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Bancassurance:

Details Measure Its Success in Various Countries

by Adrian R. Pask

Bancassurance is the distribution of life insurance products through banks. As its European sounding name suggests, this method of distribution has captured the majority of market share in France and Spain and has a substantial market share in many other European countries. The potential for explosive sales growth, high market share, and large profits make bancassurance a distribution channel to watch.

The most interesting aspect of bancassurance is that while it is an international success story, the details of the success vary from country to country. This article focuses on the core problems that drive banks and insurers into cooperation, the competencies that make these unions work, and the challenges that must be overcome to make bancassurance a success. As a result, this article is written with a universal focus, outlining the strategic issues that a bancassurer faces.

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Problems Solved

Banks and life insurers are struggling with different business challenges. Life insurers are struggling with the challenges of distribution and the scarcity of surplus. Insurers are looking to expand market share in a mature market. With ever decreasing margins, insurers focus on high net worth individuals because 1) it is the market that traditional agent distribution has gravitated towards and 2) the larger sales theoretically improve the margins. Unfortunately, the popularity of this strategy has created brutal competition in terms of product pricing and distribution costs.

Additionally, insurers are looking to increase their market share in existing market segments and break into new areas of low competition. To compound the problem with distribution, the surplus strain associated with selling insurance policies is draining increasingly scarce free capital. The ideal fit for insurers would be to find a distribution channel that could penetrate new markets with low acquisition costs.

On the other hand, banks face a different set of challenges. Banks have bricks and mortar branches with high fixed costs. These branches provide the banks with a permanent community presence but with a high cost. At a time of rising costs, banking is facing shrinking margins of an increasingly commodity business. Banks are looking for ways to make high fixed cost branches profitable and to find high margin products to supplement their low margin bank products.

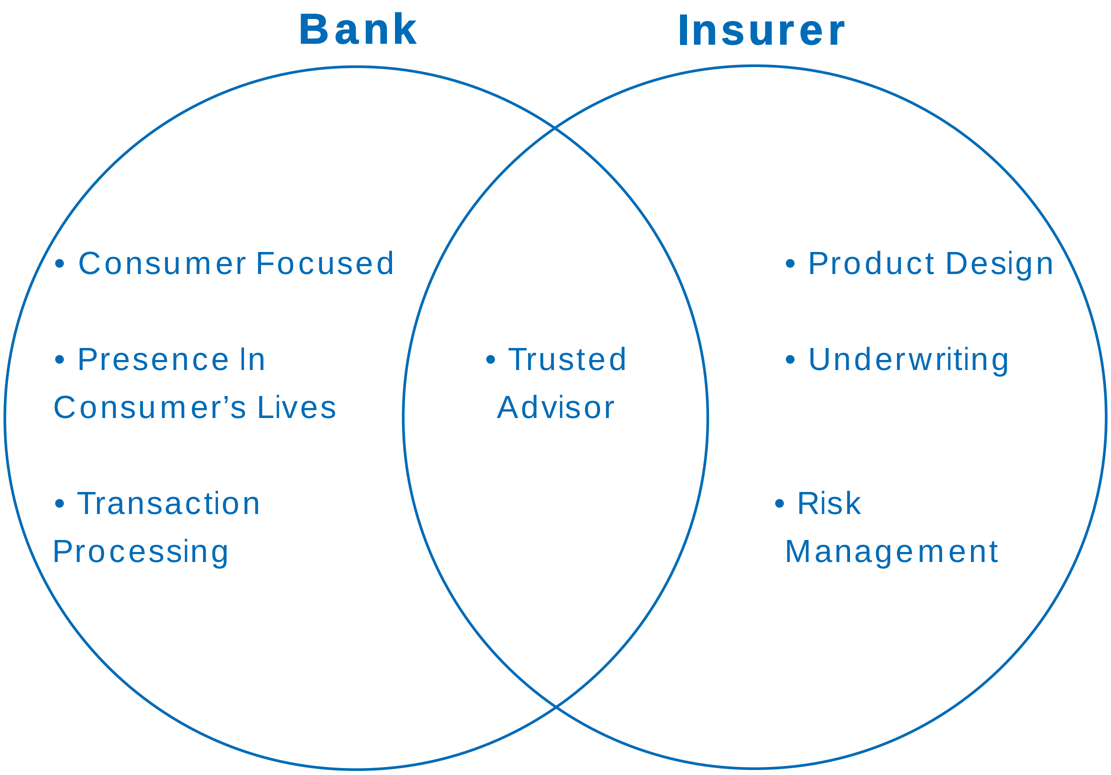
Bank and Insurer Core Competencies

Banks have many core strengths. Banks are focused on the customer. Unlike insurance companies, banks think about and manage the customer relationship. A bank's decision process is to determine the customer's financial needs, and then to find a product to meet those needs. The second core strength of a bank is routine communication with the customer. The third competency is that they execute transactions rapidly and in mass production.

On the other hand, life insurers core competencies revolve around long-term financial planning and advice. Life insurance companies develop and manage risks associated with long term risks. Insurers have strong capabilities in underwriting, managing long-term assets and liabilities and designing long-term insurance products.

The key area of overlap between bank and insurer key competencies is the desire to be a "trusted advisor" to the end consumer. Both banks and insurers have a high degree of trust and respect with the public, but they approach the role of the trusted advisor differently. Insurers provide complex solutions to consumer's financial problems. Solving consumer's problems requires a trusted advisor to explain both the problem and the solution, requiring consumer education. Insurers have traditionally relied on the agent to educate consumers as a trusted advisor. On the other hand, banks view the trusted advisor role as a way to increase revenues by strengthening the customer

Core Competencies



relationship and increasing the product offering. For the bank the status of "trusted advisor" is a value-added benefit; for the insurer, it is a requirement to sell its products. This area of overlap can become an area of conflict if it is not managed correctly.

Why Bancassurance Works

Bancassurance is profitable to both parties if they can achieve:

- Distribution economies of scale
- Value added benefits to the customer
- Organizational economies of scale

Distribution economies of scale arise because:

- The customer has a deeper relationship with the financial institution
- The customer makes larger purchases
- Sales require less effort to complete

A deeper relationship means, that because of bancassurance, the customer owns more products with the bank. In theory, the more products the consumer has with the bank, the more interaction and trust he or she will have with the institution. As a result of the increased trust, subsequent sales will be either larger or easier to complete.

Value added benefits to the customer arise when the consumer can see benefits from owning multiple products from a single entity. Value added benefits include integrated billing for all products, combined monthly statements for all products showing a complete financial picture, or time savings from having one point of contact for all financial matters.

Organizational economies of scale are the potential reduction of costs from combining banking and insurance operations. Generally organizational economies of scale are negative. The amount of systems integration and additional training required to merge operations more than offset any cost savings from streamlining corporate overhead.

Organizational Strategies

There are many ways a bank and an insurer can cooperate or combine to form a bancassurance operation.

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- **Bank as an Agent**
  In a bank agency arrangement, the bank distributes life insurance products as an agent. The insurance products are "off-the-shelf" and are not customized for bank distribution. The bank receives commissions for selling the products.

- **Partnership**
  In a partnership arrangement, both entities have a stake in the success of the venture. The strength of the partnership determines the level of commitment by the partners. In a strong partnership the companies could engage in cross holding of equity, make mutual investments and enter into a long-term exclusive selling arrangement. A weak partnership agreement may last a few years and involve a limited amount of mutual effort.

  For the bank, a weak partnership agreement provides a strategic advantage. The bank gains knowledge about the insurance business with little commitment. At the end of the partnership agreement, the bank will have the option of exploring any of the organizational strategies with the advantage of a customer base and extensive insurance knowledge gained from the insurer.

- **Joint Venture**
  In a joint venture arrangement, both the bank and insurer own a stake in a new insurance company.

- **Bank Manufacturer**
  In the bank manufacturer strategy, the bank and insurer are a vertically integrated company.

Many factors determine the optimal organizational structure including the regulatory environment, each company's risk tolerance and the long-term strategy of the players.

This hybrid product would allow the consumer to move seamlessly from cash transactions to wealth protection to annuitization.

Products

The bancassurance channel can support any life insurance product. The products can be as simple as credit life or as complex as Variable Universal Life (VUL). At one end of the spectrum, credit or term insurance can be sold through promotional inserts into regular bank communications. At the other end of the spectrum, VUL or Long-Term care products can be sold through face-to-face consultations with bank financial planners. The critical decisions when selecting products for a bancassurance channel are:

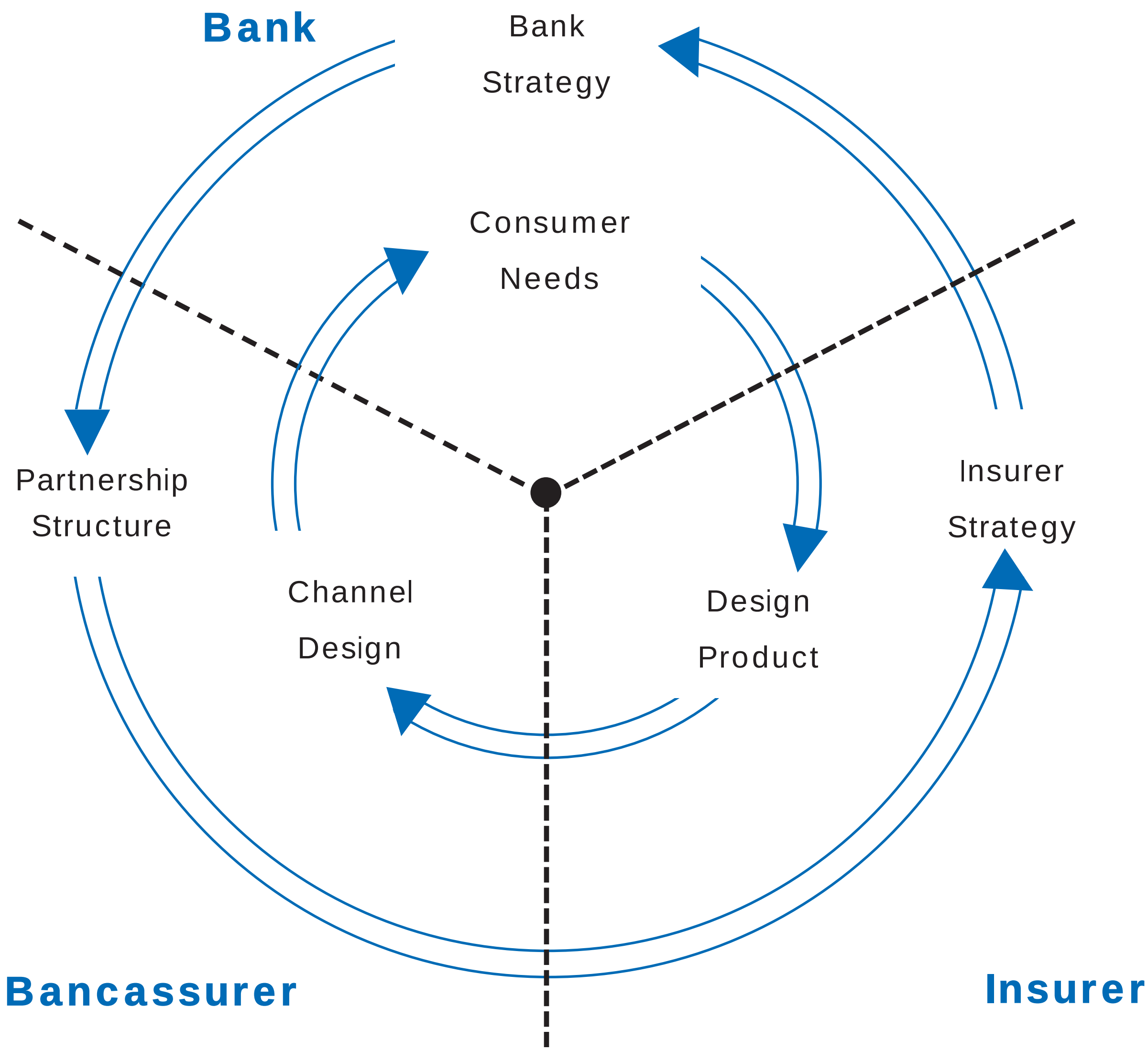
- Match between bank customer and product
- Level of training required by bank sales staff to sell the product
- Complexity of integrating systems

Currently the insurance products offered through bancassurance are regular insurance products. A potential for differentiation in this market would be to offer a hybrid "bancassurance product." This product would combine features of a bank account, asset management, and insurance protection into one account. This hybrid product would allow the consumer to move seamlessly from cash transactions to wealth accumulation to wealth protection to annuitization. The function would be similar to an asset allocation account with the difference being that in addition to allocating money between asset classes, the customer would have a third decision to make: What risks do you want to protect against? This hybrid product has the potential to offer higher margins as it adds value to the consumer of one stop shopping and one-stop advice. Obviously, the product development, regulatory, and consumer education challenges in creating such a product are formidable.

The Decision Wheel

The decision wheel on the following page describes the process by which a bancassurance operation approaches the decision process. The outer wheel describes the strategic decision making process for selecting the organizational structure of the bancassurance operation. The inner wheel describes the tactical selection process for the products and how the products are sold. The most important element of the decision wheel is that each element integrates with every other element creating a value to the bancassurance operation that is greater than the sum of its parts.

Decision Wheel



Case Study

Bank: The bank is concerned about the number of products that each consumer has with the bank. Most consumers have a checking and a savings account. Some consumers have additional savings products. The corporate goal is to boost the average number of products owned from 1.5 to 2.0.

Insurer: The insurer is concerned about both expanding its term insurance market share and managing the surplus strain associated with the increase in business. The insurer is looking for a distribution channel that will complement its existing brokerage channel and accept a level commission for selling term insurance.

Organizational Structure: The bancassurance operation is a three-year partnership agreement between the bank and the insurer. The bank agrees to exclusively sell only the insurer's products and the insurer agrees to provide marketing support and develop products that will fit into the bank channel. After three years either party can renegotiate the partnership.

Customer Needs: The bank has identified a group of middle income prospects who have recently had a "life event" such as buying a house that would require them to rethink their insurance needs. The bank estimates that the average customer should purchase a 20-year term policy with a $500,000 face amount.

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Channel Design: The channel will utilize a direct mailing campaign. Product brochures will be included in monthly statements to selected customers. The premiums can be automatically deducted from their checking accounts and their monthly statements will report their life insurance protection.

Product Design: Unlike traditional insurance agents, the bank understands how to translate a heaped commission into an equivalent level commission. As a result of the direct nature of the sale, simplified underwriting must be used. The insurer develops a term product with simplified underwriting and level commissions.

Key Success Factors

Understanding Foreign Success Stories
Despite the distribution advantages banks offer, especially in the middle market, the success of bancassurance has not been universal. There is a temptation to say that insurance is insurance the world over and the formula that succeeded in France or Australia will export well and work locally.

After speaking with many bancassurers, it is apparent that it is the combination of subtle differences in products and the role of banks in society that translate into success. "Life Insurance" outside the United States is often defined as primarily an investment vehicle with some death protection on top. In some cases, life insurance is the only way an individual can get access to certain types of investments, making the product attractive for reasons other than protection.

Understanding A Country's Regulations
The regulatory challenges for bancassurance are vast and vary from country to country. The questions include:

- What restrictions are there on selling insurance products through a bank?
- Do privacy regulations limit sharing customer data or leads between the banking and insurance organizations?
- How does bancassurance impact the capital requirements of either the bank or the insurer?
- Is a bancassurer required to comply with insurance regulators for either product filling and/or financial reporting?

Bridging Bank and Insurer Cultures
The strength of a bancassurance is that the best of banking and insurance competencies can be combined to create something that is more than the sum of its parts. If the differences in culture are not managed effectively, value is destroyed because the differences overwhelm any potential synergies.

Who Do I Call?
The operational challenges of implementing bancassurance are immense. For both the customer and bancassurer they are embodied in the question, "Who do I call?"

The customer wants one source of information for all of his or her accounts, either a person, a telephone number, a monthly statement, or a Web site. If the customer encounters an uninformed customer service representative, or a broken Web site then any possible value of one stop shopping has been destroyed.

For the insurer implementing an overarching solution is a large task. The most formidable tasks are integrating dozens of computer systems and training staff to have good knowledge of all products.

Conclusions

Bancassurance has the following conclusions:

- Bancassurance will succeed only if tailored to the local environment
- Banks and insurers have compatible strengths and weaknesses
- If not carefully managed, the overlap can cause conflict
- Distribution, product, and corporate strategy must all align
- The success of bancassurance ultimately rests on implementation

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