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Financial services in the 21st century: An opportunity for actuaries

by Harry Panjer and Harry Panjer

The age of digital capitalism — where financial information is instantly available and money is moved electronically, both locally and globally — is here. And, the world financial industry is being transformed at an unprecedented pace, led by trends such as:

- Traditional distinctions between banks and insurance companies are fading away in some parts of the world.
- Geographic expansions of financial service companies have accelerated.
- Technology is eliminating the boundaries of geographic borders.
- Intense competition has forced many mergers within the same industry: banks with banks, investment brokers with investment brokers, and insurance companies with insurance companies.
- Businesses that were traditionally separated began to merge or become linked: banks, insurance companies and investment brokers.
- Globally active financial conglomerates are determining the future landscape of the financial services industry.

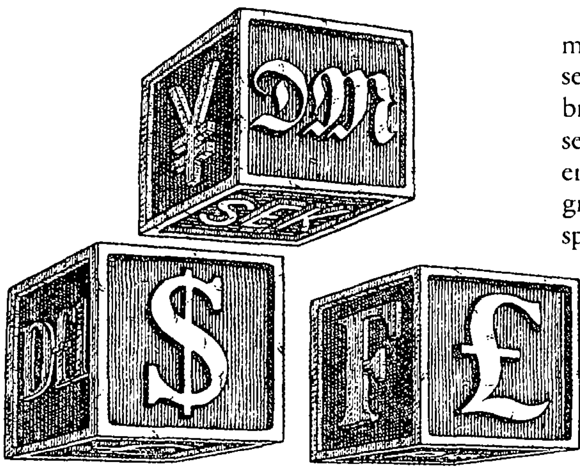
The globally integrated financial services industry affords opportunities and presents challenges for individual actuaries and for the future role of the profession. Let's examine these issues from a European perspective.

Driving forces in Europe

Three main forces are behind the recent trend of European-based companies building financial conglomerates:

1) The general trend toward the institutionalization of the savings/investment/insurance dollar of the consumer
2) The deregulation of the financial industry
3) The power of technology

The earning power of the baby boom brought a demand for investment opportunities. This resulted in the enormous growth of the mutual fund industry in the 1980s and direct competition from insurers with annuity products that had favorable tax status in many European countries.



The deregulation of financial services, the so-called "Big Bang," allowed financial institutions to move into each others' arenas. The Second Directive (1989) of the European Union (EU) opened up a broad new horizon for the financial industry. Since July 1994, banks and insurers both operate throughout the EU with a single license.

Computer-based information technology has undergone dramatic changes in the past few years. The inexpensive ATM in a shopping plaza is open 24 hours a day and replaces the expensive teller counter. The term "virtual banking" is already a part of bankers' vocabulary. Purchasing insurance and other financial services electronically from home without human contact is well developed in Europe.

Bancassurance/allfinanz in Europe

The term *bancassurance* has been used to describe the new combinations of banks and insurance companies. The newer term, *allfinanz*, has been used to describe the new financial conglomerates providing a full range of financial services throughout a consumer's entire life cycle.

In Germany, a major bank has been marketing life insurance policies for several years directly within its branches, using specially trained staff to sell to bank clients. This bank had enormous initial success. Similar growth in the *allfinanz* concept has spread throughout Europe, but with highly varied success.

Many large banks in the United Kingdom, Ireland, Germany, and France have developed insurance operations. Similarly, traditional insurers have developed or acquired banking subsidiaries or developed relationships with existing banks to cross-sell each other's products.

Although it is not necessary to market different products through the same channels, *allfinanz* has provided the opportunity for a specific channel to market additional products. In Spain, a large insurer sells a full range of life and property/casualty insurance products and mutual funds and is expanding its banking networks. It is counting on customer loyalty developed in personal lines insurance to give it the edge in competing directly with banks in its newly developing banking operations.

In the newly developed, less-regulated countries of Eastern Europe, *allfinanz* organizations have been developed from scratch or from existing organizations. In Hungary, ventures into *allfinanz* are beginning from domestic companies founded in

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the late 1980s and from foreign companies. In Poland, similar developments are occurring.

Reactions to the prospects of *allfinanz* are not uniform in the insurance field. In the Netherlands, one of the major insurers has merged with a major bank. At the same time, another appears to be focusing on its core insurance business and leaving banking to others. The financial results of insurers involved in *allfinanz* have frequently been less than expected, with most profits coming from the insurance operations.

The key arguments for *bancassurance/allfinanz* are:

- The financial institution can capitalize on its long-term relationship with clients throughout their life cycle.
- Financial institutions can lower their cost base by selling more products to the same client.

Specialty niche players can continue to find opportunities missed (or avoided) in all markets by the conglomerates. In fact, technology allows conglomerates to act like a large number of niche players with different markets, services, and distribution systems.

From the investor's point of view, the development of the *allfinanz* conglomerate has not always been positive, at least in the short-term, with price/earnings ratios that are traditionally higher for insurance companies lowering to the level of the banking partner. This may improve as the results of synergy emerge.

Prospects for North America

In Canada and the United States, financial services traditionally have been provided separately by different organizations using different marketing/distribution channels while competing for the same consumer dollar. Insurers have started to look like mutual fund managers as they separated the insurance component from the savings component in many products and competed on margins. As experienced investment managers, insurers naturally look to providing all types of investment products to attract the consumer.

Meanwhile, banks have recognized that insurance can be a profitable business and can be marketed directly using its established branch system on the strength of the personal relationships built through their banking services. The concept of the "financial supermarket," in which the consumer could buy a variety of off-the-shelf financial products (financial hamburgers, to mix metaphors), was popular in the 1980s.

As in Europe, one of the key factors in North America is regulation. Canada is one of the few countries where banks and insurers are under the supervision of the same regulatory authority. In Canada, under the federal regulations that came into force in 1992, insurers were allowed to create wholly owned banking subsidiaries. Similarly, banks could establish insurance operations. However, selling insurance contracts in bank branches was prohibited for at least five years. In response, most major banks already have set up insurance divisions, and most large insurers have entered the banking field by setting up a retail banking operation. It would appear that, because of the much greater infrastructure needed to support a retail banking operation and to compete with the current convenience provided by the existing multibranch banks, it will not be easy to wean customers into the insurers' smaller banks.

Some have argued that banks have an unfair advantage because of customer prospecting information and personal contacts through bank branches. However, banks now have less personal contact with their customers. As more customers increase their use of ATMs on non-bank sites, banks are cutting costs by reducing the number and size of branches. This flies in the face of the perception that to sell insurance, specialist "agents" need to be available to customers in each branch. Because of automation, banks may actually be giving up their ability to sell other financial services, including insurance, unless they stick with simple products (the hamburgers) or market through multiple marketing channels.

The future of financial services in North America will depend on politicians' desire to separate various financial services and apply different regulatory requirements to different financial institutions. Even with continued regulatory separation, organizations will find ways of cooperating to try to control the consumer's investment/savings dollar.

Technology has a huge influence on marketing financial services. With consumers using PCs to travel the "information highway," insurers may be able to compete more directly with banks to provide banking services. Commercial applications, with the necessary "firewall" security required, are being developed now on the Internet. Increased access to Internet and the "Worldwide Web" may be the key to allow smaller organizations to deal more directly to this mass of unidentified consumers. Some insurer are already marketing insurance through private secure networks such as CompuServe.

It is hard to imagine that any regulator will be able to police the information highway. It may not need to be policed. As information becomes more readily accessible, markets become more efficient. Consequently, all forms of financial services will be more closely connected. Network payment systems are being developed in Amsterdam under the name "Digicash," in which the banking system is avoided entirely in the fund transfer process.

Implication for actuaries

A common perception is that banking and investment management comes from non-technical generalists, while insurance management has more technical specialist skills. It also is generally believed that banking and investment operations are not as complex and are easier to manage than insurance operations. This may have been true in the past; however, many highly technically trained persons (who might otherwise be actuaries) have moved into the banking field, principally in investment management-related areas. This can be an opportunity for actuaries who can compete in the strategic area of asset/liability management and complex financial product design. As financial management and reporting from banking and insurance involve more technical analysis, including asset/liability management and prospective solvency and stress testing, the skills of actuaries can be expanded to non-insurance areas. With technological and specific actuarial skills, the actuary can have an edge over other professionals.

Actuaries in other countries are already active in various aspects of banking and investment management. North American actuaries may now be approaching the point of expanding into non-insurance areas beyond the investment banking field entered so successfully by actuaries in the past decade.

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Universities seek candidates

Ball State University, Muncie, Ind.

Position: Tenure-track position in actuarial science in the Department of Mathematical Sciences to begin August 21, 1995. Salary, benefits, and rank are competitive and commensurate with qualifications.

Duties: Teaching at graduate and undergraduate level, research, professional service, and advising students.

Qualifications: Either (1) Must hold a Ph.D. in a mathematical science by August 21, 1995, and be an Associate of the Society of Actuaries (or near completion) or (2) be a Fellow of the SOA with some research produced in actuarial science. Associateships must be completed for tenure. Consideration will be given to the practical work experience of applicants, i.e., insurance company actuarial work or consulting actuarial work.

Application: Evaluation of applications begins January 31, 1995, and will continue until the position is filled or the search is terminated. Send a letter of application, curriculum vitae, research plan or list of publications, and three letters of reference, one of which addresses teaching ability and performance, to Dr. John A. Beekman, Chair, Actuarial Science Faculty Search Committee, Department of Mathematical Sciences, Ball State University, Muncie, IN 47306-0490, or fax 317/285-1721, E-mail 00jabeekman@bsuvc.bsu.edu. Applicants should indicate whether or not they are authorized to work in the United States at the time of appointment.

Georgia State University, Atlanta

Position: An assistant, associate, or full professor of actuarial science in the Department of Risk Management and Insurance, beginning either June or September 1995. Salary and rank depend upon qualifications and experience.

Qualifications and Duties: An earned doctorate or a master's degree and an Associateship or Fellowship designation from one of the actuarial societies. Excellent teaching skills. Preference will be given to candidates who have skills and interest to become director of the Actuarial Science Program and who will be primarily devoted to teaching and program administration, with little or no expectation of research or publication. Continuance in the position for such a faculty member would depend on his or her performance in teaching and administration, not on meeting requirements for tenure.

The department also is accepting applications for those who have a strong interest in research and a desire to publish for this position or a possible future position. These applicants would not be expected to engage in extensive program administration and would be considered for a tenure-track position.

Application: Send letter of interest with resume to Harold D. Skipper, Jr., Chair, Faculty Recruitment Committee, Department of Risk Management and Insurance, Georgia State University, P.O. Box 4036, Atlanta, GA 30302-4036, 404/651-2729.

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