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Research on Bancassurance

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I. Introduction

Welcome to Bancassurance. Bancassurance - a term coined by combining the two words bank and insurance (in French) - connotes distribution of insurance products through banking channels. Bancassurance encompasses terms such as 'Allfinanz' (in German), 'Integrated Financial Services' and 'Assure banking'. This concept gained currency in the growing global insurance industry and its search for new channels of distribution. Banks, with their geographical spread and penetration in terms of customer reach of all segments, have emerged as viable sources for the distribution of insurance products. And everyone wants to jump onto the bandwagon for a piece of the action cake. The insurance industry has finally woken up from its long slumber to an altogether new awakening. It is the rise of a new dawn that has brought with it opportunities galore. From innumerable insurers, to affordable and quality covers for the consumer, from increase in distribution channels to incorporating information technology measures, from net selling to bringing about increased transparency - it's all there. The ubiquitous agent is no more the only distribution channel today for insurance products. Increase in distribution channels has among others also seen the concept of Bancassurance taking roots in India, and it is emerging to be a viable solution to mass selling of insurance products.

Bancassurance is a long-standing dream of offering a seamless service of banking, life & non-life products. India, being the one of the most populous country in the world with a huge potential for insurance companies, has an envious chain of bank branches as the lifeline of its financial system. Banks with over 65,000 branches & 65% of household investments are the backbone of the Indian financial market. In India, there are 75 branches per million inhabitants. Clearly, that's something insurance companies - both private and state-owned - would find nearly impossible to achieve on their own. Considering it as a channel for insurance gives insurance an unlimited exposure to Indian consumers. Banks have expertise on the financial needs, saving patterns and life stages of the customers they serve. Banks also have much lower distribution costs than insurance companies and thus are the fastest emerging distribution channel. For insurers, tying up with banks provides extensive geographical spread and countrywide customer access; it is the logical route for insurers to take.

The business of banking around the globe is changing due to integration of global financial markets, development of new technologies, universalization of banking operations and diversification in non-banking activities. Due to all these movements, the boundaries that have kept various financial services separate from each other have vanished. The coming together of different financial services has provided synergies in operations and development of new concepts. One of these is bancassurance.

Bancassurance simply means selling of insurance products by banks. In this arrangement, insurance companies and banks undergo a tie-up, thereby allowing banks to sell the insurance products to its customers. This is a system in which a bank has a corporate agency with one insurance company to sell its products. By selling insurance policies bank earns a revenue stream apart from interest. It is called as fee-based income. This income is purely risk free for the bank since the bank simply plays the role of an intermediary for sourcing business to the insurance company.

Bancassurance has grown at different places and taken shapes and forms in different countries depending upon demography, economic and legislative prescriptions in that country. It is most successful in Europe, especially in France, from where it started, Italy, Belgium and Luxembourg. The concept of bancassurance is relatively new in the USA. As mentioned above bancassurance growth differs due to various reasons in different countries. The Glass-Steagall Act of 1933 prevented the banks of the USA from entering into alliance with different financial services providers, thereby putting a barrier on bancassurance. As a result of this life insurance was primarily sold through individual agents, who focused on wealthier individuals, leading to a majority of the American middle class households being under-insured. With the US Government repealing the Act in 1999, the concept of bancassurance started gaining grounds in the USA also. Coming to Asia, it has been estimated that bancassurance would contribute almost 16% of the life premium in the Asian markets in the year 2006 primarily due to the growth expected in India and China.

Coming to India, bancassurance is a new buzzword in India. It originated in India in the year 2000 when the Government issued notification under Banking Regulation Act which allowed Indian Banks to do insurance distribution. It started picking up after Insurance Regulatory and Development Authority (IRDA) passed a notification in October 2002 on 'Corporate Agency' regulations. As per the concept of Corporate Agency, banks can act as an agent of one life and one non-life insurer. Currently bancassurance accounts for a share of almost 25-30% of the premium income amongst the private players in India.

Bancassurance provides various advantages to banks, insurers and the customers. For the banks, income from bancassurance is the only non interest based income. Interest is market driven and fluctuating and quite narrowing these days. Banks do not get great margins because of the competition this is why more and more banks are getting into bancassurance so as to improve their incomes. Increased competition also makes it difficult for banks to retain their customers. Banassurance comes as a help in this direction also. Providing multiple services at one place to the customers means enhanced customer satisfaction.

For example, through bancassurance a Customer gets home loans along with insurance at one single place as a combined product. Another important advantage that bancassurance brings about in banks is development of sales culture in their employees.

As for the insurance company the advantage that bancassurance provides is evident. The insurance company gets improved geographical reach without additional costs. In India around 67,000 branches are there for PSU banks alone. If all 67,000 branches sell the insurance products one can see the reach. This is one method of penetrating the market. There is also another method called 'Bank Referral'. Here the banks do not issue the policies; they only give the database to the insurance companies. The companies issue the policies and pay the commission to them. That is called referral basis.

India's rural market has huge potential that is still untapped by the insurance companies. Setting up their own networks entails such a huge cost, that no company would be interested in doing so. Bancassurance again comes as an answer. It helps the insurance companies to tap the market at a much lower cost. As for the customer the competitive nature of the Indian market ensures that the reduction in costs would result in benefits in terms of lower premium rates being passed on to him. The penetration level of life insurance in the Indian market is abysmally low at 2.3% of GDP with only 8% of the total population currently insured. With almost half of the population likely to be in the 'wage earner' bracket by 2010, there is every reason to be optimistic that bancassurance in India will play a long inning.

The life insurance industry in India has been progressing at a rapid pace since opening up of the sector in 2000. The size of the country, a diverse set of people combined with problems of connectivity in rural areas, makes insurance selling in India a very difficult proposition. Life insurance companies require immense distribution strength and tremendous manpower to reach out to such a huge customer base. This distribution will undergo a sea change as various insurance companies are proposing to bring insurance products into the lives of the common man by making them available at the most basic financial point, the local bank branch, through Bancassurance.

Simply put, bancassurance is the process through which insurance products are sold to customers at their local banks. With banking network of 65,000 branches serving more than 300 million retail banking customers, insurance can be available at affordable prices to people even in remote corners of the country. The relationship is symbiotic; but there are challenges. The most common challenges to success are poor manpower management, lack of a sales culture within the bank, no involvement by the branch manager, insufficient product promotions, failure to integrate marketing plans, marginal database expertise, poor sales channel linkages, inadequate incentives, resistance to change, negative attitudes toward insurance and unwieldy marketing strategy. Even insurers and banks that seem ideally suited for a bancassurance partnership can run into problems during implementation. Before targeting the market, it is essential to do a SWOT analysis. One more important obstacle in development of bancassurance in India has been a set of regulatory barriers. Some of these have recently been cleared with the passage of the Insurance (Amendment) Act, 2002. Looking at the west where sales through the banking network have been a roaring success, the Indian banking sector has far to go. But one thing stands obvious. If insurance in India is to succeed, it can only be through the Bancassurance channel.

II. REASONS FOR GROWING PHENOMENA OF BANCASSURANCE

The opening up of the insurance industry to private sector participation in December 1999 has led to the entry of 20 new players, with 12 in the life insurance sector and eight in the non-life insurance sector. Almost without exception these companies are seeking to utilize multiple distribution channels such as traditional agency, bancassurance, brokers and direct marketing. Bancassurance is seen by many to be a significant or even the primary channel (the latter being the case for at least SBI Life).

In other Asian markets we have seen bancassurance make significant headway in recent times. For example, bancassurance accounted for 24% of new life insurance sales by weighted premium income in Singapore in 2002. This is a significant increase on the equivalent 2001 statistic of 15% and is as a result of growth in significant bank-centric bancassurance operations. In Hong Kong the figure for 2002 is expected to be at the 20% level for the same basic reasons.

- Life insurance premium represents 55% of the world insurance premium, and as the life insurance is basically a saving market. So it is one of the methods to increase deposits of banks.
- In non-life insurance business banks are looking to provide additional flow of revenues from the same customers through the same channel of distribution and with the same people.
- Insurers have been turning in ever-greater numbers to alternative modes of distribution because of the high costs they have paid for agent services.
- Insurers operate through bancassurance own and control relationships with customers. Insurers found that direct relationships with customers gave them greater control of their business at a lower cost. Insurers who operate through the agency relationship are hardly having any control on their relationship with their clients.
- The ratio of expenses to premiums, an important efficiency factor, it is noticed very well that expenses ratio in insurance activities through bancassurance is extremely low. This is because the bank and the insurance company is benefiting from the same distribution channels and people.
- It is believed that the prospects for increased consolidation between banking and insurance is more likely dominated and derived by the marketing innovations that are likely to follow from financial service modernization. Such innovations would include cross selling of banking, insurance, and brokerage products and services; the increased use of the Internet by consumers; and a melding of insurance and banking corporate cultures.
- One of the most important reasons of considering Bancassurance by Banks is increased return on assets (ROA). One of the best ways to increase ROA,

assuming a constant asset base, is through fee income. Banks that build fee income can cover more of their operating expenses, and one way to build fee income is through the sale of insurance products. Banks those effectively cross-sell financial products can leverage their distribution and processing capabilities for profitable operating expense ratios.

- By leveraging their strengths and finding ways to overcome their weaknesses, banks could change the face of insurance distribution. Sale of personal life insurance products through banks meets an important set of consumer needs. Most large retail banks engender a great deal of trust in broad segments of consumers, which they can leverage in selling them personal life insurance products. In addition, a bank's branch network allows the face-to-face contact that is so important in the sale of personal insurance.
- Another advantage banks have over traditional insurance distributors is the lower cost per sales lead made possible by their sizable, loyal customer base. Banks also enjoy significant brand awareness within their geographic regions, again providing for a lower per-lead cost when advertising through print, radio and/or television. Banks that make the most of these advantages are able to penetrate their customer base and markets for above-average market share.
- Other bank strengths are their marketing and processing capabilities. Banks have extensive experience in marketing to both existing customers (for retention and cross selling) and non-customers (for acquisition and awareness). They also have access to multiple communications channels, such as statement inserts, direct mail, ATMs, telemarketing, etc. Banks' proficiency in using technology has resulted in improvements in transaction processing and customer service.
- By successfully mining their customer databases, leveraging their reputation and distribution systems. (Branch, phone, and mail) to make appointments, and utilizing sales techniques and products tailored to the middle market, European banks have more than doubled the conversion rates of insurance leads into sales and have increased sales productivity to a ratio which is more than enough to make bancassurance a highly profitable proposition.
- Insurers have much to gain from marketing through banks. Personal-lines carriers have found it difficult to grow using traditional agency systems because price competition has driven down margins and increased the compensation demands of successful agents. Over the last decade, life agents have sold fewer and larger policies to a more upscale client base. Middle-income consumers, who comprise the bulk of bank customers, get little attention from most life agents. By capitalizing on bank relationships, insurers will recapture much of this underserved market.
- Most insurers that have tried to penetrate middle-income markets through alternative channels such as direct mail have not done well. Clearly, a change in approach is necessary. As with any initiative, success requires a clear understanding of what must be done, how it will be done and by whom. The place to begin is to segment the strengths that the bank and insurer bring to the business opportunity.

III. Why Bancassurance in India?

The management of the new Indian operations is conscious of the need to grow quickly to reduce painful start-up expense overruns. Banks with their huge networks and large customer bases give insurers an opportunity to do this efficiently. Regulations requiring certain proportions of sales to the rural and social sectors give an added impetus to the drive for bancassurance. Selling through traditional methods to these sectors can be inefficient and expensive. Tying up with a bank with an appropriate Customer base can give an insurer relatively cheap access to such sectors. This is still an issue for insurers despite the recent widening of the definition of the rural sector (so that it now accords with the census definition).In India, as elsewhere, banks are seeing margins decline sharply in their core lending business. Consequently, banks are looking at other avenues, including the sale of insurance products, to augment their income. The sale of insurance products can earn banks very significant commissions (particularly for regular premium products). In addition, one of the major strategic gains from implementing bancassurance successfully is the development of a sales culture within the bank. This can be used by the bank to promote traditional banking products and other financial services as well. Bancassurance is not simply about selling insurance but about changing the mindset of a bank. In addition to acting as distributors, several banks have recognized the potential of insurance in India and have taken equity stakes in insurance companies. This is perhaps the precursor of a trend we have seen in the United Kingdom and elsewhere where banks started off as distributors of insurance but then moved to a manufacturing role with fully owned insurance subsidiaries.

IV. INSURANCE MARKET IN INDIA - A QUICK LOOK

With the progress of reforms, Insurance market has been flooded with a number of players. As at end-March 2006, among the life insurers, there were 151 companies in private sector and Life Insurance Corporation of India (LIC) was the solitary public sector company. Among non-life insurers, nine companies were in private sector and four companies were in public sector (Annex II). As regarding the present size of the insurance market in India, it is stated that India accounts not even one per cent of the global insurance market.

However, studies have pointed out that India's insurance market is expected to grow rapidly in the next 10 years. Mathur (2004) for instance, stated that in spite of significant growth of life insurance business through the outstanding efforts of LIC, only 25 to 26% of insurable population in India has been insured. In terms of 'insurance penetration ratio' (defined as ratio of insurance premium to GDP), a key indicator of the spread of insurance coverage and insurance culture, India compares poorly by international standards. The penetration ratio was less than one per cent in 1990s and it improved to 4.8% by end-March 2006. As against this, a Survey Report of Swiss Re revealed that the penetration ratio as at end-March 2006, in respect of some of the European countries, viz., UK and Switzerland at 16.5% and 11.0%.

In Asia, Taiwan and South Korea had registered their respective ratio of as high as 14.5% and 11.1%. Insurance Penetration ratio for the World was placed at 7.5% far greater than that of India Thus in a country with more than 1.2 billion populations; the poor penetration ratio indicates that a vast majority of population remain outside the reach of the insurance, especially in rural and semi-urban areas, in the context of the absence of social security schemes. This clearly suggests the presence of vast potential for tapping the insurance market particularly by widening the distribution channels. This is where the strategy of bancassurance could possibly become more relevant.

V. SWOT ANALYSIS OF BANCASSURANCE

Strengths

In a country of 1Billion people, sky is the limit for personal lines insurance products. There is a vast untapped potential waiting to be mined mainly for life insurance products. There are more than 900 Million lives waiting to be given a life cover (total number of individual life policies sold in 1998-99 was just 91.73 Million). There are about 200 Million households waiting to be approached for a householder's insurance policy. Millions of people travelling in and out of India can be tapped for Overseas Medi-claim and Travel Insurance policies. After discounting the population below poverty line the middle market segment is the second major in the world after China. The insurance companies worldwide are eyeing on this, why not we pre-empt this move by doing it ourselves? Our other strength lies in a huge pool of experienced professionals whether it is banks or insurance companies who may be easily relocated for any bancassurance venture. LIC and GIC both have a good range of personal line products already lined up, therefore R & D efforts to create new products will be minimal in the beginning. Additionally, GIC with 4200 operating offices and LIC with 2048 branch offices are almost already omnipresent, which is so essential for the development of any bancassurance project

Weaknesses

The IT culture is unfortunately missing completely in all of the potential and future collaborators i.e. banks, GIC & LIC. A late awakening seems to have dawned upon but it is a case of too late and too little. Elementary IT requirement like networking (LAN) is not in place even in the headquarters of these institutions, when the need today is of Wide Area Network (WAN) and Vast Area Network (VAN). Internet connection is not accessible even to the managers of operating offices. The middle class population that we are eyeing at is today overburdened, firstly by inflationary pressures on their pockets and then by the tax net. Where is the money left to think of insurance? Fortunately, LIC schemes get IT exemptions but personal line products from GIC (mediclaim already has this benefit) like householder, travel, etc. also need to be given tax exemption to further the cause of insurance and to increase domestic revenue for the country. Another drawback is the inflexibility of the products i.e. it cannot be tailor made to the requirements of the customer. For a bancassurance venture to succeed, it is extremely essential to have in-built flexibility so as to make the product attractive to the customer.

Opportunities

Banks' database is gigantic even though the goodwill may not be the same as in case of their European counterparts. This database has to be dissected variously and different homogeneous groups are to be churned out in order to position the bancassurance products. With a good IT infrastructure, this can really do wonders. Other developing economies like Malaysia, Thailand and Singapore have already taken a leap in this direction and they are not doing badly. There is already an atmosphere created in the country for liberalization and there appears to be a political consensus also on the subject. Therefore, RBI or IRA should have no hesitation in allowing the marriage of the two to take place. This can take the form of merger or acquisition or setting up a joint venture or creating a subsidiary by either party or just the working collaboration between banks and insurance companies.

Threats

Success of a bancassurance venture requires variations in approach, thinking and work culture on the part of everybody involved. Our work force at every stages are so well entrenched in their standard way of working that there is a specific threat of conflict to any change that bancassurance may set in. Any transfer to a new company or subsidiary or change from one work to a different kind of work will be presented with vehemence. Another possible threat may come from non-response from the target customers. This happened in USA in 1980s after the enactment of Garn - St Germaine Act. A rush of joint ventures took place between banks and insurance companies and all these failed due to the non-response from the target customers. US banks have once again (since late 1990s) twisted their attention to insurance i.e., life insurance. The investors in the capital may turn their face off in case the rate of return on capital falls short of the existing rate of return on capital. Since banks and insurance companies have major portion of their earnings coming from the investments, the return from bancassurance must at least match those returns. Also if the unholy alliances are allowed to take place there will be severe competition in the market resulting in lower prices and the bancassurance venture may never break-even.

VI. BANK INSURANCE MODEL ('BIM')

The Bank Insurance Model ('BIM'), also sometimes known as 'Bancassurance', is the term used to describe the partnership or relationship between a bank and an insurance company whereby the insurance company uses the bank sales channel in order to sell insurance products. BIM allows the insurance company to maintain smaller direct sales teams as their products are sold through the bank to bank customers by bank staff. Bank staff and tellers, rather than an insurance salesperson, become the point of sale/point of contact for the customer. Bank staff are advised and supported by the insurance company through product information, marketing campaigns and sales training. Both the bank and insurance company share the commission. Insurance policies are processed and administered by the insurance company. BIM differs from 'Classic' or Traditional Insurance Model (TIM) in that TIM insurance companies tend to have larger insurance sales teams and generally work with brokers and third party agents. An additional approach, the Hybrid Insurance Model (HIM), is a mix between BIM and TIM. HIM insurance companies may have a sales force, may use brokers and agents and may have a partnership with a bank. BIM is extremely popular in European countries such as Spain, France and Austria. The usage of the term picked up as banks and insurance companies merged and banks sought to provide insurance, especially in markets that have been liberalized recently. It is a controversial idea, and many feel it gives banks too great a control over the financial industry or creates too much competition with existing insurers.

In some countries, bank insurance is still largely prohibited, but it was recently legalized in countries such as the United States, when the Glass–Steagall Act was repealed after the passage of the Gramm-Leach-Bliley Act. But revenues have been modest and flat in recent years, and most insurance sales in U.S. banks are for mortgage insurance, life insurance or property insurance related to loans. But China recently allowed banks to buy insurers and vice versa, stimulating the bancassurance product and some major global insurers in China have seen the bancassurance product greatly expand sales to individuals across several product lines.

Private Bancassurance is a wealth management process pioneered by Lombard International Assurance and now used globally. The concept combines private banking and investment management services with the sophisticated use of life assurance as a financial planning structure to achieve fiscal advantages and security for wealthy investors and their families.

VII. THE BANCASSURANCE CHANNEL

The Bancassurance channel is a channel that has been the most profitable channel for assurance businesses worldwide. So what is it that makes the channel work? Penning down a few thoughts of mine. This is basically my understanding on the bacassurance channel A Watson Wyatt study on India’s bancassurance sector has revealed that bancassurance would generate about 35 per cent of the private insurers’ premium income by 2012. Nearly 90 per cent of the life insurers expect (my guesstimate) not less than 75 per cent increase in new business premium income during the current fiscal from the bancassurance channel.

VIII. RBI GUIDELINES FOR THE BANKS TO ENTER INTO INSURANCE BUSINESS

Following the issuance of Government of India Notification dated August 3, 2000, specifying ‘Insurance’ as a permissible form of business that could be undertaken by banks under Section 6(1) (o) of the Banking Regulation Act, 1949; RBI issued the guidelines on Insurance business for banks.

1. Any scheduled commercial bank would be permitted to undertake insurance business as agent of insurance companies on fee basis, without any risk participation. The subsidiaries of banks will also be allowed to undertake distribution of insurance product on agency basis.

2. Banks which satisfy the eligibility criteria given below will be permitted to set up a joint venture company for undertaking insurance business with risk participation, subject to safeguards. The maximum equity contribution such a bank can hold in the joint venture company will normally be 50 per cent of the paid-up capital of the insurance company. On a selective basis the Reserve Bank of India may permit a higher equity contribution by a promoter bank initially, pending divestment of equity within the prescribed period. The eligibility criteria for joint venture participant are as under:

i. The net worth of the bank should not be less than Rs.500 crore;

ii. The CRAR of the bank should not be less than 10 per cent;

iii. The level of non-performing assets should be reasonable;

iv. The bank should have net profit for the last three consecutive years;

v. The track record of the performance of the subsidiaries, if any, of the concerned bank should be satisfactory.

3. In cases where a foreign partner contributes 26 per cent of the equity with the approval of Insurance Regulatory and Development.

4. A subsidiary of a bank or of another bank will not normally be allowed to join the insurance company on risk participation basis. Subsidiaries would include bank subsidiaries undertaking merchant banking, securities, mutual fund, leasing finance, housing finance business, etc.

5. Banks which are not eligible for ‘joint venture’ participant as above, can make investments up to 10% of the net worth of the bank or Rs.50 crore, whichever is lower, in the insurance.

Companies for providing infrastructure and services support. Such participation shall be treated as an investment and should be without any contingent liability for the bank. The eligibility criteria for these banks will be as under:

i. The CRAR of the bank should not be less than 10%;

ii. The level of NPAs should be reasonable;

iii. The bank should have net profit for the last three consecutive years.

6. All banks entering into insurance business will be required to obtain prior approval of the Reserve Bank. The Reserve Bank will give permission to banks on case to case basis keeping in view all relevant factors including the position in regard to the level of non-performing assets of the applicant bank so as to ensure that non-performing assets do not pose any future threat to the bank in its present or the proposed line of activity, viz., insurance business. It should be ensured that risks involved in insurance business do not get transferred to the bank and that the banking business does not get contaminated by any risks which may arise from insurance business. There should be ‘arms length’ relationship between the bank and the insurance outfit.

IX. CONCLUSION

1. Where legislation has allowed, bancassurance has mostly been a phenomenal success and, although slow to gain pace, is now taking off across Asia, especially now that banks are starting to become more diverse financial institutions, and the concept of universal banking is being accepted. In India, the signs of initial success are already there despite the fact that it is a completely new phenomenon. The factors and principles of why it is a success elsewhere exists in India, and there is no doubt that banks are set to become a significant distributor of insurance related products and services in the years to come.
2. The success of bancassurance greatly hinges on banks ensuring excellent customers relationship; therefore banks need to strive towards that direction. As pointed out by Low (2004), the changing mindset is cascading through the banking sector in India and this would be a right time for banks to resorting to bancassurance, especially in the context of proactive policy environment of regulatory authorities and the Government.
3. The fact that the banking operations in India, unlike in other developed countries, are still branch oriented and manually operated vis-à-vis highly mechanized and automated banking channels, viz., internet banking, ATMs, etc. are all the more conducive for flourishing of bancassurance. Regulators could explore the possibility of allowing banks having tie-up arrangements with more than one insurance company, giving wider choice for the customers.
4. In addition to acting as distributors, banks have recognized the potential of bancassurance in India and will take equity stakes in insurance companies, in the long run. This is somewhat similar a trend observed in the United Kingdom and elsewhere where banks started off as distributors of insurance but then moved on to the fully owned insurance subsidiaries.
5. Going by the present pace, bancassurance would turn out to be a norm rather than an exception in future in India. Supervisory concerns as pointed out earlier, could best be tackled by way of closer and systematized coordination between the respective supervisory authorities there needs to be a clear cut identification of activities between banking and insurance at the institution’s level as also at the level of regulators.
6. Adequate training coupled with sufficient incentive system could avert the banks’ staff resistance if any. In sum, bancassurance strategy would be a ‘win-win situation’ for all the parties involved - the customer, the insurance companies and the banks.

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