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BANKS, BUILDING SOCIETIES AND INSURERS:
THE WHOLE GREATER THAN THE PARTS?

by

Demos Papasavvas

and

David Parmee
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### Appendices

A. PROFILE OF TARGET TO BE PURCHASED

B. INFORMATION MEMORANDUM
1. **INTRODUCTION**

1.1 Over the past two or three years a number of enterprises have been jointly undertaken by banks or building societies and insurance companies. The enterprises have varied immensely and have been established in the United Kingdom, throughout the rest of Europe and in many other countries. Many of them have attracted a great deal of publicity.

1.2 For those interested in "Bancassurance" or "Allfinanz" - two words which have entered the language, or at least the financial services jargon - there is a wealth of material available: press articles, research papers, substantial volumes analysing the ventures established, and conferences on the theme. But as yet, as far as we are aware, there has been little formal discussion of the phenomenon amongst actuaries, despite the fact that insurers - the employers and clients of many of us - are an essential ingredient.

1.3 The objective of this paper is simply to foster discussion of Bancassurance or Allfinanz. We have summarised the key aspects of the concept as we see them and have tried to draw out the points at issue. We have not analysed each of the ventures since this has been done, at least in part, elsewhere.

1.4 The following sections consider in turn: the concept of Bancassurance or Allfinanz, attempting to analyse and define it; the motivation of the parties involved; the advantages and disadvantages to the parties of the various options for implementing Bancassurance; the mechanics of implementing the concept; distribution strategy and the product range; and general insurance considerations. We close by drawing a few general conclusions. We have included some references for further reading.
1.5 We shall use the word Bancassurance rather than Allfinanz to describe the concept, since we believe it to be the most commonly used expression. In addition, Allfinanz, in our view, implies wider scope and does not restrict itself simply to banks and insurance companies. For the sake of simplicity, the word "bank" has been used to embrace both banks and building societies, unless the context clearly implies otherwise. We shall also take the phrase "insurance company" to include composite insurers, life assurers, general insurers and friendly societies as appropriate.

1.6 In certain parts of the paper we have taken the stance of the Devil's Advocate to stimulate discussion. Hopefully, the reader will not be aware of this when it happens. As a result, the paper represents the views of the authors and the Devil's Advocate.
2. THE CONCEPT

2.1 Over the past few years those of us working with insurance companies, banks or building societies have been hearing the expression Bancassurance with increasing regularity. But what exactly do we mean by Bancassurance?

2.2 Bancassurance is a French word that does not as yet appear in the Oxford dictionary but, despite its origin, it should not be long before it does. Even though it is a foreign word, most people in this country could guess that Bancassurance has something to do with banking and insurance. In practice, it has become generally accepted that it means the provision of banking and insurance products or services by the same organisation.

2.3 Opinion differs, however, as to the precise definition of provision and to the types of banking and insurance products that could or should be included. Everyone would, we think, agree that a bank selling its own insurance products or an insurance company merging with a bank would both be considered to be Bancassurance ventures. But take the example of a bank acting as an independent intermediary and selling insurance products of, in theory, all life insurance companies. Is this Bancassurance? Consider the example of a building society selling, as an exclusive agent of an insurance company, home and contents insurance together with its mortgages. Is this Bancassurance?

2.4 We shall define Bancassurance as

"the provision of insurance and banking products or services through a common distribution channel or to a common client base"

and we shall consider various arrangements of this nature.
2.5 In our definition we do not differentiate between life and general insurance business as we firmly believe that there is much to be gained by utilising a bank's or a building society's distribution outlets and client base to sell personal lines products. We would also confirm, in the event of any doubt, that "provision" embraces both manufacture and distribution of the products or services.

2.6 For the purposes of this paper we shall consider "unit trusts" or "mutual funds" to be banking products and not insurance. Unit trusts or mutual funds could be viewed as one example of Bancassurance with the insurance companies selling banking products.

2.7 We also refer to a bank or building society selling "its own insurance products", and to an insurance company selling "its own banking products". We recognise that technically this is incorrect, at least in the United Kingdom, but we use the expressions in their colloquial sense to mean "insurance products of a company controlled by the bank" or "products of a bank controlled by the insurance company".
3. THE MOTIVATION

3.1 What is the motivation for a Bancassurance venture? Why should a bank or a building society seek to move beyond the basic forms of the concept and become a manufacturer as well as a distributor of insurance products? Why should an insurance company seek to forge links with a bank or building society beyond those between an insurer and an Independent Financial Adviser ("IFA") or an Appointed Representative?

3.2 To illustrate the motivation at any level we speculate below for three institutions, the first two of which are already undertaking Bancassurance (according to our definition) in simple forms. The motives described would, in our opinion, be typical no matter what form of the concept might be under consideration. In describing the motives we have also brought out some of the general advantages and disadvantages of the concept, or of extension of the concept. The advantages and disadvantages of the different ways in which Bancassurance can be implemented are discussed in more detail in Section 4.

The Perspective of the Building Society

3.3 Imagine yourself as the Chief Executive of a medium sized or large building society. Assets might amount to several billion pounds and you have a national network of branch offices, perhaps a few hundred. You may well have an estate agency chain within your group. Your society provides the usual building society deposit taking and lending services to customers, and might also issue cheque books, cash cards, credit cards and debit cards.

3.4 The society is already undertaking Bancassurance in one of its simplest forms in that it sells life and general insurance, mainly in connection with its mortgage business, but there are also sales of investment, protection and pension plans
unconnected with mortgages. It might also offer PEPs and unit trusts.

3.5 The society operated initially as an IFA under the Financial Services Act 1986 but for the past three years or so has been an Appointed Representative of a major life assurer. Independent advice is offered to those customers who require it through a subsidiary authorised as an IFA by SIB directly or by FIMBRA.

3.6 The society's publicly stated position with regard to conversion to plc status is "Not envisaged in present plans", but a merchant bank might well have been appointed, or consulted, with regard to future strategy.

3.7 In recent years commission income has grown steadily and is a significant contributor to profits. While interest rates and profits arising from interest rate margins have been volatile, insurance commissions have provided a degree of stability. Indeed, the accounts item "Other Income and Charges", which includes insurance commissions, now represents around 23% of total income (i.e. net interest receivable plus other income and charges) and is equivalent to 60% of pre-tax operating profits and 90% of post-tax operating profits.

3.8 As a result of being an Appointed Representative of Insurance Company X you have watched the profitability of its life operations over the past few years and wondered whether the commission the society receives, even though it is of the order of 150% to 170% of the old Lautro mca scale, really is a fair share of the margins arising on the business sold by the society.

3.9 Your managers responsible for the insurance operations of the society complain frequently of the training and compliance problems associated with the diverse product range of Insurance Company X, many products being inappropriate for the needs of the society's customers. They also mention increasing competition for resources and management attention between the many distribution channels.
of Insurance Company X, and the competition between appointed representatives within the society’s own particular channel. Insurance Company X also has different systems and culture in some respects to the society and the operational constraints imposed by these differences are becoming increasingly irritating. You are also aware that many of the insurance products offered by Insurance Company X are competing directly with the core products of the society and, whilst this might always be the case, you are nervous about your lack of control on this front. Moreover, the penalty on early surrender of insurance products is causing the society some customer relations problems because such penalties apply only in a small way to banking products.

3.10 You are conscious that under the provisions of the Building Societies Act 1986 the society can wholly own a life insurance company, and you are frequently reminded of this by visiting consultants and merchant bankers, and by the chief executives of other building societies which have established some form of Bancassurance venture more ambitious than that of your own society.

3.11 You are also conscious that, although the society is a mutual organisation, it is increasingly being measured by third parties, including the supervisory authorities to an extent, as though it were a proprietary operation. In other words, the yardsticks against which societies have been measured in the past have changed. Operating profits and added value have become of increasing significance.

3.12 In the light of all your market knowledge and research you might naturally conclude that there is an even more important role for insurance, both life and non-life, in the society’s operations than the current one, adding more value to the core products and to the society, and adding greater stability and quality to earnings, thereby protecting the society’s independence. You are also aware that, in the current insurance market, distribution is the key. The case is made: the society’s profitability, influence, operational activities and customer satisfaction
are all very likely to be enhanced if the society develops its insurance operations further, extending the boundaries of its Bancassurance operations. You reach for the 'phone to call your advisers.

**The Perspective of the Bank**

3.13 Now put yourself in the shoes of the General Manager responsible for the insurance operations of a clearing bank. Once again, you are employed by a substantial organisation with a national branch network. The bank provides the full range of banking services to its customers, and is currently undertaking Bancassurance as it sells life and general insurance as an IFA authorised directly by SIB and is a major player in the IFA market. PEPs and unit trusts are also sold.

3.14 You perceive that remaining an IFA will be expensive through increasing requirements with regard to training and compliance. You might also feel from your market research that being an IFA is of little significance to the vast majority of your customers. Some of your banking colleagues have queried whether being an IFA when the sector is subject to so many scandals is in the bank's best interest - might not the image of the bank be tarnished, if only a little?

3.15 In the recent past some of your competitors in the retail banking sector have developed their own insurance operations, predominantly life, but also general. You are conscious of the increasing threat to the core retail banking services posed by the building societies, many of which have expanded their insurance activities adding value to the core products competing directly with your own core products.

3.16 As an IFA you have experienced poor service from insurance companies on too many occasions and your people in the branches are becoming increasingly tired
of fielding the complaints of customers on matters outside the bank's control. Some of the servicing standards have been extremely poor and many of your colleagues are stating in no uncertain terms that if the insurance companies cannot improve the service then the bank could do better itself. In addition, a significant number of the bank's customers, albeit a minority, have experienced difficulties over claims, particularly on personal lines business, and this has reflected badly upon the bank as well as causing some customers to defect to other banks.

3.17 The bank as a whole is experiencing reduced profitability for reasons both national and international. There is strong encouragement from senior management to improve productivity and profitability, and to seek ways to diversify profitably. Capital is available to develop new areas if the business case is sound.

3.18 Like your counterpart in the building society, you fully realise the importance of distribution in the insurance sector, and you have often questioned whether the commissions you receive are a fair slice of the cake. You have been particularly aggrieved by some of the commission deals apparently on offer to Appointed Representatives, indeed some of the deals have been presented to you by life offices to tempt the bank to become an Appointed Representative. The deals are particularly galling because you believe that the costs of an Appointed Representative are less than those of an IFA.

3.19 Last, but by no means least, the bank is a major, national institution and there is the need to weigh the value added to the bank's prestige and influence by its IFA activities against the value added by owning and controlling what would undoubtedly be a major insurance operation.
The Perspective of the Insurer

3.20 Now, finally, let us come a little nearer home and imagine ourselves as the Chief Executive or, perhaps more modestly, the senior marketing actuary for a life insurance company. Like the building society and bank already considered, the company is undertaking Bancassurance to a limited extent, at least according to our definition, in that it is selling unit trust products through a subsidiary.

3.21 Until recently the office derived most of its business from the IFA sector. The Financial Services Act 1986 has forced the office to review substantially the distribution channels through which it is operating. While a strong presence in the IFA market has been maintained, a number of Appointed Representatives have also been engaged, many previously being brokers who had passed a significant proportion of their business to the office. One or two smaller, regional building societies have also become Appointed Representatives of the office. Many of the Appointed Representative agreements are coming up for renewal at the end of their first three year period and you are aware that tempting offers to change allegiance are being made to your tied agents. There are mounting pressures to lock in sources of business, even if the price of such locking in is reduced profitability on the business produced through the source. The pressures might be particularly great if your office is proprietary since you may well need a continuing flow of new business to sustain dividends. If your office is a mutual then the pressures from your "owners", the participating policyholders, through fulfilment of their reasonable expectations, might not be so great since, arguably, rapid rates of growth are not so critical if the office is able to "downsize" if necessary. The pressures from your management team may, however, be every bit as great as those from the management team of a proprietary office.

3.22 Apart from the new business difficulties, the Appointed Actuary has made it clear in no uncertain terms that the office faces an expense problem. The pressures of
competition and the need for increased investment in technology, from point of sale through to claims processing, have caused the office's overhead expenses to rise dramatically. Increased business to finance the overheads and reduce per policy costs is an urgent requirement.

3.23 You have considered the option of establishing a direct sales force remunerated by commission or by salary and bonus but you view the prospect as daunting, requiring expert sales management, of which there appears to be little available, and taking a number of years to achieve a stable, critical mass. Your own modelling work suggests that the cost of establishing a sales force will be substantial, certainly several millions of pounds. There will also be substantial demands upon head office management and systems where resources are already strained and costs are under tight control. There is a significant risk that the effort required to establish an effective sales force will cause the office to take its eye off the ball in other areas. Nevertheless, this option is one which will be taken up, if only through a pilot scheme initially, should a better option not materialise.

3.24 The prospects of some form of Bancassurance venture with a bank or building society look more appealing. Such a venture offers a ready made distribution channel, probably under exploited, and the bank or building society can share the financial development strains and contribute management resources. The status of the life office in the venture might well be that of junior partner because of the distributive power of the bank or building society, and the profitability to the life office of the business produced through the venture might be reduced. Moreover, there is the risk that some of the existing agents might be unhappy if a substantial Bancassurance venture is implemented, particularly so if the bank or building society is one of the market leaders. Nevertheless, you are reasonably confident that your Board will accept the price and potential risks to secure significant volumes of new business, although the degree to which it is secured will vary
according to the nature of the Bancassurance venture undertaken.

The Missing Perspective

3.25 There are two striking omissions from the perspectives painted above. The first is that none of the parties has been motivated by the desire to sell more banking products. Defensive considerations are mentioned but no party has set out with the express intention of expanding the retail banking services of the "group". This omission is apparent in many of the ventures established to date. It is the bank's or building society's customer base and branch network which are usually exploited for sale of insurance and investment products. We have seen little evidence that a primary motivation in any venture has been that of exploiting the customer databases of both parties to sell a comprehensive range of financial services products. Why should this be so? Are banking products inherently more difficult to sell? Are the customer databases already fully exploited for banking and lending services? Are banking products and services intrinsically less profitable than insurance products and services?

3.26 The second striking omission, and perhaps the more telling, is that there is no consideration of the benefits to the customers of either party arising from a Bancassurance venture, other than consideration of service standards. Does any additional financial benefit accrue to the customer of the bank or building society or the policyholders of the insurance company through the establishment of a Bancassurance venture?
It should also be clear from the above that human nature plays a significant part in a decision of this kind. Personal ambition, perhaps in the genuine guise of ambition for one's company or society, is, in our view, a significant driving force in many Bancassurance ventures. And why not? Ambition is a basic business instinct which, when coupled with sound analysis and judgement, will be the foundation of a profitable enterprise. The risk is, however, that ambition might cloud the vision and distort judgement; that partnership might be forged on the grounds of image and self-esteem rather than solid business grounds.
4. THE OPTIONS: ADVANTAGES AND DISADVANTAGES

4.1 There are many ways in which the concept of Bancassurance as we define it can be implemented. In our view, there are five main scenarios:

A. Opening the client base of one party to the distribution channels of the other.

B. General agency agreements, e.g. in the United Kingdom the bank or building society acting as an IFA.

C. Tied agency agreements, e.g. in the United Kingdom the bank or building society acting as an Appointed Representative.

D. Ownership of one party by the other, or both parties owned by the same company or group.

E. Joint Ventures.

4.2 The best type of a Bancassurance venture for any one bank or insurance company depends on its strengths and weaknesses and on the availability of suitable partners. It may even be that a particular bank or insurance company may choose to get involved in more than one Bancassurance venture.

4.3 Not surprisingly, different approaches find favour in different territories. We have seen a number of mergers in the Netherlands and numerous joint ventures in Italy and Germany. In Spain most of the major life companies are owned by the banks, while in France the banks seems to favour establishment of their own insurance companies. Local history, custom and practice, including in particular tax implications and marketing regulations, will obviously influence the
development of Bancassurance. The United Kingdom would appear to have the widest variety of approaches to date.

A. Opening the Client Base to the Other Party

4.4 The simplest form of Bancassurance under our definition of the concept, and one which many people would not consider to be Bancassurance, is when one party sells all or part of its client list to the other party. This would usually involve the bank or building society selling its client list to an insurance company and, in this guise, is no different to a direct marketing company selling its client list to an insurance company. The bank or building society would receive a payment for the sale of the list and this would be the end of the co-operation. In the majority of cases the bank’s or building society’s clients will not even know that their name has been provided to the insurance company by their bank or building society.

4.5 Although such an arrangement cannot be excluded from consideration, especially in the cases of the smaller banks, building societies and insurance companies, it is of limited scope and is constrained by legislation in various countries. It is therefore of limited interest and we shall not consider it any further, other than to note that the issue of customer confidentiality is paramount and one for heated debate.

B. General Agency Agreements

4.6 A bank or a building society in the United Kingdom may only sell life products of more than one insurance company if it acts as an IFA. As the Financial Services Act 1986 requires independent financial advisers to give "best advice" when recommending a particular company or product to their clients, the bank or building society can have no tie or special agreement whatsoever with any one company and must, in theory, offer the products of all companies.
**Advantages to the Bank or Building Society**

4.7 By having available the best products drawn from all companies, the bank or building society clients can enjoy the benefit of the best terms in the market for any product they require.

4.8 The bank or building society is seen to be acting independently and hence its clients may arguably have more faith in the advice given to them. With the majority of banks and building societies in the United Kingdom having opted for the tied agency route, a bank or building society acting as an IFA also stands to gain additional banking clients in the shape of individuals who are wedded to the benefits of independent advice. One needs to question, however, how many people realise they are getting independent advice or indeed are particularly bothered about it.

4.9 By selling products of insurance companies having no corporate connections with the bank or building society there is no exposure to the underwriting risk unless there are profit sharing arrangements, as could be the case with credit insurance business. The prospects of profit to the bank are therefore guaranteed, provided that the commission it receives is at least adequate to cover its marginal expenses in distributing the products.

4.10 The level of technical expertise needed by the bank or building society to sell insurance is relatively limited. The actual level would depend on the method used for selling the products (this is considered in detail in Section 6), but the bank need only concern itself with the distribution aspects and not get involved in any of the valuation, premium rating, medical underwriting and other technical details.
4.11 Should any dispute arise between the client and the insurance company, the bank or building society might on many occasions be able to stand back and not get involved, unless the client considers the bank to be at least partially responsible as it had recommended the product and the company to the client. As the final choice of product and company, technically and legally speaking, always rests with the client, the volume of sustainable complaints should be limited.

**Disadvantages to the Bank or Building Society**

4.12 Turning now to the disadvantages of acting as a general agent, as the bank takes no underwriting risk it stands to make no underwriting profit. This could be considered as a fairly major drawback, especially when considering life insurance, as one of the attractions of the Bancassurance concept from the bank's point of view is the perceived high profitability of the life insurance industry.

4.13 Another major drawback is that for the bank or building society to be able to act properly as a general agent, a great deal of market research would need to be carried out. In the United Kingdom, under the terms of the Financial Services Act 1986, being an independent intermediary is now an expensive business and the IFA market has been rapidly contracting over the past few years.

4.14 As the bank is dealing with a number of insurance companies there is a need to achieve at least an adequate fit with a number of administration systems. The required systems could prove to be complicated and therefore possibly inefficient and expensive.

4.15 Despite attempts by the bank to protect "ownership" of its client list, its customers are gradually being passed on elsewhere for what may only be a temporary benefit to the bank. It is not unforeseeable that at some stage in the future the insurance company might contact the bank's clients, which would by then also be
the insurance company's policyholders, and sell further business direct, not paying any commission to the bank in respect of this future business.

4.16 One of the most successful ways of selling insurance to bank clients, or indeed of selling any product to any customer, is to offer specially customised products. The customisation could even package insurance and banking products together. If the bank is acting as an independent intermediary such customisation is not possible. Branding of products is only a partial solution to this disadvantage.

4.17 There could easily be cases of conflict of interest where an insurance product that meets the client's requirements provides benefits not too dissimilar to those which are available from a purely banking product. If it is difficult to differentiate between the products on the grounds of "best advice", which product will the adviser recommend: the bank's own product or the insurance company's product on which the bank, and possibly the adviser, will receive commission?

4.18 The terms that the bank or building society is able to negotiate with insurance companies might not, in general, be as generous as the terms that could be obtained if the bank was acting as a tied agent of one insurance company. The profit to the bank per unit of premium written is therefore lower. The lack of an exclusive arrangement with one insurance company could also adversely affect the support the bank can expect to get from the insurer.

4.19 One of the reasons for wanting to sell insurance may be the bank's wish to be seen to be offering a complete range of financial services. The fact that the bank would clearly be offering insurance products of other organisations may be considered by some to be a sign of weakness, particularly if the bank is a high street name.
Advantages and Disadvantages to the Insurance Company

4.20 The insurance companies offering good value to policyholders should do very well out of such agreements and the larger the number of general agents the better it is for them. It should be particularly beneficial financially if a bank or building society with a big branch network and a large client base opts to act as a general agent.

4.21 The recent trend, however, has been for the banks and building societies to opt for the tied agency route and this has created significant problems for the companies relying on business from general agents. No matter how good the insurance company's products might be, a reduction in the number of general agents means less business sold. Banks in the United Kingdom had always been significant players in the general agency field but this has recently changed with all the major banks now owning, or having announced that they will own, their own insurance company. In some cases the general agency has also been maintained but with a dramatic reduction in the business sold.

4.22 Needless to say, the insurance companies with uncompetitive life products stand to sell very little, if any, business through a bank or building society acting as a general agent.

C. Tied Agency Agreements

4.23 Under a tied agency agreement the bank is acting as the agent of one insurance company and in the United Kingdom would not be allowed to sell life assurance products of any other insurance company.
Advantages to the Bank or Building Society

4.24 As with the general agency option considered above, the bank or building society takes no underwriting risk and the insurance expertise needed is again limited.

4.25 Acting as a tied agent, the bank should be able to negotiate good commission terms from the insurance company for its services especially if it has a particularly large client base.

4.26 The exclusive arrangement with one insurance company should also ensure that the bank or building society receives good service from the insurance company. This might also extend to the provision of customised products to satisfy the precise requirements of the bank's or building society's customers.

4.27 Having to deal with only one insurance company should make the administration much simpler, more efficient and less expensive.

4.28 On the assumption that the bank or building society is tied to a good, established name in the insurance industry, its credibility might be increased and sales might be easier to make.

4.29 The likelihood of the bank or building society being blamed following any dispute between the insurance company and the policyholder is again limited, especially if it is made clear at the time of sale that the product is an insurance company product. As we mention below, however, the extent to which the products are customised or branded will reduce the benefits of this advantage.
Disadvantages to the Bank or Building Society

4.30 On the negative side, once again as it takes no underwriting risk the bank or building society stands to make no underwriting profit, and its client list is gradually being passed on to the insurance company for what may only be a temporary benefit.

4.31 If products are strongly branded this could lead to dissatisfaction with the bank on the part of the client should any problems arise. This could ultimately result in the loss of the client not only for insurance business but also for banking services. If, on the other hand, the bank does not use its own name in the insurance products it sells it might not be seen to be offering a full range of financial services.

4.32 As mentioned earlier, under a tied agency agreement in the United Kingdom the bank or building society would be restricted to selling the life assurance products of the insurance company to which it is tied. This may mean that a particular type of benefit may be unavailable if it is not part of the range of products offered by the insurance company. It also means that the terms offered to the bank's client may be considerably worse than others available in the market.

4.33 There is also the risk that if the bank or building society ties to an insurance company which is not a household name dissatisfaction may arise on the part of its customers. There may also be a minority of customers which has a particular dislike for the chosen insurance company and does not wish to do business with it. The bank or building society will lose insurance business in these instances and may even lose banking business.
4.34 The potential conflict of interest with banking and insurance products offering similar benefits, described in paragraph 4.17 for the general agency option, applies equally in this instance.

4.35 If the insurance company fails to provide a good service this could reflect badly on the bank or building society. It may even result in the bank being temporarily unable to write any more business and loss of commission income if the insurance company is having serious administration and processing problems.

Advantages and Disadvantages to the Insurance Company

4.36 Under a tied agency arrangement an insurance company secures a good source of income with no dilution of its underwriting profit provided the higher rates of commission which might be payable are covered by economies of scale. Tied agencies, however, need not last forever and if, or when as some would argue, such an arrangement comes to an end, the insurance company might find itself with a substantial reduction in new business with surplus resources on both the human and systems fronts.

4.37 The amount of business that the insurance company is able to generate from a tied agency will depend on how keen and able the bank or building society is to sell insurance products. This might depend to an extent on the precise distribution arrangement agreed between the two parties and the amount and nature of the commission payments and other support to the bank.

4.38 By securing a bank or a building society as a tied agent, an insurance company may face discontent amongst its own salesforce who may feel threatened by the new distribution channel, especially if there is a significant overlap of client bases.
4.39 Finding a bank or a building society to become a company's tied agent is an attractive way of expanding into a new geographical territory; a sales network is acquired overnight and the insurance company has no existing sales force in the territory which might feel threatened.

D. Ownership of one party by the other or common ownership

4.40 We consider here the scenario of a bank or building society selling insurance products that are underwritten by an insurance company which is in the same group as the bank or building society. We believe there are five ways in which this may arise:

i. An insurance company and a bank already exist in the same group.

ii. A bank buys an insurance company.

iii. A bank establishes a new insurance company.

iv. An insurance company takes over or sets up a bank.

v. A merger between an insurance company and a bank.

Advantages to the "Group"

4.41 The group gets the full benefits of the underwriting profit made on the business sold.

4.42 As all the selling and underwriting of both insurance and banking products is carried out "in house" there should be scope for increased efficiency within the group and hence higher profitability.
4.43 Neither the bank's nor the insurance company's client list is released outside the group. Furthermore, this is probably the only option under which the bank is able to access the customer database of the insurance company.

4.44 The group is able to offer a complete range of services and should be able to offer customised products of all kinds to all its clients.

**Disadvantages to the "Group"**

4.45 The group is taking all the underwriting risk.

4.46 If the service provided by the bank or the insurance company to its customers is of poor quality, this will affect the relationship between all members of the group and their clients. Moreover, if the expertise of any company in the group is inadequate the opportunity to fully exploit the venture will be impaired.

4.47 The bank no longer has the freedom to obtain the best commission terms for itself especially if the insurance company has overall control of the group. Whilst this may not necessarily be bad for the group as a whole, it could lead to conflict between parts of the group, especially if they operate as individual profit centres.

4.48 The products of the bank or the insurance company may not be good value for money as far as the customers or policyholders are concerned and thus would not be particularly popular with the clients of the other party.

4.49 It may be that the size or nature of the insurance operation within the group is such that the range of insurance products available for sale through the bank is restricted.
E. Joint Ventures

4.50 This is an option that seems to be proving increasingly popular. Under this option a bank and an insurance company form a partnership to establish a new insurance company to be jointly owned by them. The balance of ownership will vary from venture to venture, depending on the contribution each partner makes to the joint venture. This contribution is measured not only in terms of the capital provided by each partner, but also in terms of technical and managerial expertise, the range of products and distribution channels, and the size of the client base of each.

Advantages and Disadvantages

4.51 The advantages and disadvantages are very similar to those outlined above under the "Group" scenario with the following differences:

4.52 The bank or building society participates in only part of the underwriting risk - the proportion depending on its share of the joint venture company - and consequently its underwriting profit is limited.

4.53 Similarly, the insurance company's underwriting profits are restricted to a share of those made by the new company. Even a small share of what could be very substantial volumes of new business that would be unavailable to the insurance company without the joint venture is, however, worth having.

4.54 Both the bank and the insurance company are able to maintain full control over the activities of their own operations. Not surprisingly, this has been proving popular with both teams of management and must have played an important part in the number of such ventures already established or currently under discussion.
4.55 Under such an arrangement it is not unusual for the technical expertise and part of the administration to be provided, at least initially, by the existing insurance company for a fee through a management services agreement. Depending on the terms negotiated for such a service the insurance company may find itself with an additional source of profit to add to its share of the new company’s profits.
5. **THE OPTIONS : IMPLEMENTATION**

5.1 In this section we consider how each of the major options identified and described in Section 4 might be implemented.

A. **Agency Agreement**

5.2 First, we consider the implementation of the Bancassurance concept through a marketing agreement between a bank or building society and an insurance company. As already mentioned, in the United Kingdom this relationship would require the bank or building society to be an IFA or an Appointed Representative of the insurer.

5.3 There are four main aspects to a marketing agreement between the parties:

i. the commission terms, including assistance with operational and marketing costs;

ii. the operational procedures and constraints imposed on one partner by the systems and culture of the other;

iii. the influence of the bank or building society on the insurance company's management, and vice versa, which is usually directly proportional to the volumes of new business produced; and

iv. in the United Kingdom at least, the diversity of the insurance market and its implications for the training and compliance costs of the bank or building society.
Commission Terms

5.4 In agreeing the commission terms, the insurer will take a number of factors into account, including:

i. the likely expense savings for the insurer, particularly in the area of sales and marketing, on business generated through the agency;

ii. the economies of scale in accepting a significant volume of business from one source and the ability of the insurer’s administration to process this business efficiently; and

iii. the terms available to large independent and tied agents in the market.

5.5 The bank or building society, for its part, will be aiming to cover its sales and marketing costs and its training and compliance costs, and will be looking for a contribution to overheads and profits.

5.6 For the bank or building society to evaluate the likely expense savings for the insurer the results of a detailed expense analysis of the insurer would be required. Such an analysis is, for commercial reasons, unlikely to be released by the insurance company. The bank or building society could, however, carry out an approximate analysis using the statutory returns and other information published by the insurer and its knowledge of the breakdown of life office expenses. Such an analysis would clearly have to be viewed with caution, since some considerations might be difficult to analyse, for example the capacity of the insurer’s system to process increased volumes of business and the costs of potential systems development. Nevertheless, it is possible to analyse the expenses of the insurer and the business volumes of the bank or building society to produce profit studies of the major product lines which will indicate the levels
of initial commission and renewal commission the insurer can afford. The bank or building society can therefore be as well armed in negotiations as the insurance company will no doubt be since it will have carried out its own detailed, and more accurate, profit studies.

Operational Procedures

5.7 The degree to which the sales and marketing, training and compliance operations of the two parties are intertwined will depend upon business volumes, costs and the attitude of each party towards the likely length of the relationship. At one end of the spectrum, a major bank or building society acting as an Appointed Representative and the insurer to which it is tied might well develop substantial computer links, and joint training and compliance procedures (over and above the legal minimum). There may even be some form of "board" established by the two parties to manage the relationship. At the other end of the spectrum a small regional bank or building society acting as an IFA might have limited systems links with insurance companies, perhaps no more than access to the generic quotation and information systems.

5.8 It is our perception that many banks and building societies are concerned by the operational constraints imposed upon them by the insurance company's systems and culture. We have already mentioned that, in the United Kingdom at least, banks' and building societies' management have a strong desire to retain their independence - and here we mean the independence of the management team, not necessarily the independence of the bank or building society itself. Banks and more particularly building societies are also very aware that they have a "warmer" public image than insurance companies. Branding of products to keep the insurer well hidden from sight will therefore be of importance.
Influence on Respective Managements

5.9 A major bank or building society, irrespective of its status as IFA or Appointed Representative, will normally have significant influence on the management of insurance companies because of the business volumes it is able to generate; significant, that is, relative to the other agents of the insurer. On the other hand, the management of an insurance company is likely to have significant influence on the management of a bank or building society which is an Appointed Representative but far less influence, if any, on the management of a bank which is an IFA.

5.10 For successful implementation of the Bancassurance concept through an agency agreement we would argue that it is essential for there to be close liaison between the respective managements. This is more than regular visits by an inspector to the marketing department of the agent. It requires regular senior management contact at a level with sufficient authority to make operational and marketing decisions, effectively creating a marketing task force. Such an approach should be reasonably straightforward to implement if the agent is an Appointed Representative, but great care needs to be taken not to compromise the independence of an IFA. The overriding objective of the task force will be to maximise customer satisfaction since this is, in our view, the primary, necessary condition for a flourishing, profitable business. This objective implies that product quality and service quality are of equal importance. Our experience to date suggests that it is the quality of service provided by the two parties to the customer which most inhibits the successful development of a profitable marketing agreement.
Training and Compliance

5.11 Establishing satisfactory training and compliance arrangements will be expensive and time consuming. For an Appointed Representative the costs and resources can be shared with the insurer, although the compliance responsibility will ultimately rest with the insurance company. For an IFA the burden must be borne alone.

5.12 The compliance requirements must at least meet the minimum requirements of the law, but there may be an argument, particularly for a bank or building society which is a household name and which is acting as an IFA, to go beyond the legal minimum and use the quality of its compliance procedures as a marketing feature.

5.13 Training is a major contributor to the success (or failure) of any business venture. For an IFA the quality of training on product knowledge is certainly a vital factor - and a very expensive factor - in the operation. However, product knowledge is not the only training matter of importance. The success or failure of a Bancassurance venture hinges upon the ability of both parties to exploit the customer databases. Training of branch staff to identify potential customers and alert the product experts to the opportunity will be of great importance. We consider this further below.

B. Acquisition of One Party by the Other

5.14 In considering how a bank or building society might acquire an insurance company, or vice versa, we use the word acquire in its broadest sense, ranging from the purchase of a quoted public company to the "acquisition" of a mutual.
5.15 There are many ways in which such an acquisition might be carried out and the relative strengths of both parties will be significant as will the nature of any existing relationship.

Finding the Acquisition

5.16 In our view, the first step is for the acquirer to define carefully the ideal profile of the target it would wish to purchase. The principal features of such a profile are shown in Appendix A, and the following issues will be of prime importance:

i. The quality of the existing management

Ideally, the existing management should have proven ability and a management philosophy consistent with that of the acquirer.

ii. The existing business

Assuming that the bank or building society is the acquirer and it wishes to offer with profit contracts, which is quite likely the case for the latter, the insurance company purchased will need to have an existing with profit fund. Apart from that consideration, a relatively small number of different types of contract and simplicity in their design will ease the administration requirements of the existing portfolio.

If the insurance company is the acquirer then operating profits, bad debt provisions and management expenses are likely to be the major items for consideration with regard to banking services.
iii. Effectiveness of administration

For the bank or building society not only is it essential that existing systems of any target should be administering efficiently the current business and sales volumes but, because of the potential for a significant increase in sales through the branches, the existing systems of the insurance company should have the capacity to cater for the increased business and the flexibility to cope with new product designs. In practice, however, future capital expenditure on computer systems may well be required.

iv. Sales and Marketing

If the bank or building society is the acquirer and since it will itself be providing a major distribution network, there is a strong argument against purchasing an insurance company with thriving new business. The shareholders or members of such companies would expect a substantial goodwill element in the purchase price whilst the bank or building society may not want to use the company’s existing distribution channels.

If the insurance company is the acquirer then the branch network and other distribution channels such as an IFA arm or an estate agency chain are amongst the prime assets being acquired, and they will greatly influence the eventual price.

v. Investment Performance

For the bank or building society a track record of good investment performance for the target insurance company is likely to be of crucial importance, particularly if the bank or building society has no in-house
investment management operation.

5.17 There is a strong possibility that a search for a suitable acquisition will be fruitless. The importance of a good fit between the bank or building society and the insurance company as regards management style and corporate philosophy are of great importance. There is also the added complication that the purchaser will be acquiring an existing identity and image, existing business and activities, and existing systems, some of which will not form part of its mainstream plans. Following the acquisition it may be necessary to re-brand the new company or society so that its image is consistent with that which the purchaser portrays for itself. It may be, however, where the company or society had a strong and well known identity within the market place, that this could be retained.

5.18 Confidentiality will be crucial in this exercise. If the acquirer or the potential acquisition is a publicly quoted company then the need for secrecy is clear. But the need does not diminish greatly if, for example, at the other extreme, the acquirer and the potential acquisition are both mutuals, since the existing business of both parties could be damaged if plans are leaked.

5.19 A shortlist of potential acquisitions can be drawn up through research of publicly available material and from the market knowledge of the main advisers likely to be appointed in such a venture: merchant bank, consulting actuaries and accountants. Some parts of the profile will be more difficult to investigate than others, the quality of computer systems being a notable example.

5.20 In our view, it might also be important at this early stage to meet with the supervisory authorities, for banks and building societies and insurance companies, to seek their views and concerns. To illustrate the reason for this view it can be envisaged that, in the current climate, the Building Society Commission might be concerned about a medium-sized building society acquiring a sizeable insurance
company, for reasons both of financial impact and dilution of management resources. Likewise, the banking supervisors and the DTI might be concerned if an insurance company, particularly a mutual, were to acquire a relatively large banking operation, for reasons of capital adequacy. The precise timing of an approach to the authorities will depend upon a number of factors and might be delayed until a target has been identified and agreement reached in principle. If the approach is at a very early stage, effectively testing out options, then it might be done by an agent with anonymity of the parties preserved.

The Acquisition

5.21 If the target company identified is a proprietary company then the acquisition will follow a path which has been trodden many times before, but this is not to say that the exercise will be straightforward. There are a number of different circumstances of which the most common are perhaps the following:

i. The bank or insurance company is wholly owned, or effectively wholly owned, by another institution and is known to be for sale. The shareholder could already be circulating sales documents or could have made clear its intentions with regard to its subsidiary.

ii. The bank or insurance company is wholly owned, or effectively wholly owned, by another institution but there is no apparent desire to sell. Indeed, there may be strong indications that the shareholder wishes to retain its subsidiary.

iii. The bank or insurance company is privately owned by a number of institutional or individual shareholders, or both. In all other respects the circumstances will be as in (i) or (ii).
iv. The bank or insurance company is quoted on a recognised stock exchange which has well-established and well supervised procedures for the acquisition of a quoted company.

5.22 If the target insurance company or building society is a mutual then there are precedents for the way in which it can be "acquired", both in the UK and in the rest of Europe. The demutualisations or transfers of engagements we have seen to date have differed in motivation and, to an extent, in implementation, and no doubt different motives and methods will emerge in the future. The crucial, initial aspect to determine is the attitude of the management of the target, since there is a strong argument and indeed some evidence, if only circumstantial, that any mutual organisation is "owned" by its management and not its members. As a consequence, a "hostile" takeover of a mutual would be very difficult, if not impossible. Again, the management may already have made its attitude clear, by public statement or by "messages" through its advisers. Indeed, the very appointment of an adviser is indicative of the attitude. It has been notable in recent years that many building societies have publicly appointed merchant bankers as advisers.

5.23 This paper is not a guide to the acquisition of a bank, building society or an insurance company, mutual or proprietary. There are a number of past cases which can give guidance and there have been actuarial papers on the topic as it relates to insurance companies, some of which are listed in the references in Section 10. However, some general comments are appropriate.

5.24 A valuation of the company or society will be highly desirable whether it be proprietary or mutual. If the circumstances are as described in 5.21 (i) and if a sales document is being evaluated, then a scrutiny of the seller's valuation will be required, which is usually less onerous than valuation from scratch. If an appraisal valuation of the target has to be carried out secretly, without the
assistance of the target or its parent, then the well-known problems of valuation from published material will be faced.

5.25 The determination of the Existing Structure Value or Goodwill needs to be handled with great care. The value of the existing structure of an insurance company is almost invariably determined prospectively by calculating the present value of future profits arising from future new business sold through the structure. This approach reflects the fact that the company’s goodwill depends upon the ability of its management to write profitable new business through its existing operations. A bank or building society purchasing an insurance company must ensure that it does not pay for goodwill which it will itself generate through its own branch operations. Furthermore, the bank or building society must have a clear view as to which part of the existing distribution network and product range of the insurance company it will not be retaining and the Existing Structure Value must be reduced accordingly. The Goodwill of the bank or building society could be determined through techniques similar to those applied to an insurance company, but we suspect that the profitability of banking products is not well understood. It may be necessary to adopt traditional methods such as studies of comparable price earnings ratios.

5.26 As mentioned above, one of the prime assets being purchased is the management team. It is an important part of the acquisition process to ensure that those management personnel of the target wanted by the acquirer remain in place. It is possible that the management will privately welcome the acquisition, not only because it presents an opportunity to resolve existing distribution difficulties, but also because the management team will be less at risk than if the acquirer had been an institution from the same sector. Whatever the situation the buyer should ensure through its statements, public or private, through its stance on "price" and through its negotiating position that the management succession is protected. Although changes in the incumbent management team may be
inevitable, it is preferable not to have to make changes shortly after the acquisition so that an orderly transition is achieved and there are few, if any, discontinuities.

5.27 The rate of growth in new sales following acquisition will affect the capital requirements of the purchase. The total capital absorbed in these circumstances will therefore consist of the initial capital outlay to acquire the company or society, based on the appraisal value, plus the capital to finance new business during a period of growth in new sales. The source of this second tranche of capital could well be the target's own reserves, but might have to be the purchaser. In either case, the emergence of profit will be delayed if new business growth is particularly rapid.

C. New Venture by Bank or Building Society

5.28 The establishment of a new life insurance company requires a substantial commitment of time and resources:

i. management from the bank or building society, at least as regards planning;

ii. recruitment of key personnel for the insurance company;

iii. preparation of business plans and submissions to the DTI for approval;

iv. development of administration systems; and

v. design of products and marketing plans.

5.29 The initial capital required for a new company is almost certain to be higher than
that required for an insurance company set up as a joint venture with an existing insurer. For a new, stand-alone venture it will, for example, be necessary to develop and test an administration system prior to launch and the transaction of business. This will require capital expenditure well in advance of receipt of any premium income. The difference in the capital requirements effectively represents the value which an insurance company brings to a joint venture and we have considered how this might be recognised below.

5.30 Despite the higher capital requirement of a stand-alone venture compared to a joint venture, it should be possible to obtain an overall return on the capital invested broadly similar to that obtained in a joint venture company. The cost of servicing the additional capital (over that required by a joint venture company) could be recouped by building in slightly higher margins when pricing products.

5.31 The authorisation process, including the timescale and the project team, for a new company is discussed briefly below in the context of a joint venture company. Generally speaking the position will be the same for a stand-alone company but the timescale could be considerably longer than that for a joint venture, to allow for recruitment of key personnel and systems development.

D. Joint Venture

5.32 There are many ways in which a joint venture between a bank or building society and an insurance company can be initiated and established, and the way chosen will depend to a great extent on the nature of any existing relationship between the two parties. To bring out issues which might be of greater interest to an insurance company, we shall assume that the insurance company is initiating the joint venture and does not have an existing strong relationship with a bank or building society. In practice, many of the joint ventures established to date have been initiated by the bank or building society.
5.33 In our view, it is important to recognise when deciding upon potential partners that the insurance company may only be able to establish one joint venture of this nature. If this is the case then the bank or building society chosen should be commensurate with the insurance company in all important aspects. This is particularly important in the area of corporate philosophy and objectives.

5.34 To tempt a bank or building society into a joint venture an insurance company might prepare an Information Memorandum. A suggested contents page for such a Memorandum is shown in Appendix B.

5.35 The insurance company could send the Information Memorandum to a small number of banks or building societies (possibly just one) which appear, from research, to be suitable partners. The Information Memorandum should be followed very shortly after by a personal visit from two or three senior executives from the insurance company. These senior executives should be responsible for, or have knowledge of, the insurance company's financial management, computer systems and marketing. As discussions progress there will come a point, probably quite early in the proceedings, when chief executives should meet.

5.36 A weakness in this approach is that it is very difficult to ensure confidentiality. It is possible that it will become known that the insurance company is seeking a joint venture and this could have undesirable effects on its business, particularly new business from other sources. The alternative approach is to despatch an anonymous Information Memorandum which describes the company without naming it and then have a representative visit the bank or building society on a "no names" basis. This approach removes, or significantly reduces, the risk of confidentiality being breached but, as the bank or building society will be interested in the management team and systems of the insurance company, some questions will be left unanswered at this early stage. The representative visiting potential partners on behalf of the insurance company would draw up a shortlist
The executive team of the insurance company would then visit those on the shortlist.

**The Structure Of The Joint Venture**

5.37 Assuming that a suitable joint venture partner is found, and this is by no means certain, the next stage is to open negotiations on the structure of the joint venture. The joint venture company will be jointly owned by the two partners. Apart from a chief executive and perhaps one or two other key officers, the joint venture company could well be a "shell" as regards administration. Administration services and investment management could be provided under agreement by the insurance company. There may in addition be a separate reassurance treaty between the joint venture company and the parent insurance company. Distribution will be the responsibility of the bank or building society which will be an Appointed Representative of the joint venture company. It is a matter for debate as to whether the sales force, or the inspector force, should be employed by the bank or building society, by the joint venture company or by a separate sales company. Financial aspects, including taxation, and the leverage required by the bank or building society in the joint venture will be key factors in this debate.

5.38 The key points for negotiation between the two joint venture partners will be as follows:

i. **The Initial and Subsequent Shareholding of each Partner**

   The balance of ownership will depend upon the relative strengths of each partner and their respective contributions to the joint venture company. The insurance company is likely to be the minority shareholder as the bank or building society has the upper hand through its ownership of the
distribution channel. Indeed, if the insurance company is simply providing administration services to the joint venture company then any initial shareholding might simply reflect the capital saved compared with that required for a stand-alone company as discussed in paragraph 5.29. Whatever might be its initial level, the shareholding of the insurance company could well reduce over time, further capital injections being provided by the bank or building society at a price to be negotiated at the outset. The requirements of each party with regard to consolidation of profits and group taxation would be considerations in this discussion.

ii. The Composition of the Board

The balance of directors will reflect the shareholding to an extent. There may be some merit in having equal numbers of directors in the early days with the Chairman being from the stronger partner. The DTI will probably want to see suitably qualified non-executive directors, and we refer to this again below.

iii. The Chief Executive

If the joint venture company is a "manufacturer" and "wholesaler" of insurance products then the chief executive might be drawn from the insurance company partner or could be a new recruit with insurance company background. Alternatively, if the joint venture company is essentially a sales operation with administration and investment management wholly provided by the insurance company then the choice might be more open. Negotiations will be required and the relative strengths of the partners will be a key factor.
iv. Appointed Actuary

If the Appointed Actuary to the parent insurer is also the Appointed Actuary of the joint venture company, and if the joint venture company has a with profits contract under which policyholder funds are invested, through a reassurance agreement, in the with profits fund of the parent insurer, then we would argue that the actuary would face significant professional problems in trying to satisfy the reasonable expectations of both groups of policyholders. Similarly, if there is a management services agreement between the parent insurer and the joint venture company with variable and negotiable charges then for the Appointed Actuary to each company to be one and the same person would, in our view, give rise to unacceptable conflicts of interest. For these reasons we would argue that the Appointed Actuary of the parent insurance company should not also be the Appointed Actuary of the joint venture company. Indeed, we would go further and say that although the Appointed Actuary of the joint venture company might be employed by the parent insurer and provide advice through the management services agreement, he or she should not report to the Appointed Actuary of the parent.

v. The Discontinuance Terms

In our view it is important at the outset to negotiate the terms of disengagement. It is a difficult subject to address when both partners are looking optimistically to the future, but it is a vital part of the arrangement. The discontinuance terms will vary according to which party is withdrawing from the partnership.
5.39 The outcome of the initial discussions between the two parties will probably be incorporated in Heads of Agreement, which are not legally binding. In due course a legally binding Master Agreement and possibly a Reassurance Agreement will be drawn up and these will cover all aspects of the relationship between the joint venture partners.

Authorisation

5.40 Once Heads of Agreement have been struck the process of authorisation can begin. It will be helpful to make personal contact at senior level with the DTI and the GAD at an early stage.

5.41 The DTI require an application for authorisation in accordance with the Insurance Companies Regulations 1981. To avoid embarrassment over the formal application this is normally submitted in draft initially, for consideration and discussion. In broad terms the authorisation process from preparation of the application through to formal authorisation might take at least nine months.

5.42 It has been our experience that the DTI will pay particular attention to the following factors:

i. Non-Executive Directors

Even if the pedigree of both partners is impressive it is likely that the DTI will insist upon one independent, non-executive director with adequate insurance experience. At the outset, the DTI might ask for two, but hopefully this could be negotiated down.
ii. The Appointed Actuary

Equitable treatment of the policyholders in the joint venture company and in the parent insurance company is the concern here. The DTI will probably be concerned if the same person is Appointed Actuary to both the parent insurer and the joint venture company, and will possibly not be happy if it is proposed that one person is both Chief Executive and Appointed Actuary of the joint venture company.

Timescale

5.43 If an insurance company was to set out now, during the first quarter of 1992, to establish a joint venture then it would be reasonable to expect that a joint venture partner might be found during the third quarter of 1992. However, it should be recognised that there is a significant possibility that a suitable partner will not be found. If the search is successful it would probably take two to three months to negotiate and draft an acceptable Heads of Agreement. Let us assume that the Heads are in place by the end of 1992.

5.44 Preparation of the draft application for authorisation would probably take two to three months. It would therefore be ready for submission by the end of the first quarter of 1993.

5.45 Discussion of the draft with the DTI might take two to three months. Hopefully, the formal application could be submitted during the second quarter of 1993, with authorisation being granted during the autumn of 1993.

5.46 All being well, the joint venture company might be ready to write business on 1st January 1994.
Project Team

5.47 In our view the project should be managed by a senior executive of the dominant partner, who might ultimately become the chief executive of the joint venture company. This executive must have sufficient authority to make material decisions and should report directly to the board of the partner for whom he or she works.

5.48 The other partner should appoint a senior executive for liaison. He or she should also have direct access to their own board and have adequate authority.

5.49 The project team should have systems, administration, actuarial, accounting and legal knowledge. The skills and resources might be found in-house in either of the partners, or could be external consultants. In addition to establishing the project team, each partner might seek independent advice for its own purposes, particularly the bank or building society if, for reasons of expertise, the main project team is largely made up of representatives of the insurance company.
6. DISTRIBUTION AND PRODUCTS

6.1 The quality of customer service should be central to the strategic objectives of any retailer of financial services. Customer satisfaction is optimised by having the right products delivered and administered in a sensitive and efficient fashion.

6.2 The customers of a bank have much in common with the customers of a building society, but there are differences at the level of the individual customer and in the composition of the customer base as a whole. There will be borrowers and savers and, with the increase in the provision of retail banking services by the building societies, there will be retail banking customers for both. The nature of the borrowings, savings and retail services varies, and hence there are differences in the customer profiles. The most striking example of such a difference is for borrowers, where borrowing from building societies is substantially for house purchase, while for banks the use of loans can range from multi-million pound commercial ventures to survival to the end of the current college term, or to the next pay cheque.

6.3 The degree to which a bank or building society might have analysed its customer base will vary immensely. We suspect that, in general, the customer base of banks and building societies is not analysed to the same extent as that of insurance companies. We also suspect that all three institutions could do more to improve their knowledge of customers and potential customers. During the past five to ten years there has been increasing application of geodemographic marketing techniques to gain a fuller understanding of the profile of a customer database. Census agencies and financial research services are able to analyse customers and potential customers according to their geographical location (down to census units of approximately 150 households), their personal characteristics and their financial profile. The synergy from a Bancassurance venture will be much enhanced if distribution and products are properly focussed, and this focus
will be much sharper if the customer database is analysed as far as possible.

**Distribution: The Branch Network**

6.4 In the United Kingdom at least, the greatest asset which the bank or building society brings to the Bancassurance venture is its branch network. The network may well be organised by areas and there could be an area management team, including a manager responsible for insurance sales and development and perhaps a training manager. Area management might report to branch network management in head office. The branches themselves will have a manager and one or more assistant managers, and depending upon the size of the branch there may be a resident insurance specialist. For smaller branches, particularly perhaps in a building society network, a manager may be responsible for a number of branches and the insurance specialist might have a roving brief.

6.5 The branches in each area might be set a range of performance and productivity targets covering the full spectrum of services provided, and including insurance sales. The insurance targets might be set at the level of individual products and could be expressed in terms of numbers of policies, premium income or commission.

6.6 In the past, the insurance business sold by branches has probably arisen largely from mortgage borrowers and will have been sold by the branch manager, the assistant branch manager(s), or the insurance specialist. The remuneration of the branch personnel for insurance sales can vary widely from immediate sales bonus through to reflection in the annual appraisal and salary increase.

6.7 With regard to administration of insurance products at the branch there are a variety of approaches. Quotations might be obtained through Inview or Prestel. Proposals might be sent directly to the appropriate insurer or might be sent via
head office. Acceptances and policies can be directed to the policyholder through the branch or sent directly by the insurance company. Claims, including surrender, are likely to be dealt with by the insurer. Customer records could be held locally or centrally.

6.8 Because the branch network is so fundamental to a Bancassurance venture we would suggest that the following structure at branch level is the minimum requirement for success, but we recognise that there are some limitations, to which we refer, which might constrain achievement of this minimum. It is essential to recognise and remedy the inescapable fact that bank and building society employees are not natural salespeople, indeed there may be entirely understandable reluctance and resistance to carrying out sales activities, particularly when insurance salesmen enjoy such bad press.

i. Branch manager, assistant branch manager and, of course, branch insurance specialist to be comprehensively trained in the major aspects of the insurance market, insurance products, insurance administration and insurance legislation.

ii. Branch counter staff to be trained to respond quickly and positively to queries from customers and, perhaps more importantly, to recognise when customers might not be aware that they need advice.

iii. A "rapid response" system to be initiated so that customers queries fielded or initiated by counter staff are passed back to the appropriate trained adviser as fast as possible.

iv. The remuneration system of branch staff to reward insurance sales and introductions in cash as close to the time of sale as possible. There may well be legal restrictions with this requirement or there may be resistance
from staff trade unions.

v. The quotation and administration systems for insurance products to be located or accessed as far as possible at the branch so that customers deal locally rather than with a faceless head office or insurance company.

**Distribution: The Sales Force**

6.9 Perhaps the greatest benefits from a Bancassurance venture arise when a professional insurance sales force is allied to an efficient and energetic bank or building society branch network. The difficulty as we see it is that the adjectives in the preceding sentence represent ideals which are not often achieved.

6.10 Our views on an efficient and energetic branch network are outlined above. The professional insurance sales force is one which not only acts professionally in terms of the advice and service it provides to customers but also achieves high productivity and profitability. Unfortunately, professional sales forces and efficient and energetic branch networks do not abound, and when they do come together cultural and operational differences can sour the relationship and reduce the synergy.

6.11 There are, of course, considerations of confidentiality, particularly when the sales force is engaged by the insurance company and not by the bank or building society. The matter of an individual's banking records being made available to third parties, even third parties within the same group of companies, is one which is hotly debated. To us this issue falls into the same category as religion and politics, you believe or you disbelieve, and beliefs are incapable of reason or rationale. The key point to make is that if a well trained branch clerk or manager refers a prospect to a professional sales person then at the end of the day there should be a satisfied customer and confidentiality ceases to be an issue. We
suspect that it is the instance or likelihood of ill-trained branch staff joining with semi-professional or even unprofessional sales people which fuel the debate.

**Distribution: Direct Mail**

6.12 Direct mail offers the opportunity to access all the customers of a bank or building society in a controlled fashion and in a relatively short space of time. Sales activities at the branch or by the sales force will take far more time to be fully effective.

6.13 In the United Kingdom direct mail is a fruitful source of business for many insurance companies, banks and building societies, and appears to be particularly popular with the IFA arms of the major societies and banks.

6.14 In our view a direct mail operation is an essential part of any Bancassurance venture, but to be truly productive is needs to be coupled with the geodemographic analysis techniques referred to in 6.3.

**Products**

6.15 We have identified five broad categories of insurance products which are usually available from a Bancassurance venture.

i. **Banking related low premium/short term cover products**

   The first category consists of the products which provide short term cover and which are either essential or strongly recommended to protect the profitability of a banking activity; for example, death and disability cover to repay a short term loan. The cover is usually sold automatically to the client together with the banking service unless he positively decides to opt
out. Insurance of this type can be sold very easily by the bank, especially as the cost is very low compared to the cost of the associated banking activity. The profit margin on such products may be extremely high and banks can easily negotiate very high commissions and profit sharing, if they are acting purely as agents, for very little or no extra administration.

ii. Banking related high premium/long term cover products

A very similar category to that described above consists of the products which are again related to the banking activity but are either for a longer duration or are considerably more expensive, for example, a mortgage endowment policy or a household buildings and contents policy. The bank or building society cannot force its client to buy the cover it itself provides, although it is becoming increasingly popular to offer preferential terms on the banking product if the client does so. The sale of such products requires some training and the premium rates need to be reasonably competitive as, in theory at least, the client has the option to obtain the cover elsewhere. It must be said, however, that in the majority of cases the client is either not aware that he can obtain better terms elsewhere or finds it significantly easier to take out the insurance cover through the bank at the same time as arranging the banking service.

iii. Tax efficient savings products

There are insurance products which are savings products offering similar benefits to banking products, but because of differences in taxation can offer better value for money. An example of such a product is Guaranteed Income/Growth Bonds. The bank would be offering its client better service by recommending that he opts for such products instead of its own banking products. The extent to which this will happen will, of course,
depend on the incentive the bank has to recommend this course of action.

iv. Investment products

This category of insurance products comprises the savings products which, unlike the traditional banking products, enable the investor to choose from a wide range of investments. These vary from the regular premium endowment plans, which also offer a reasonable amount of protection cover, to the single premium investment bonds which are essentially banking products with a minimal amount of insurance cover added to enable the insurance company to write such products and to provide the policyholder with an advantageous tax treatment of the benefits. The bank's willingness to promote such products, especially if it is acting purely as an agent, would depend on its own product range and its financial reward.

v. Protection products

Finally, we have the insurance products which offer substantial protection cover which cannot be provided under a banking product. Examples of such products are whole life and disability income policies. These products would usually be sold by trained insurance salesmen.
7. GENERAL INSURANCE

7.1 The earlier sections have concentrated almost entirely on Bancassurance activities associated with life assurance and we felt it necessary to include this section if only to reinforce our view that general insurance business cannot be excluded from the concept. There are substantial benefits for both banks or building societies and insurance companies in trying to sell general insurance, personal line products in particular, through a Bancassurance venture.

7.2 As we have already mentioned, when selling a number of banking products it is often necessary, or at least highly desirable, to have some insurance cover that would enable the bank to recover its assets. Most insurance products sold with short term loans to secure repayment in the event of death, disability or unemployment are underwritten by general insurance companies.

7.3 General insurance cover is usually much easier to explain to a potential policyholder than most life assurance products - at least the need for the cover and the general benefits provided - and the level of technical insurance expertise required by a bank or building society employee trying to make the sale is lower.

7.4 We must accept, however, that selling general insurance products is not without its problems and these have contributed significantly to the reluctance of a number of banks and building societies to date to consider Bancassurance ventures outside the life and pensions field.

7.5 The terms and conditions of a general insurance product offered by several companies are similar to each other and this often makes it easier for the policyholder to identify the product that gives him best value for money. As the contracts are usually renewable each year, it is also easy, and quite common, to switch from one company to another to obtain a better deal. As a result, the
competition is very fierce and the profit margins are considerably lower than companies would wish. In the case of some lines, motor business for example, companies can often only justify writing the business either on the grounds of using it as a "loss-leader" or in the expectation of significant improvement in the results. It would therefore be very unwise for a bank or a building society to become materially involved in underwriting such business, unless it felt it had some advantage over the existing insurers, either on the technical, distribution or expense control fronts that would enable it to succeed where others seem to be failing.

7.6 The annual renewability of most contracts and frequent switching from one insurance company to another almost certainly means that administration costs will be relatively high, even if the bank or building society acts simply as a distributor. Profit per pound of premium income is therefore likely to be lower than that for life assurance, unless high volume business can be generated. This should be no surprise, however, since the personal lines market, at any level, is one which depends for its profitability on high volume, good administration and sound management information systems.

7.7 Claims control for general insurance business is more involved than that of life business and requires high technical expertise, at least if the insurer wishes to operate profitably. Such expertise may be difficult to acquire but would be essential if the bank or building society decided to do more than distribute the products.

7.8 Another drawback of selling general insurance products is the potential for complaints at the claim stage, which leads to disputes between insurance companies and policyholders. The bank or building society that has sold the product is exposed to losing not only the insurance business but also the banking business of a discontented client.
7.9 There is much to be said for the banks and building societies restricting their
general insurance activities to acting as agents for insurance companies without
taking any of the underwriting risk. There are certainly a number of banks and
building societies which currently sell, purely as agents, a range of general
insurance products; some under their own name with only a note in the small
print that the risk is in fact underwritten by another company. Such arrangements
seem to operate very successfully with the distributors making a good profit
through commission. Nevertheless, investment in general insurance companies
to a limited extent, for example the extent permitted in the United Kingdom for
building societies, might be an acceptable level of exposure to underwriting risks
and profits.
8. CONCLUDING THOUGHTS

8.1 In this paper we have described many aspects of Bancassurance in the hope of stimulating discussion of the concept. We close by setting down a few thoughts on the topic which have occurred to the authors and the Devil's Advocate.

8.2 It has been quite a surprise to us how rarely we have referred to the customers of the various parties other than as a database to be exploited for further sales. Indeed, the existing customers of insurance companies, the policyholders, have hardly been mentioned at all. Is this an oversight on our part? For building societies, we have referred to the greater stability of profit and greater likelihood of continuing independence. But is this for the greater good of the society customers or the management team? Customised products have been mentioned and, to the extent these can genuinely be designed, there are clear benefits to the customers. We have described the benefit to an insurance company of locking in sources of new business. To what extent do these benefits accrue to the policyholders, and is the answer different for mutuals, for proprietary, with profit offices and for proprietary, non profit offices? We are left with the feeling that the case for Bancassurance giving rise to substantial benefits for customers of the various institutions has yet to be proved.

8.3 What about the institutions themselves? Which of them are getting the most advantage out of Bancassurance at present? To our mind there is little doubt about the answer to this question: at present the banks and building societies are gaining greater benefits from Bancassurance than insurance companies, except when an insurance company acquires a bank and, to a lesser extent, when a bank and an insurance company merge. In the United Kingdom we have yet to see a genuine example of the first of these. We would suggest that in mergers the bank is still likely to be the dominant party, but arguably there is no such thing as a merger other than in strict legal terms; one party must be dominant and
therefore effectively the "acquirer". We would also argue that one partner must dominate in a joint venture and if we are correct then we are led to wonder what it implies for the future of Bancassurance joint venture companies. Can a joint venture company survive or will the bank or building society inevitably acquire the whole operation, and perhaps also the insurance company partner?

8.4 Banks or building societies might currently be dominating Bancassurance ventures, but will this always be true? Will insurance companies be able to change the balance to their favour? We believe so, but only if the bank or building society is significantly smaller than the insurance company. In our view, an insurance company will find it difficult to control a venture involving a bank or building society of equivalent or greater stature. If the insurance company should gain control in such a situation then we would have doubts about the quality of the bank or building society management.

8.5 Overall, then, is Bancassurance a good thing? Our answer to this is a resounding yes. A successful Bancassurance venture should result in greater volumes of sales of banking and insurance services and products, higher productivity, and increased profits, all of which are presumably high on the list of objectives for any commercial operation. In our view, the likelihood of success should be high, but we accept that there have been some failures. We would attribute these to the fundamental motivation for the venture being wrong, which led to half-hearted or misdirected implementation.

8.6 Finally, are there any professional actuarial aspects to Bancassurance? We referred in 5.38(iv) to the potential professional problems for the Appointed Actuary of a joint venture insurance company and its parent insurer. We wonder also whether the Appointed Actuary or the consulting actuary to a with profits office faces any special problems when advising his or her board of directors or client on the merits of a Bancassurance venture. We would suggest that the
nature of the problems varies according to the type of the Bancassurance venture and, perhaps more interestingly, the way in which the venture arose. The questions to be answered would include:

(i) What is the long term risk to the reasonable expectations of policyholders, shareholders, if any, and staff if a substantial proportion of new business arises from a bank which is an Appointed Representative or from a joint venture company, neither of which forms of Bancassurance is permanent? Should a with profit office ever enter into such an arrangement?

(ii) If a bank or building society is an Appointed Representative of the office and is a major source of new business, what are the considerations if the bank presses for a more ambitious form of the concept? Is the life office held to ransom? How does the office reconcile the reasonable expectations of its existing policyholders, the need to be a "continuing entity" and the aspirations of its staff and management?

8.7 We are sure that we will see many more examples of Bancassurance and we are equally sure that the debate about its merits and demerits will continue. As we have yet to see the effects of disengagement between Bancassurance partners, the debate may yet be in its infancy.
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APPENDIX A

PROFILE OF TARGET TO BE PURCHASED

1. The current position
   - distribution channels
   - product range (in outline)
   - new business (by channel)
   - premium income (by channel)
   - net interest income
   - funds under management
   - investment performance
   - expense performance
   - profitability

2. The product range (in detail)
   - essential requirements
   - minimum development requirements

3. Management profile
   - age
   - succession
   - key management positions

4. Systems profile
   - essential requirements
   - minimum development requirements

5. Costs
   - initial budget and capital for acquisition
   - subsequent development budget and capital

6. Timescale
APPENDIX B

INFORMATION MEMORANDUM

Draft Contents

1. Introduction
   - purpose of the document
   - contact names, addresses and telephone numbers
   - disclaimers

2. The history of the insurance company

3. The current position of the company
   - distribution channels
   - product range (in detail)
   - new business (by channel)
   - premium income (by channel)
   - funds under management
   - investment management
   - profits

4. The product range

5. Management profile
   - brief curricula vitae of senior executives who would deal with joint venture
6. Outline proposal for joint venture company
   - ownership
   - board
   - chief executive
   - distribution channels
   - product
   - termination

7. Outline business plan for joint venture company
   - for joint venture as a whole
   - from perspective of building society, i.e. commission plus profit share versus commissions only
   - embedded value accounting and profit recognition

8. Timescale and costs

Appendices

A. Report and Accounts
B. Half year accounts
C. DTI Returns
D. Outline Heads of Agreement
E. Detailed Business Plan