

Banks Are Selling Their Customers Unsuitable Investment and Insurance Products

by Robert L. Nellson

In 1994, an insurance carrier that specializes in annuity sales surveyed recent purchasers of its annuity products. Among questions on the survey was one that asked when customers planned to use the invested funds. More than half the customers expected to pass the funds to their heirs.

Simply stated, these customers bought products that were unsuitable for their perceived needs. A life insurance product – like a single premium life policy – would have been a better purchase because an annuity becomes part of customers' estates. At the time, this carrier did not even have a suitable product "on the shelf."

Since seeing the results of the above study, other sources have provided independent confirmation of these findings. This is not a single carrier event, but an industry problem – one that is generally acknowledged by those close to the carriers and the sales process. Moreover, it is a problem that extends to

other product trade-offs (e.g., mutual funds vs. annuities and single premium life vs. multiple premium life), focusing primarily on the tax efficiency and liquidity implications of representative/agent recommendations.

The magnitude of the problem can be easily illustrated – investing in riskier investment options could result in the loss of 30 percent of customers' principal value, while investing in an annuity for an estate-type need can result in the loss of 30 to 50 percent of principal value. Many banks are selling unsuitable products to their customers a significant percentage of the time, and they are doing it with a regulatory stamp of approval. Banks are not alone here; many insurance companies and brokers have the same issue.

Addressing several logical aspects of this situation will help clarify and focus the issue:

Limited Suitability Profiles

Most of the suitability profiles in use today are single-product profiles. They are designed to assess the risk tolerance and liquidity needs that advise customers what mix of stocks, bonds, cash, or equivalent funds they should hold. They rarely indicate whether the investment mix should be held in fully

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taxable instruments, tax-deferral vehicles (401ks, IRAs, or annuities) or estate-sensitive vehicles (life insurance or trusts). In effect, profiles are done and suitability is judged after a product type has been selected.

Sales Methods

There are several reasons for inappropriate sales methods:

➤ **Product Limitations** In many cases, sales representatives do not have access to products that are more suitable for the clients they serve. For instance, many bank brokers do not have access to life insurance or annuities. Even when a bank has access to the products via a selling agreement, representatives such as branch platform representatives often are not appointed or authorized to make sales.

➤ **Limited Licenses** If representatives only have life licenses, they cannot sell variable products. If representatives only have Series 6 licenses, they cannot sell annuity or life insurance products.

➤ **Narrow Training** Being well trained to sell a product or to sell multiple product lines requires time. Frequently, representative training is limited to fulfilling continuing education requirements to keep licenses in force. Justifying a major investment in training is difficult when some representatives, such as branch-level platform representatives, sell investments and insurance as a part-time activity. The result is that some representatives are uncomfortable with certain products or sales techniques, and they push customers to their areas of comfort – not toward what the customers may actually need. Customers then tend to get options that are too safe (relative to the risk profile), too liquid, and fully taxable.

➤ **Wholesaler Focus** Product providers hire wholesalers who are well compensated and motivated to push a single product or set of products and provide ideas and sales support materials that all point to their employers' products. Many banks depend heavily on these individuals for training, mentorship, and motivational support. The result, however, is that individual sales representatives often bond with these wholesalers (or their products) and sell them to the exclusion of other products – not always for the right reasons.

➤ **Incentive Biases** There are generally two areas where incentives may bias representatives' recommendations toward unsuitable results. First, products that are more managed, more risky, or tax enhanced tend to provide both the bank and sales representative much higher compensation. Consider the following compensation to the banks from third-party providers (a portion of which is generally passed on to sales representatives, frequently front-end loaded):

	<u>Up Front</u>	<u>Annual</u>
Deposits	None	None
Money Market Mutual Funds	None	.1% to .3%
Index or No Load Funds	None	.25% to 1%
Load Funds	None	.25% to 1%
Wrap Accounts	None	.75% to 1.5%
Annuities	5% to 6%	.0% to .5%
Single Premium Life	8% to 10%	.25% to 1%
Variable Life	40% to 60%	3% to 5%
Whole or Universal Life	70% to 100%+	8% to 10%

Referrals create the other incentive bias. A bank will often have multiple sales forces selling investment and insurance products to the same customers. Participants generally include branch platform representatives, Section 20 company brokers, private bankers, trust officers, telephone service center staff, insurance agency staff/specialists, third-party marketers, and alliance or

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joint venture partners. Large banks often have more than four or five of these sales forces competing with each other.

- ▶ **Inadequate Profiling/Planning Tools.** Ordinarily, profiling tools are used to meet regulatory compliance requirements. They are often specific by product type and supplied by a product manufacturer or a third-party marketer.

Availability of Suitable Products

If banks do not have suitable products for their customers, the simple solution is to acquire them. The reality is more complex. Banks can:

- Decide what comprises the minimum required product set to address the primary needs of their customers. Setting priorities is key because banks cannot simultaneously acquire all the products they will need. Some products (like single premium life and long-term care) are minimal requirements.
- Go through a request for proposal (RFP) process to identify those carriers and products that best meet customer needs and put in place the necessary selling agreements.
- Be sure the appropriate elements of their sales forces are trained, supported, and licensed to sell the products.

Recommending the "Right" Products

For the sales process to result in the recommendation of the "right" products, three general areas need to be covered – training, incentives, and tools.

- Training is required so that representatives understand tax efficiency trade-offs and thus are able to explain the right answers to their customers.
- Incentives need to be balanced so they motivate representatives to sell the products customers need. If a product is more difficult to explain, has deferred payouts, or requires more work, the incentive level should be higher.
- In cases where representatives lack training, licenses, or product access to sell customers what they need, the representatives should have sufficient incentive to refer customers to some-

one who can help them. The incentives (or controls) should be increased until the right behavior is evident.

- Profiling and planning tools are necessary to help representatives understand, make, and sell the right products.

Financial Planning for Customers

Preparing a full financial plan is not necessary for most customers. Usually, they come to banks with four general types of issues:

- ▶ **Desire to purchase particular products.** The representatives can give "yes" or "no" answers. The answer will generally be "yes," and the sale can be made (directly or by referral). If the answer is "no," the representatives should have lists of substitute products which are equally good.
- ▶ **Assistance with addressing a product class.** The tools currently available to assist with choosing a product within a product class (e.g., one among many mutual funds or a fund within a variable annuity) work fairly well. Representatives will help customers find the right mix of product options, but often will not examine whether the product class is the right choice. The customers' needs should be determined so representatives can validate customers' product class choices.

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- ▶ **Using products to address a specific need.** In these cases, the customers have a specific life event in mind for which they have a need and are not amenable to a full financial plan. They generally want simple, straightforward product recommendations and options. Representatives may want to move the customers toward full financial plans, but they should be prepared to answer these more limited questions. "Marginal product assessments," which require limited information and provide answers to meet specific needs are necessary here, and even well-trained



representatives need tools that help them make on-the-spot recommendations.

- **Lack of knowledge about what to do with their finances.** These are customers who may be candidates for financial plans if they have the money (or fee payment) to make doing so worthwhile and the necessary time and information to go through the process. Only about 30 to 40 percent of the customers who should be profiled will accept representatives' offers to do so. A financial planning tool is needed here, but typically the tool needs to be more streamlined and easier to administer than the traditional tools available today. Usually, customers are not worth (or will not sit still for) multiple meetings. Self-administered plans help in some cases, but simpler general planning tools are needed.

Whatever questions customers present, representatives should have the ability to assess needs and help them make the right selections.

Availability of Packaged Programs or Tools

No vendor has an "off-the-shelf" package that provides the necessary answers in a manner that is appropriate for the typical bank sales environment. Some vendors have tool kits that can be used to build this type of planning and profiling system, but they do not offer a working model. Someone will hit a home run with a profiling and planning application that:

- **Responds to all of the above issues.** The tool should be able to support full plans, product selections, and choices within product types – all with the same logic "engine" to ensure consistency.
- **Bridges across all products.** The "tool" should encompass deposits, stocks, bonds, mutual funds, annuities, and various life products. Logic trees already exist to determine the right questions to ask for each particular situation.
- **Can be completed in one short meeting.** While a full financial profile usually requires two or

three meetings to complete, banks need a process that can be completed in one meeting with phone follow-up. A "marginal product assessment" should typically require 10 to 20 minutes.

Several vendors are working on software that can integrate "life stage" frameworks into profiling and planning applications for various levels of sophistication based on the same logic engine. Some are even structured for simple application on the branch platform. Careful research will be required to identify tools that have the capabilities, flexibility, and user friendliness needed to work in a bank setting.

Regulatory Concerns

Regulation of insurance and securities is highly fragmented. So much effort is expended to determine that customers do not confuse deposits with annuities that there is little attention paid to making sure banks correctly advise customers on choices among products. Disorganization among the various regulators (i.e., banking vs. insurance vs. investments, fixed vs. variable products, federal vs. state oversight) reduces insight and the authority needed to cross product boundaries as they should.

Banks should ensure their recommendations keep their customers happy and prosperous. The more money customers make and retain, the more banks earn. Generally, banks will be able to reach their potential when more of the elements come together – broader product availability, tools that guide decisions, better training, and more effective controls (internal compliance and external regulation). Banks should also take advantage of opportunities to consult with seasoned bancassurance professionals.

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