. Whether it's over CNN, CNBC or all the other newscasts, whether it's all the proliferation of publications or whether it's over the Internet—there is more information now than ever. In addition, people are more educated than ever. However, through research we are finding that although the information is there for the taking, most clients do not have the time or inclination to sift through all the information and make sense of it. We believe that what clients need is wisdom—the ability to take information, know what to do with it, and leverage it for the benefit of the client. The wisdom to know what to do with the information for the benefit of the client is the value added.

It used to be that you could create a difference for yourself in the product. As everyone here knows, you can have the greatest product today and six months from now, everybody else has it. Product no longer is a sustainable competitive advantage. So what then makes the difference? If information is a commodity and if products are a commodity, we believe that the value is in the wisdom and in what you do for your clients. In essence, we integrate all the products and services—asset management, liability management, transition management—in the pursuit of serving our clients.

One of the ways that we are able to deliver integration is through technology. We're leveraging technology in ways that are different from other financial services providers. Merrill Lynch OnLine is where clients are directly linked to their accounts at Merrill Lynch. They have access to all the information about their accounts. They have connection to online seminars and to their financial consultant. We are in the stages of rolling this out nationwide. We have already more than 100,000 subscribers to Merrill Lynch online. We believe that this is another link—the glue that binds us to our clients.

As an organization, we try to consistently question and challenge ourselves. It is a part of what we do as a firm. It is a part of our culture. We are constantly searching for better ways to improve ourselves. We do believe we are a firm where people serve people. The bottom line is that in this business, as well in as any other business, strategy continuously evolves. There is, however, one thing that never changes. That is the principles of the organization. We believe our strongest competitive advantage are our five principles: client focus, respect for the individual, teamwork, responsible citizenship, and integrity. We think that core principles are a distinct, competitive advantage.

Mr. Gough: I have a question for all three panelists, but especially for Mr. Kosavac, with respect to his comments of the need to make the sale an immediate one at the point of sale. How do you see that affecting the current use of illustrations in the sale of life insurance? Clearly illustrations are used more heavily in estate planning sales, and the mass market that you were talking about is getting away from that. Nevertheless, one would expect that with the whole change in marketing focus—the use of the Internet and so forth—that the use of illustrations will probably change, too. I'd like some thoughts on that in relation to these new sales distribution methods.

Mr. Kosavac: Not being a regulator, it is hard for me to say which direction it will go. However, being a practitioner, I think that you have to limit the sale to a basic marketing strategy that denies the customer all information except the essential. Rather than giving the customer options, you define the option as the one that you think is essential. This is opposed to some of what goes on—which is not only nonessential but misleading.

When we go off with an offer for term life, for example, for which an illustration really isn't necessary, we are in essence telling the customer not that we represent every insurance company in America but that we have analyzed every one. They now meet our standard and among the ones that meet our standard at Chase—because the customer has bought that standard already—we can say that these are the two that we think are the most relevant for you. By the way, we're giving you the one that we think is absolutely perfect for you.

Now, that may be a bit extreme, but I think it's in sharp contrast to the other extreme, which is that we represent everybody. So I think the answer is simply put—deny the customer all the essential information, and keep on narrowing the focus. If you come to a place where the brand conveys and the customers expect to have low emotional overhead, they walk in knowing they can't possibly make a wrong move. You can get rid of that wide range of illustrations that you need to persuade the customer that they have made a smart move. So we lose some of the fringe, obviously, meaning people are really looking for the best deal in America, and need to have it documented entirely. But that's the nature of the business—we're going for the broad market.

From the Floor: As technology improves and customers want more high information, low-load products versus the high-load, high-advise products, how do you migrate your old distribution networks to sell lower-load, higher-information products, or do you? Do you have any strategies for that?

Mr. Vespa: We have an old as well as a young distribution network and that same concept that was just asked about, has been going on in the securities business for the last 23 years. The rates that you had on securities transactions—mutual funds as well as many other products—were significantly higher 20 years ago than they are today. But interestingly, in any product or in any industry, what happens as products decline? Volume expands. We're doing a lot more business today at lower prices than we did 20 years ago at higher prices, and everyone is better off for it. I think in the insurance business that situation is evolving and is currently accelerating. As it has been in the securities business for many years, I believe that we will go to more full disclosure for clients, which I think is critical. I think product pricing is going to get more competitive. Front-end commissions will come down, and the insurance industry has to get away from transaction-based pricing and transaction-based compensation to more asset-based and long term. I think level-loading, level-pricing, long-term compensation is coming, and either you create change, you respond to change, or you die from change. I hope it's to create change or respond to it. Some companies right now don't think that's coming, which is very surprising. Others are leading the way. It's an evolution, as you called it, of your distribution.

Mr. Hatton: I would concur with that. I think where we're going in the future is more relationship-based, with fewer fees up front and more fees over time based on the relationship you have with that client. I think there will be more wrapped products, more things that tie the client together, more as a total rather than product by product. I would agree exactly with that strategy, and that's where we're going as an industry.

Ms. Alice M. Fontaine: When speaking of financial consultants and the broad range of products that they're supporting or advancing toward the clients, what challenges do you find in them keeping current with the wide variety of products that they have to be knowledgeable about?

Mr. Vespa: That's a very good question. We consider our financial consultants primarily to be relationship managers. As I mentioned before, they're supported by specialists, such as the Merrill Lynch Insurance Group Specialist, the Merrill Lynch Credit Specialist, and the Merrill Lynch Trust Specialist. The specialists keep them up to date, as well as themselves up to date, on all the changes in the knowledge base needed in the marketplace. It is a challenge, especially when we as a firm have hundreds and hundreds of products that we offer to clients. Another part of that is that at the point of sale, when one of our financial consultants is talking with a client, the compensation for all products is identical. Our financial consultants get no added incentives if they sell our products or someone else's. This way there's a purity in the recommendations to the client—the product best fits the needs of the client. If it happens to be ours that's fine, and if it happens to be someone else's, that's fine. In a sense that keeps us on our toes to make sure that our products are state of the art and very competitive.

Mr. Tracy Alan Anderson: You mentioned that you have a full line of insurance products. My question is with regard to the bank platform employees—what products do they sell, and do you limit the type of products that they can sell to their clients?

Mr. Kosavac: At this point, the branch platform staff sells really just one product. This product is, as I said earlier, not an instant issue, but a limited underwriting product. We're, of course, into this just a few months, as we have only started on the strategy of best penetrating the mass market. So at this point, there's one product. As this evolves, the branch staff will be selling universal life (unlikely variable) and term products. They will probably end up with, similar to Merrill Lynch, a suite of products, but a limited suite of products—something that will ultimately be proprietary once the people in Washington move along and also something that will be nonproprietary, indifferent again to what they sell as long as they do the right thing for the customer. There will be caps on face amounts. The caps will be designed to make sure that they're within the target markets. If you use the general rules of thumb in terms of multiples of income, we will probably issue face amounts that accommodate the usual multiples. The aspect of this is that part of the automation with the carriers being proprietary carriers, or outside carriers, will ensure that what they do is online and that all the facts that are needed to analyze whether that was an appropriate sale will be done right there.

Ms. Julie A. Decker: Mr. Kosavac, I was intrigued by your comment about the immediate sale and the paperless transaction. That's one thing that my company has been working on also, but unfortunately, 50 states require volumes and volumes of paper right now. Have you been active working with state regulators, and do you see any progress from that standpoint?

Mr. Kosavac: I guess the short-form answer is yes. We have hired people who come from the traditional insurance industry arena, typically associate general counsels, who have been at one point in their lives regulators of one state or another. They're going back to the states, along with outside counsel, to try to work through some of the issues. Typically we buddy up with an insurance company that has a similar issue. The progress is slow. However, I guess the distinction between paperless and not paperless isn't as the words would imply. If you can simply get a product that has fast forms and limited options, you can deal with a lot less paper at the point of sale than the products issued by the traditional company. I'm more inclined to have the delivery to the carrier be paperless as a first course of action, rather than what goes on at the point of sale. I really want underwriting on the spot. If I can do that, and give the customer a definite answer, the amount of paper is important, but less important.

Mr. French: I have one question for each of our guests. Tony, I'd like to start with you. You and your competitors all have brick and mortar, if you will, or storefronts. If you go to Stamford, Connecticut where I live, Schwab and Fidelity have their storefronts in Stamford and Merrill Lynch has its storefront in New Canan, Connecticut. For anybody who has been in that area, you know that New Canan is a little bit different than Stamford. The impression of where you put your bricks and mortar is that you need a lot of money to walk into a Maryland storefront. Can you give us some idea of what household income you're looking at, and are you going to stick with that market? Or will you perhaps move to different markets over time?

Mr. Vespa: The construct of our client base is individuals as well as small and mid-sized corporations. In our market, our average what we call priority customers have incomes above $100,000, have six figures in their accounts with us, and that is a market we will continue to explore, penetrate, and develop. When we look at our market share, there are many clients whom we currently do not have. I think it also is an acknowledgment of our strategy. We can't be all things to all people. We have to understand who we are and what we do well and what makes sense for us as an organization, and stick with those core capabilities. The more upscale, affluent market has been our market. We have many clients including the small, mid-sized corporation (by that I mean, 3/4 of a billion dollars or a billion dollars and down), who don't get that which we service. We will stick to that strategy. What we may change is how we deliver to that strategy.

Mr. French: Dennis, I did some work with a bank in Australia a few years back and its customer segmentation was amazingly simple. They had four segments—wealthy, ought to be wealthy, mom and pop, and poor. A lot of research said that many poor people were customers and had bank accounts. You talked about your mass market with family income of less than $50,000. Do you have a minimum family income? Is the poor bank customer a concern for Chase?

Mr. Kosavac: We have a suite of products that goes from, in terms of target segments, the unfortunately poor to the painfully wealthy. As an example, we had our first million-dollar premium life insurance policy just last week. A couple weeks before that, on the personal property and casualty side, we had a $250,000 total premium sale. At the other extreme, we do sell products such as credit insurance. We do sell products for the people who have death costs that exceed twice their income and are afraid of leaving their families with their only assets being negative. We also have preneeds-type offerings. In very simple-issue face amounts, for someone who has never thought about life insurance, we offer face amounts as small as $10,000. The only question we would ask is whether there is a valid economic interest for the person to have it? Our marginal cost of distribution is low. The size of the market and all the segments are big. We believe that there is virtually no segment that we cannot serve profitably. That includes the poor segments of the market. In fact, if you look at the product that the Federal National Mortgage Association (FNMA) came out with, it intends to issue life insurance automatically on every mortgage holder. Its appeal is to the broad market. If you try to sell mortgage-based life insurance or credit life insurance, whether it's credit or not, but to a mortgage borrower, you get a best-case penetration rate of about one in four. The FNMA came out with a product that basically says, I'll give it to everybody and everyone gets coverage for their mortgage. That is an example of something that can very nicely serve the entire middle-class market and 100% penetration. So in short form, we serve everybody and we think we have the product to serve everybody. We just need the economics of origination on the underwriting side to match.

Mr. French: Bob, I don't have a net worth of $3 million, but if I deal with the top-tier American Express Financial Advisor, and I know your top tier does a lot of work with the small business owners when they do estate planning and things such as that, usually there’s an accountant, a lawyer, and some type of advisor at the table. Do you supply the lawyer and the accountant, or are your advisors working with other professionals for that client when estate planning and such is being put in place?

Mr. Hatton: That's a very good question. Right now if we think of our advisor, I would look at our advisor as the quarterback among a whole group of advisors who deal with that client. He or she uses the planning process to get the information. They then involve the attorneys and the accountants in the strategies. If the client doesn't have an estate-planning attorney and needs some assistance, the advisor may recommend one. However, that's always outside the firm. Some estate-planning lawyers are now partnering in some offices around the country because they're getting a lot of business. For many attorneys, the last thing they want to do is be out prospecting. That has turned out to be a fairly successful partnership in a number of cities. Right now, they help the client, they deal with the attorney, and they make sure that the papers get drafted properly.