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Session 7I
Bancassurance Products

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Moderator: J. LYNN PEABODY
Panelists: JEAN C. GORA†
CHRIS M. RUTTEN‡
OSCAR ZIMMERMAN

Summary: The lines between the insurance and banking sectors are blurring. Cross-selling of financial products has become an everyday practice in other countries. Is this an indication of what is to come in the U.S. and Canada? If so, how will we get there? The panelists for this session discuss key issues related to bancassurance, including identification of consumer need, marketing issues, products, administration requirements, and regulations.

Mr. J. Lynn Peabody: I'm with Milliman & Robertson (M&R) in Seattle and have been with M&R for about 24 years. In the last four or five years, I've spent quite a bit of time involved with banking and banking-related issues. I chaired a Society of Actuaries (SOA) Task Force on Banks and Financial Institutions for about three years that was oriented toward gaining exposure for actuaries in the banking area and also for finding ways that actuaries can bring their talents and their expertise to bank and bank-related insurance issues.

We have a panel of what I think are experts in the field, and because of that, I think you're going to get some very good information. The format of the session is one that's called an interview. It will be a question-and-answer type of format. We have

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†Ms. Gora, not a member of the sponsoring organizations, is Vice President and Manager of Research of Life Office Management Association in Atlanta, GA.

‡Mr. Rutten, not a member of the sponsoring organizations, is Vice President of Structured Reinsurance, Security Life Reinsurance in Denver, CO.

a list of prepared questions, and I'll be asking the panelists those questions. At the same time, we would like this session to be interactive.

I'll introduce all three of the panelists first, and then we'll go ahead and get into some of the questions. Chris Rutten is one of our panelists. Chris is currently the vice president of structured reinsurance with Security Life Reinsurance. He has been there since 1989. His responsibilities include the expansion of structured reinsurance activities for Security Life and its international reinsurance business. Chris has worked primarily in the Netherlands. His degree was from the University of Amsterdam. He's a Fellow of the Actuarial Institute of the Netherlands. He worked for the International Nederlanden Group (ING) and was responsible for the expansion of its insurance activities in the Far East. He has had a quite varied background, and Chris is going to be talking to us primarily from the standpoint of bancassurance activities in the Netherlands and, to some extent, in the European community.

Jean Gora is currently a vice president and manager of research at Life Office Management Association (LOMA) in Atlanta. She has been with LOMA for about seven years, and prior to that she was with a marketing research firm that specialized in banks and insurance activities. She actually has about 20 years of experience in the area of banking and insurance and currently is working on a LOMA research project, a major report that she has been working on for about a year now. It's going to be published in August, I believe. During that time, it led Jean to do some interviews of people in the U.S., in France, and also in Canada, in the area of banks and insurance. During that time you may have even interviewed Oscar along the way.

Our third panelist is Oscar Zimmerman. Oscar is the president and chief executive officer (CEO) for Scotia Life and Scotia General Insurance Companies. These are wholly owned subsidiaries of Scotia Bank, which is Canada's fourth-largest bank as ranked by assets. Mr. Zimmerman joined Scotia Bank in 1992 as a senior vice president of Scotia Insurance with responsibility for developing the strategy and managing the execution of the insurance products and services through the bank's domestic and international operations. Before he was with Scotia Bank, Oscar was senior vice president at Crown Life Insurance Company. He is a Fellow of the Society of Actuaries, a Fellow of the Canadian Institute of Actuaries, and a Member of the American Academy of Actuaries.

I think you can see that we have some people on the panel who are very well-versed in the area of insurance and banking, and hopefully their input is something that's going to be very valuable to you. With that, let me go ahead and get into our questions. Chris, just as some general background, can you give us a sketch of the historical development of the market for bancassurance in the Netherlands?

Mr. Chris M. Rutten: The reason why I'm talking about the Netherlands, other than that's the market that I know most about, is because I think a lot of experimental bancassurance has happened in the Netherlands that I think can give us some lessons for the future for the market here, too. As some background, the Netherlands is a fairly small country, the size of Maine, with about 15 million people. Over the centuries, it has had a very strong trading background and, as a result, has had a very strong banking and financial services industry. Some of the very global, strong, powerful banks have their home base in the Netherlands.

They also have a branch network in Holland that is really quite astonishing. I won't say that you'll find a bank office on every street corner, but it's not much of an exaggeration to say that, and it's very well-accepted for people to go to banks and do business at banks, at their branches. Having said that, that's obviously very expensive to maintain, and you have two ways to deal with that. You either cut back on your branch office structure (which at least in Holland and several other European countries banks have been reluctant to do), or you find ways to increase revenue through that branch structure. As a result, the bank branches in Holland have really an incredible range of products that are available and are being sold through those branches such as: traditional banking products, mortgages, personal investment management, tax planning tools, stock brokerages, and a whole range of insurance products.

Cross-selling of financial products has been an everyday practice in the Netherlands for decades. Traditionally, banks have operated as independent insurance brokers, and overall, in the Dutch market, the independent insurance brokers or insurance agencies are still the dominant force in insurance distribution. In 1991, there was a change in legislation. The Structure Act was adopted in Holland which allowed for different structures of financial conglomerates and basically allowed for banks to fully own insurance companies, insurance companies to fully own banks, and various holding company structures. My company, ING Group, was formed in that year, and really that merger has resulted in a catalyst of all kinds of bancassurance activities in the Netherlands. Still, it's a very unique type of merger because it truly is a merger of equal partners, a bank and an insurance company. As I'll get to later when we answer some different questions, you'll see where some of the benefits of that come into play.

Initially, by the way, when the company was formed out of the merger between the bank and the insurance company, there were some pretty drastic developments there. The insurance company was always focused on the independent distributors and was really in favor of more and more independent advice, even though they tried to get a larger share of the distribution of each of those agencies. When that merger took place, initially the agents, which were very well-organized in trade associations, literally boycotted the group, and where you have a market share of something like 20% of the market, that starts to become troublesome. After the company decided not to use dual pricing in the marketplace and to use a somewhat limited form of distribution through branch offices of the banks, the dust settled, business was back as usual, and bancassurance activities moved forward.

Every bank branch since then has strongly focused on insurance sales for two reasons. First, they wanted to meet the competition. No bank wanted to be left out. I think ING set the pace there with great opportunities. We're going to go after this marketplace, and other banks just didn't want to be left out. Second, even if a bank doesn't own an insurance company, or doesn't actually underwrite the insurance products, that doesn't mean that down the road that insurance sales are not going to be a very important element of the profits of banks. Therefore, they ought to play and see if they can be successful. They can later see if they can actually start the underwriting of insurance products, too.

The impact on retail banks has been much more customer focus rather than product focus. Traditionally, the banks were much more product focused, and now there's a strong desire to service a customer with a range of products. The impact on the insurance distribution has been greater emphasis on value-added services and cost-effective, value-added services, as well as a much greater segmentation of the customer base with respect to the ability to provide those value-added services in a cost-effective manner. That is some background on the Netherlands.

Mr. Peabody: Great! Good. Oscar, what's happening right now in Canada?

Mr. Oscar Zimmerman: As I will outline in more depth a little later on, restrictions imposed by Canada’s federal government in 1992 severely limit the extent to which banks can engage in the business of insurance in Canada. These restrictions were left untouched in the recent round of amendments to financial institutions legislation which came into force just this past Sunday (June 15, 1997). As some of you may recall, government officials precluded any further discussion of the issue by announcing the extension of restrictions in the 1996 spring budget. The rationale for the federal government's position for continuing restrictions on bank distribution of insurance is unclear. As you will see from my later comments, there is no evidence, international or domestic, to support the government's current policy direction.

It should be of no surprise that Canadian banks welcome the opportunity to address the question of business powers, including the retailing of insurance, in the context of the recently launched task force on the future of the Canadian financial services sector. Chaired by Toronto lawyer, Jim Bailey, task force members represent a broad range of regions, including the U.S. industry. There is no direct representation from either banks or insurance companies, although certain members are directors of financial services institutions. The government has given the Bailey task force a very broad mandate. The group has committed itself to undertake a comprehensive review of the appropriate framework for the financial sector in the 21st century. It will be very interesting to see how task force members sort out the conflicting interests of the various suppliers of products and services, particularly in light of their explicit mandate to advise government on ways to enhance the contribution of the financial sector to the best interest of Canadian consumers. The task force is expected to issue a final report and recommendations by the end of September 1998. That's an update on Canada.

Ms. Jean C. Gora: I have a little bit of documentation on what has been happening in Europe and in Canada, and I will go through that quickly. Then I'll get to the U.S. situation. These are the results of a study the *Financial Times* conducted of bancassurance in Europe which showed market share of bank-owned or bank-dominated insurance companies in Europe by country. France has the highest level of bank ownership of the life insurance market with a 55% share. In the U.K., banks have about a 15% ownership of the life insurance market. I think the U.K. model is closer to the one that will occur both in Canada and in the U.S.

I want to give you some information about bank ownership of insurance companies both in the U.K. and in Canada. In the U.K., virtually every major bank now has an insurance subsidiary. Hong Kong-Shanghai Bank Corporation, which has $49 billion in the market capital, does so through a joint venture with Commercial Union, an insurance company. There are a number of joint ventures in the U.K. between insurers and banks to do bancassurance. Usually the bank has the majority interest in the joint venture. I'm not going to go through these in detail. I think you have this information in your notes. But, as you can see, there is a pervasive entry of banks into the insurance market. Initially, it started with large banks and moved onto smaller ones. It now involves the building societies, which are the U.K. equivalent of savings and loans. As Oscar will talk about, a very similar phenomenon is occurring in Canada, where I believe five of the six chartered banks now have insurance subsidiaries. When the banks get the power to manufacture, they do so.

Let me talk a little bit about the legal situation in the U.S. In general, banks traditionally were precluded from acting either as an agent or as a manufacturer of insurance with four exceptions. They could manufacture and sell credit insurance. If they had owned an insurance company prior to 1982, they could keep operating it, and there were 16 banks that did so, some of which are now large, like First Bank System and Norwest. A bank in a town with a population below 5,000 could have an agency or a company if it wanted to. And a bank that had assets of no more than $50 million could do so. Since this law was promulgated in 1982, there has been a tremendous amount of movement. The law applied initially just to national banks. States could do different things. In some states, the interpretations of the laws were much more liberal, and banks got to do a little more. In other states they can do a little less. In general, the controller of the currency who regulates national banks has been very willing to expand bank powers. In 1990, he allowed Nations Bank to sell annuities and said that annuities really aren't an insurance product; they're really a bank product. In 1995 that issue reached the Supreme Court. The Supreme Court agreed with the controller and said that annuities are really not an insurance product. They are really a bank product.

Back in 1986, the controller had allowed one of the Barnett Bank’s small subsidiaries in Florida to buy an agency in a town with fewer than 5,000 people. That was challenged in court. In March 1996, the court blessed this arrangement. More recently the controller has ruled that a bank in any of these small towns can direct market insurance virtually anywhere. In November 1996, he ruled that banks could set up operating subsidiaries that could do all manner of things, including engage in insurance. I don't know whether that interpretation has been challenged yet, or what all the legislation going through Congress right now will do to that interpretation. In any event, the rules against bank involvement in the insurance industry have been leaking like a sieve and will continue to do so.

Banks have significant limitations on their operations. Banks cannot affiliate with industrial companies the way, for example, Jefferson Pilot has affiliates in the cable TV industry and has sports franchise affiliates. They cannot (or could not until recently) own securities firms, so that you don't have big banks that own big securities brokers the way Prudential, Travelers, and some of the other large insurers do. Banks could not branch nationwide until recently. U.S. banks were once among the ten biggest banks in the world. They dropped off the list of the top ten banks because banks all over the world have insurance and securities powers, and U.S. banks don't. You have a situation where whatever administration is in power, there is a very, very strong impetus to expand bank powers, and that impetus is not going to go away.

Insurance companies have begun to become more receptive to affiliations with banks over the last year. Many of them believe that their agency system is overly expensive. Everybody is tired of the bad publicity in the press that the insurance industry has received regarding market conduct. There is a tolerance in insurance companies for affiliations that did not exist before, and the insurance lobbies have been supporting bills that would allow banks and insurance companies to affiliate, basically since last fall.

There is another financial modernization bill going through Congress. The current fight is over who is going to regulate all the different parts of financial conglomerates. Obviously the state insurance regulators want to preserve their role. Then there are assorted other issues. I don't know whether a bill will get through this time or not, but I think the trend is clear. No administration is going to abandon this issue completely.

To give you an idea of the position of banks, let's look at household financial assets, assets held in savings instruments. These are the traditional bank instruments. In 1980, basically 20% of household assets were in those instruments. That level has been cut in half. The life insurance industry saw some drop in the share of assets held in life insurance, but it did not compare with the disintermediation suffered by banks. Many of their former commercial borrowers, instead of borrowing from banks, now issue commercial paper in the money market. They don't need to borrow from banks. Banks have been under pressure to diversify into other activities, and they have done so. Basically, in 1980 only 7% of their income was noninterest income. In 1993, about a quarter of their income was noninterest income, and I just saw some recent figures showing it to be over one-third now. They are very much trying to diversify into other areas.

Banks now sell about 15% of the annuities that are manufactured in the U.S. I've seen different figures here, but these are figures from the Life Insurance Marketing and Research Association (LIMRA). We did a study of banks and other financial institutions that currently sell insurance and the products they sell. Among organizations that are selling insurance, there is a significant interest in selling a lot of different kinds of products and in expanding those products. As of about two years ago, there were approximately 5,000 financial institutions in the U.S. that were distributing insurance, and I would imagine that the number is much larger now.

Mr. Peabody: You had indicated a little earlier that you thought that if banks have an opportunity to manufacture products, they're probably going to do it. Which ones are going to do that and why? And then, as a second question, do you see that they're already moving their way into that arena?

Ms. Gora: We surveyed basically the same group of institutions—institutions that are currently selling. We asked them: If you could manufacture these products, would you? Many of them would. This sample of institutions included both large and small ones. The smaller institutions are probably unlikely to manufacture. I think you should know that there's a lot of interest in manufacturing. There has been a great deal of interest out there for a long time, primarily in the annuities and life areas and also in personal lines, property and casualty, and in group products.

Mr. Peabody: Let me make a clarification, and I think this is right. When we're talking about manufacturing, we're talking about underwriting.

Ms. Gora: Right, we're talking about operating an insurance company as opposed to operating an insurance agency. Who do I think will be the big manufacturers? I think you can take the top hundred bank holding companies. Basically, they distribute two-thirds of the annuities that are sold by banks right now. They're the ones that are going to manufacture, particularly the top 30 banks. They have the majority of bank deposits. They have the majority of bank assets. They have seven out of ten bank employees. They have 36,000 branches. The banks that have big branch networks are almost certainly going to underwrite. This is not to say that there will not be some banks that become manufacturers primarily for direct marketing rather than branch distribution. When you do scans through published literature, you see that. It's these banks with big branch networks that are actively selling insurance. They are selling enough to justify their entry into underwriting.

Mr. Peabody: How are banks actually moving into the manufacturing area at this point?

Ms. Gora: First, let me back up a bit and talk about what banks bring and what insurance companies bring to joint activity. Banks have lower-cost access to capital. Their cost of funds is lower because they benefit from the federal guarantee on deposits up to $100,000 per person per bank. Their brand names tend to be strong and well-known by consumers. They have good customer lists. They have a channel sitting there that they want to push more products through. The insurance industry brings tax-advantaged products, tax-advantaged asset growth, tax-advantaged intergenerational wealth transfer, plus actuarial skills and sales skills that may not exist to a comparable degree in banks.

The main way banks are getting into insurance right now is through distribution agreements. Basically, over the last two years, the barriers against selling have really dwindled so that many insurance companies have begun distributing through the bank channel. They've established new business units to do it. There are a lot of strategic alliances out there right now.

Banks have traditionally been able to manufacture credit insurance, and some of the big banks like Citibank, Nations Bank, Bank America, and Mellon Bank, all have credit insurance subsidiaries already.

Banks are also using their credit relationships to enter the insurance business. I am aware of a bank right now that owns 5% of an insurance company. It has loaned the insurance company additional money. If affiliations are permitted, that loan will be turned into an equity investment. Banks lend a lot of money to insurance companies. There are a lot of relationships out there that could convert in this manner.

Banks are also using captive reinsurers to enter the insurance business. Basically, banks have been allowed to set up captive reinsurers to reinsure some of their employee benefits and officers' and directors' liabilities. They have these entities sitting there. What they have done now is enter into deals with established insurance companies that provide credit insurance on loans the banks make, and basically the primary insurers cede the policies to the captives. You're seeing a lot of these little relationships pop up here and there. Take the case of Advanta. Advanta is a major credit card manufacturer/distributor. Its accident and health policies are written by American Bankers Life and American Bankers Insurance. This coverage is then ceded to Advanta's reinsurer. There are several relationships like that—one involving Mellon Bank, Prudential, and U.S. Credit Life, and another involving Barnett Banks and American Heritage Life, etc. We're going to see more of these arrangements.

From the Floor: What's your point on that?

Ms. Gora: I guess my point in this is how banks are moving to acquire manufacturing capability.

From the Floor: Actually, I would view it in just the opposite way. The banks don't want any manufacturing capability. They just want the profits. That's all those reinsurance companies are for.

Ms. Gora: I am quoting to you what bankers have told me.

Mr. Peabody: I think possibly, too, you may also see as we move ahead that there's a transition that's occurring from strictly what was at one time a fee-based desire to one that is turning into more of a control-based desire or an ability to really maintain the whole power of the insurance relationship. It's happened in other areas. That's why we wanted to talk some about what's happening in Canada and then in the European area, too, because I personally see those as models for the direction of what's happening in the U.S.

Ms. Gora: These are selected distribution alliances involving banks with large branch networks and that have the market capital to establish insurance companies if they want to. There are lots and lots of these relationships, and I think banks are, to some degree, using their due diligence investigations of insurance companies that are part of these alliances to check out insurance companies to see what they like, what they don't like, and how they would manufacture insurance if they were going to do it.

From the Floor: When you say distribution relationships, do you mean that the bank is like an agent?

Ms. Gora: Right. Many banks have set up or acquired agencies.

From the Floor: Are these distribution arrangements mainly annuities or are we talking some life insurance distribution here?

Ms. Gora: We're talking about the whole insurance product line. Many banks are now selling the full lineup of insurance products.

Mr. Peabody: I think the other thing to consider is maybe 90% of the banks in that survey are writing annuities now; 70% are writing life insurance; and maybe 40% are writing health insurance. One of the questions in the survey was, in two to three years where do you see yourself? Over 90% of those organizations indicated that they would be selling in each of the different areas, not just annuities. So it's all part of a transition that's going on. Let me try and get some input from some of the others. Oscar, could you outline a little bit the 1992 revisions to the financial institutions legislation in Canada, please?

Mr. Zimmerman: Sure. Significant changes in the 1987 and 1992 revisions of the Bank Act fundamentally altered the institutional structure of Canada's financial system. These changes removed most of the barriers that enforced the separation of the four pillars: banking, trust, securities, and insurance. In 1987 legislation had allowed banks, trusts, and insurance companies to buy securities firms; in 1992 new legislation opened the way for even greater competition between the pillars. Trust companies could now offer a full range of banking services while not being subject to the same limited ownership rules. Insurers can own trust companies and Schedule 2 banks, and banks can now sell trusts and insurance products through separately incorporated subsidiaries.

However, last-minute restrictions imposed by the federal government in 1992 have limited the extent to which banks can engage in the business of insurance in Canada. Banks are allowed to buy or create insurance companies and operate them as subsidiaries, but they are not allowed to use their branch networks to distribute most types of insurance products. Further, there are prohibitions on customer targeting and cross-selling. Essentially, the banks have been allowed to own insurance subsidiaries, but legislative restrictions have hampered efforts to create, market, and deliver insurance products to Canadian consumers through bank branch networks.

Central to the government's restrictions on insurance is the issue of target marketing and the use of customer information. The government of the day accepted the insurance industry's contention that banks would have an unfair advantage if they were permitted to compete with insurance companies. Certain myths perpetuated by the insurance industry that banks will come to dominate insurance companies and squeeze independent brokers out of business were simply accepted by government as fact. Yet many of the international insurers operating in Canada are larger than any of the Canadian banks. In the life insurance sector there are at least two foreign insurers operating in Canada with assets greater than those of Canada's largest bank. International insurers dominate the market for property and casualty insurance, accounting for over 60% of net premiums written in Canada. Four out of the top five property and casualty insurers in Canada are subsidiaries of large, multinational insurance firms, and all are based in countries that allow banks to sell insurance.

Banks around the world are now routinely permitted to distribute insurance, the U.K., Europe, Australia, New Zealand, and 37 of the 50 U.S. states allow the retail distribution of insurance products through bank branches. Canada and South Korea are the only two countries in the developed world that have not acknowledged the natural tie-in between banking and insurance and the provision of financial services to consumers.

Nonetheless, in the spring budget of 1996 Finance Minister Paul Martin announced that the federal government would not loosen restrictions on the marketing and distribution of insurance products. Partway through his budget speech Martin said, "We are currently reviewing the legislation governing financial institutions with a view to improving the framework established in 1992. We have concluded that the financial sector has yet to fully adjust to this framework. Therefore, the present restriction on banks selling insurance will be maintained. The present framework for selling insurance through agents and brokers will be preserved." Some of you may remember that the House of Commons gave Martin a standing ovation when he announced the government's position on this issue. Actions are often more telling than words. The reaction of government members can only be construed as evidence of the outstanding political power and influence of the insurance lobby in Canada.

Ms. Gora: Interesting. Oscar, what do you see as the impact of these regulatory restrictions on the marketing and distribution of insurance products by banks through their branch network?

Mr. Zimmerman: Restrictions on the marketing and distribution of insurance products through branch networks have proved an effective barrier to banks making a meaningful entry into the retail insurance market in Canada. While five of the big six banks have established Canadian insurance subsidiaries, Bank of Montreal is alone in not having established a domestic insurance subsidiary. The mere ability to own an insurance company does not necessarily provide an efficient basis for greater bank participation. It is relationship marketing that motivates it to be a one-stop source of financial services, a financial superstar, if you will, offering every conceivable financial product and service.

Insurance is the last significant financial service that banks need to add to their roster of services in order to achieve superstore status. The banks believe, and international experience confirms this view, that sale of insurance products through bank branches will promote consumer welfare, bringing better pricing, easier access, and improved availability to lower income customers, as well as giving Canadians the wider choice they are asking for. As George Addey, past Director of the Competition Bureau, noted in a speech to life insurers in May 1996, entry by deposit-taking institutions into the retailing of insurance would be positive. Enhanced competition resulting from such entry would benefit consumers and promote greater efficiency.

Research shows that 97% of Canadians want to be able to choose where they buy their insurance. Moreover, a recent study by Market Solutions shows that over 50% of respondents would like the opportunity to purchase auto, home, and life insurance from their bank. Yet cross-selling and target marketing restrictions limit the customers' access to insurance through their branch network. In essence, banks are prevented from marketing insurance to their own customers. Instead, they have been forced to market to the public at large, principally through the medium of direct-response call centers.

As I've already mentioned, Finance Minister Paul Martin preempted the recently completed review of financial sector legislation by announcing in early 1996 that his government would not loosen restrictions on the sale of insurance through bank branches. I have to admit the banks were caught off-guard by this announcement, particularly in light of comments made by Michael Kirby, liberal chair of the Senate Banking Committee, to a life insurance forum in January 1995. Kirby said that legislative changes this time must have a definite consumer orientation, and he noted that the evidence the Senate Banking Committee had reviewed to date, to quote, "suggested that consumers would be better off if banks were allowed to fully market insurance."

While he acknowledged the insurance companies' contention that serious questions exist concerning customer privacy and the ability of banks to unfairly influence the choices of their customers, he also warned insurers that what will be badly needed in this debate is factual analysis, not emotional and unsubstantiated assertions. The empirical evidence is that coercion or tied selling is a nonissue. In studying the U.K. experience, Canada's Public Interest Research Center concluded there's no evidence that the experience with insurance retailing by banks has led to complaints about tied selling.

The same holds true for other foreign jurisdictions according to the economists conducting a 1996 study for the C.D. Howe Institute. Their study reveals further that concern about the potential for banks to misuse confidential information is unsubstantiated. They argue that, in other countries, the primary check on illicit use of customer information is the bank's view that aggressive use of their confidential customer data to market insurance is not in their best interest, and where they distribute insurance, banks have taken the lead in developing guidelines for protecting privacy and guidelines which, I might add, already exist in the Canadian context.

Speculation about tied selling and potential threats to consumer privacy are just two of the myths perpetuated by insurers in an attempt to maintain the status quo. The reality is that banks have implemented stringent privacy codes as well as the dispute resolution process to deal with concerns of retail and small-business customers. The insurance industry, in contrast, is not subject to the same rigorous market conduct requirements. The number of articles citing inappropriate sales practices by insurers in the U.K., U.S., and most recently in Canada, is overwhelming. Insurance agents and brokers are routinely disciplined for actions such as misrepresentation of themselves, the products they are selling, unlicensed sales activity, and unwarranted and systematic replacement of life insurance policies.

The Canadian publication *Consumer Reports* maintains that deceptive interest rates and inadequate cost disclosure are commonplace with life insurance. An article in *The Economist* back in 1994 stated that for years, life companies have been accused of: being mean to customers cashing in their policies early, providing a narrow and inflexible range of products, and siphoning off a large chunk of their customer savings through excessive management fees and sales commissions. The recent spate of lawsuits in Canada over inappropriate life-insurance-selling practices is just part of a broader problem of inadequate disclosure and well-publicized cases of misconduct. The resulting consumer pressures led politicians and regulators to establish new rules on disclosure in the U.K. and the U.S. The Canadian insurance market remains largely self-regulated. Moreover, there is minimal interest by politicians in taking a leadership role in this issue. Canadian banks have stringent guidelines firmly entrenched in routine operating procedures governing their collection, use, and disclosure of customer information. There are strict policies concerning tied selling, and as I've already noted, there were both bank and industry ombudsmen appointed to deal with the concerns of retail and small-business customers.

Some of you may also be aware that the House of Commons' Industry Committee meets quarterly just to review the banking sector's performance related to small-business lending. It is interesting to note that while insurance companies also have small-business lending powers, the sector's performance related to small-business lending has received little or no attention in industry committee discussions. What the banks want is for government policies and regulations to be fair and equitable to all financial institutions. In light of recent lawsuits over inappropriate selling practices and inadequate disclosure in the life insurance industry, we're puzzled by the lack of visible leadership by our elected officials on this issue.

Mr. Peabody: Chris, I'm going to move things a little bit here, but I want to ask you in an environment like the Dutch market, for instance, where there have been very few limitations on excess ownership or cross-ownership of banks and insurance, what are the opportunities for a high level of bank insurance activities?

Mr. Rutten: First, I think there are a few realizations that there are still some limits. Even in the Netherlands, there is still separate regulation of insurers and banks. The banks are regulated by the Dutch Central Bank, and the insurers are regulated by the insurance regulatory authorities, which, I would gather, would continue to be the case in the U.S., too, no matter how many laws are going to change. What kind of insurance regulatory authorities they will be is perhaps a different issue.

Second, there are also some privacy law issues in the Netherlands. Even in an affiliated company system, the insurance companies do not have free access to the customer database that the banks have. As a result, in an integrated bank insurance environment, it's quite clear that the banks control and have access to the customers. They control the customer relationships, and that's a very powerful realization when you're active in integrated bancassurance, and the sizzle is in the integration where companies can reap the benefits of both the margins in distribution as well as the margins in underwriting or manufacturing and have greater control over the end customer, especially when you start moving towards combined products where you combine your banking and insurance products in one packaged product.

I'll add one comment. There's a whole range of other reasons why it would make a lot of sense to have a combined integrated bancassurance operation that has little or nothing to do with the retail distribution of insurance products. One could be, as I've seen in my company, that the merger between the bank and the insurance company resulted in improved ratings on the bank, which means better access and cheaper access to capital and funding which flows directly to the bottom line. It's extremely important in a banking business. Second, the combination of the long-term focus of insurance and pensions business with the shorterterm focus of the banking business has opened up to opportunities in megafinancing projects that combine these very long-term with very short-term investment projects. Only operations that have truly combined those two elements of the business can play in that without having to fragment those opportunities.

Ms. Peabody: Let me ask you a question, Jean, and then I want to get into products a little bit. In the U.S., what's the structure of a bancassurer?

Ms. Gora: Here is what you find in a lot of continental bancassurers. I think this is what banks would like to do in the U.S. if they are allowed to. Basically, the insurance operation is highly integrated into the bank. There is a small insurance company that operates kind of on the side, and then within the bank there is an insurance product management group that coordinates everything in the insurance area that, in some way, requires links to banking. Here is an example of a real product development process in a continental bancassurer. The bank's market research department conducts market research and comes up with product specifications. These are sent over to the insurance affiliate, where actuaries are employed who design the products. The insurance affiliate is responsible for the technical results of the products, and then the bank decides how the products will be marketed.

Here is another example. Very frequently the insurer will establish the underwriting rules, but then bank employees in branches will be charged with executing them. They will be able to make decisions on the spot. Usually, from a financial point of view, these arrangements are structured so that bank branches receive commissions. When the overall insurance operation shows profits, these are given to the parent in the form of dividends. If, in the U.S., we have a holding company structure with separate subsidiaries that have to be separately capitalized, banking and insurance may be less integrated than they are in the continental model.

From the Floor: In the U.S., the insurance company comes up with a product and files it with the state. How would that work in this situation? I can't imagine New Jersey just saying, "Oh, go ahead."

Ms. Gora: Well, that, as we speak, is a big issue. The federal bank regulators are determined not to allow the state insurance regulators to keep banks out of the insurance business.

I just want to mention one other thing. This integration of bancassurance enterprises causes all manner of interesting financial consequences. I know of one case where an insurer was selling insurance through a bank's branches, but wasn't forced to absorb any of the costs of running the branches. The insurer was showing profits right and left while the branch was not profitable. That arrangement did not continue. In the French bancassurance arrangements, the people who work in the insurance part of a venture and the people who work in the bank part of it get together every year, and they decide what commissions the insurer is going to pay the bank branches and how profits will be divided. In other words, there is a great deal of ability to manipulate financial results in these situations.

Mr. Peabody: I think another point is that the model that we're working with in the U.S. has been built from, or is being structured around, what we already have from the insurance industry and from the bank industry. Both industries are very separate, have very strong lobbying organizations, and are very heavily regulated but in completely different ways. We didn't have that in Europe, or it's evolving differently in Canada. Until those other barriers break down in the U.S., we'll have to deal with those kinds of problems that you were talking about. As soon as those start breaking down, and the latest court cases indicate that they are breaking down, then it's all up for grabs. I think that's when you're going to see the transition to what we're seeing now in these other areas. It's just taking a little bit more time. Let's talk about products a little bit. Jean, what products will banks offer?

Ms. Gora: Well, we've already seen the full insurance product line. In my conversations with the heads of bank-owned insurance agencies in the U.S., they said that they don't like many existing insurance products. They want really simple products. They don't want to employ a lot of actuaries. They don't want to take people's blood in branches. They want to issue life insurance products without medical underwriting if they can. So I would expect we will see the development of a lot of simple products. I think it makes a lot of sense to develop products that look like bank products if you're going to sell them through a bank, and I think the reason annuities have been so successful is they do look like bank products. They're sort of a certificate of deposit with a tax advantage, and then there's the ability to annuitize. The concept is simple. People who are going to banks can make the leap into it.

Several banks have developed products called certificate of deposit (CD) annuities that really integrate CDs and annuities and have the Federal Deposit Insurance Guarantee up to $100,000 on it. So far the courts have not given this product the tax advantage annuities enjoy. So it hasn't become successful. If the tax situation ever changes, this is a product that will be very successful. In France, the product that has given the banks such a big market share is a form of endowment insurance, which really looks very much like a savings account. You put the money in for eight years. You get back the principal plus interest. You have a tax advantage on contribution. The growth has a tax advantage. If you die, your heirs get that amount, the amount accumulated up to the point of your death. They get that tax free. There is a very tiny mortality component in it that affects the calculation of the interest rate on the product. Basically, it's a bank account with tax advantages.

I think term insurance is another promising bancassurance product. Consider refund-of-premium term insurance. How do you make a term insurance product look like a bank product? You give people some money at the end of the term. I know there is at least one company that has developed a 15-year term policy that guarantees a refund of 100% of the premium after 15 years. I think there are many opportunities to make links between bank products and insurance products. Why not have the interest from a savings account pay the premium on term insurance? Basically, this is turning the traditional whole life policy inside out. We are also going to see banks provide group coverage to their customers.

Then there are all the obvious areas for packaging related bank and insurance products. Much of this packaging is already going on in the credit insurance area. The U.K. has a really interesting sort of combined endowment insurance policy with tax advantages and mortgages. It's very complicated, but the tax advantages (now significantly reduced) drove sales of the product. They are the main reason many bancassurers in the U.K. grew rapidly.

Medical savings accounts are also promising bancassurance products. These are authorized on a trial basis right now in the U.S. for up to 750,000 people in very special circumstances. They offer tax-advantaged savings. Employers who set up plans involving them can make tax-free contributions up to 65% of the deductible for individuals. Individuals can obtain their own medical savings accounts if their employers do not provide health insurance. Golden Rule Insurance and Northern Trust have offered these accounts. Mellon Bank, I understand, is working with about 20 insurance companies to offer them. If this product is ever authorized on a general basis, I think it will be a really significant one.

And then there are the obvious packages of bank and insurance products: auto insurance and auto loans, mortgages, mortgage insurance, and homeowners' insurance.

Mr. Peabody: Oscar, have bank insurance companies in Canada focused on any particular product lines or market segments, and is that focus likely to change once banks are able to market and distribute insurance products through the branch network?

Mr. Zimmerman: Those banks that have entered the business have tended to focus on individual life and property and casualty products, particularly auto and home insurance. Auto and home insurance are ideal products for banks to offer under the current regulatory environment. LIMRA has conducted surveys in Europe that show that auto insurance and home insurance are two of the top three financial products consumers would like to purchase by telephone. Telemarketing and direct mail marketing are the sales and delivery channels of choice. Again, this is largely due to the current regulatory environment that does not allow us to distribute insurance products, excluding travel and credit insurance, through our bank branches.

In essence, banks have been prevented from marketing insurance to their own customers which, as I've already noted, forces us to market to the public at large principally through the medium of direct-response call centers. In a certain sense, the regulatory environment has forced banks to take the lead in distribution of insurance through these remote channels. Customers increasingly demand access to electronic services in banking, and all banks are experienced in offering products and services by telephone and, increasingly, by computer. Scotia Bank, for one, is expanding its Internet activities, which will include insurance initiatives. Over time, the bank's Internet site will provide information and tools, including insurance needs and analysis tools, to consumers to support all their financial needs. Scotia Bank owns Scotia Life Insurance Company and Scotia General Insurance Company, with a staff of about 60. We offer a mix of credit and travel insurance products through our branch system. Accident insurance, as well as hospital cash insurance, and legal protection coverage are direct-marketed through mail and telephone. In keeping with our international focus, Scotia Bank has established a Greenfield Life Insurance operation in Jamaica. We're also in the process of acquiring the Mortgage Insurance Company of Canada, an inactive mortgage insurance company.

Scotia Bank continues to work in partnership with best-of-the-breed organizations to deliver insurance products. In Canada we have a number of collaborative programs with product suppliers including Canada Life, Alliance, CIGNA Canada, and Canada Life Casualty. Our view is that these partnerships allow us to combine the bank's core strengths in marketing, distribution, and customer service with the technical and administrative capabilities of major insurance companies. We also focus on stock brokerage distribution channels. Scotia McCloud began distributing third-party insurance products, in other words, our competitors' products, through dual-licensed investment executives in British Columbia in 1992 and has expanded as provincial regulations permit. More recently Scotia Discount Brokerage has expanded its offerings to include third-party products. Our view is that distribution of insurance products through Scotia McCloud and Scotia Discount Brokerage meets the growing customer demand for a complete range of financial services from telesales and teleservice, through discount brokerage, to full-scale financial planning through Scotia McCloud.

Mr. Peabody: Chris, there's a very well-developed bank insurance market in the Netherlands. What has happened with respect to products there?

Mr. Rutten: We should have a bank meeting rather than an insurance meeting because the short answer is, “Nothing.” After having experimented for quite a while with various approaches to integrated bancassurance in Holland, the bank branches have been asked a couple of questions. What kind of products do you need? The answer was there's no great need for product innovation, at least not at this stage. The current product range that's available is quite suitable for the customer needs, and there's no need to change that. What about competition? The answer is the same. There is very little pressure on the competitive side, and if you have a customer in a bank branch willing to talk about these things, competition's no longer an issue. What is important is: information technology with back-office efficiency, financial planning software, connectivity between the bank branches and the insurance companies for quick delivery of policies, and no feeling that the banks have a subordinate relationship versus the other agencies. Banks want quicker treatment than anyone else.

There is currently a strong focus on employee benefits. Many of the bank branches have very strong relationships with small, medium-sized, privately held corporations that have a need for employee benefits. They already have the entry there, and sales of group pension, disability, and health plans are quite active at this stage. I think the next step will be to move into work-site distribution in order to reach the employees directly via payroll deduction techniques or marketing mortgages or services. There's a broad range of products that can be marketed that way. Perhaps the strongest focus in terms of product is not so much on product innovation but on how to package them better. When you talk about bancassurance, in many respects, you're talking about the convenience of access, and I think, in the Dutch market, there has been a tremendous development in terms of packaging products and making them easier for customers to understand. For example, you can have your homeowners' and motor and life insurance policies all together and just give it one policy number. It's easier for the customer.

When you have five different insurance coverages, why don't you just bundle all the premiums and let the bank decide together with you on a convenient premium payment pattern so you don't have those peaks in premium payments? Then you won't have to write checks to five different institutions? All of those things are very well-accepted and very successful in the Dutch marketplace. In the small-business environment, keyman, buy/sell policies, and various property and liability coverages are also quite successful. To the best of my knowledge, there hasn't been much of a need for any discretionary pricing or any more competitive pricing if products are offered through the bank. In a nutshell, that's the Dutch situation with respect to products.

Mr. Peabody: Good. It seems to me that we have a mature or uninhibited, to some extent, bancassurance market in the Netherlands. There has been a bancassurance market in Canada that has moved toward that, but has had to deal with a lot of regulations, but it has worked through that. Then there's a bancassurance market in the U.S. that is still going through early stages of what will turn out to be a bancassurance market similar to some of the others. Let me ask you this question: Focusing five years in the future, what would you paint as a picture of what bancassurance will look like compared to what it is today?

Mr. Rutten: The issue we've more or less skipped over here is that I think the difficulty in integrated bancassurance is the bank's organization. Insurers don't understand banks. Banks don't understand insurers. When you're talking about five years in the future, I think the answer's relatively easy because it takes a long time to change those misunderstandings and get that connectivity going. When asking bank account managers to develop insurance sales, you'll find they don't have a clue about insurance, and it'll take a long time to make them fully appreciate insurance. Frankly, most bank people would think that insurance sales take away from bank sales. Combine those two aspects—if you talk to a bank account manager about insurance, they'd rather avoid the topic than talk about it. What's the big thing that's going to happen in the next five years? I think there's going to be continuous cross-selling just as there is now. I think there's going to be a move towards integration of bancassurance activities by bank assurers, assuming there's a higher level of cross-ownership possible in the U.S. I think that'll go hand in hand with further rationalization of bank branch networks. Those surviving bank branches will be of a much higher level of competence and much higher level of knowledge about delivery of the services and the products, and I believe the products will be advice heavy because that, I think, is the only reason why the bank branches are around; otherwise just use your automated teller machine (ATM). As far as I'm concerned, you can pay for your personal accident policy through an ATM, too.

I believe small, privately held corporations, business owners, and middle-income families will be good targets five years from now for aggressive bancassurers. And I think that banks are slowly going to regain the trust of customers. I think that within the banks there's going to be a great deal of experimentation with what organizational models work the best to truly make these efforts successful, but this effort will be much less visible to customers.

A question often raised is whether rates of returns on sale through banks are more attractive or less attractive? And how do insurers and banks in one of those systems look at that? I don't like to make this too complex. I believe the insurance company still sees insurance policies being sold in a very traditional fashion, and the bank does the same thing. However, once you have a larger organization where there's a top management focus on selling insurance products through its own bank branches, the perspective changes; even if the bank branches continue to act as independent insurance distributors, they can push a much larger portion of their product delivery towards their affiliated insurance carrier. So I think it comes out as a corporate profitability goal. I don't think there is much use of advanced techniques of measuring differences in rates of return. There has just been a very strong drive at the top level of the organization to make this happen. It’s not a matter of finding out how we'll make it happen. That has created some situations where, for instance, some of the very best performers and financial planners with insurance companies have simply been transferred to the bank branches. That possibility wouldn't exist had you had unequal partners or had you had unaffiliated partners in a bank/insurer alliance. So the productivity improvements are clearly there. The higher internal rates of return are there, but I'm not sure that there's much sophistication of measurement.

Mr. Peabody: Oscar, what's your vision of the future?

Mr. Zimmerman: It's my expectation that amendments to the Federal Financial Institution's legislation, scheduled for 2002 but likely to come earlier, will finally remove the remaining barriers to competition across the financial services sector, including restrictions on bank sales of insurance products. Federally regulated institutions, including banks, will be able to distribute a wide range of banking, insurance, trusts, and investment services. Unfortunately, jurisdictional issues, in particular, provincial market conduct restrictions, will continue to limit banks' ability to fully realize consumer benefits. Canada's federal structure as well as intensified insurance industry lobbying efforts at the provincial level will continue to slow the course of change. I'm hopeful that, five years from now, Canadian banks will be able to compete in all areas of financial services, but given the successful track record of insurance industry lobbying efforts in Canada and the government's willingness, at all levels, to give into their concerns, it may be ten years or more before Canadians can finally reap the benefits of lower prices and improved access, a convenience currently enjoyed by their friends in Holland.

Ms. Gora: I'm not sure whether the most recent bill going through Congress will pass. I think it's generally unwise to focus too much on legal issues. It would be more useful to start looking at the economics of affiliations. Who would you affiliate with? How would you work a bank affiliation if you wanted one? Develop some contingency scenarios for this situation. I think the trend is toward ever greater involvement, and I don't think that trend is going away. The distribution alliances that exist now are educating the banks on how to integrate the sale of insurance into their branch system. That's the hardest part of bancassurance. When affiliation becomes possible, many of them that have become sophisticated distributors will be able to go into manufacturing without a lot of the organizational headaches that have afflicted some of the European examples.

Mr. Peabody: Let me just throw in my own thoughts. The traditional U.S. vision of bancassurance has been the agent in a bank selling an insurance product. That conflicts with what bancassurance really has become in Europe, is becoming in Canada, and will become in the U.S. It will be a much more integrated process. I think it's going to move from an area of looking for fee-based income to an issue of who's going to have the power and who's going to have the control of the entire financial services industry. That's what the real issue is, and I think that's what we're moving toward.

And if I could introduce another term, maybe we could also talk a little bit about "insurabank?" It's backwards. There are now about 20 insurance companies that own bank organizations. Just recently, ReliaStar announced that it was buying a thrift. State Farm just recently announced that it is forming a thrift institution. Principal Mutual, Prudential, and Aegon all own thrift organizations, which they're allowed to do. The party line on that is, "We're buying these institutions to be able to offer broader products to our customer base." I don't think that's what it really is. They're positioning themselves, just as the banks are positioning themselves, to be able to have the power and the control of the entire bank and insurance-related marketplace in the future. In the U.S. we're seeing insurance companies and banking institutions developing strategic plans for moving in that direction. I agree with Chris. It isn't going to happen quite that quickly, but I think you'll see things happening much more quickly in the U.S. over the next couple years than what has happened in the past five to ten years.

From the Floor: You mentioned that France was able to dominate the market with one particular product.

Ms. Gora: Right.

From the Floor: Can you describe that product?

Ms. Gora: Well, I alluded to it earlier. It's an eight-year endowment life policy. They call it an endowment, which is basically very similar to a savings account, but it has tax advantages. People going to the bank for this product don't even know it's an insurance product.

From the Floor: Is that a fixed premium or variable product?

Ms. Gora: It is a fixed-premium product.

Mr. Zimmerman: It’s just a follow-up to that question. When you're looking at statistics on international banks and insurance, you have to determine whether they're taking a savings product and, through local regulations, calling it insurance and allowing it to be sold in a bank branch (and that's essentially the French experience), as opposed to term life or disability insurance or traditional risk-based. You have to be a little cautious, and you have to look through the data.

Mr. Peabody: That's a good point. I had made the comment at a meeting recently that France is the third-largest insurance market behind the U.S. and Japan in the world, and about 60% of the insurance in France has been sold in the last year through either banks or the post office. One company, and this may be the company you're talking about, now manages over $34 billion in assets. It wasn't even in business ten years ago, but that product, even though it's considered insurance, as Oscar said, has a very small insurance element to it. You have to be careful about that. It’s still the integrated distribution and market that I think we've been talking about.