Bancassurance

New concept catching up fast in India

ABHEEK BARUA

One of the more recent examples of financial diversification is 'bancassurance', the term given to the distribution of insurance products through branches or other distribution channels of the banks. The concept that originated in France, now constitutes the dominant model in a number of European and other countries and the same is fast catching up in India as well.

The strategy for using the established, entrenched distribution network for one product to market other new products has long existed in the consumer goods sector. Thus the networks for soaps and detergents have been used by companies to distribute newly launched food products, the distribution channel for Rados has been used to market televisions and so on. Of course, the basic premise for this kind of cross-selling is the fact that companies keep diversifying their product portfolios, using established 'incumbent' networks to promote and distribute new product lines.

Banks, too, have in the recent past adopted this strategy both in India as well as internationally. They have moved away from the classical model of deposit taking and credit disbursal through their branch networks and have begun to offer a wide range of products and services like security broking facilities and mutual funds. This is the phenomenon of 'universal banking' that builds on the principle of leveraging existing networks to broaden portfolio offerings. Change in regulatory regimes has also facilitated this diversification.

In India the concept of bancassurance appears to be gaining ground quite rapidly both through commission based arrangements and joint ventures between banks and insurance companies

The famous Glass Steagall Act in the US that restrained bans from diversifying into related areas was effectively rendered obsolete by the late 1990s.

This diversification of banking services has been driven by a number of factors, all of which have threatened bank profitability.

The author is senior economist, with CRISIL Ltd. He can be reached at abarua@crisil.com

Growing disintermediation by corporate borrowers (direct borrowings by firms from the debt market for both working capital and term loans), better inventory practices that have reined in working capital needs and a liberalised external borrowing regime coupled with dwindling international rates have all eaten into 'fund incomes' of banks. In short, the margins or spreads that banks make between the cost of funds (deposits plus borrowings) and the returns on funds (interest earnings on loans).

Diversification

Banks have felt the need to offset these through growing fee incomes particularly from the retail side. To target the retail segment, banks have felt the need to offer a more diversified product range to appeal to a diverse range of risk profiles.

On the other hand, stand-alone financial product providers (NBCs, mutual funds etc.) have faced crippling distribution costs that in the face of growing competition, they have not been able to pass on as 'load' on this product. Thus as far as banks and other financial services providers are concerned, there has been a 'double coincidence' of needs that has led them to collaborate either through direct equity participation or ownership by banks or strategic alliances.

One of the more recent examples of financial diversification is 'bancassurance', the term given to the distribution of insurance products through branches or other distribution channels of banks. The concept that originated in France now constitutes the dominant model in a number of European countries.In France 70 per cent of new business premiums come through this distribution channel, 69 per cent in Portugal, 63 per cent in Spain and so on. Projections by insurance giant Aviva peg the distribution share of bancassurance at 33 per cent by 2010, making it the single largest distribution channel. In Asia, the share of this network is small but growing rapidly. In China for instance,this accounts for more than 20 per cent of the urban market in insurance in 2003. (It is, however, interesting to note that in some countries bank regulations prohibit bancassurance and it is this regulatory diktat rather than conscious strategic choice that has harnessed the growth of this marketing channel.)

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Modus Operandi of Bancassurance

There are various models through which bancassurance operates internationally. In the so called integrative model, branch bankers themselves directly sell insurance products. In the specialist model, specialised personnel of the bank or the insurance company have specific knowledge and training of insurance to sell these products Bancassurance could operate through 'strategic alliance' models involving a simple 'marketing' tie-up or through 'full integration' where the bank sells insurance products under its own brand and undertakes all other functions associated with insurance. In India, this scheme, until now, operates largely through strategic alliances or joint ventures. Under RBI regulations, the maximum equity that a bank can hold in JV with an insurance company is 50 per cent, subject to the fact that bank has a net worth of Rs 500 crore, its Capital adequacy ratio is 10 per cent or more and has a reasonable level of non performing assets. The insurance Regulatory and Development Authority also sets guidelines regarding eligibility of corporate agents. Banking personnel who sell insurance products have to satisfy the same training and examination requirements as insurance agents.

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ance companies. According to SBI Life insurance estimates,about 15 pr cent of the gross premium of new players in FY 2003 came through bancassurance and is estimated to grow further.

While we have examined the motivations that banks have for taking insurance products on board, the incentives for insurance companies to run to banks for marketing and distribution support particulary in India need to be examined. Before that it is useful to review the traditional channels of insurance distribution. Internationally and in India, the bulk of distribution is done through the direct sales force (DSF) of insurance provides followed by insurance brokers. Direct marketing and more recent innovation such as internet marketing constitute only a minor fraction of the total distribution effort.

Impact on retail customer

While banks and insurance companies stand to gain, what impact does it have on the retail customer? Retail saving choices are getting increasingly complex internationally and Idea is no exception. There is growing need for more divers instruments and avenues of investment. This coupled with need of integrated financial 'one stop shops' to reduce the transaction costs associated with diversification. Globally, insurance products are a major internment savings and this is likely to be the case in India as well as insurance penetration gathers steam.

The issue of building brand equity is critical for new entrants into the insurance market. However, , tying up with a bank might provide counter-productive if this objective is to be achieved. A number of surveys in the European market have shown, for instance, that in bancassurance partnerships, it is the bank's rather than the insurers brand that dominates and insurance brands often get stifled.

The issue of integrating the bank's IT and other support systems also needs to be emphasized. if these are not dovetailed, the possibility of serious systems failure becomes real. Often this issue is relegated to the background and the obvious synergies between banks and insurers get more than their due emphasis.

Regulatory perspective

From a regulatory perspective, bancassurance raises some key questions regarding anti-competitive

Why insurers are turning to banks?

One of the key factors is that banks continue to command the highest trust among Indian savers and investors and of the total pool of financial savings of households, 3 per cent (the largest share) goes to bank deposits (RBI annual Report 2002).

For any providers of new financial products, banks are the fastest and most 'trusted' channel to reach households. Besides, the bank branch network of 62000 is virtually impossible to replicate and would be indispensable in penetrating newer markets such as rural markets. Bank assurance also leads to a significant lowering of distribution costs for insurers.

Swiss Re estimates for the UK for instance peg average costs through bank assurance at roughly 25 per cent of the cost of selling through a direct sales force.

The cost reduction is the corollary of a sharp rise in the numbers of policies sold per employee that follows from enhanced customer access that bancassurance fosters.

Bancassurance addresses twin needs of portfolio diversification by retail customers and integration of marketing.

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behaviour. It is a basic tenet of competition law and regulation that the ownership of large networks is a significant barrier to entry. thus insurers who tie up with ones with large networks could effectively keep out potential entrants. This might not have a immediate impact on the pricing of premium. The need to penetrate the untapped Indian market might keep premiums low at this state. However, over the medium to long term this could lead to monopoly power and high premiums.

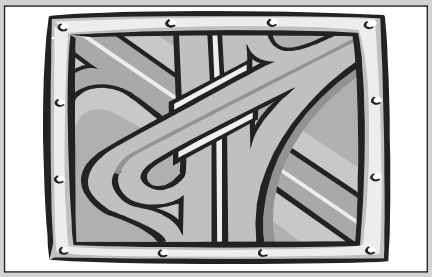
This is a regulatory issue that needs to be addressed as bancassurance gets under way in India either through the competition commission or through the insurance regulator's office. This is by no means an issue that is unique to bancassurance -- the regulation of ATM networks and other payment systems in Europe has been a hotly debated issue. A possible solution is to have an arrangement by which all entrant insurers have access to bank networks.

Another regulatory issue related to 'binding' or the phenomenon through which banks offer a consolidated package of products at a single rate. This often involves cross-subsidization within the package. Thus a bank could charge an artificially low premium for an insurance product and subsidize it through a relatively high charge on say a credit card. This form of 'bundling' not only impedes transparency of pricing but could also lead to 'unfair' advantage for banks offering bancassurance vis-a-vis stand-alone insurers. This might warrant regulatory intervention.

Thus, while bancassurance does provide an apparently viable model for product diversification by banks and a cost-effective distribution channel for insurers, there are some potential areas of conflict between the two that need to be ironed out. The success of the partnership between the two entities depends on the right' model' partnership. It is vital for this model to ensure that banks remain fully committed to promoting and distributing insurance products. This commitment has to come from both senior management in terms of strategic inputs and the operations staff who would provide the front-end for these products.Prima facie, a formal collaboration between banks.

There are costs associated with setting up a successful bancassurance network. The proper training of bank personnel to understand and market insurance schemes is vital to the success of these ventures. There is also a need to invest extensively in IT and other support systems that would provide an integrated 'back-end' for banking and insurance services Regulatory issues need to be addressed comprehensively and sorted out particularly with respect to competition and market structure problems. Given these changes, bancassurance and collaboration between banks and insurers has a long way to go in India. ■

Potential areas of conflict



While the benefits of bancassurance appear somewhat clear, prima facie to all participants, the potential areas of conflict should not be glossed over. Recent surveys of Indian savers show that they perceive insurance as a 'savings' product rather than as a risk management product There lies the rub. If insurance is indeed viewed as a savings instrument, the insurer's products compete directly with term deposits facilities that banks offer and there could be conflict of interest. Thus branch-bankers might not have any incentive, indeed have a negative incentive, in promoting insurance products. Even if there is no direct competition between the banks and the insurance product portfolios, bankers under the current structure might not find it in his interest to hard-sell insurance. Lack of familiarity with insurance products could be another deterrent.

Another potential source of conflict arises in a configuration where the insurance company is promised by an international bank that might have non-insurance business interest in India. In such an instance the domestic partner bank of the insurance company might find it strategically necessary to hold bank sensitive customer information.