REVIEW OF RESEARCH
ISSN: 2249-894X
IMPACT FACTOR : 5.7631(UIF)
VOLUME - 10 | ISSUE - 10 | JULY - 2021

BANCASSURANCE PRACTICES AROUND THE GLOBE: A CONCEPTUAL STUDY

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ABSTRACT

Bancassurance, also known as 'allfinanz' describes a package of financial services that can fulfil consumers banking and insurance needs. In fact, financial institutions can offer a combination of both banking and insurance services at the same time. Bancassurance as a way of financial conglomeration has appealed widespread attention in the world of academics and business. It offers consumers a 'one-stop-shop' option for a larger range of financial product. This form of a complete financial conglomeration has rapidly grown since the 1980s when interest margins on loans decreased steadily and banks started exploring new sources of revenue. This paper is a modest attempt to study about bancassurance practices around the globe.

KEYWORDS : *Bancassurance, CGER, Emerging Economies, Financial Services.*

INTRODUCTION :

As from the early 1990s, bancassurance has become a major distribution channel in many insurance markets. The sales channel is particularly present in Indian markets, but the business the business model is used in other regions as well. Noteworthy is the growth of bancassurance in a broad set of emerging economies. The opportunity to tap from different client segments combined with the chance to offer one-stop-shop financial services have globally persuaded both banks and insurance companies to merge their activities. In a few regions the bancassurance integration has been constrained by regulation. The distribution of insurance products through a bank's distribution channel brings diversification advantages by generating non-interest related income. Both insurers and banks are financial intermediaries that pool savings of individuals to channel these funds to the capital markets. The bancassurance model could eventually create cross-selling business synergies for banks that in turn can lead to cost savings through economies of scope. On top of that, financial conglomeration puts institutions in a position to become full service financial firms. To offer a wider range of services is beneficial for Bank Assurers (BAs) that opt for relationship management and could in the end bring comparative advantages over regular commercial banks and insurers. Nevertheless, there are also advantages embedded in financial institutions that operate separately. A bank or insurance company usually builds upon a larger experience in offered services. This will often be reflected in a stronger reputation for excellence in the particular market of interest. And obviously, separated institutions are generally smaller and are therefore argued to be more efficient and flexible. Over time it remains to be seen whether bancassurance will sustain as a fully integrated business

model. At first glance, it seems that the structure of cross equity holding has become a matter of the past. E.g., as seen with Allianz selling Dresdner, ASR was sold by Fortis plus more recently Rabobank divesting in Eureco and ING splitting its Nationale Nederlanden insurance activities. Insurances have become more universal (e.g. car-, healthcare- and travel insurances). The same holds for banking services. On top of that, financial services are increasingly ordered from distance due to the evolved e-commerce sales channel. Consequently, this has led to stronger competition in the markets for financial services. Furthermore, consumer attitude proves to be a key driver for bancassurance. Consumers must feel comfortable when buying a broad range of financial products such as insurances. For example, in 2006 discovered swindle in the life insurances market, harms the reliability of financial conglomerates as full financial service providers. A sound understanding of consumer behaviour and local legislation can help to examine in what way insurance services could optimally be sold to consumers.

IMPORTANCE OF BANCASSURANCE

The importance of Bancassurance are listed as follows:

- **Cost-effectiveness**: Insurance companies look to Bancassurance as a cost-effective mode of distribution.
- **Helpful environment:** Given that the customers already trust the bank with their money, they are also generally more willing to consider new products from the same financial institution, thereby creating an enabling environment to sell the products.
- **Commission-based income:** A bank is able to income base and increase its overall productivity by strengthening its branch network, goodwill and client base by presenting itself as a one-stop-shop for its customers, therefore improving customer

Bancassurance is a relatively new idea in the financial sector. The belief behind Bancassurance is to combine the marketing capabilities and selling-culture of insurance companies with the distribution network and sizeable customer base of banks.

CRITICAL FACTORS FOR BANCASSURANCE

The business drivers and performance of bancassurance depend on numerous variables. This chapter discusses the most cited factors to take into consideration for the viability of the bancassurance model. The proportion of consumer's total expenses for a product/service that is purchased at one individual supplier. Regulatory Regime across the world, the rise of bancassurance as a distribution channel for insurances has been impeded by regulation. The institutional regulatory environment is critically important in for roll out of bancassurance practices. If the condition of a supportive regulatory regime is not met, then banks are (in part) blocked from diversification into assurance. Several markets still do not allow for full consolidation in the financial services industry. Some protectionism can be found in emerging markets in South-East Asia that force foreign investors into constricted forms of control (i.e. no further integration than joint ventures). Canada is an extraordinary example since cross-equity holdings are allowed between banks and insurers. However, banks in Canada are de facto prohibited to sell insurances through bank offices. The Anglo-Saxon economies are considered to be relatively deregulated. Nonetheless, traditionally powerful unions and also the presence of powerful insurance lobbies have restricted the national development of bancassurance. For India as a whole, Solvency is set to mark a shift in the regulation for the insurance industry aimed to protect policyholders, which is inspired on Basel II, will call for governance towards more transparency, higher capital reserves and tighter risk management. Therefore, Solvency II compliance will put pressure on adequate portfolio management. A fundamental shift towards products with small capital requirements is expected. The higher costs associated with capital intensive services are expected to be passed on to the consumer. At least, Solvency II will certainly restrain an integrated bancassurance conglomerate practice due to the burden of stronger regulatory compliance. Another development in regulation is the Basel III. This accord is due for implementation in 2013 as well. The new Basel accord will replace the 2004 Basel II accord. Basel III is anticipated to tighten capital buffer requirements. Special attention has to be paid for the topic of so-called 'off balance sheet activities'. These activities will be further

restricted in order to limit risk. The tendency is to set more stringent legislation in order to strive for a more resilient financial sector. As such, Basel III sets forth on the course of regulation as prescribed in Basel II. The most important lesson from Basel II for banks is that it is indeed necessary to focus. Solvency II is a EU directive that will come to effect from the beginning of 2013. It forms a set of requirements, which insurers in the EU will ultimately have to obey to. The Bank for International Settlements (BIS) designated the Basel Committee on Banking Supervision to continue in safeguarding banks stability by setting more rigorous regulation on banking. Basel III as a result will set more stringent requirements for the banking industry. on portfolios that create most value in respect to the regulatory capital they require. There exists a strong agreement in academic literature on the effect of deregulation on business performance. It is either argued that deregulation shortens the pace of innovation directly or indirectly by pushing rather inefficient incumbent market players with relative inefficiencies out of the domestic market. Furthermore Carow (2001) scrutinizes this for bancassurance and finds positive effects of deregulation for all parties involved (i.e. insurers, banks and consumers). Chen et al. (2009) recently underlined this view, stating that deregulation has a positive impact on bancassurance. However, regulatory changes do not only impose permitted sales channels or levels of consolidation. Another global tendency can be found in the restriction of tied-selling, as a way of duty-bound product bundling. This form of coercive cross-selling should not be confused with preferential pricing in package deals. Preferential pricing implies that the supplier offers more favourable terms – such as a lower combined price – by linking services or products. The difference is that the customer is not given a separated alternative in tied-selling offerings. Okeahalam (2008) found empirical evidence that product bundling indeed reduce service fees to the customer. Especially the more mature markets for financial services are increasingly restricting tied-selling. It remains to be seen what the (perceived) impact of new banking and insurance legislation will be.

BANCASSURANCE PRACTICES AROUND THE GLOBE

The bancassurance model initially evolved in Europe. The first recorded settlement of bancassurance was in 1860, when the CGER savings bank from Belgium started to sell mortgage linked insurances. From this, bancassurance in Belgium build up a solid position in life insurances with over 40 per cent in today's market share for life insurances. From a European perspective, the 'Latin-European' countries and Austria rank higher in bancassurance presence than Belgium. Portugal leads in bancassurance distribution with 61.8 per cent of the total insurances sold by BAs. France, Spain and Italy have a more or less comparable pension scheme structure as Portugal. On top of that a more specific driver in this area was seen in Italy, Whereas, governance costs are driven by incongruent goals between management and subordinates. Nayyar (1992) refers to bureaucratic distortions when non-rational behaviour emerges from major changes in the corporate portfolio. where bancassurance distribution accelerated after the introduction of the 1990 Amato Law that allowed shared equity bancassurance structures. Additionally, the growth in Italy and France was enhanced by favourable tax treatments that were introduced in the 90s. Still, the growth of bancassurance in the European region stemmed from life insurance distribution. Bancassurance distribution in the market for non-life insurances stays limited. Also, investments in non-life sales remain fairly low. However, the cluster of Germany, the Netherlands and the UK, stayed behind in general in terms of bancassurance emergence compared to the 'Latin-European' countries. Though, as being demonstrated by mergers of ING-NN, Allianz-Dresdner and the Lloyds-TSB portfolio, the same bancassurance offerings existed in this region from the early 90s. Nevertheless, according to recent data from 2008, bancassurance distribution remained relatively small with an average cluster proportion of nearly 10 per cent on total insurance sales. The relative lag in penetration coincides with a high maturity in the market for financial services and especially the maturity in the local insurance sector. This has led to competition from well-rooted IFAs. Nonetheless, Europe ranks much higher in bancassurance distribution rates than North America. According to SCOR, a leading reinsurance company, in 2005 hardly 20 per cent of all US Banks sold insurances against nearly 90 per cent in many Western European countries. Therefore, up to 2007 less than 3.8 per cent of total insurances were sold by BAs in the US. In turn, the US bancassurance is mostly

limited to distribution agreements. Additionally, so far US banks have focused on the 'hard-to-get' wealthy class. Further integration with insurers could possibly benefit more as consumers ask for higher levels of customisation. Canada has a concentrated retail banking market. However, the leverage of the relatively large individual client bases is strictly limited by 'Federal Charters'. In fact, only loan protection and travel insurances can be sold through bank branches. This rare legal restriction is similarly found in Switzerland with laws on banking secrecy. The spread of bancassurance in the Arab world hampers for different reasons. Muslim countries show lower (no more than 1 per cent of the regions GDP) penetration rates of insurance due to cultural and religious factors. Generally people in the area count rather on family solidarity. Besides Islamic 'sharia' prohibit usury, a classification where insurance products are often considered to belong to. Instead, the little demand for insurance is served by IFAs and deters bancassurance to unfold. Moreover, there is very few presence of Bancassurance in the remainder of Africa and Central America. BAs are keener to exploit the potential in emerging markets. Asia has recently been easing the regulatory environment for foreign investments such as in Bancassurance undertakings. However, the opportunities are limited to at best joint ventures as cross-holdings. Individual legislative frameworks still differ tremendously in Asia though. Besides, local banks are prudent in setting up cross-holdings and sharing client databases. In general, more Western markets of Asia (e.g. Taiwan, Singapore, South Korea, Hong Kong) have opened up sooner and have consequently surged forward in bancassurance. It reveals the potential for the emerging regions in Asia where public and private 'readiness' rapidly increases. Comparable developments occurred in Eastern Europe where growth rates are still soaring. The previous Communist sphere undermined trust in the financial system. In Poland, for example – that joined the EU in 2004 as a rather developed country in the region – just a third of the population used a bank account when the country became a EU member. This infancy thrived BAs to gain a market share from 11 to 30 per cent from 2006 to 2008. Finally, bancassurance established fairly well in Latin America. BAs such as BBVA, Banco Santander and HSBC moved to Brazil long since the 1970s. Besides, insurers chose to join forces with the extensive local network of retail banks rather than to deploy greenfield operations. This has been an expansion strategy that thrived for foreign insurers in Spain before as well. Also, throughout the continent there has not been an impediment on financial services groups to exist. It has led to a mature market offering by international BAs. However in contrast with Europe the concept has been less sophisticated with low insurance penetration rates and even more particular, it is driven by non-life offerings.

BANCASSURANCE MODELS

A point of attention in this research is to resolve the question in what way the bancassurance practice would function optimally. There are multiple ways to extend company's activities. The aim is to achieve optimised synergies and a smooth blend in of corporate cultures as the bancassurance model shifts towards a higher degree of integration. Bancassurance structures vary widely, with the extent of financial control and the degree of operational integration being the most critical variables. Each business model has its benefits and limitations. It should be noticed that some countries do not permit (partial) bancassurance practices and therefore admit fewer bancassurance business models due to regulatory constraints. Benoist (2002) described the adequate choice of an appropriate bancassurance business model as a key determinant for future bancassurance performance. A bank that starts to expand its operations in insurances pursues a strategic horizontal diversification strategy. In general there are 4 forms of expansion; distribution agreement, strategic alliance, joint venture, acquisition. The quality of the model's response to organisational challenges differs. Each form embraces a different level of acquirer's commitment and accordingly a different level of integration. Hence, every bancassurance business model should adhere to a specific strategy. Nowadays there is a tendency of loosened ties between banks and insurers. Recent (partial) splits suggest that cross equity holdings have become a matter of the past. For example the Dutch ING banking group will diverge from insurance in an intended IPO-split of the insurance division. Furthermore Allianz has sold the majority stake in Dresdner, ASR has been separated from Fortis' banking activities and Standard Life divested the Standard Life Bank. Contrarily, a distribution agreement bancassurance model requires very little

commitment, as there is no need to purchase any stake in the cooperating insurance companies. Moreover, the involved entities do not or barely share customer base information. Commitment increases when moving into other more tied agreements. An engagement in a financial services group requires the largest commitment since the acquirer has to purchase a majority stake in order to gain full control in the targeted insurance company. Thus, through a majority stake in an either internally setup – or either acquired insurer, banks could form a so-called financial services group. This is a group of subsidiary companies linked together offering various types of products. Between the distribution agreement and a financial services group one could distinguish the strategic alliance and joint venture options for expansion into bancassurance. Those two combined with distribution agreements are so called financial conglomerates 'sensu lato'. Though there is no cross-equity ownership, the involved parties still strive for potential distribution synergies and economies of scope.

LIFE VERSUS NON-LIFE MARKET

Bancassurance emerged much stronger in the market for life insurances compared to non-life insurances. A reason for this can be found in the nature of life insurance products and retail banking products. They are seen to have close similarities as they both pool individual funds for unforeseen future events. Life insurances are designed as long term products, for which confidence in the issuing company is indispensable. Banks are still considered as more resilient and trustworthy institutions compared to insurers. The aftermath of the credit crunch turmoil, in which systemic banks received funding from governments, have further established confidence in major banking corporations. For sure, the reputation of banks in general has dramatically been damaged. Nevertheless, there is an increased awareness that banks are essential for economic stability. Additionally, this deep-seated position is empowered by recent tightened regulatory reforms and government bailouts. Life insurance products involve higher stakes of investments for a larger time horizon and hence call for more priority on financial security. The advantage is stronger for life related products as they depend more upon the individual welfare. On the contrary, the nature of non-life insurances deviates from banking services more significantly and hence, requires additional training and motivation. In the end the argument of synergies in life insurances for bancassurance appears to be stronger.

CONCLUSION

This paper tries to extend the knowledge of bancassurance by investigating country level bancassurance development. As far as known, this is the first time that bancassurance is proxied by the share it has in insurance distribution. Diversification in bancassurance is often called universal banking. BAs are characterised by integrating both insurance and banking services in the product portfolio. The chapter advocates to what extent the demarcation lines between the insurance and banking sector blurred.

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