

# THE INTEGRATION OF FINANCIAL SERVICES IN EUROPE

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## ABSTRACT

Changes over the last few decades in managing risk and investing money have been so radical that we can only describe them as being huge disruptions, maybe even revolutions. The boundaries that used to exist between the different financial activities have disappeared. Although things have accelerated rapidly over the last few decades, we should keep in mind that these developments are by no means new. The pawnbrokers and foreign exchange dealers of the Middle Ages, whose professions were separate and clearly identifiable, have seen their activities completely integrated into so-called universal banking services. More recently, merchant banks in France, who used to be the subject of specific regulation, have disappeared as separate legal entities. In the insurance field, it was barely 30 years ago, that some large businesses insured only against fire risks and others only casualty risks. The distinction between life and non-life, which is still maintained in the regulations, makes little sense in the everyday reality of insurance groups who transact these two activities together.

However, when we talk of the integration of financial services, we have in mind an even more recent phenomenon. Financial integration incorporates two developments, known in French as *bancassurance* and *assurfinance*. Today, under extremely diverse legal guises but following the same economic logic, banks sell insurance products and insurance networks sell banking products.

This movement can only be understood initially as the result of a need to diversify. Each one of these two large categories of financial intermediaries borrowed something from the other in order to increase its product range or bolster the know-how of its networks. It was simply about making sales organizations more cost effective by having them sell products outside of their traditional skills area, at more or less marginal cost. Today the expansion of offerings is done, approved, and even expounded on by theorists. And so now the next question is whether we should go further—turning our attention from distribution to manufacturing. This is where the current debate on the integration of financial services lies. Bluntly, if we allow banks to sell insurance policies and insurers to sell consumer credit, should we allow a joint organization to design such products and distribute them down both channels at the same time? More subtly, we might ask ourselves whether we should be exercising more specific control over these financial conglomerates that, while maintaining a formal legal separation between banking and insurance, constitute in fact a single decision-making center.

This article sets out to portray what is perhaps not the state of the law, but at least the state of the art, on this topic in the European Union. In the first part, it will show that while sales integration is an undeniable fact, with the customer seeing fewer and fewer differences, it still remains that banks and insurance carriers are separate entities from a legal perspective and that the European Union remains totally committed to controlling financial conglomerates. In practice, integration of financial services takes different forms. In part two, we examine cases involving problems between entities doing the same job, and cooperation between design facilities without any apparent desire to go further. In the long run, this integration will succeed only if it receives the public's approval. Part three addresses what consumers and investors want. We observe that after decades of exposure to specialized networks, consumers are not necessarily as enthusiastic as proponents of integration would have hoped. As adult consumers, they are not prepared to buy just any financial service anywhere they can, and they still largely place their trust in the brands they know.

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## 1. LIMITS POSED BY NATIONAL REGULATIONS

People talk about the integration of financial services as if it were already a reality. This is also the impression we get when we see that our bank sells insurance policies and our insurance agent offers revolving credit. However, in each of the countries covered in this article and practically everywhere in the world, bank and insurance activities are carried on by separate legal businesses subject to two sets of regulations and two different systems of control. There is a tendency to bring these different financial activities into one universal organization, or at least to bring them closer together, in such a way that they represent one decision unit, even if they use different means to carry out the process. Out of this tendency came the concept of the financial conglomerate, which the Bâle Committee defined in 1995 as “a group of companies under common control, of which the exclusive or predominant activities consist in providing services in at least two different financial sectors (banking, insurance, stock market activities).” Before providing the latest on what the European Union authorities are doing, I will outline the main elements of the debate on the control of conglomerates.

### The Main Points of Debate

During the 1980s, we saw a reduction in the differences that existed between financial intermediaries and the products and services they could offer. Consequently, each financial intermediary, banker or insurer, found itself up against new forms of competition in fields of activity that used to be taken for granted. This competition was coming from new entrants who normally would not have operated outside the limits of their natural market. Those European countries where financial activities were traditionally more supervised found themselves confronted by a wave of sales innovations resulting from unprecedented deregulation. This resulted in strong competitive pressure from which consumers and investors benefited, but which produced a profound erosion of margins, particularly for banks.

There followed an increase in amalgamations of banks, insurance companies, and other financial market, investment, reinsurance, or factoring activities. The concept of financial conglomerates was born and with it a number of problems.

These financial groups bring together activities

that are not subject to the same system of control, for example they operate in several countries and sometimes include activities that are not supervised such as reinsurance and consumer credit. In all European countries, with the exception, since 1988, of Denmark, insurance companies report to one control body and banks to another. Nevertheless, the necessity for specific control of conglomerates was seen as needed but nothing has been put in place.

Such a control system must be Europe-wide, and one day worldwide, because national control would be useless. The financial conglomerate brings together entities from several states and carries on business in several countries, and so it is at the Brussels level that supervision can be leveled efficiently.

It is extremely difficult to define rules for ensuring across-the-board financial security for organizations carrying on activities that are not as closely related as they first appear. The duration of commitments from insurers and bankers towards their clients is fundamentally different and means that the two jobs have to be treated differently, both in terms of economic theory and prudential control. In the case of banks, where assets are mainly in the form of low-liquidity loans, control authorities are concerned with credit risk and monitoring long-term viability. For securities firms, where values fluctuate according to market whim, supervisors are interested, in market risk and accordingly keep an eye on liquidity to ensure the firm can, at any given time, meet potential losses. As for insurers, it is the underwriting risk that, until now, has been the subject of the controllers' primary attention. Here we are far from the logic that underlies the supervision methods of banks. As far as insurance is concerned, growing attention is being paid to the control of investments because recent history and new products have shown that they can have dramatic consequences to the viability of an insurer. In France, the crisis at GAN Insurance, still nationalized at the time, placed them in a position of virtual bankruptcy. The crisis has shown the impact that losses resulting from a falling real estate market can have, even though the insurance activities were turning in acceptable, albeit somewhat mediocre, results.

From the above you can see both the difficulties of exercising unified control over all the activities of a conglomerate and the advantages there may be for financial institutions working in a less regulated environment. European legislation is relatively permissive

when it comes to share holding links between different financial firms. There is nothing to stop a European bank from possessing an insurance company and vice versa. According to the second banking directive, there is no distinction made between a bank investing in any business or in an insurance company. There are no authorizations to be requested and no special limits to abide by.

Thus, in the European Community, one ends up in this slightly paradoxical situation, which means that legally banking and insurance activities are totally separated and carried out by corporations that have no link between each other. In practice when a bank employee sells an insurance policy, it is underwritten by an insurance carrier that is legally separate from the bank and subject to a separate system of control. Moreover, this employee (agent) must take an exam that has been validated by the insurance control authorities and which tests his or hers professional knowledge and aptitude to sell these products. But this insurance company is a 100% subsidiary of the bank and reports to the same decision makers as part of an overall corporate bancassurance strategy.

The same sort of situation can happen in an insurance network selling products such as consumer credit which have been designed by a credit institution that is part of the same financial conglomerate. The state of European law on the subject is clear. All the evidence confirms that the conglomerate is one organization and the fact that it sells products through different distribution systems doesn't change the economic and financial unity that it represents. Acknowledging this unity illustrates clearly how out-of-date and ineffective control measures, exercised individually on each of the components of the conglomerate, will be.

Given that most conglomerates have been formed out of banks that sell insurance contracts with a very strong financial content—resembling traditional banking products—the problem has remained somewhat theoretical. There have certainly been skirmishes between regulators and financial institutions, but nothing particularly serious since regulation of banks and insurers is very similar. Apart from the differences of legal structure, the solvency of the bank was considered sufficient guarantee of its subsidiary. Today, with the addition of stock market activities to a conglomerate's portfolio and the integration of property and casualty insurers, where the logic of risk taking is fundamentally different, the

necessity for real control becomes evident. This explains the revival of the debate on this theme and also the difficulty of arriving at common positions given the administrative cultures that have resulted from different historical backgrounds.

However, the people in Europe are not ready for supervision that would only take place at a holding company level and ignore a century of separate controls over banks and insurers. Our countries, judges, and consumer lobbyists are too used to seeing investor protection intervene at the moment of purchase, to accept supervision that only operates at the holding company level.

Our tradition, which sees the consumer as weak and mostly uninformed in the face of a strong and potentially abusive financial institution, favors prudential rules. These rules are applied as near as possible to the sales act and are based on respect for business methods designed to protect the consumer. In this sociological context, the maintenance of separate control on banks and insurance carriers is a political necessity. But economic reality shows that separate supervision is no longer sufficient. Indeed the current state of the debate in the European Community is based on an attempt to reconcile these two objectives.

### **Current Efforts**

Over the last decade, the European Union has made many attempts to improve control over conglomerates. The EU has not opposed conglomeration formation, in so far as this form of organization is considered a critical element in the evolution of financial institutions.

In 1992, Directive 92/30 dealt with the supervision of credit institutions on a consolidated basis with the goal of streamlining control of the banking sector. The following year, Directive 95/26 extended this supervision to investment firms. In 1995, in the wake of BCCI, Guideline 95/26 reinforced the prudential supervision of banks, insurance companies, investment firms, and mutual fund managers (OPCVM). New demands appeared in an attempt to achieve transparency in the organization of these groups. In addition, exchange of information between control authorities has been encouraged.

The proposed directive on separate control over insurance companies forming part of insurance groups operating in several states has not yet been adopted. Notably, it provides for reinforcement of

information exchange between control authorities, increased transparency of shareholdings, and measures seeking to prevent the dual application of shareholders' funds.

As regards the actual financial conglomerates, that is, those groups, largely international, who have integrated banking and insurance activities, much work is being carried out as part of the framework of the Bâle Committee whose powers extend beyond the European Union. In parallel with the work of the Bâle Committee, European experts began meeting in 1996 to lay the foundation for a directive on financial conglomerates. The points that have been discussed concern the dual application of shareholders' funds, the surveillance of intergroup transactions, and the information access to be given to the control authorities of the different states involved.

During the summer of 1999, work was suspended due to tactical differences between participants. Certain delegates wish to pursue the work so as to arrive at a community solution, while others prefer to wait, not only for the adoption by Brussels of the Insurance Groups Directive, but also for the end of the work of the Bâle Joint Forum on financial conglomerates. The Bâle Joint Forum is a tripartite group, strongly influenced by Anglo-Saxon practices, which brings together experts from the Bâle Committee who themselves come from the BRI, IOSCO, and the International Association of Insurance Supervisors. This joint forum aims to improve exchanges of information between control authorities and to define the role and responsibilities of supervisors. The joint forum is seeking to establish prudential norms that would be applied to financial conglomerates. As is the case at the European Union level, the joint forum set out to control intergroup transactions, eliminate the dual application of shareholders' funds, and monitor the competence and integrity of managers.

While legally the situation is uncertain in light of present European regulation, the European countries appear to have reached agreement on the method of supervision best adapted for financial conglomerates. We know that currently each country has prudential control institutions that approach banks, securities firms, and insurance companies separately. Only Denmark and Sweden have taken decisive steps towards integrating by merging their control authorities. Other countries, including France and Spain, have not gone that far but, while

maintaining separate controls, they have adopted a common philosophy for their laws on banks and insurance. This process of despecializing supervision will be useful for conglomerates that remain national, but does not respond to the questions posed by multinational groups that most likely will make up the majority of conglomerates.

Europeans have agreed on setting up a supervision method called *solo plus*, which contemplates, apart from supervision of each group entity by its specialized supervisor, control of the whole of the conglomerate by a principal supervisor. The mechanism assumes that each controller will be fully responsible for the firm that he or she is in charge of. The principal supervisor will not have the right to interfere in the control carried out by the specialized controller, regarded as more informed in the specialty area.

Primarily, the principal supervisor will be required to ensure that the specialized supervisors share information concerning the conglomerate as a whole. It is a critical point appreciating the capital needs of the group. It is the principal supervisor who will be responsible for the coordination of control efforts that involve several supervisors. The very fact that a conglomerate has activities that are diversified and cross-border can damage the quality and the quantity of information available to the supervisors. Conglomerates find it easier than a purely national business to set up complex organizations in order to evade consolidated control. Supervisors must therefore be granted sufficient powers at the time activities are launched and licenses granted. In addition, they must be able, during the life of the business, to punish groups who intentionally make their organizations more complex than necessary.

The only difficulties that may arise from *solo plus* control will result from potential differences in opinion between controllers. The fact that, in different countries of the European Union, controllers can have different visions of their mission—which is inevitable considering the secular traditions of certain government bodies—may tempt conglomerates into a sort of *supervision arbitrage*. This involves the transfer of certain activities of a conglomerate from one country to another or from a regulated entity to a non-regulated entity, in order to benefit from more lenient or even non-existent supervision.

There appears to be only one solution to completely exclude this temptation. It would require

the total harmonization of prudential regulations between banks, insurance carriers, and securities firms across the whole European Union. Such a harmonization is unrealistic at this time; only rapid and disinterested cooperation on the part of the supervisors can reduce the danger of supervision arbitrage. This is not just wishful thinking. The 3<sup>rd</sup> Directives, which represent the latest state of European law on the subject are founded on the principle of "home country control." The idea here is that the control that is exercised in the state where a business has its head office is valid for all countries in the European Union. This allows the insurance carrier to work in those countries without having to apply for new authorizations. Common sense rules borrowed from the principle of home country control ought to be used to increase the effectiveness of supervisors, until such time as an appropriate set of prudential rules can be established.

By now it should be clear that the integration of financial services in the European Union is complex. Banks and insurance companies obey different laws and are subject to different controls. But at the same time financial conglomerates have emerged with a high interpenetration of banking, insurance, and stock market activities that exceed the framework of individual States. If it is true that no European directive explicitly controls conglomerates, it appears that supervisors and company management agree that the solo plus supervision approach should be translated into reality, even before it has become community law.

## 2. WHAT THE PLAYERS WANT

If the European states, like the authorities in Brussels, are doing their best to regulate the development of financial groups, this is because these mergers are on the increase and everywhere in Europe we see a strong movement towards the integration of businesses. These movements take on two forms: businesses that plan to merge the whole of their activities, and alliances that aim to merge only certain parts of their businesses.

### The Movement in Favor of Mergers

We are witnessing a general and rapid wave of mergers in all areas of financial activities and in all European countries. As far as business management is concerned, "big is beautiful." The list of compa-

nies that have come together during the last few years is endless. It is certain that between the end of the summer of 1999, the time when this article was written, and December 1999 at the conference when it was discussed, other movements will have taken place. Without attempting to provide a complete list, the following is a sampling of recent financial services mergers in the European Union.

### The United Kingdom

In the insurance sector, we have seen Royal Insurance and Sun Alliance become Royal and Sun Alliance, and Prudential bought Scottish Amicable. The French AXA, which had already acquired Sun Life, purchased Guardian Royal Exchange in May 1999. In the banking sector, the current success story is Lloyds-TSB, a merger that goes back to 1995. After going through the doldrums, Lloyds-TSB has developed excellent results for its shareholders. With the merging of its banking activities barely completed, the new group has extended its activities to the world of retirement and life insurance by buying Scottish Widows. The largest British bank, HSBC-Midland, is also the result of a recent merger.

In September 1999, the big event was the purchase of Legal & General by National Westminster Bank (Nat West). The third largest bank in the country acquired the fourth biggest insurer, thus creating the fifth largest European financial institution. This is a major development for Nat West, which for several years has been focusing on its core business as a retail bank. The consumer credit business of its subsidiary, Lombard, had been sold to Abbey National, and the investment bank activities had been sold to foreign interests. By taking over Legal & General, the new group will have access to 6.5 million customers, to whom they can sell banking products, life insurance, and property and casualty insurance. The strategy is quite obviously one of total integration, where the only common denominator is access to the customer so as to offer the widest possible range of products.

Even more recently, Nat West was the subject of a share exchange offer on the part of Bank of Scotland, even though it is much smaller than Nat West in terms of total assets. This hostile action sparked a fight around Nat West and all the big names of British finance. Several other Europeans are quoted as possible white knights. Since the Bank of Scotland decided to withdraw the bid which they made

for the insurer, their hostile bid has interfered with the amalgamation of Nat West and Legal & General.

### **The Netherlands**

The Netherlands has always been at the forefront of innovation as far as financial activities are concerned. It was the birthplace of the first financial conglomerates, which occurred several years ago when, Rabobank, specializing in the agricultural market, had taken over its insurance partner, Interpolis.

On a larger scale, the merging of the insurer Nationale-Nederlanden and the bank NMB-Postbank gave rise to ING. ING has acquired the Brussels-Lambert Bank with a presence in Belgium and France. ING is not content to remain European. It has acquired Equitable of Iowa in the United States, and Barings, in liquidation, in order to have a presence in the Far East. ING wishes to reinforce its presence in France and is the declared candidate for the acquisition of Crédit Commercial de France, a large and very profitable private bank. Benefiting from the experience of finance and trade, which is a characteristic of the people of Holland, ING is certainly one of the groups that offer its clients the most diversified range of financial services. The acknowledged objective is that when an investor puts money in one of the subsidiaries of the group, this subsidiary advises the investor for life. Whatever investment requirements development, the investor's capital remains in one of the group companies.

Situated both in Holland and Belgium, the Fortis group is just as much a symbolic example of a conglomerate. As well as former insurers like AMEV in the Netherlands, and AG and CGER in Belgium, it also houses a bank, in this case, la Générale de Belgique.

### **Germany**

Germany remains, more than other countries, a market where the roles of the banker and insurer are well defined. But cooperation exists between the two sectors. For example, R & V, a group bringing together agriculture cooperatives, banks, and insurance companies, is seen as a European pioneer in bancassurance. Also Commerzbank, which cooperates with Winterthur, is linked with Crédit Suisse. The Deutsche Bank works with the insurer Deutscher Herold which it owns. Dresdner Bank cooperates with the insurer Allianz. In direct insurance

and under the leadership of Munich Re, one saw the birth of Ergo and, in the banking world, the elevating of HVB to the number 2 ranking in the sector, as a result of the merger between Bayerische Vereinsbank and Hypo-Bank. The movement has not finished. Banking leader Deutsche Bank recently admitted having had conversations with the third largest banking establishment, the Dresdner Bank, a subsidiary of Allianz, with a view to cooperating in the private individuals' market.

### **Italy**

Many movements, above all in the banking sector, have been seen in the Italian peninsula because Italian banks are numerous, rich, and often still relatively regional. In 1997, Banco Nazionale di Lavoro and Banco di Napoli merged. In 1998, we saw the coming together of Credito Italiano and Unicredito as well as Ambroveneto and Cariplo. In 1999, we witnessed the failure of the public share exchange offer of Unicredito for Comit and of San-Paolo-IMI for Banca di Roma. Even if the markets, and above all the Italian monetary authorities, have not been favorably disposed toward these operations, they do demonstrate how great the desire is for expansion on the part of certain institutions. This desire is particularly evident at Generali, who have expressed a desire to acquire INA, a one-time nationalized company and third largest insurer in the market. The amalgamation of INA and its banking ally the group San-Paolo-IMI was an immediate result of this attack. At the time of writing, I do not know if the Generali offensive will succeed in creating a very large Italian insurance center, or, if it fails, whether it will favor the emergence of a bancassurance group through the amalgamation of INA-San Paolo-IMI.

### **Spain**

In Spain we have witnessed the birth, and above all the success, of Banco Santander Central Hispano, resulting from the merging of Banco Santander and BCH. The Basque Country Savings Banks, until now organized on a provincial basis, have been regrouped, clearly looking for critical mass. The market is bristling with rumors concerning a possible merger between two major contenders, the Bilbao-Vizcaya Bank and Argentaria. These firms resulted from the privatization of entities, which, several years ago, were public companies. In the field of major insurance players, Mapfre struck a strategic

deal in 1998 with Caja Madrid, a large savings bank, however, information is limited as to the scope of this agreement.

### Switzerland

Switzerland, renowned like Germany for traditionalism in its financial sector, has witnessed some interesting developments. In the insurance sector, Zurich bought the financial activities of the BAT group, and with it the English insurer Eagle Star. In the field of bank-insurance connections, Zurich has had its products distributed by the Société de Banque Suisse since 1994, while Winterthur works with Crédit Suisse, part owned by the major reinsurer Swiss Re.

### France

Naturally, France has not remained excluded from these developments. In the banking field, the latest large move is the amalgamation between the Banque Nationale de Paris, Société Générale, and Paribas. We know that after an epic battle BNP took control of Paribas but did not acquire Société Générale. Société Générale is isolated and isn't hiding its intention to move closer to another institution, probably a European one. This battle is interesting because one of the themes hotly debated amongst French professionals was that of the need to merge establishments in order to achieve synergies. Some considered that only a complete merger of establishment would allow synergies to be created between the different financial professions. Others argued that you could collaborate perfectly well in a given activity, be it consumer credit or insurance, without necessarily bringing together the parent company organizations.

Over the last few years, before this debate, France had seen developments which were less extensive but nevertheless significant. For instance, Crédit Agricole, the prototype of clearing banks, bought Indosuez, the prototype of merchant banks. The Crédit Commercial de France is in the process of changing hands and three main European contenders, including ING, are in competition. Crédit Mutuel, which possesses a very large insurance subsidiary, has acquired Crédit Industriel et Commercial which sells insurance products from Socapi. Socapi was once a joint subsidiary of Crédit Industriel et Commercial and of GAN.

In the insurance sector, the major development was the takeover of UAP by AXA to constitute a

group which represents, a quarter of French insurance sales. There was also the buy-out of GAN by Groupama, of the Mutuelle du Mans Assurance by MAAF, and of GMF by Groupe Azur. There were also takeovers involving companies of different nationalities. The Victoire group was bought by Commercial Union and, more recently, AGF was bought by Allianz, the top German firm, and Athéna was bought by Generali, the top Italian firm.

In every case, these mergers between institutions are aimed at achieving critical mass. There is hardly any point in analyzing one experience in comparison with another because the conclusion is always the same. Subject to variations due to national context and slight differences linked to the personal ego of the management, these mergers are always aimed at realizing economies of scale. By combining geographic expansion and a diversification of jobs, the goal is to reduce risks, or at least to diminish the cyclic effect, whether it is general economic cycles or underwriting cycles peculiar to insurance. Finally, for companies planning for the future, the objective is to be in a position today where the markets will be tomorrow. The establishment of AXA and ING in Asia can be explained in this way.

This integration of financial activities reaches varying degrees of complexity. We see the merger of two banks in the same country, and a bank and an insurance carrier of the same nationality establishing links. The financial cultures of the different European states are quite different and if the international component is introduced far more complex combinations result, such as a bank from one country merging with an insurance company from another country. Products and services would be offered from a multinational base but, economically, there is one unique decision center which decides what the group must offer in the way of products and services, and at what price. But besides these conglomerates, which can be classified as generalist, indeed imperialist, in that they aspire to be present in every sector of the market, we can also observe a movement in favor of more subtle mergers, dealing only with certain areas of the business activity.

### Pooling Activities

Pooling occurs when two businesses join their material and human resources together in order to handle a section of their activity, but limit their collaboration to this activity. While examples of

pooling are numerous, they are more difficult to detect than mergers that get greater media coverage. The objective is to look for economies of scale but in a less ambitious, more discreet, and supposedly more efficient way.

In the insurance world there have been numerous examples, often old ones, of cooperation in this style where insurers find themselves confronted with small markets, the narrowness of which rules out the possibility for any one business to be profitable on its own. Thus, the creation of a number of pools to manage special risks such as construction insurance or satellite insurance. More interesting for our purposes are experiences such as that of MAAF, a French direct-writing mutual carrier, which created a department to handle complementary healthcare insurance. In order to spread out general expenses, this department works for MAAF and also for the Banques Populaires network. Therefore, Banque Populaires did not need to set up its own insurance company. It simply distributes a health insurance product that complements its range of services but which was designed by a competitor.

In other cases, capitalistic links reinforce technical cooperation but by no means rule out commercial competition. For example, a sizeable share of the capital of Crédit Lyonnais belongs to Allianz, which owns the insurance company AGF. This relationship does not prevent Crédit Lyonnais from being principal shareholder in UAF, an insurance company that distributes its products exclusively through Lyonnais branches. An example mentioned earlier was the case of Socapi, a subsidiary of GAN which is owned by Groupama, and sells policies through the network of Crédit Industriel et Commercial. Crédit Industriel et Commercial is a subsidiary of Crédit Mutuel, owner of a large bancassurance company.

In Spain there are a few examples of purely operational mergers, such as the company created by the Bilbao-Vizcaya bank and AXA solely to sell automobile insurance by telephone. AXA has signed an agreement with another bank, the Banco de Comercio, to design and sell multifund insurance contracts. These technical agreements are not limited to the Iberian Peninsular. The Bilbao-Vizcaya Bank, traditionally present in Latin America, has made an agreement with a Spanish company, Adeslas, which specializes in health insurance, in order to sell this type of coverage in Argentina.

Besides its complexity, which is thankfully not

obvious to the consumer, pooling poses several questions regarding its true objectives: How did these businesses find each other in the first place? Is this collaboration a sort of trial marriage to allow the teams to work together with a view one day of full integration? Are these pooling arrangements simply following the "big is beautiful" fashion? Or is this search for size a part of the outsourcing trend that allows the business to expand in scope without diluting its core competency?

Finally, we ought to mention another strategy in which European banking and insurance businesses are merging before legislation is in place. While bank and insurance mergers have to respect the legal personality of each entity, once they set up joint organizations in order to provide a service on behalf of both or to design a product to be sold by each, they transgress the spirit of the prudential regulations, while respecting the form. People may wonder if this is not the whole point of setting up synergies at an operational level between institutions from different backgrounds.

### 3. WHAT DO CONSUMERS WANT?

This is an important question given the many forms that the mergers between insurers and bankers in Europe have taken. Obviously, the integration of financial services results from an initiative from providers, and not spontaneous demand from consumers. This is the normal and logical situation where the provider, by definition, has to be proactive in presenting the consumer a choice of service products. However, while it is true that the corporation takes the initiative to offer an innovation, this innovation will only be successful if there is consumer demand. It seems that public demand is very product focused as opposed to provider image focused.

#### Suitability as a Key to Success

The success of the sale of life-insurance products by French banks has been absolutely astonishing. Business school students quote the French example as a textbook case. In 1980, banks and post office branches were distributing 17.3% of the life-insurance market that was then 29.5 billion francs. In 1990, these same banks and post office branches were distributing 39% of the sales that, in the meantime, had reached 206 billion francs. In 10 years they had more than doubled their share in a market

that had increased seven fold. This evolution has continued. In 1998 (last known official figures) banks held 61% of the life insurance portfolio of 435 billion francs and their production represented 63% of new business flows. Certainly for the last few years, the growth in the sale of life insurance has slowed but banks have continued to increase market share. Today, banks constitute the normal channel of distribution for life insurance in France.

If you look at the situation in Spain you will see changes that are very similar to those in France. In Italy and Portugal, the trend is identical; the penetration of banks in the sale of life insurance is strong, but slightly less spectacular than Spain and France.

A number of studies investigated the reasons for the bancassurance revolution in France and in countries of southern Europe. For the purpose of this article, it is enough to emphasize how much life insurance products distributed by banking branches have come to be integrated in the bank's services. They are designed and serviced by a life insurance company legally different from the bank but, from the point of view of the customer, a banking product.

This life insurance product is a contract whose primary objective is to increase capital value, where risk is reduced to the minimum, and where the methods of payment and withdrawal are as flexible as possible. Because the product features frequent indexing against stock market measures and links to the stock exchange in multi-fund contracts, the insurance contract appears as a banking product in the eyes of the customer. Similarly, the bank's clerks and managers treat the insurance contract like a banking product in sales pitches. For the success of a bancassurance operation to be assured, it is vital that the bank makes no difference between opening an account, organizing a real estate loan, or selling an insurance contract. These operations must be equally easy, profitable, and straightforward.

Although life insurance sales have been successful, banks in France and Spain have launched into real estate sales, auto and homeowners' insurance, and term life insurance contracts. The main difference between life insurance and the new products is that the new contracts must respect underwriting rules and result in sometimes having to decline or disappoint a potential customer. For example, in property insurance contracts, claims settlements can give rise to difficulties if the actual payout does not match the customer's expected payout. These products require more attention and consideration than

the financial-type life insurance products that the banks had been selling.

Some banks have succeeded in this market sector far removed from their traditional focus. An example in France is Assurances du Crédit Mutuel which has been selling property and casualty insurance for more than 20 years. Another example is Pacifica, the Crédit Agricole subsidiary that had the same success in risk insurance that its sister company Predica has had in life insurance.

The key to success here seems to be integration into banking services. The sales pitch made to the customer by the bank follows naturally from many banking transactions. For example, the prospective customer applies for an automobile loan and automobile insurance is offered as part of the package. The same approach applies when the customer buys a house, and the banker offers comprehensive homeowners' insurance for the new residence. Because of the success of certain banks, many more are looking into integration. Recently MAAF, a large and dynamic direct-writing mutual carrier, launched a product called Pack MAAF. This product is a package that includes a loan for the purchase of an automobile, a traditional automobile policy, and a minimum value guarantee in case of total write-off of the vehicle.

Studies of successful examples for the sale of term life insurance lead to the same conclusions. In Spain, the Bilbao-Vizcaya bank, with its subsidiary Euroseguros, offered term insurance contracts. More recently, Predica did the same in France. In Europe, where social insurance coverage is widespread, these policies are not easy to sell, and yet banks have succeeded. The success is largely because the product is presented as a natural corollary to the advice role of the bank. Term insurance is offered as a moral, essential, and indisputable means to protect a family in the case of death of one or both parents. The policy is portrayed as just as necessary and ordinary as homeowners' insurance. Today Predica is the leading French company for new term life business.

Integration is also the key to success in the less common cases where insurance networks sell banking products. A notable example is in Spain where several banks, who essentially work by telephone, decided to augment their distribution by selling their products through insurance agency networks. While not all attempts have succeeded, Openbank, a subsidiary of Banco de Santander has been suc-

cessful. They now offer investment products that appeal to their middle-to-high net worth clientele. Openbank has been successful because the transition from one product to the next in the sales pitch appears natural. Their agents first address the business' first competency, covering risks, then life insurance, and, finally, investments. Here again, the legal nature of a product is masked by the personality of the sales network.

With the development of networks of financial advisors, Italy provides another example of integration that has succeeded. In the mid-1980s, a number of Italian banks launched commercial networks. These networks were composed of salespeople who sold both banking investment products and life insurance products with strong financial components. The success was astonishing. Life insurance companies like Mediolanum and Fideuram grew from nothing to become essential players in the market in a few years.

The case of Italian financial advisors is truly exemplary because products are integrated at both the sales network and customer level. Sales staff come from either banking or insurance, and offer the same products. Whether to offer the customer an insurance or a banking product depends entirely on economic considerations, particularly taxation. At a given moment and for a given client, it may be best to offer an insurance contract while, for another, it may be better to offer a banking investment. The same network is capable of proposing the most advantageous alternative for the customer.

### **Image Is Everything**

Over the last two decades, the development of bancassurance has made people believe that Europe is moving towards a sort of generalized despecialization. Some have come to assume that coverage could be provided without taking precautions and that products from both banking and insurance could be sold through a network without difficulty.

However, in France numerous attempts have been made by insurance companies to sell banking products through network agents. At the time when payment cards were fashionable, almost all the French insurers working with networks of general agents wanted to have these cards distributed by those intermediaries. All attempts ended in failure. Consumers perceived the cards as coming from two fields: payment or credit cards belonging to the

banking world, and customer fidelity cards belonging to the retail trade world. Experience has shown that insurers do not have a place here because payments made to an agent are not frequent enough for an insurance customer to have a fidelity card. As for the policyholders who only sought out an insurer to obtain a credit card, they certainly don't constitute the higher net worth clientele traditionally pursued by agents or the type that appeal to the card issuing companies.

Similar conclusions can be drawn from the many attempts to distribute consumer credit through general agents. In the process leading to the purchase of a long-term asset such as a house or a car, the customer first goes to the bank, seller, real estate agent, or car dealer for a loan. It is only in the event of failure at this stage that the customer looks elsewhere. Therefore, insurers would be only extending credit to customers who have been refused a loan. This illustrates the fact that money lending is not seen as a primary function of an insurer. In professions like insurance or credit, where success is built on customer selection, the limits of this system are clear.

While many attempts to distribute consumer credit failed in France, there is one notable counterexample that illustrates the importance of defining the role of the provider to the customer. About 15 years ago, AXA, in partnership with SOVAC, created a subsidiary named AXA-Crédit to work with the network of general agents. AXA immediately set to integrate credit into the world of insurance. The advertising message stated that AXA was there to assist the insured in case of an accident, but that AXA-Crédit recognized that difficult financial situations were not always the result of an accident, and that AXA-Crédit was there to assist the customer who needed a loan. AXA-Crédit has been a success and now looks after about 10% of AXA's clients. The credit activity is presented as a continuation of the insurance process that remains the primary activity of the group and its agents.

Banks have encountered experiences similar to insurers when they have tried to offer products too far removed from their traditional image. At the beginning of the bancassurance phenomenon, many small and medium sized business clients of banks were approached with insurance risk audits and follow up proposals. CIC, a French bank very prominent in the medium-sized business market, was a bancassurance pioneer but the experiment was a

failure. Even in the field of group life insurance contracts, where the financial dimension is more prominent, attempts made by the bank were not successful. The problem appeared to stem from the preference of firms to talk about insurance with a professional who corresponded to the traditional image of the sector, in France this is an insurance broker not a banker.

Spanish bancassurers have reached the same conclusions. While successful in the market of products for private individuals, bancassurers have not ventured into the field of complex contracts needed for small and medium sized businesses. Rather than risk failure, the Spanish bancassurers have wisely avoided the market.

The failures to sell bank and insurance products side by side may be due to the sales network system. Network salespeople, even salaried and disciplined like that of banks, do not sell just any product. They sell only products that they feel are suitable and with which they are comfortable. These notions of suitability and comfort are fundamental when speaking about the integration of financial services. If a salesperson has to choose between two seemingly identical products for a client, the salesperson will offer the one he knows the best, which corresponds best to his culture, and which will be the simplest to explain, sell, and set up administratively.

Similarly, failure can stem from the customer. Customers ask themselves, "Why would I go to a non-traditional provider when I could use a trusted specialist?" Across Europe, the frequency with which this question is asked varies. We know, for example, that it helps explain the extreme conservatism of the Swiss and German markets and that it is just below the surface everywhere, because it stems from the most basic common sense.

Asking this question by no means suggests that the status quo is the only answer. As far as the integration of financial services is concerned, it simply signifies two things. On one hand, the firm that

specializes in banking or insurance has an excellent chance to build and retain business as long as its services are high-quality. On the other hand, firm integration can succeed provided that the products are offered in a way that it seems natural to the prospective customer.

## CONCLUSION

In Europe, the integration of financial services is under way. The examples quoted in this article show that the integration of financial services is an irreversible tendency that the public authorities ought to regulate, but which they will not be able to stop. If apart from the institutional aspects, one looks at the conditions of the commercial success of these mergers, we can see that successful integration between banks and insurers is achieved at both ends of the scale.

Upstream, firms design and manufacture products or services that are sold under different trademarks by different distribution networks in the worlds of both banking and insurance.

Downstream, the same sales network offers customers alternative products belonging to different legal systems, insurance or banking, but which meet the same requirements for the customer.

When integration takes place either totally upstream or totally downstream, it is the image of the distributor that is most important. For the customer, it is of little importance whether the product is a banking product or an insurance contract. What is important is that the product satisfies the customer's needs, it is what the customer intuitively expects, and it is offered by a representative from a trusted firm.

*Additional discussions on this paper can be submitted until January 1, 2001. The author reserves the right to reply to any discussion. Please see the Submission Guidelines for Authors on the inside back cover for instructions on the submission of discussions.*