REFLECTIONS

Bancassurance – An Emerging concept in India

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Executive Summary

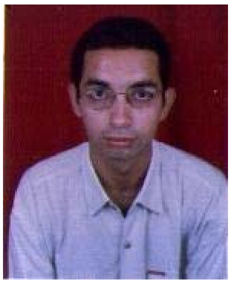
The life insurance industry in India has been progressing at a rapid pace since opening up of the sector in 2000. The size of the country, a diverse set of people combined with problems of connectivity in rural areas, makes insurance selling in India a very difficult proposition. Life insurance companies 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 a 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.

About the Author



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Introduction

Your bank has already changed a great deal over the past decade. Your banker was once content to collect your deposits and then lend the money to companies at a profit. Now he wants to lend to you as well. It could be a loan for a new house, a new car or even for education in a foreign university. Then there are products like demat services and mutual funds. Soon, there will be more. When you walk into your bank six months from now, it is likely that they will try to sell a host of insurance products to you even.

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 `Assurebanking'. 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. Presently, there’s more activity here than anywhere else. And every one 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 - its 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.

However, the evolution of bancassurance as a concept and its practical implementation in various parts of the world, have thrown up a number of opportunities and challenges. Aspects such as the most suited model for a given country with its economic, social and cultural ramifications interacting on each other, legislative hurdles, and the mindset of persons involved in this activity, have dominated the study and literature on bancassurance.

The motives behind bancassurance also vary. For banks it is a means of product diversification and a source of additional fee income. Insurance companies see bancassurance as a tool for increasing their market penetration and premium turnover. The customer sees bancassurance as a bonanza in terms of reduced price, high quality product and delivery at doorsteps. Actually, everybody can be a winner here.

Will it work in India? That can only be answered in the future; the initial action does show that many banks seem to believe that bancassurance will be a big success here. Some foreign and Indian banks -- Stanchart-Grindlays, ABN-Amro, Citibank, HSBC, Bank of Baroda (BoB) and State Bank of India (SBI) -- are hoping to replicate the French success of this insurance-cum-banking model.

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. These

costs became too much of a burden for many insurers compared to the returns they generated.

- 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 reason 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 that 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 line 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 line 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 under served 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.

Why Bancassurance in India?

The management of the new Indian operations are 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 recognised 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.

Bancassurance in India - A SWOT Analysis

Bancassurance as a means of distribution of insurance products is already in force. Banks are selling Personal Accident and Baggage Insurance directly to their Credit Card members as a value addition to their products. Banks also participate in the distribution of mortgage linked insurance products like fire, motor or cattle insurance to their customers.

Banks can straightaway leverage their existing capabilities in terms of database and face-to-face contact to market insurance products to generate some income for themselves, which hitherto was not thought of.

Huge capital investment will be required to create infrastructure particularly in IT and telecommunications, a call center will have to be created, top professionals of both industries will have to be hired, an R & D cell will need to be created to generate new ideas and products. It is therefore essential to have a SWOT analysis done in the context of bancassurance experiment in India.

1.1. Strengths

In a country of 1 Billion people, sky is the limit for personal lines insurance products. There is a vast untapped potential waiting to be mined particularly 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 Mediclaim and Travel Insurance policies. After discounting the population below poverty line the middle market segment is the second largest 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 skilled 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.

1.2. Weaknesses

The IT culture is unfortunately missing completely in all of the 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 available even to the managers of operating offices.

The middle class population that we are eyeing at is today overburdened, first 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.

1.3. Opportunities

Banks' database is enormous even though the goodwill may not be the same as in case of their European counterparts. This database has to be dissected variously and various 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.

1.4. Threats

Success of a bancassurance venture requires change in approach, thinking and work culture on the part of everybody involved. Our work force at every level are so well entrenched in their classical way of working that there is a definite threat of resistance to any change that bancassurance may set in. Any relocation to a new company or subsidiary or change from one work to a different kind of work will be resented 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 now again (since late 1990s) turned their attention to insurance mainly 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 income 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 fierce competition in the market resulting in lower prices and the bancassurance venture may never break-even.

Regulatory issues

The development of bancassurance in India has been slowed down by certain regulatory barriers, which have only recently been cleared with the passage of the Insurance (Amendment) Act, 2002. Prior to this, all the directors of a company wishing to take up corporate agency (such as a bank) were technically required to undertake 100 hours of agency training and pass an examination. This was clearly an impractical requirement and had held up the implementation of bancassurance in the country. As the current legislation places the training and examination requirements upon a designated person ('the corporate insurance executive') within the corporate agency, this barrier has effectively been removed.

Other regulatory changes of note in this area are the recently published Insurance Regulatory and Development Authority (IRDA) regulations relating to the licensing of corporate agents. This specifies the institutions that can become corporate agents and sets out the training and examination requirements for the individuals who will be selling on behalf of the corporate agent, the so-called 'specified persons' 'Specified persons' have to satisfy the same training and examination requirements as insurance agents. A noticeable exception is that for those possessing the Certified Associateship of Indian Institute of Bankers (CAIIB) only 50 hours of training (rather than 100 hours) will be required. This also applies to certified accountants and actuaries. It is hoped that this aspect of the regulations will lead to well educated, professional bank officers carrying out the financial advisory process.

Although expected, a restrictive feature of the bancassurance regulations is that they appear to constrain the corporate agent to receiving only commission; profit-sharing arrangements would seem to be ruled out. We feel that this, if applied in practice, is unfortunate as profit-sharing agreements, which are increasingly common internationally, serve to align the interests of the bank and the insurance company. Also, as products sold through bank channels can be highly profitable, such agreements may be financially advantageous for banks. In the longer term a profit-sharing agreement can help a bank move from being a distributor to a manufacturer of insurance products thus leading to greater integration in the financial services marketplace.

Given the open-mindedness and responsiveness of the IRDA to regulations in general, we hope that it will not be too long before profit-sharing agreements are permitted between insurers and corporate agents.

Summary

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 exist 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.