

Bancassurance in insurance sector economics essay



**ASSIGN
BUSTER**

Over the last two decades one of the most important changes in the financial services sector has been the development of bancassurance business.

Bancassurance can be simply described as the sale of insurance products through a bank, but it doesn't represent only a new distribution channel for insurance products: this innovation has helped to overcome the usual barriers between insurance companies and banking institutions.

The first models of bancassurance have been developed in France and in other European countries, however the various successful operations set up between institutions have attracted the attention of the financial sector across the world.

The success of the business depends on several components, such as the structure of the insurance market, the legal context of every country, the size of banks networks, the cooperation between the parties and the distribution model arranged.

Bancassurance has become an established distribution channel in the financial services sector and represents nowadays an important issue for bankers and insurers, who keep on building this kind of operations. The process is increasing and its growth is carried on by the need to decrease operational costs and to adapt the business strategies to the customer needs. Besides, a set of mergers and acquisitions between banks and insurance companies have also contributed to spread the bancassurance formula.

The purpose of this thesis is to analyze which risks and benefits are associated with this business to understand why bancassurance can be

<https://assignbuster.com/bancassurance-in-insurance-sector-economics-essay/>

considered a winning distribution strategy. The study will explore the methods used today to set up a bancassurance operation, focusing on how this strategy can affect the sales of different insurance products and the reasons why banks and insurance companies decide to enter in this business.

Chapter 1

Bancassurance overview

European market trends

The involvement of the banks in insurance distribution varies from product to product and from country to country. The first model of bancassurance has been developed in France in the early 70s when banks were officially enabled to retail insurance products. However, the real success of the business took off 15 years later, after a set of reforms regarding the deregulation of French credit market[1].

In the years that followed, Bancassurance spread rapidly through other territories achieving important results in Spain, Portugal, Belgium and Italy while had limited success in other countries such as United Kingdom and Germany.

Nowadays, in many western European countries Bancassurance still represents the main distribution channel for life insurance segment. As shown in the figures 1. 1[2]below, Bancassurance accounts for more than 60% of the life distribution channel in Austria, Italy, France, Spain and Portugal. Nevertheless, Germany and especially UK remains the two

European countries where banks have a limited role in the distribution of life insurance policies.

In Germany, this low penetration (around 20%) can be related to the fact that insurance products tend to be more complex than in other European countries and moreover that historically, people has been used to buy policies mainly from insurance agents and therefore banks are not perceived as insurance distribution channels.

In the United Kingdom, this is may due to regulatory requirements that imposed only qualified financial advisers to sell investment products.

Another reason can be found in the weak segment of group life insurance policies that could not be very profitable for the bank because this type of coverage is often provided by the employers and therefore already included in the employment contracts.[3]

Figure 1. 1 Life insurance distribution channels – Main European countries, 2010

Note: For the Netherlands, agents include also brokers

Source: CEA “ European Insurance in Figures”, December 2011

However, the results achieved in the selling of life insurance products had not influenced the development of Bancassurance in the non-life sector. For almost every European country this channel has a level of penetration lower than 10%. In Italy, for instance, the market share of non-life insurance account for less than 5% despite a penetration of 60% in the life business.

This is might due to the alternative networks of agents that plays the major role in this market.

Figure 1. 2 Non-Life insurance distribution channels – Main European countries, 2010

Note: For the Netherlands, agents include also brokers and bancassurance is included in “ Other”

Source: CEA “ European Insurance in Figures” of December 2011

Development of Bancassurance in the Italian insurance market

In Italy the origin of bancassurance has been driven by the Amato law which authorized banks to own shares in insurance companies (and vice versa). The legislation, introduced in 1990, allowed also banks to create joint ventures and sell insurance products provided by the insurance company. At first, Italian banks started promoting life insurance policies which initially were mainly characterized by annual premium or single premium.[4]

The introduction of the Amato law combined with the Italian public’s trust in banks and the widespread banking network contributed to the development of Bancassurance. As can be seen in the figure 1. 3 below the bancassurance’s share in the life sector increased from 1% in 1990 to more than 50% in 2011.

Figure 1. 3 Life insurance distribution channels in Italy

Source: Swiss Re, 2012

Unlike the life insurance trend, non-life policies started to be sold via banks only few years ago. Figure 1. 4 points out the limited penetration of this channel in the non-life business.

Despite Bancassurance accounts for less than 10% of the total, its trend is slowly increasing and recent data outlined good prospect of growth and a vivid interest of Italian families in the non-banking services. As a matter of fact, as reported by a survey conducted by Gfk Eurisko[5], Italian families have a widespread interest and knowledge about the bancassurance market and are especially interested in assistance and protection services for home and health.

The study revealed that 72% of the families surveyed are aware of the possibility of buying an insurance policy (life or non-life) through the bank. In particular the customers of small and medium local banks appeared to be the most knowledgeable (75%), compared to those belonging to national and large banks (73%) and to post office clients (67%). In addition, 13% of respondents said they own a non-life insurance policy underwritten directly through the bank. From the survey emerged also that 14% of the bank account holders benefit of extra-banking services and that the residual 86% said they are willing to spend a small amount per month (for hypothesis 10 euro) to take advantage of insurance coverage for the protection of the person, the car or the house.

Figure 1. 4 Non-Life insurance distribution channels in Italy

Source: Swiss Re, 2012

Although the distribution of bancassurance services in the non-life business in absolute terms is a phenomenon that is still quite limited, what it is worth mentioning is that banks have experienced a successful selling of a particular product: the pecuniary losses policies. This type of insurance is mainly characterized by a guaranteed loan, namely *cessione del quinto*, that is linked to the recent explosion of consumer credit in Italy.[6]

Figure 1. 5 Banks' market share for selected lines of business (%)

Source: Swiss Re, 2012

Chapter 2

Entering into bancassurance

Reason why

One of the most important reasons for banks to enter into the bancassurance business lies in the possibility to increase the source of revenue and diversify their activities. The banking system has become very competitive and this intense competition has limited the profitability of the traditional banking products. Customers nowadays are more oriented in addressing their personal savings into an insurance products or mutual funds rather than into the traditional deposit accounts where the return is usually lower. Changed customers' needs, high operating expenses and decreased interest margins have driven banks to an improvement of their productivity.

From this perspective, the selling of insurance products can substantially cover part of the operating expenses and raise their earnings, thanks to the additional fees and commissions that can be achieved. In particular, the

<https://assignbuster.com/bancassurance-in-insurance-sector-economics-essay/>

selling of life insurance products allows banks to meet customers' long-term investments preferences and to reduce banking fixed costs as they are spread over the life insurance business. Banks also have the opportunity to enhance the efficiency of the staff since they offer a broader range of services.

Another reason for banks to sign a bancassurance agreement concerns the client relationships management. The selling of a variety of financial products gives banks the chance to increase customer loyalty. As a matter of fact, customers may address their savings to more than one institution, thus the possibility to offer a one stop-shop approach allow banks to maintain client relationships. It is believed, indeed, that as the number of products a customer purchases from an organization increases, the chance of losing that specific customer to a competitor decreases.[7]

From a point of view of the insurance companies the main reason to enter into a bancassurance arrangement, is the opportunity to reach new customers (in terms of geographic and demographic features) and increase its market share, without making additional investments on its own existing channels. Indeed, insurance companies have direct access to a new source of business, the bank's client network, which can be analyzed to discover customer's financial and social situation. The information available from the banking client database help the insurers to find out customer needs in order to promote and develop new products or services. Along with this feature, insurance companies can also be able to sell some products which usually are difficult to offer through their existing channels, due to the higher sales costs of their traditional agents. Indeed, high insurance distribution costs

<https://assignbuster.com/bancassurance-in-insurance-sector-economics-essay/>

may force premium rates and let the product being uncompetitive. In addition, the use of the banking network gives the insurer a greater control on the client-relationships rather than the usual agency distribution model.

[8]

Finally, Bancassurance model can also be used by foreign insurance companies that aim to enter rapidly into a new market, as this approach allow them to deal with domestic banks and therefore take advantage from their branch network across the country.

Operating models

A critical factor that influence the success of the business is the level of integration of the banking and insurance activities.

Bancassurance can take various forms that differ from one country to the other and therefore there is no one standard operating models to combine both operational processes (such as product development, sales, IT). Of course, the decision on which contractual relationships set up with the partner depends on a variety of elements such as where partners are starting from and what their strategy is.

The different approaches, which diverge from the degree of integration, can be summarized into the following scenarios[9]:

Figure 2. 1 Bancassurance operating models

Pure distributor

The first developed operating model is the pure distribution agreement, a contract under which the bank acts as an intermediary (agent) of insurance

<https://assignbuster.com/bancassurance-in-insurance-sector-economics-essay/>

companies. This arrangement, also known as the multi-tie approach, allows banks to offer to their retail customers, insurance products produced by more than one insurance company which agree to pay distribution commissions to the bank.

Strategic alliance

This model can be defined as the exclusive version of the pure distribution agreement since the banks sell insurance products of only one particular third party insurer.

Figure 2. 2 Distribution Agreements

Profits and risks are shared between both entities: banks take sales regulatory risk while insurance companies take all manufacturing risks.

Both models allow banks and insurance companies to take advantages of the mutual know-how and technical resources without making large financial investments. Indeed, these two co-operation arrangements do not require start-up costs and can be implemented quickly as fixed costs are already sustained by the existing activities. Banks can choose which insurance providers can fit their customer needs and select the best ones in terms of image and quality of products while at the same time insurers gain access to the bank's customer base.[10]

However, the ease of entry of these models implies also an ease of exit from the alliance due to the lack of commitment of both parties. As the level of integration is low, banks and insurance companies remain independent and continue to act as separate institutions. The lack of flexibility to launch new

products and the uncertain long-term value creation may appear weaker than one in-house product solution.[11]Moreover, distributors' incentive to sell is highly correlated with their remuneration, as these products will compete against other products (either banking products or insurance products sourced from other insurers if the distribution agreement is not exclusive).

In Europe, the countries where these models are most popular are Germany and United Kingdom. Distribution agreements are often on an exclusive basis in Germany, while in UK is developing the multi-tied distribution. Outside Europe also USA, Japan and South Korea adopted this kind of arrangements. [12]

Joint Venture

Another approach to set up a bancassurance agreement is the creation of an Insurance Joint Venture by a bank in partnership with an existing insurance company. The new company is jointly owned and requires capital from both parties which will receive their proportionate share of revenues. The ownership percentage can vary but banks and insurers usually aim to have balanced cross-shareholdings to stabilize the alliance and fix the structure of both entities.

Figure 2. 3 Joint Venture

Joint Ventures produce its insurance products and distribute them only through the banking network. This structure ensure a strategic partnership between the parties, as banks and insurers can leverage each others' competitive advantages and make joint decisions while keeping the

independence and the possibility to dismiss the partnership. Both partners have clear responsibilities: typically bank takes distribution risk and both insurer and bank take manufacturing risks. Joint Venture allows also partners to gain access to respective knowledge and resources. For instance bank can take advantages from insurer's expertise in terms of product development, risk management or IT systems. From the other side, the insurance company can achieve economies of scale in administration costs combining its own business with JV's activities.[13]

Nonetheless this kind of alliance can be difficult to manage in the long term due to potential conflicts that may arise from both partners. Another potential disadvantages can be found in the limited customer ownership.

Joint Venture agreements are very popular in Southern Europe countries such as Italy, Spain, Portugal and Greece.

Merger and Acquisition

This type of model is represented by the combination and integration of two separate corporations either through merger or control acquisition. For instance, a bank can partially or completely own an insurance company which thus becomes an integrated subsidiary of the bank (and vice versa). In this case the bank controls the insurance subsidiary; it is in charge for implementing the integration process and has the responsibility for both distribution and manufacturing risk. The bank sells and underwrites branded subsidiary insurance products, while the insurer sells its own branded products as well.[14]

Financial conglomerate

In this business model a group or a holding company owns both a bank and an insurance company which agree to collaborate in a bancassurance partnership and use their networks to sell their products. Here a key issue related to the success is represented by the strong level of commitment established by the management of the group.

Figure 2. 4 Integrated Models

Under these structures all operations are fully integrated and companies benefit from economies of scale since they can take advantages from the existing infrastructures, resources and know how. Through the integrated model approach companies are able to define a common strategy and offer a wider range of financial services, shrinking the competition. In addition, they have direct access to profits and the value creation is fully retained.

Models' disadvantages are related to the potential difficulties that may arise after the integration. Companies can face business cultures differences and problems regarding the loss of independence. Moreover, integrated models have higher risk concentration.

Countries where these models are most widespread are France, Spain, Belgium, UK and Ireland.

New company

Entering with this type of model means that a bank establishes from scratch a new insurance company as its subsidiary; therefore it has direct access to

insurance profits, a full control over the insurance company and also can benefit from the advantage of having the same corporate culture.

Nevertheless, such greenfield operation involve substantial investments and wide knowledge and skills that bank must acquired. As a matter of fact, banks can face difficulties in entering into the market due to lack of expertise.[15]

The approaches listed above represent a general classification of all the bancassurance models that banks and insurance companies can arrange. The critical issue for partners is determining which one among them can be the optimal type of agreement to adopt. The need in fact is to choose an arrangement which, according to the objectives of both partners, allows on one hand to optimize professional expertise, integration between the banking system and insurance, risk mitigation and reduction of structural costs, and on the other guarantees wide productivity and profitability, compared with a suitable range of products and services designed to meet the insurance needs of the customers.

Actually, there are several factors that influence the choice of the most appropriate form of ownership.

One of the factors is related to which strategy the partners decide to implement to enter the market. For instance banks, in order to be ready to operate in the shortest possible time, may decide to choose the pure distribution agreements avoiding in this way to invest huge amount of capital and leaving all the insurance risks to the insurers. However, as mentioned above, this type of strategy might not lead to a strong

<https://assignbuster.com/bancassurance-in-insurance-sector-economics-essay/>

development of Bancassurance as banks probably will sell only traditional products which are not much differentiated and therefore less competitive compared to the offering of other banks that instead have a more forward-looking strategy (notably the case of establishment of Joint Venture or Captive).

Another critical factor linked to the choice of the agreement is related to the profitability provided by the Bancassurance. As a matter of fact, several banks, after achieving successful results with the selling of life insurance products through its own insurance company, have attempted to replicate this strategy in the non-life sector forming a captive company. This strategy has provided a big competitive advantage to banks that by focusing on maintaining low cost structure and low marginal costs of sales have been able to achieve high levels of insurance profitability often higher than those recorded by traditional banking activities.

The last factor to consider for choosing the optimal type of agreement is the level of capital that partners had employed for the development of Bancassurance. The new capital requirements required to banks by Basel III and to insurance companies by Solvency II could have a significant impact on the type of Bancassurance agreements.[16]

Clearly, the success of the business depends not only from the choice of the most appropriate form of ownership but also from a variety of other factors.

Key factors

The major key drivers that can positively or negatively affect the success of bancassurance can be distinguished into three categories: market-based, strategic and operational.

Actually market based drivers are critical for every financial product and can be represented through the economic growth and the demographic features of the target region or country. Clients' characteristics such as age, education level, habits and profession may have a high influence on the type of product or services offered.

On the other hand, a favourable regulatory and tax environment is probably the most important market driver. As a matter of fact, tax advantages related to life insurance products offered in some countries (e. g. France) have largely contributed to the development of bancassurance. On the other hand, regulation can also be seen as a limit since its increasing may result in higher costs for the industry and therefore also for customers.

The second issue affecting bancassurance dynamics lies in the strategic elements adopted by the companies. As explained before, the clashing of different business culture may play a negative role in the development phase. Thus partners should be flexible in matching each others' attitudes in order to maximize the corporate value..

From this perspective it could be normally think that a deeper integration between the two companies will lead business to the success, but actually there are differing opinions regarding this topic. For instance, as reported in some papers of Geneva Association[17]"...entities do not necessarily need to <https://assignbuster.com/bancassurance-in-insurance-sector-economics-essay/>

merge to reap benefits maximally"[18]and "...the fact that conglomerates visibly run both banking and insurance activities with typically a common brand name does not necessarily mean that there is much interaction and integration between the two".[19]

As a matter of fact, in recent years some medium-size banks have changed their operating model moving away from the ' fully owned' arrangement. Banks who owned insurance subsidiaries sold part of their stake to make a joint-venture with an insurance company. This strategy allowed banks to enhance the value of their business and the insurance companies had the opportunity to improve their penetration in bancassurance. For instance, in Spain Generali and Aviva have strengthen their bancassurance presence by acquiring stakes in companies which were owned completely by banks. AXA has also built up a similar joint venture with Monte dei Paschi in Italy.[20]

In fact, even though the corporate closeness between the partners affect the development of the business, the organizational structure is not always critical. It is all about how companies fulfill the synergies, which means that the level of the management commitment in organizing activities is probably the crucial strategic element that drives the success of bancassurance. Indeed, the level of influence each management has on the other and the characteristics and quality (e. g. strengths and weaknesses) of the chosen partner can strongly affect the success of the business. Thus both managements have to make an effort to run the project and the strategies must be imposed from the top throughout the supply chain organization to final customers.

This 'top down' approach allows management to have a global view on the project and give employees clear roles and responsibilities. It is important to remind that originally the network is formed by bank employees which must be trained and motivated to sell insurance products, thus it is essential to set up an appropriate remuneration policy to motivate the sales network.

Training and financial incentives tend to be specific to each bancassurance operator and is linked to the particular history and corporate culture of the companies.

A suitable branch environment is surely a part of the operational factors that affect bancassurance success as well as the customer relationships and the related corporate brand value. In this context it is a matter of how consumers perceive the bank image, how much customers trust their banks. This trusting relationship is directly proportional to the power of the brand and its reputation. For instance, in countries such as France, Spain and Italy clients believe in face-to-face communications and have a special relationship of trust with their bank rather than with their insurance company.

Apart from the elements outlined above, another crucial driver is technology: it can be a part both of the strategic and the operational factors and it is the one that determines an effective and efficient cooperation. The growth in technology applications and the increase in the online business has generated the chance to redefine how insurance products are manufactured and distributed. For instance, the Spanish bancassurer BBVA Seguros, by making high investment in IT, has increased the number of their branches but decreased the number of employees.[21]

<https://assignbuster.com/bancassurance-in-insurance-sector-economics-essay/>