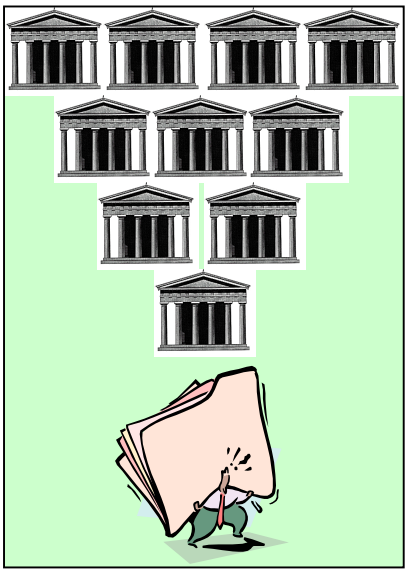
Personal Finance, Institutional Overload and the Internet

A Consumer's View on Personal Financial Services

When it comes to personal financial services, you don't need to look any further than your own personal portfolio of products to realize that the industry is incredibly competitive, surprisingly fragmented, and still very paper intensive. To prove it, make a list of all of your bank accounts, credit cards, loans, insurance policies, and investments: and the institutions that provide these products. After a quick count of my own, I identified 25 financial products, from 18 separate institutions, in my household portfolio. All of them use traditional mail as their primary means of communicating with me, and only a handful of them offer any meaningful way for me to manage the products I own via the Internet.



The amount of time, coordination, and oversight needed to maintain all of these products requires my wife and I to conduct a weekly household finance meeting. With monthly, quarterly, and annual statements flooding the mailbox, along with applications for new products and renewals, invoices for existing products, prospectuses, proxies, and activity reports, the agenda for these meetings is always chuck full.

In fact, the record keeping, filing, balancing, and other analysis that goes along with owning all of these products is almost overwhelming – even for a household with two MBA's. To make matters more manageable, we've actually had to establish a division of responsibilities – I handle "long-term" financial issues while my wife handles "short-term" financial issues.

To add insult to injury, most financial institutions have been slow to move away from paper-based communication – even if they also offer some on-line services. The result is an endless cascade of paper statements to file (or scan), paper invoices to pay, contracts to review and sign, etc. To manage the inevitable whirlwind of paper, I recommend a three-tiered system comprised of a large accordion folder (with pockets labeled A-Z), a Nike shoebox, and 2 drawers of a fancy buffet table.

Two things could surely help to ease the administrative burden required to track all of these products: (1) Industry consolidation and (2) the Internet. Actually, these two things are closely related. The Internet provides a tool for customers to "virtually" consolidate their finances while at the same time it provides a competitive weapon for small financial institutions that will help them survive amidst industry consolidation.

An Informal Office Poll

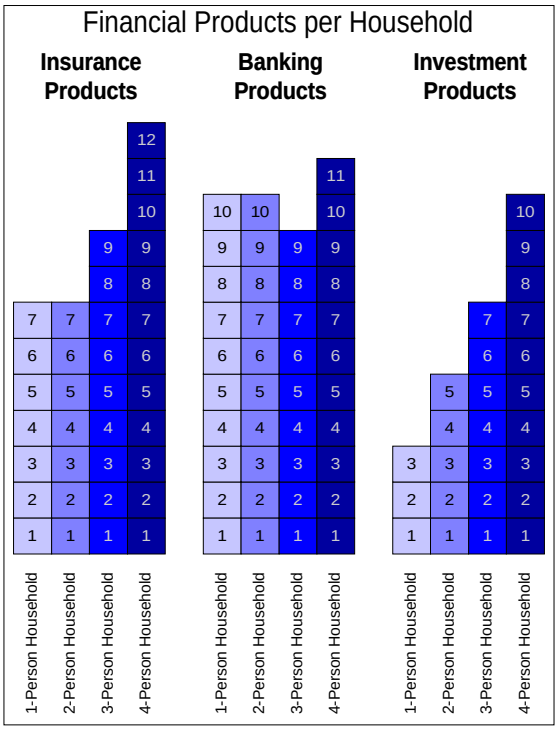
To ensure that I wasn't the only one having a tough time keeping track of my financial products, I decided to conduct an informal poll of my colleagues. Using a random sample of three co-workers (to guarantee statistical accuracy), I asked them to list all of the financial products they owned and the corresponding institutions that provided those products. The results were exactly as I expected: one co-worker owned 20 financial products from 13 institutions, another owned 22 products from 14 institutions, and a third owned 34 products from 19 institutions.

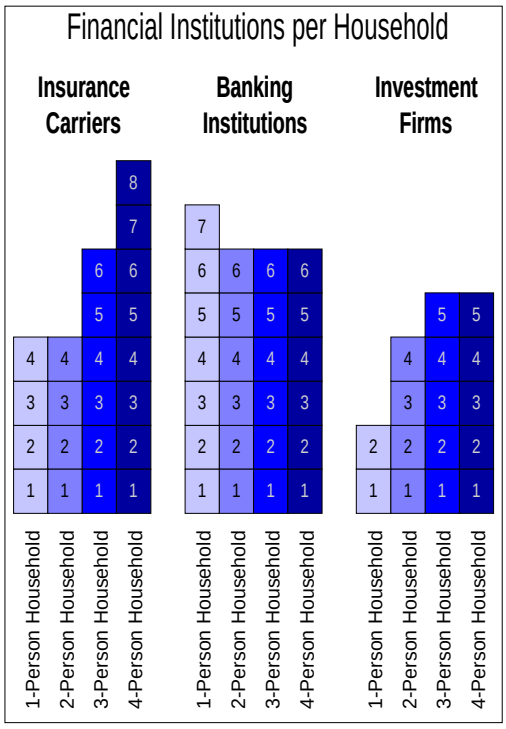
A trend immediately emerged from the data: a one-person household owned 20 products while a two-person household owned 22 products, a three-person household owned 25 products, and a four-person household owned more than 30 products. The number of institutions providing these products also increased with the size of the household. While these trends were not surprising to us, the data also told another story that raised a few eyebrows. While all four of us live and work within the same basic geographic area, we own financial products from a surprisingly wide array of institutions.

In total, 28 different types of financial products were identified between the four of us. This indicates that there is a "core" set of 18 or 20 products that we all own, and then a handful of additional products that are variable - based on individual needs. By contrast, there are 42 separate financial institutions that provide these products to us. In fact, there are only 6 institutions that are common among us, and all of these 6 are institutions that provide our corporate benefits (so we essentially had no part in selecting these firms). In spite of the close geographic proximity of our homes, we virtually never selected the same institutions to provide our personal banking, insurance, and investment products.

Although the data used for this "back of the envelope" study is limited, it illustrates an important point about the financial services industry; (a) although there are a great number of financial products, there is also a "core" set of products that do not vary greatly from one individual to another (b) there are a great number of financial institutions offering the same products, therefore competition for customers is intense, even within a small geography.

Couple the intense competition with the power of the Internet and it seems likely that personal financial portfolios will continue to become even more fragmented. The availability and accessibility of financial products on the Internet has made comparison-shopping easier. As a result, consumers are able to quickly identify the lowest cost providers for the financial products they need. All of this shopping around will most likely lead consumers to new (sometimes unknown) financial institutions that can suddenly market their products across vast geographic distances because of the Internet. In the end, the Internet's ability to help consumers easily identify all of the players (from local boutique specialists to global diversified institutions) could certainly lead to an increased number of institutions in each consumer's portfolio of products.





How Many Banks Do You Use?

My three colleagues and I rely on between 5 and 7 institutions apiece to handle the full array of banking services we require. Between us, we are customers of 20 different banks or credit unions, and we average more than 6 banks apiece. Chase and American Express were the dominant banking players among our group, while Summit Bank of New Jersey also held a strong position. Outside of these three, we also had relationships with 19 other banks or credit unions, but we rarely bought more than one product from these other institutions. PNC, Citibank, MBNA, First Union, Bank of America, Morgan Stanley Dean Witter, and Fleet were among the other 19.

Typical Banking Products

- Credit Card
- Savings Account
- Checking Account
- Line of Credit
- Student Loan
- CD
- Auto Loan
- Mortgage

There are two possible reasons that we use so many banks. One possibility is that each of these banks excels in one or two areas but can not satisfy the requirements for all of our banking needs. Therefore, as discriminating consumers, we shop around for the best provider of credit cards, loans, checking/savings accounts, etc. The other possibility is that all banks offer relatively competitive products and services, but there is a perception that some banks are superior to others in certain areas. This implies a shortcoming in some banks' marketing capabilities – i.e. they actually can offer a full array of competitive banking products, but consumers believe that some of these products are inferior.

Regardless of the reason, the result is that consumers end up using different banks for many of the banking products they desire. While we may end up getting a good rate on a loan or a no-fee credit card, we also suffer the inefficiency of having to deal with 5, 6, or 7 separate institutions on a day-to-day basis.

By contrast, a single institution that could offer a full array of competitive banking services could essentially put together a customer package including checking and savings accounts, credit cards, and all the necessary lending services (mortgages, auto loans, home equity loans, student loans, etc.). Ideally, all of these products could be linked so that credit card balances and loan payments could be automatically deducted from the checking and/or savings accounts. In addition, the package of products would be simpler to manage if each customer's portfolio was accessible via the Internet and/or a single banking card that could trigger almost any type of transaction within and across these products. Chase is moving quickly in this direction. The online banking services they offer are geared toward integrating banking products for both retail and commercial customers. Customers with one or two Chase products may be enticed to switch to Chase for other banking needs when they see the benefits of their consolidated, online account management services.

A bank that provides 5 products to a customer instead of just 1 or 2 will also capture a larger share of that customer's wallet. Adding each incremental product for that customer will be cheaper than obtaining a new customer. If the bank can establish links between the products and easy access to the products (i.e. – Internet), the cohesive and automated nature of common transactions will help to greatly reduce the bank's operating costs. As a result, the size of the staff may decrease, the number of bank branches required may decrease, and the cost of processing paper invoices/statements may also decrease.

These types of efficiencies would translate into the most important aspect of consolidated banking services - lower cost to the consumer. The processing efficiency associated with these products, combined with the packaged nature of the sale would allow the bank to minimize the traditional "extras" like annual fees for credit cards or monthly fees for checking and savings

accounts. Presumably, loans could also be offered at more competitive rates, or with lower processing and initiation fees.

How Many Insurers Do You Use?

My three colleagues and I rely on between 3 and 9 institutions apiece to handle the full array of insurance products we require. Between us, we are customers of 14 different insurance companies, and we average about 6 insurers apiece. CNA is the dominant player among our group, but that is because our company offers several insurance products through CNA. Aside from CNA, we are customers of 14 other insurers collectively. Chubb, Prudential, Travelers, State Farm, John Hancock, and MetLife are among the "other" 14, but we rarely bought more than 2 products from any of these firms.

Typical Insurance Products

- Auto Insurance
- Home Owners Insurance
- Valuable Item Insurance
- Life Insurance
- Long Term Disability
- Short Term Disability
- Medical Insurance
- Dental Insurance

In the insurance world, this is *almost* understandable. Most people have insurance needs that cover the spectrum of health, life, and property. With such a diverse set of products in the market, it is not difficult to understand why few institutions can be competitive in all of these areas. In rare cases, where an insurance carrier is actually competitive in health, life, and property/casualty insurance, it is certainly a marketing challenge to convey to consumers the nature of such broad-based expertise.

Some of the differences that exist across insurance products have to do with the underlying risks associated with each type of insurance and the underwriting rules that are required. Other differences have to do with the way in which customers are viewed for each type of insurance. In some cases, (i.e. health insurance) two customers are considered (1) the plan sponsor (employer) (2) the end-customer (insured). In other cases, (i.e. homeowner insurance) there is only one customer – the insured. Many other differences also exist, but the bottom line is that although they are all considered insurance products, they vary greatly.

To complicate matters, many people receive their health and life insurance from their employers – making it difficult to control which carrier is used for those benefits. By contrast, most people shop around on their own for property insurance (auto, home, etc). In many cases, consumers select carriers for these products on the basis of price alone. As a result, it is not uncommon for consumers to have different insurance carriers for auto and homeowners. In addition, many people also purchase extra disability insurance and/or life insurance to supplement the coverage offered by their employers. It is not uncommon for personal financial advisors to offer these products in the context of financial planning sessions. This creates another opportunity to add insurance from a different carrier. The implication to all of this is that consumers will always have a tough time limiting the number of insurers they deal with to handle all of their needs.

Perhaps the best hope for consumers is for other financial institutions to begin taking over insurance companies. Takeovers by banks or brokerage houses would give consumers the ability to gain some efficiency by obtaining insurance products from their existing provider of banking or investment services. In most cases, banks and investment firms will also offer consumers more advanced technology to help them manage their portfolio of products. For instance, existing ATM's and technology platforms used for Internet banking and investing could be extended to support newly acquired insurance products. Given the current/historical state of the insurance industry with regard to technology (i.e. true e-commerce is virtually non-existent in insurance

today), it is safe to say that the technological enabling of insurance products will happen more quickly if it is driven by takeovers.

Given that insurance products will be the most difficult set of financial products for people to consolidate, the best bet for consumers might still be to retain a good insurance broker who can help navigate the insurance maze until these companies begin to understand customer service, technology, and product management.

How Many Investment Firms Do You Use?

My three colleagues and I rely on between 2 and 5 institutions apiece to handle the full array of investment products we require. Between us, we are customers of 9 different investment companies. Overall, the investment sector is the most consolidated sector for us. Although we all have employer sponsored investment products in addition to personal investment products, we average only 3.75 investment firms apiece and many of the same firms service all of us.

This indicates that clear leaders have emerged to dominate the investment industry, and these leaders are able to compete in many different products, on many different fronts. Firms like Charles Schwab have established strong market positions by offering their customers broad product selections coupled with competitive prices and first-rate service. Firms like this can make a compelling case to customers to handle all (or most) of their investment needs.

Typical Investment Products

- 401K
- Mutual Fund
- IRA
- SEP
- Stock Account

Intense competition in the investment industry has forced firms to develop broader product lines with more competitive products. As a result, consumers are more likely to purchase multiple products from a single provider. Firms that offer stock and bond mutual funds, individual stock and bond accounts, money market funds, 401K's, IRA's, SEP's, etc. must be competitive in all of these areas or risk losing customers' entire portfolios to the competition. These forces are driving consumers toward a handful of "best of breed" investment firms. These firms excel by offering product variety (even offering competitor funds), exceptional service (i.e. Internet access to manage accounts), and top-tier product performance, while also meeting competitor costs.

The Internet technology that leading investment firms have recently invested in has given their customers the ability to manage their portfolios efficiently and effectively at any time of the day, from any location. Opening accounts, researching products, executing trades, transferring funds, and contacting service representatives can all be done on-line, at the customer's convenience. These cutting edge product features not only reduce processing costs for the firm, they also give customers more control and make their lives easier. As a result, customers who experience this type of high-tech investing are more likely to increase the portfolio of products they maintain with these industry-leading firms.

From a consumer perspective, consolidating investment firms has always been more common than consolidating insurance firms – so maybe the industry naturally lends itself to consolidation. Financial advisors frequently consolidate their clients' assets with a few trusted firms, while job-hoppers have traditionally made a habit of consolidating 401K's from various employers. In spite of these natural tendencies, it *does* seem that the industry has made a conscious effort to encourage consumers to maintain relationships with the fewest number of firms possible. Investment firms want to handle each customer's entire portfolio of assets – and they have been willing to compete and invest in infrastructure and technology to prove that they deserve this type of customer loyalty.

Opportunities Arise for Virtual Consolidation

The simple personal inventory and counting exercise described above illustrates that things could be made much simpler for consumers of financial services. While it is unrealistic to think that everyone should have a single provider for all of the 20+ products they needs, it *is* realistic to think that these products could be provided by fewer than 20 companies.

By taking a quick look at the financial products that my colleagues and I own, it is easy to imagine some of the benefits that consumers could enjoy as a result of consolidating their relationships with fewer financial institutions. In a rather extreme case of consolidation, consumers might be able to reduce the number of institutions they deal with to three - one for banking, one for insurance, and one for investments. In the most extreme case, these three institutions could even be related – just as Citibank, Travelers, and Salomon Smith Barney all operate under the Citigroup umbrella.

Even in the most extreme example however, consumers are not likely to reap all of the benefits that such physical consolidation might imply. Regulatory restrictions coupled with legacy system limitations will most likely mean that even customers of huge multi-line financial institutions will feel like they are doing business with a variety of separate companies instead of a collection of firms that are all affiliated under a single corporate umbrella.

Looking beyond physical consolidation within the financial services industry, virtual consolidation may actually present the most significant benefits for consumers. For smaller, "best of breed" financial institutions, the Internet has (and will continue to) provide opportunities for virtual consolidation and creative partnerships. Dot-com startups with the vision of bringing together diverse selections of financial products on the Internet have begun to broker partnerships between banking institutions, insurance carriers, and investment firms.

These firms are racing to be the first to market with services that will allow customers to visit one website to fulfill all of their financial service needs from a "Chinese menu" of product offerings. Their vision is to build Internet-based aggregators of financial products that will act as on-line "brokers" for consumers. These firms will be designed to pull together complementary product offerings from "partner" institutions to create compelling financial service packages for customers at competitive rates.

By partnering with firms that offer complementary products, and using the Internet to market and distribute these products across broad geographic areas, smaller firms with limited product offerings or specific areas of expertise will also be able to offer consumers a one-stop shopping experience. Consumers will benefit from the efficiency of buying bundles of products in one place, while these virtual partnerships will allow smaller financial institutions to emulate and compete with financial powerhouses like Citigroup.

Web-Based Aggregators

For consumers who don't believe that physical or virtual consolidation will actually help them manage their financial lives more easily, there still may be hope. New firms called "account aggregators" or "screen scrapers" have popped up within the past year to enable consumers to view their billing, banking, and investment statements in one place on the web. These web-based information aggregators provide consumers with the ability to access some of their banking and investment accounts in a consolidated manner through a single website. While their services are far from perfect, these firms will at least provide consumers with some additional efficiency and convenience when checking account balances and paying bills.

Basically, web-based account aggregators allow consumers to gather on one page their bank statements, brokerage account statements, credit card balances, and other information like phone bills and frequent flier miles. To take advantage of these services, users must register by providing their name, zip code, and e-mail address. After registration, users must set up their account by giving their online user names and passwords for all accounts to the information aggregator. Once registration and account set up is complete, users can go to the Internet to see their credit card balances, phone bills, airline miles, and brokerage account balances, all updated on a daily basis on one web-page.

Since arriving on the scene about a year ago, these information aggregators have created quite a stir among banks and other financial institutions that are afraid of losing customers, losing brand identity, and suffering security breaches. From the bank's point of view, the problem with these firms is that they usually collect information from financial institutions without permission. In essence, the aggregators log on as the customer, extract data and use it for their own purposes without notifying the bank.

By most accounts, these firms have become the primary concern for bank CIO's. Banks typically view these aggregators as a significant threat – these firms provide a valuable service to bank customers and yet banks are not capable of competing with this service offering. As a result, most banks have realized that they must join the aggregation game as soon as possible. Quite simply, if banks had access to information about the products their customers' owned elsewhere, they would be in a great position to persuade those customers to move those products to their institution.

The current situation sets the stage nicely for partnerships between banks and aggregators. On one hand, banks desperately need to enter the aggregation game to keep their customers happy. Their problem is that they don't have the technology or the "know-how". On the other hand, the aggregators have struck a chord by fulfilling an important customer need, but they cannot generate profits from aggregation services alone. In most cases, they are hoping to structure licensing agreements with large financial institutions and portals. In addition, their services will continue to be limited unless they partner up with banks and brokerages. For example, aggregators cannot process transactions across institutions – like transferring money from a customer's bank account to a brokerage account.

It's still relatively early in the game, but FleetBoston has already partnered up with aggregator Yodlee to provide the technology behind its new NetFriday.com site. Elsewhere, Ameritrade and VerticalOne have also partnered to handle the data aggregation for Ameritrade's OnMoney.com.

Aggregators to Watch

OnMoney happens to be one of the most popular financial information aggregators on the web today. In order to execute the information aggregation process, OnMoney.com gives its customers' user names and passwords (along with permission to use them) to VerticalOne. VerticalOne is OnMoney.com's partner, and they do the actual account aggregation.

While Ameritrade has achieved initial success with OnMoney.com, part of the problem with it (and most other information aggregators) is that it only captures part of your balance sheet. For instance, it doesn't come close to aggregating the full set of financial products that were identified in my "back of the envelope" office survey. In addition, these aggregators still have some bugs like the inability to export a customer's data to a spreadsheet. As mentioned before, user also can't use the aggregator to do cross-account transfers. In addition, in spite of OnMoney.com's attempts to win customers' trust, the company limits its liability to $100,000 - even if they are grossly negligent.

Elsewhere, Intuit recently added a new feature to its popular Quicken.com e-finance site. The new feature is called MyFinances, and it is designed specifically to allow consumers to consolidate and manage their personal financial data. MyFinances allows consumers to consolidate their personalized data, their investment portfolio, and their banking and credit card account data and bills. In addition, it provides portfolio specific news and educational material to help investors make more informed decisions.

The basic services offered by MyFinances include bank transactions and balances, credit card transactions and balances, bill presentment and payment, reminders of bills coming due, portfolio tracking, customized investing news and alerts, and historical investment performance data. Of course, MyFinances only helps if your financial products are already web-enabled – note that it does not provide any services for insurance products. Also note that the list of services is not at all comprehensive – there are still many aspects of maintaining financial services products that cannot be done via the Internet (e.g. – moving funds between institutions). Quicken plans to expand its service offerings in the near future.

Despite its shortcoming, MyFinances does make life somewhat easier for consumers by simply providing a web-based medium that can pull together different aspects of an individual's portfolio and create a consolidated snapshot.

CompuBank, an increasingly popular on-line bank also takes a stab at offering consumers a consolidated way to manage their financial lives. CompuBank provides banking, credit cards, credit reports, auto insurance, homeowners insurance, term life insurance, health insurance, auto loans, mortgages, mortgage tools, financial planning, tax planning, and investor research through its web-site.

While this appears to cover the majority of financial needs for consumers, the offering is somewhat deceiving. For most insurance products, CompuBank sends customers to InsWeb (for life insurance they are sent to Term Life Pros.net) and for most investment information, CompuBank sends customers to Multex Investor. The end result is that many of the products are actually offered by institutions other than CompuBank. This means that they cannot be managed in an integrated and efficient way – in spite of the fact that they are web-based offerings.

Other players in the information aggregator space are My Accounts (Altavista), My MoneyCentral (MSN), AccountKeeper (Go Network), and My Yodlee (Yodlee).

While current Internet offerings like the ones described above do not fully address consumer needs, they are certainly moving in the right direction. If the traditional providers of financial products do not offer consumers more convenience, greater ease of use, and integrated product management, web-based intermediary services are sure to seize the opportunity to provide these desperately needed services. If these firms truly move at Internet speed, managing your personal portfolio of financial products promises to get much easier – in the not too distant future.

About the Author: Andrew Pfaff is a Senior Consultant for the Madison Consulting Group, based in Jersey City, NJ. Mr. Pfaff has been with Madison since 1997, consulting on a variety of topics within the financial services industry, including e-commerce and Internet applications.