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The Role of Banks in Insurance Markets

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Summary: Panelists discuss how banks have entered the insurance markets in Canada, the U.S., U.K., and continental Europe. In each area such roles have developed in a unique way because of different legal climates and cultures. Current issues and future directions are discussed for each area. At the conclusion of this session, attendees will understand how these markets have evolved and what the future may have in store.

Mr. Gaetan Nicolas: We have the pleasure to have two speakers with us: Nick Dumbreck and Denis Kaplan, who I will introduce more formally later. They are both experts in the subject of dealing with banks.

The format that I would like to follow for this session is to let the speakers make their presentations, one on the U.K. and the European markets, and the other one on the U.S. market. After that, we can go to a question period.

We will start with Nicholas Dumbreck in regard to the U.K. and the European markets. Nick Dumbreck is a Fellow of the Institute of Actuaries (FIA) and an ASA. He's a graduate of Cambridge University and he qualified as FIA in 1982. He worked with Imperial Life of Canada becoming corporate actuary and appointed actuary of the company's U.K. subsidiary. He joined Watson Wyatt in 1986,

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became a partner in 1987, and he was appointed head of the insurance practice in 1995.

Nick has been heavily involved in the development of two major banks' insurance department practices in the U.K.: the Median Life, a subsidiary of Hong Kong and Shanghai Bank, and Halifax Life. He has been appointed actuary of both companies. He also advised two Irish bank insurers. He spent much of his time advising on purchase, sales, demutualization, and mutualization of life companies mainly in the U.K.; however, he also will address the other markets in Europe.

Mr. Nicholas J. Dumbreck: I'd like to begin with two apologies. First of all, this presentation is based on one I gave at the end of last year to the Caribbean Actuarial Association in Jamaica. That's where I try and get most of my CPE credits, and I hope it translates well to cooler climates.

Second, I have quite a good firsthand knowledge of the U.K. market. My knowledge of continental Europe is a little less comprehensive, and so I might struggle to answer any difficult questions in that area. I hope that won't prompt you to spend the rest of the meeting thinking up difficult questions on bank insurance in continental Europe.

What is the basic concept behind bank insurance? As far as the U.K. is concerned, at least, the idea is to take a simple product range aimed at the mass market and sell those products to the banks' warm customer base using the branch staff to identify leads partly based on banking transactions, people taking out mortgages, borrowing money and so on, and partly based on their general knowledge of the financial affairs of the banks' customers. That ability to identify potential customers for insurance products without going through an elaborate prospecting process leads to a high level of productivity of the sales people. And that can be coupled with efficient low-cost administration by keeping the product range simple and selling the products in substantial volumes.

I think it's worth spending a bit of time on the history and the development of bank insurance in the U.K. The tradition, I suppose, was that banks sold a certain amount of life insurance business to their customers. And in the early days, typically the branch managers got involved in the sale and kept the commission themselves instead of selling another insurance company's products.

The first bank insurer in the U.K. was established in 1965. That was Barkley's Life. But over the next 20 years, there were only two more. One of them was Black Horse Life, a subsidiary of Lloyds Bank, and the other was TSB Life. And it's

interesting to note that the parent companies of those two bank insurers have recently merged.

At this stage, there was really no compulsion on the bank branches to sell the products of the in-house life company. They could sell other companies products as well, and usually did. And so this meant there was relatively small growth over the period from the mid-1960s to the mid-1980s. And then in 1988, everything changed because the Financial Services Act came into force in the U.K. and this introduced the concept of polarization. Polarization meant that the bank branch network of any bank had to decide whether it would operate on a tied basis, selling the products of only one life company, or on an independent basis, selling the products of many companies.

And the requirements that had to be fulfilled to operate on an independent basis were quite onerous. They had to effectively search the market on behalf of each customer and find the best product. And for what was essentially a mass market operation, that was quite an inefficient process. So only one of the major banks, National Westminster, opted to give independent advice at that stage.

The others were not always tied to their own life companies, but the fact that the banks that already had life companies were channeling all their business to their in-house companies led to further growth in the market. And the polarization introduction caused a number of banks to set up their own in-house life companies.

In the early 1990s, National Westminster Bank, having spent four years telling everyone how much better it was to give independent rather than tied advice, decided to set up their own life company, and that basically completed the process of every major bank having its own life insurer.

Since then, we've had two banks, Abbey National and Halifax, that have acquired sizable mutual life insurers by demutualizing them to gain access to independent financial advisor distribution networks. And since the beginning of the 1990s, or at the beginning of the 1990s, there was quite strong growth in the bank insurers, and predictions at that time that market share of bank insurers would reach 50% by the year 2000.

Now, that hasn't happened, or at least it's not likely to happen because the growth has faulted, and market share, at the moment, is stabilized at about 15%. And that's shared among 13 bank insurance companies. So no individual company has a very large market share.

Typical distribution arrangements in the U.K. consist of a sales force based in the bank branches acting on referrals from the branch staff. So a specialist sales force based in the bank branches is remunerated usually by salary plus a bonus. The bonus typically will account for about a third to a quarter of the total package, and will be related to volume of business. And quite possibly, also to the quality of the business measured by persistency or some other measure of quality.

Until, perhaps, five years ago, most of the sales forces were remunerated predominantly by commission. Typical levels of productivity—well, it's not unusual for bank insurers to sell five policies per week per salesman. And that's maybe four or five times as productive as a typical prospecting sales force. In some cases, the sales force does all the selling. And in others, some of the simpler transaction base products, mortgage-related products are sold by branch staff. And clearly, which model applies affects the level of productivity. But even where the transaction base products are not sold by the sales force, they sometimes achieve the five-sales-per-week level in a few cases.

There's a tendency not to have too many branch staff selling part-time because the training requirements in the U.K. are now very onerous, and it's not really efficient to spend a lot of time training people to sell relatively small amounts of business.

What about the products then? Well, there have been some successes and some failures here. The most successful products have been mortgage-related products. I don't know how many people were at the session on bank insurance. But the mortgage endowment product was mentioned there as a product that was quite tax efficient. It used to be tax efficient until about 1984 when tax relief on insurance premiums was abolished, and it's become less tax efficient since tax relief or mortgages have been scaled down.

And really, there's no very strong tax-driven case for buying a mortgage endowment policy anymore. But, nevertheless, they continue to be sold in large volumes. I don't think many actuaries buy mortgage endowments. They design them, but they don't buy them themselves.

Mortgage protection for protecting repayment mortgages is sold quite widely, as are single premium savings products, because the banks know when people have money in their bank accounts and they're able to tell the sales people that information.

Areas where they haven't been so successful, particularly selling pension business, there's one exception. Barkley's Life, which doesn't operate a branch-based sales force, but a home-based sales force, visits customers in their homes, and has been

very successful in selling personal pension business. And it’s having to compensate many of its customers for misselling as a consequence of that success. And products like flexible whole life, a sort of variable universal life product, also have been sold in much lower quantities.

The products have generally been fairly similar to the products of traditional life companies. There hasn't been a great deal of innovation by bank insurers, but then there are two examples where bank insurers have led the way. One is in equity index bonds, which were introduced primarily by the bank insurers about six or seven years ago in the U.K. and have been sold in quite large volumes, but those have declined recently. Also, critical illness business has been a big seller for bank insurers.

In order to show which age groups the bank insurers concentrate on, the question that was asked was, where did you buy your last life insurance product? This is from a Swiss-Re survey. And the answer was that 26% of 18–24-year-olds bought from a bank, compared to only 13% of 55–74-year-olds. So predominantly they're operating among the lower age groups, and typically among the middle income groups.

Bank insurers have made quite extensive use of outsourcing, particularly for some of the newer bank insurers. The life company is something of a shell. It has general management and it may have a marketing function, but it subcontracts most of the other activities. Distribution will be subcontracted to the bank. Administration may be done by an existing life company.

Early on in the development of bank insurance, the price that an existing life company demanded for carrying out the administration was an equity stake in the bank insurer. Nowadays, they're prepared to do it on the basis of just a TPA agreement. And there are a number of life companies that specialize in providing services in this way.

Investment management has usually been outsourced. Most bank insurers in the U.K. have concentrated on unit linked or variable products, but some wanted to sell with profits. And it's difficult to set up a with-profits fund from scratch. So some of them have chosen to do a deal with an existing company and reinsure the business from the bank insurer into the existing with-profits company. Actuarial services, I'm pleased to say, have sometimes been outsourced to consulting firms.

Some of the bank insurers have used outsourcing as a temporary solution to get going, really intending to bring things in-house as soon as they were able. But

others see it as a more permanent feature, and I can see a lot of attraction in not having to carry out all these peripheral functions.

So what does all this mean for that cost? Well, since January 1995, in the U.K., there's been a requirement for all life companies to disclose their selling costs at the point of sale to their customers. Banks have to include overhead costs, cost of a share of the branch office premises, branch staff time in putting forward leads and so on. And to cut a long story short, I think the general impression is that the selling costs of a typical bank insurer are roughly half those of a typical established life insurance company selling through other means.

There are quite wide variations in administration expenses in between companies. They tend not to be among the highest, but not the lowest either. Perhaps that's surprising given that they haven't got the same legacy problems as traditional companies, maybe partly because most of the bank's shores are quite new, so they haven't really had opportunities to benefit from economies of scale yet; partly because perhaps they haven't always resisted the temptation to make products more complicated than they need be.

And what does all this mean for product competitiveness? Well, ten years ago, the conventional wisdom was that a bank insurer would aim to pitch its products in the third quarter measured by the value for money. That's changing partly as a response, I think, to criticism, and partly as an attempt to get the market share moving upwards again. Some of the bank insurers are giving the benefit of their lower cost, their lowest sales cost in particular, to the customers through more competitive products. And there are a number of top core products around now.

And what about shareholder profitability? Well, at one time, bank insurance seemed like a license to print money. Although I think all U.K. bank insurers are profitable, that's not something that can be said of many U.K. life companies in terms of, you know, whether or not the economic value added of new business is positive or not. But they're not necessarily as profitable as you might think, and not always as profitable as they might have thought either.

National Westminster Life, as I said, was launched in January 1993, the last of the big new bank insurers. And in November 1992, its chief executive told the press that he expected the embedded value, the value of the company, including the value of future profits from its in-force business, to grow from 150 million pounds which was the initial capital, to 530 million pounds after four years of operation. Growth of 37% per annum compounded.

Now, I think he later regretted making this statement because we now know what the result was at the end of 1996. And instead of 380 million pounds of growth, it actually achieved 119 million pounds. Now, the chief executive is still employed by this organization. But considering that the company is paying commission at roughly half the rate that the bank could get from an external arrangement, it's not a particularly impressive performance.

The bank had a very good start, and it seemed set to benefit from this disclosure of selling cost introduced in 1995. But actually, it had a terrible year in 1995. New business fell dramatically. It cut back the sales force to reduce cost overruns, and it has been struggling to recover ever since. But it's not fair to single out one company. All the companies have suffered to a greater or lesser extent. But it does illustrate the fact that bank insurers haven't really had things all their own way.

So the problems stem from the rather fragile relationship between the branch staff, who are expected to pass on leads to the sales people, and the sales people. The branch staff feel they own the customers and they won't pass on the leads unless they're confident that the sales people won't mess up their relationships with their customers. And some of the sales people, needless to say, have messed up the relationships with the customers.

The 1990s can be characterized by inadequate training and monitoring of the sales staff leading to them selling inappropriate products to their customers in many cases. And this has led to some compliance breaches, some fairly high profiled reprimands from the regulators of the selling process. In response to that, the bank insurers have to take their sales forces off the road for retraining, and there's been a loss of confidence by the branch staff.

And the upshot of all that is that, of course, the banks are mortified by the damage that's being done to their reputation, and have instituted much more rigorous compliance procedures that have made the sales process much more laborious, much less slick than it used to be. Confidence is returning now, and I think it's felt that things are back on an upward track. But it has been a significant setback to the bank insurance movement in the U.K.

So that's the U.K. What about the rest of Europe? Market shares in a number of different European countries are in the 15–20% range. This was at the end of 1994. And there are really three exceptions: France and Spain, which are much higher, and Germany, which is much lower. And I'll talk about each of those three because I think they're all quite interesting.

France is usually cited as the big success story for bank insurance. Much of the success has been tax driven. A capitalization product which was mentioned at the bank insurance session, is essentially an eight-year single premium guarantee contract. That is, if you keep it for the eight years, it gives a tax-free return to the policyholder. It's typically sold over the counter by branch staff as an alternative to their banking product.

Banks like it because it locks in the money for eight years, so there's no competition from other banks. And it's quite unsound actuarially because it offers a guaranteed return at the end of the term. It also offers guaranteed surrender value. So it's not possible to buy any suitable assets to match the liabilities, and there is a significant theoretical exposure to the life companies if interest rates rise and policyholders choose to surrender and buy another product at a higher return. That doesn't happen in practice because of the tax penalties at the moment, but it could if the tax laws ever changed.

It's said the banks have a good relationship with their customers in France. Any of you who have been to France and tried to change currency may find that difficult to believe. But I'm assured it's true. And lack of independence isn't seen as a drawback in France because there is really no independent intermediary set up there.

The largest company, Prédica, which is a subsidiary of Credit Agricole, had a 12% market share in 1994, and was the second largest company. It has only been in existence for about ten years.

I think Spain is really quite similar to France. Very rapid growth in recent years. The slides show the market share at 33%, I think, in 1994. It was in excess of 50% in 1996. And nine of the top 15 life insurers in Spain are now bank owned.

The top company in Spain is a bank insurer that is a subsidiary of Spain's largest savings bank. It’s basically selling simple savings products in the main capitalization products. The selling is by branch staff and agents. I guess most of it is branch staff selling over the counter, and the agency force is really there to deal with any other complex products. And it's said that the banks have much better information technology than traditional insurers, and they benefit from that.

Now, Germany is rather different because in Germany there traditionally have been long-standing cross-share holdings between banks and insurers. And in Germany, they have this concept of AllFinanz, which is where the banks distribute insurance products, and the insurance companies’ sales forces distribute bank products. And everyone seems quite happy with that arrangement. I think it's partly because there

really is quite limited scope to actually making money out of manufacturing life insurance in Germany.

By law, nearly all the profits from the manufacturing process have to be redirected to the policyholders by way of bonuses, and the shareholders tend to make their money out of things like administration and investment management agreements. Nevertheless, there are two companies, Deutsche Bank and Citibank, that have their own life insurance subsidiaries.

Finally, back to the U.K. The relationship between banks and insurance companies in the U.K. has been reasonably harmonious. The insurance companies are relatively happy that banks have not made the inroads that have been predicted. But, nevertheless, life insurance companies are now getting into the banking business. And about six life companies have set up banks primarily to retain proceeds from maturing policies.

The main products they're offering are deposit accounts and mortgages. And because they have no branch infrastructure, they're mainly dealing by telephone. They're able to offer very competitive terms, and competition has tended to be partly on price and partly on product features, simple products, no unnecessary penalties on early redemption, and mortgages and things like that. I don't think they're aiming for a huge share of the market, but I think they're quite pleased that they're moving in the opposite direction of the bank insurers.

And what does the future hold? Well, as far as the U.K. is concerned, I think there is an expectation that the market share of the banks will continue to grow because there are many companies outside the bank insurance area that really aren't making any money from their new business, and are unlikely to carry on in business for all that much longer. But I think it's felt that it's unlikely that the banks' market share will go much above 25%, and they'll have to work quite hard even to get that far.

Bank insurers are looking at new distribution channels to cover the customers who don't come into the bank branches, particularly they're looking at the use of telephone selling, they're looking at the use of computer terminals in branches, and they're looking at setting up sales forces to visit customers in their homes. They will tend, I think, to move away from the narrow product base that they started with to include products like health, group pensions possibly, and move away from the mass market products. And whether that will be as successful remains to be seen.

There are also signs of some changes in product design. Particularly in Ireland, many of the bank insurers are introducing simple savings products, flexible products with much better surrender values than traditional savings products in the U.K.

They're not having it all their own way. All banks have a significant advantage in the area of cross-selling.

There are other organizations that have a similar advantage, particularly retailers, grocery stores, because of their loyalty card schemes they have a lot of information about people's lifestyles, what they're spending their money on. And they're beginning to come into the life insurance market, and may take some business away from the banks.

There's been much talk about a potential price war. In other words, whether the banks would really use their competitive advantage, their low cost to drive down the price of insurance and try and force some of the traditional companies out of the market. There are no signs at the moment that it is likely to happen. But, of course, it only takes one organization to break ranks to precipitate the price war. The feeling is that there won't be one, but, nevertheless, margins will gradually reduce over time.

Mr. Nicolas: I will introduce our second speaker. If you have any questions, we'll have the questions after. And I'll try to do justice to the second speaker.

He's not an actuary, but he has made a heck of an effort to provide us with many numbers and statistics. Denis Kaplan was born in Johannesburg, South Africa. He graduated from the University of Witswatersrand in 1963. That's a South African university. He has a bachelor's degree of commerce. He formed the Financial Planning Services company which was marketing financial planning, mutual funds, and insurance services to banks in 1970 in South Africa. It was also marketing to CPAs and attorneys.

He moved to the U.S. in 1986. Since 1987 to present, he has been the president and CEO of a company called Independent Financial Market Group. This company is recognized as a leading financial services distributor and consultant for financial institutions and services. He has approximately 150 financial institutions as clients. It takes a lot of patience to deal with 150 banks, I have to admit that. He deals with banks, community banks, savings and loans, credit unions, financial planner confederations, and discount brokers.

Oh, there's one thing I have forgotten. About two years in his career, Denis was a stockbroker, so he's got some background there, too.

His firm has over 3,000 licensed representatives, and operates in 18 locations with major clients across the U.S. He's looking at Canada right now as the land of opportunity. In 1986, he became a member of the Liberty Mutual Group.

Mr. Denis Kaplan: Nick, in just looking at your figures there, I'm really getting excited about getting back to the states on Monday and see the tremendous opportunity that we have there.

In November 1995, I celebrated 30 years in the insurance business, and I've had a great time; I love the insurance industry. And in 1970, I sold my first unit linked insurance policy, and that's basically going to be maturing in about four years' time. It's done extremely well. And I just thought, for interest sake, that I'd ask a question at this time.

Are there any actuaries from South Africa here? Oh, I can say a couple of words then. Second, could I have a show of hands of who currently is working with banks? Could I have a show of hands of who's from Canada? Who's from the U.S. and Canada? That's an open market. The U.S.? And foreign, offshore? So it's mostly U.S. and Canada over here.

I'll give you some statistics on the South African market which I visited about six or seven weeks ago. There has been a very interesting development in the South African market in that it doesn't have restrictions. Since 1976, banks have been involved in insurance, and insurance has been involved in banks.

Every bank has some stake in an insurance company, and every major insurance company in South Africa has a stake in a bank. And the interesting thing is that it was always limited by law to not more than 30% until quite recently, when the law raised the limit up to 50%. But it's always been done on a partnership basis instead of the bank actually owning 100% of insurance companies. They deal in a partnership relationship with each other in terms of their working arrangements.

Today, all the banks in South Africa have some form of insurance relationship. They have some form of insurance ownership using both kind of methods. Interestingly, statistically speaking, more than 70% of the business today in South Africa is unit-linked variable. Banks account for more than 25% of the total insurance business. And that's why I got very excited about coming to America and looking at the percentages and statistics. I'm even more excited after having heard Nick telling what's happened in the rest of the world, particularly U.K. and Europe.

So what I'm going to try and do here for you is to give you some statistics in terms of where the U.S. is and some interesting forecasts. And what I've got here for you is some interesting information from Datamonitor, from some other research organizations, and also interpreting it with some of my own gut feeling and experiences with all the banks that we currently work with in the U.S.

Let's discuss the background of the U.S. bank industry and fixed annuities. The industry started in the U.S. with fixed annuities in the early 1980s which were sold through thrift institutions. The savings and loans (S&Ls), the Bonus Societies were the first ones to get involved in the business and really sell CD look alike fixed annuities. It was developed mostly through third-party marketing organizations like my own, like Independent.

Very few banks actually went in direct relationships and built relationships with direct insurance companies in order to market the annuity services. It was done typically with what we call third-party marketers (TPMs) in the U.S. market; distribution and marketing companies that worked with banks.

In 1989, they broke into the commercial bank marketplace. In 1992, sales tapered off and remained flat for the next four years, and then more banks started selling annuities every year. And I have some interesting statistics to share with you as we move along in the talk. In 1995, interest rates for annuities began to drop. And in 1996, 28% of all annuities sold in the country were through the banks.

Let's talk about bank market share of fixed annuity premium. From 1989 we're moving from the bank share of 17.6% to 1995 showing a figure of 23.1% of fixed annuity premiums. In 1990, the bank market share of variable annuity premiums was just under 1% of market share. In 1995, it grew to 3.5 billion, hitting a market share of 86.97%.

I have a general comment that I would like to make in this area. From the 150 banks that we work with, we have seen a major changing trend of variable annuities becoming a major part of the business. And for the first time, my company, in the last couple of months, whereas we have a higher percentage of fixed annuities against variable, for the first time we have a greater percentage of variable as compared to fixed. So I think we're seeing a great opportunity developing in the variable business.

And one can see the logic for it. In fact, many of the banks have their own proprietary funds. It's a way for them to be able to put their proprietary funds into a variable setting under a tax shelter basis. I think we're seeing some exciting new innovations in the American market. The indexed products, the benefits and features of the current variable annuity business in America are extremely attractive to clients.

It's a wonderful marketing approach to customers. Very consumer friendly with many benefits attached to it. So we see the annuity business improving

dramatically. And, at the same time, we see variable products becoming a big share of the business.

It has been said of the American market that variable business hit about $100 billion in production last year, and it could be on the verge of the start of how the mutual fund industry in America has grown over the last 10–15 years. We can see a tremendous increase in that kind of business. And we're going to see an increase in the bank's share of that kind of business.

Primarily, I will talk to you about fixed annuities, variable annuities, and life insurance. I think you all understand that the banks in the U.S. have been very involved in the credit life business, but I will direct my comments to the fixed and variable life.

Regarding life insurance, I think the interesting difference made between the U.S. market and the European market is that the U.S. market started with fixed annuities, then got itself involved in mutual funds and securities. It has now gotten involved in variable annuities, and is seriously looking at the life insurance market. And that's in development. Whereas the South African market first started off with life insurance, and then brought it all the way up to the variable and to the other kinds of investment products.

It's interesting that life insurance started in community banks in the early 1900s, but it's only in the early 1980s that banks experimented with life insurance marketing but failed. I mean there was a lot of interest at that time to develop certain life insurance relationships, but nothing really came of it.

In the middle 1990s, there was a resurgence of interest in life insurance programs in the bank marketplace. And in 1996, less than $30 million, 3% of all life insurance sold in the country, was through banks. Still very much in its infancy stage. And I can tell you that of the 150 banks that we deal with, there isn't one that is not talking to us about wanting to introduce a life insurance program.

It was interesting how it evolved. I think banks have a profitable source of annuities, securities, and variable annuity business, and they're now seriously thinking about entering the life insurance side. In the last year we have launched eight major life insurance programs with some of the largest banks in the U.S. So it's coming. The timing is right, and we see tremendous growth opportunities. I will share with you some statistics that are being studied, and that were prepared by Datamonitor recently. We'll see this trend.

In 1992, there were $1.48 billion in sales with individual policies of $13 million. In 1995, sales were literally $1.6 billion with about 13 million individual policies. A very small percentage.

Here's an interesting item in terms of the opportunity in the bank marketplace. I think this is also another very interesting differential between the U.S., Canada, Europe, and, if I can include, South Africa; and that is the number of banks in the U.S. As you know, the European market is meagerly dominated by large banks, so is the South African market. But the American market, as we all know, is much different. Of the large ones, banks, S&Ls, and credit unions, 471 are currently offering investment services. Only 124 are not offering any investment services.

The medium size banks are those under $1 billion in size. Eight hundred and thirteen are offering, 647 are not offering. Of the small banks, you'll see that there are many that are not offering any services at all. So of the total of 23,000 banks, only 3,957 are offering some form of investment services. And the percentage of institutions offering investment services and also selling annuities is a rather high percentage. Of the large banks, it's 94%. Of the total, it's about 86%.

A big problem that one has with the smaller banks, and I experience this as well, is how do we get to the smaller banks? How do you make it cost efficient? How do you put representatives into these different kind of systems? Because you know that initially the industry was developed in the U.S. primarily with TPM companies putting representatives into banks that were employed by them. Today, in the U.S., because of the changes of regulations, changes of the laws, many of the banks can now own and employ their own representatives in nearly the majority of the states. So you have a combination of banks having third-party representatives or banks that are now having their own insurance representatives in their banking halls.

And either you have dedicated professional individuals selling investment products in insurance, or you also have, with many of the banks, the platform people selling the simple fixed annuity product. And you have a merging over the last year or two, what we call combination plans, where banks are using their platform people to sell fixed annuities, and they're using their dedicated professionals to sell all the other variables, securities, and more complicated plans, and they're using the dedicated people to be wholesalers through the platform program. So the major distribution systems are either platform or dedicated, or a combination.

And I think the interesting thing here on the life insurance side is that most of the programs that are being put together at this stage are done on what we call a managed basis. And what I mean by that is we are putting the representatives into banks, we're employing them, keeping the expenses off the banks' balance sheets

until the point in time in the future where the laws are changed, and they will then take over the sales forces.

So I think it's another interesting development in the U.S. market that Nick has compared to the European market, and that's the use of intermediaries because of the vast number of banks are able to bring all these different services to the banking community and to the customer. So we still have a long way to go in the U.S. in terms of bank opportunity.

This is interesting information about bank revenue mix for the fourth quarter of 1996. Fixed annuities 25%. Stocks and bonds 18%. The gray 6% proprietary mutual funds. Twenty-nine percent other third-party mutual funds that the bank sells. Variable annuities 12%. It's interesting. In the fourth quarter 1995, variable annuities were 9%.

There's been a lot of questions about what's going to happen with the TPM companies once banks start internalizing and doing all their programs. It's interesting that since 1994–96, the TPMs have increased by more than 30% in working with banks. We currently, today, work with at least eight of the top 20 banks in the U.S. even though they have their own internalized programs. Because we're still doing major wholesaling, they're still outsourcing many of the functions.

As a matter of fact, we currently work with a bank in the U.S. that has its own life insurance company. It outsources its wholesaling, back office support, all its representatives through Independent. And that's how we have been working that in terms of a partnership relationship.

Little progress is evident in the life insurance premium sales, but that’s changing. The Barnett Bank Decision has made a change in this side of the business. And although there are some states in the U.S. today, there were about 16 that still create difficulty in allowing a bank to receive insurance commissions. The fact that we do have TPAs like ourselves that can be the intermediary inside, they'll still bring those insurance products forward.

Let’s discuss forecasts. Well, I'm coming to the end, you know. This is about the past and projected U.S. population age of baby boomers. The under 18 age group is interesting. There were 67.1 million in 1993. By the year 2010, there should be 73.5 million. The 18–44-year-olds are fairly static at $109 million. The 45–64-year-olds—these are the aging baby boomers. In 1993 there were 48.8 million and there are estimated to be 78.5 million in 2010. The 65-year-olds and older will increase from 32.7 million to 40 million.

What does this mean? Where is the opportunity? According to Datamonitor, U.S. bank insurance premiums and revenue will be $93 billion by the year 2001, which will bring in revenues of plus or minus $11 billion.

Bank annuity premiums and revenue will grow from about $50 billion in sales in 2000 and projected by the year 2001 to be just over $60 billion. Bank life insurance premium and revenue will grow from a very small figure in 1996 to $14 billion in 2001.

The most interesting observation here is that the net income to banks of the $14 billion in life is estimated to be at $4.3 billion in revenue. If we return to the annuity premiums and revenues, where we estimated to do $60 billion in sales, the estimated net income to banks will be $3.5 billion in revenues. You can see that the life side will be producing a bigger percentage of the profits in the future.

The bank share of the annuity market is just over 20% in 1996. By 2001, it is projected to be 40%. Bank share of the life market is a minuscule percentage in 1996. By 2001, it is projected to be just under 15%. The bank share of the credit life insurance market is quite consistent. It's been a very high percentage of more than 90% and is expected to stay that way.

I think what is interesting is that currently the U.S. banks' production of insurance business is about 1% of the total insurance business written in the U.S. market. And if you look at the forecast, 1% in absolute dollar terms is about $223 billion of sales, which is higher than any other country in the world. And yet, it's only 1% of the total insurance business written.

And I think if you see what's happened in the rest of Europe and South Africa, where the averages are 15–20%, there are some dramatic changes in store, either in regulations or some other major area. There is no reason that banks should not be able to achieve at least a 10–15% market share.

So that's the exciting opportunity. I think that with all the different kinds of rationalization and opportunities taking place, the bank share can only grow, provided that we, as an organization, from the actuarial side, the distribution side, and the insurance company side, handle this market.

Mr. Nicolas: People talk about the banks having a bigger market share. Do you think the banks expand the market? Or do they take the market away from another source of distribution?

Mr. Dumbreck: I think it probably depends on the circumstances of the individual market. Certainly, in countries like France and Spain, the bank insurers have caused a dramatic growth in the size of the overall market. The traditional market has been very stagnant. The overall market has been growing. And it's almost all attributable to the influence of the bank insurers.

And I think the reason why the market is growing so much in those countries is that there are significant tax advantages in dressing up savings products as life insurance, either through tax relief on premiums, or the tax treatment of the proceeds of the policies makes it attractive to write insurance products rather than other forms of savings products.

In the U.K., it's rather different because there are really no significant tax advantages in selling a life insurance product for savings purposes as opposed to other vehicles like unit trust, personal equity plans, which, perhaps, are better tax breaks. And I think there's no real evidence that the bank insurers have been instrumental in increasing the size of the overall market. Perhaps things like guaranteed income bonds, some simple savings products have had some influence.

But I think, by and large, what's happened is that their own companies are now selling products that they were selling previously on behalf of other companies, and they haven't substantially increased their overall penetration of the market. So I think, as far as I'm concerned, and as far as the position in the U.K. and Europe is concerned, it depends very much on the external environment.

I'm not conscious that there is any area where any future growth in market share is expected to come from growth in the market as a whole. I think it's mostly expected to come from business being taken by the banks away from other sales channels and other insurance companies.

Mr. Kaplan: I think the bank influence has actually increased the market penetration among the competition. The normal traditional avenues of selling insurance and competition with the banks have brought exciting new products and new areas of opportunity.

And I think the other interesting area is that many of the bank customers make up a new kind of market particularly in life insurance. I think it's somewhat like the middle market. It's a very interesting way to be able to get to that middle market efficiently through the banking area. So I think it's going to add to the overall market opportunity.

Mr. William J. Bugg, Jr: Referring to your projection of growth in the life insurance among the banks. I recall that you're projecting about $16 billion.

Mr. Kaplan: Fourteen billion dollars.

Mr. Bugg: Fourteen billion dollars. Is that face amount or premiums?

Mr. Kaplan: Premiums.

Mr. Bugg: Premiums. Fourteen billion dollars in premiums, and revenues four—

Mr. Kaplan: Four point three billion dollars in revenues.

Mr. Bugg: Now, I was just curious as to what constitutes revenues. Obviously, the premiums are not in the revenues because the revenues are a quarter of the premiums.

Mr. Kaplan: The way that I understand it from just looking at this particular exercise that's been done by Data Monitor, that's the net revenue to the banks. So it's obviously what they received in gross revenues, what they have paid out in terms of the insurance representatives selling the products, and what the net revenue is.

Mr. Bugg: And that revenue is after—

Mr. Kaplan: Commission and expense.

Mr. Bugg: Benefits?

Mr. Kaplan: Yes.

Mr. Bugg: After benefits and expenses.

Mr. Kaplan: And that's why I also said with the $60 billion in the annuity sales, after commission expenses and after everything else, that the net revenue should be around $3.7 billion in sales.

Mr. Bugg: After reserves? I thought you were referring to it like it's profit. It does seem like a very huge profit margin then.

Mr. Kaplan: Well, I think what's interesting here is not showing the profit margins from the insurance company. It's showing what the net income revenues are from the banks' perspective. This is only looked at in terms of sharing commission

revenues, although there is quite a big movement in the U.S. today of banks wanting to participate in the profits with insurance companies.

Mr. Bugg: So that's the revenue. And then the bank adds its own expenses. It has to charge against those revenues, is that correct?

Mr. Kaplan: Yes.

Mr. R. Jerome Holman: One of the things that's evident today in the U.S. banking industry is that the banks seem to, in many respects, be doing all they can to discourage at the retail level their customers from contacting people in the bank. We see fees being imposed for people to see a teller more than five times a month, or whatever the figure is. And, in essence, the banks seem to be going out of their way to discourage contact, or face-to-face contact. Can you comment on that in light of how you think that will affect the bank's ability to be an effective distribution outlet, and what really is a face-to-face business of selling?

Mr. Dumbreck: That's a good question because I think that you will find that the banks are using simple products and telemarketing. A number of them are currently doing it at this time—simple telemarketing, underwriting, and simple selling of that kind of product. So that's happening on a broad basis. But I think the banks are still recognizing that they need to have a professional in the bank who is able to really deal with the upscale clients.

And it's not only at the retail level. It's putting specialized life insurance experts or professionals even at the trust level in other areas of activity at the bank. So I think you will find a mix of marketing, direct response, telemarketing response, as well as using the face-to-face contact.

Mr. Nicolas: But then the banks' advantage is their plan base, I guess, and their information?

Mr. Dumbreck: Exactly.

Mr. Nicolas: Obviously.

Mr. Kaplan: The interesting thing, I think, in the growth opportunity of the bank is to solve the distribution and underwriting problems through banks. Because I think banks are scared of being able to ask their customers some personal questions in the banking whole. We've tried to take it out of the banking whole. We've supplied an 800 number which customers use to speak directly speaking to the insurance company in terms of the underwriting.

Mr. Dumbreck: They'll use all different kind of techniques.

Mr. Marc Tardif: I'm wondering about the underwriting. Neither presentation alluded to underwritten products. In either of the markets that you have addressed are banks avoiding or at least not tackling products that do require underwriting? I'm mostly talking about health underwriting, but evidently all facets of underwriting are a concern. Is this the case right now, or do you see the banks playing a full role in the future?

Mr. Dumbreck: I can talk a bit about the U.K. experience. I guess, by and large, the banks have tried to keep the underwriting process fairly simple. One particular bank offered a waiver of premium benefit on all its products. It found that many cases were getting held up for three weeks, five weeks because of the underwriting just for this additional benefit, which wasn't seen as a particularly important part of the overall package, by and large. The bank decided just to dispense with the benefit and then the product could be underwritten on the basis of five or six simple health questions, or maybe fewer in the case of a mortgage-related product. And the whole process was much more straightforward.

There also have been developments. I think the banks have been pioneering limited underwriting for critical illness business. This is business that pays out a lump sum on diagnosis of one or a number of serious illnesses. Underwriting has been perceived as quite important for this product because things like family history are clearly very relevant. Any indications that people are taking out a product because they have reason to believe that they have one of these critical illnesses also is important.

Banks have been pioneering simplified initial underwriting of these products, and it remains to be seen what effect that will have on the claims experience under that business.

Mr. Kaplan: A very good question. If you look at the fixed annuity market, the U.S. market developed what is called instant issue. So today, in the fixed annuity market, we have instant issue with the majority of our contracts. The representative in the branch actually issues the contract to the customer. It's done through a netting of commission; that is, we and the bank take the commission out and the net is rewired to the bank. That's mostly in the fixed annuity market, but it’s developing in the variable annuity market.

With some of our insurance companies in the U.S. we’re able to issue the policy in the bank. In life insurance underwriting we see developing a lot of the instant quick turnaround underwriting. We've just launched a single premium whole life product

where the representative faxes it to the underwriting department at the insurance company, and it's turned around in less than five minutes. Then we issue the actual acceptance document to the customer.

I think we will see a dramatic change in underwriting procedures as the banks become bigger in this business. How that will affect overall profits in the long term with claims? The banks are very scared of the long underwriting process and so are the representatives. It has to be simple, quick, and fast.

We do know that once you start dealing with upscale clients in the bigger businesses, normal underwriting processes will be required. But none of the banks are, at this time, building those back offices. They really are relying on distributors and TPMs like ourselves to provide that service for them on an outsource basis.

Mr. Philip Gold: I would like to know how you think the life insurance industry will respond because I don't think it's willing to have its market share constantly reduced. What do you think is going to happen?

Mr. Dumbreck: Again, I can only answer for Europe. I think the life insurance industry in the U.K. is fairly comfortable with where things are. Some companies have been willing to help the banks get into the manufacturing of life insurance business by providing TPA services.

And I think life insurance companies recognize that it is inevitable that there will be some further growth in the position of bank insurers. Therefore, I think that the competition is not particularly between the banks and the traditional insurers for a greater share of the market, it's more within the traditional insurers.

I think it's interesting that insurance companies are getting into banking. I think that this is really something that has happened in the U.K. only over the last couple of years. And I think it is the first sign that this process of integration between banks and insurance can work both ways.

Prudential, the U.K.'s largest life company, set up a bank that started business earlier this year. Because it received such a huge volume of maturing business, it will actually build up quite large deposits quickly. That will not make a huge difference in the short term to the existing established banks, but it will make some difference.

Below a certain size it's not worth insurance companies having their own in-house bank. It just is not cost efficient. But maybe the top ten or fifteen companies start taking business away from the banks. Now, where it all ends up is not clear.

There have been a number of rumors about potential mergers between big insurance companies and big banking groups. None of them has happened yet. Possibly because there really are quite big cultural differences between insurance companies and banks. And it's not obvious that it will be a particularly easy relationship to have two very strong organizations joined together in that way. But, again, I don't think it can be ruled out as a possibility.

I don't see, at the moment, that insurance companies regard fighting back against the banks as a major priority. They have a number of more short-term problems to deal with like mis-selling, the year 2000 issue, and how to deal with the fact that their core business isn't particularly profitable. And I think they really have to address those before they start having to go to the banks.

Mr. Kaplan: I know that independent life agents continuously hit back in the U.S. market.

But I think that the insurance industry in the U.S. is looking for ways to work even more closely with banks. I think the big difference in the U.S. is that banks still cannot own insurance companies, so they have to work with the existing insurance company structure. These are strategic relationships.

Five or ten years ago, a bank would just sell one annuity product. That’s not possible today. A bank today has to sell at least three, four, or five different type of carriers from the compliance and suitability point of view. I think there will be more partnership relationships developing in the U.S.

I'm hoping that when banks finally get the approval to own and develop insurance companies, they will follow the South African model and become joint ventures, with both using each other's skills. Personally I believe that you have to have the skill sets from both sides.

From the Floor: Gaetan, would you like to comment?

Mr. Nicolas: Yes. We have an experiment in Canada like that between Met Life and one of the banks. We still have the partnership. We believe that joint ventures are still the way to go. We have to get results, but I think it will work. In fact, it's my job that is depending on it. But it still has to be proved.

Mr. Robert V. Lyle: I'm self-employed as an international consultant. I was curious that the panelists avoided the other product area of property and casualty relative to banks. Is there any interest developing, any activity developing?

I have a second question. Do you have any figures on market share in Canada of bank insurance?

Mr. Nicolas: In Canada right now, banks are allowed to own life insurance companies. I don't have their market share, but it's very clear that they make so much money on credit insurance that going to the other markets, it's kind of like going after your own money. There is a difficulty there. I think CIBC is going into property and casualty so the market share in the property and casualty is growing.

The one that is the most surprising, I think, is the Movement Desjardins in Quebec. They're allowed to put representatives in their branch, but that's the only organization that is allowed to do that. And even though it has developed on the property and casualty side into a very significant player, I think it's over 20% of the market share on property and casualty in Quebec.

On the life side, we have not seen any movement there. And I don't know what that means for the rest of the banks. I don't know whether there is just some nervousness about it, or that we cannot find a solution to this market for Canada.

Mr. Dumbreck: U.K. banks traditionally make quite a lot of money from selling property and casualty products, particularly house-building insurance, which is a natural sale for them as they're lending money on mortgages.

I think up until quite recently, they were happy to take large commissions for selling other insurance company's products. Commission rates were typically on the order of 30% or 40% of the premium. Now, that has changed recently because there have been a number of very successful direct insurers selling by telephone that have driven prices down and taken business away from the banks. Banks have found it difficult to insist that their customers buy their own insurance products as a condition of taking a mortgage from the bank.

So we've seen in the last couple of years a number of banks and building societies, the U.K. equivalent of S&Ls, setting up their own property and casualty insurance underwriting vehicles. They're capturing some of the underwriting profits to compensate for the loss of selling. I think, nevertheless, they do realize that it's easy for the unwary to lose money on property and casualty insurance. So most of these ventures have been in partnership with existing insurance companies that provide the necessary expertise rather than the banks and the building societies going at it alone.

Mr. Kaplan: I don't have much experience in the property and casualty area, so I will quote from some recent survey results, which are estimates for 1996. Annuities

were $15.4 billion in sales in the U.S.; 82.2% of the total. Credit life was $1.6 billion in sales; 8.5% of the total. Personal life was just under a billion; 5% of the total. Personal property and casualty was $0.8 billion, 4.3% of the total. So I think in the U.S. the banks are trying to get themselves involved in all areas. Annuities, however, are still a major area.

Forecasts for 2001 show that property and casualty will have moved from $4.3 billion in sales to $15.7 billion in sales. Life will have gone from $5 billion to $13.5 billion, the $14 billion that I showed earlier. Annuities will have gone from $15 billion to $60 billion. Credit life will have gone from $8.5 billion to more than $21 billion.

Mr. Nicolas: I'd like to make one comment before I close about the Canadian market.

If you consider the Canadian marketplace right now, Royal Bank, I think, makes about as much money on their Canadian operation as all the Canadian life companies. The Royal Company probably makes more. You can see that the banks would be dominant players in the marketplace.

So far distribution is very attractive. Manufacturing does not appear that attractive because of the expected rate of return. I think everyone is trying to figure out how to lower the cost and improve the rate of return so they have a vested interest in distributing the product in order to retain the client. But on the basis of the rate of return, life manufacturing is not very appealing as compared to what they do in the rest of their business.

Mr. Kaplan: May I just make one interesting observation about Canada and the U.S.? Generally, we find that the U.S. banks on average will try and get a 2% of deposit-paid penetration. So if you're dealing with a bank that's $50 billion in size, you should easy be able to do $100 million in annuity or insurance production.

Gaetan, what's the size of the biggest bank in Canada?

Mr. Nicolas: Oh, I would say about $200 billion.

Mr. Kaplan: So the potential there is something like $400–500 million in premiums for insurance.

Mr. Nicolas: I think they want it all to themselves in Canada. That's the issue that we wrestle with.

I think companies should get together, and that's probably what will happen anyway.