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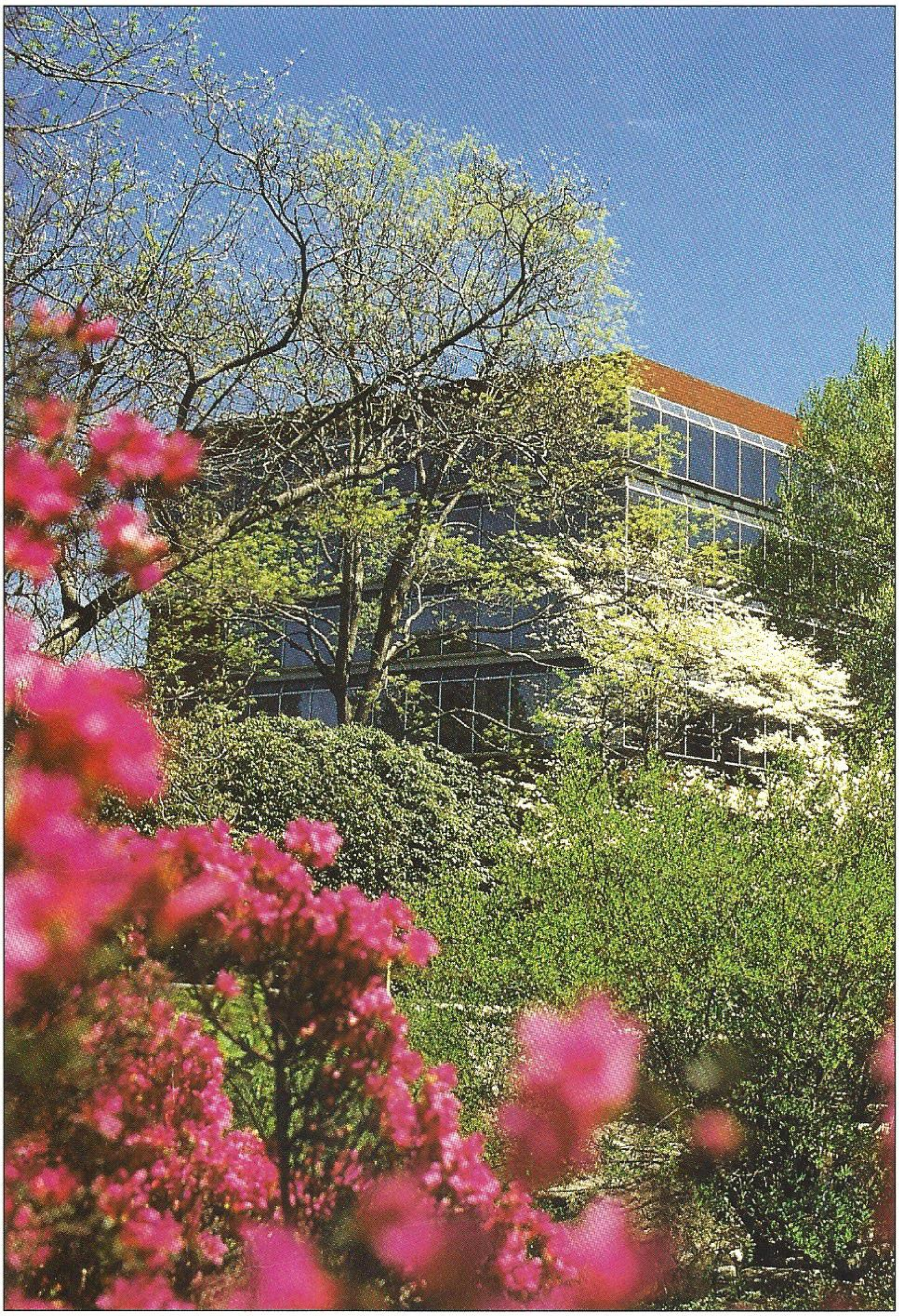

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Bancassurance in the United States: Effects on Consumers

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Abstract: *Life insurance industry data reveals that traditional distribution methods are failing to meet the needs of lower- and middle-income Americans. Banks, on the heels of favorable court rulings, are ready and willing to fill the void, but agents and brokers are concerned that they may not adhere to consumer protection regulations. Both the international and domestic empirical evidence suggests, however, that lower- and middle-income Americans would indeed benefit from bank-based distribution through increased choice, access, and value.*

Introduction

At this moment in the United States, bank special interest groups are entrenched in a legal chess match with a formidable adversary — insurance intermediaries (i.e., agents and brokers). During this melee, life insurers secretly back the bank lobbyists; regulatory bodies try to forecast public policy issues; courts reinterpret past law; and consumers, who lack both organization and information, are as confused as ever. This article analyzes the platforms of both banks and insurance intermediaries. The basis of this analysis lies in the observance of European bancassurance activity over the last decade as well as domestic empirical evidence to either support or refute the interest groups' respective arguments.

Life Insurance Marketing Effectiveness

Trends in the United States insurance industry, primarily life and health, have led many observers to declare the industry's situation a crisis. In fact, many internal and external observers have written about the ineffectiveness of the traditional agency distribution system for decades. Do these naysayers have a realistic view of the market? Unfortunately, the following facts indicate they may be understating reality. Roughly one-half the number of career life agents exist per household today than two decades ago[1] with new recruits declining in excess of 60 percent since 1982.[2] In addition, nearly 40 percent of all Americans have no individual or group life coverage (which does not account for those underinsured),[3] and life sales have remained flat for over a decade, leaving an estimated aggregate need of $5 trillion in basic protection.[4]

The most distressing fact, however, is that agents are focusing their efforts on where they will generate the greatest personal return — selling to the affluent.[5] By all accounts, empirical evidence shows a dramatic increase in life ownership for the top two quintiles of family income and a significant decrease for the lower three quintiles.[6] Thus, as insurance needs of lower- and middle-income consumers are rising, access and choice are declining. Given this data, why has the insurance industry been reluctant to partner with banks, thereby increasing sales to this underserved market?

Banks Versus Insurers: Respective Positions

Fragmentation exists within the insurance and banking industries. On one side, insurers are encumbered by an "average acquisition expense estimated at a whopping 175 to 200 percent of each dollar of new life premium."[7] Any moves by companies to tame distribution expenses, however, would result in mutiny by agents and brokers alike.[8] Therefore, many insurers are quietly forging relationships with banks as well as other distribution channels to increase efficiencies.[9] The real battle — insurance intermediaries versus banks — is over the lucrative distribution rights. Each respective argument is analyzed below as to its relative merit.

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Intermediaries' Position

Insurance intermediaries (agents and brokers) concerned about consumer protection issues specifically cite the following problems associated with bank involvement: (1) safety and soundness (contagion), (2) unfair competition, (3) coercion (tie-in sales), and (4) service quality.

Contagion. Intermediaries argue that banks will not be fiscally sound due to the risk of contagion (a domino-like effect wherein one unit of a business brings down the entire parent), which could cause adverse micro- and macroeconomic repercussions. This risk presumes the bank is both the manufacturer and distributor of the insurance products. Most Western countries, however, still do not allow banks to directly underwrite insurance products, so the risk remains with the insurer — the exceptions being a bank holding company or subsidiary arrangement. That is, the contracts do not represent an increased exposure but merely a new source of fee-generating income.[10] Many European countries are promoting increased cooperation between financial regulators (e.g., banking, insurance, and securities) to provide adequate supervision of financial conglomerates (capital adequacy requirements recommended by the Basle Committee on Banking and Supervision) to mitigate potential negative ramifications.[11] Some studies indicate that the potential economies of scope could, in fact, reduce relative risk to financial institutions due to increased product line diversification.[12]

Unfair Competition. Intermediaries argue that banks represent unfair competition. Global evidence reveals that bank entry into insurance distribution stimulates free market competition. In Europe, bank-based insurance thrives by selling simple, commodity-like insurance policies to branch customers. Bancassurance in France, for example, has captured 55 percent of the life insurance market in slightly more than a decade.[13] Similarly, bank-based distribution in the United Kingdom has experienced success, growing from a 15 percent market share to nearly 30 percent from 1990 to 1994, respectively.[14] Clearly, extreme inefficiencies must have existed to allow a new market player (banks) to quickly capture such a large share of the market.

Coercion. Intermediaries argue that banks will coerce customers into purchasing insurance products. Although such a threat certainly exists, the infrequency of reported incidents in current bank/insurance activities does not indicate a widespread problem. If problems do arise, a number of mechanisms may be used to temper coercive transactions. One such strategy, employed by the German insurance supervisory authorities, prohibits the linkage of insurance contracts and loans if the face amount exceeds the total loan. Similarly, New York already prohibits tie-in sales when a loan is granted. Still other methods provide for a cooling-off period of 30 days or a ban on lenders placing insurance before the loan is approved.[15] Ironically, while coercive credit insurance is illegal, traditional credit products enjoy a good reputation with consumers.[16] Therefore, expanded insurance powers might further enhance consumer choice and value.

Quality of Service. Intermediaries argue that banks will not be able to deliver a high quality of service or advice. In light of recent U.S. bank mutual fund problems, this is a valid concern. Successful European bancassurers use trained bank-based insurance advisers to sell standardized products and to service existing customers. As these firms continue their substantial investments in staff training, long-run service quality should improve until it becomes indistinguishable from the traditional agency system.[17] In the U.S. market, banks generally enjoy a stellar reputation as one of "the most trusted providers of financial services, while insurance agents are among the least trusted."[18] To maintain their client base and reputation, it would be logical to assume banks will make every effort to provide sound advice and a high quality of service. Toward that end, a study conducted by the Consumer Federation of America observed bank advisers disclosing more information on products than did insurance agents.[19] Because banks have historically purveyed erroneous information in some circumstances and a high quality of advice in others, prudent sales regulations may be necessary to ensure professional behavior.

Banks' Position

Conversely, banks contend their admittance to the insurance playing field would have positive effects such as competition (choice), convenience (access), and efficiencies (enhancing contract value).

Competition. Banks contend that their insurance services will have a positive effect on competition. As mentioned above, banks have enjoyed immediate success as distributors of insurance in Europe. Credit card operations, branch systems, and specialized financial services (e.g., trust, employee benefits, and personal/commercial loan operations) have potential efficiencies of scale and scope unmatched by traditional distribution alternatives. These competitive efficiencies have been credited with reducing term life insurance premiums by 14 percent in Australia from 1990 to 1994 and 8 percent in New Zealand from 1989 to 1993. Additionally, a 1994 Canadian survey ascertained that a Quebec consumer could enjoy up to a 35 percent insurance discount purchasing through the caisses populaires.[20] Many believe these discounts are attributed to banks' access to customer information, which generates leads through targeted mailings, statement stuffers, or branch personnel. Furthermore, the majority of the prospects (the customers) already have a relationship with the bank, so advisers are selling to warm leads.[21]

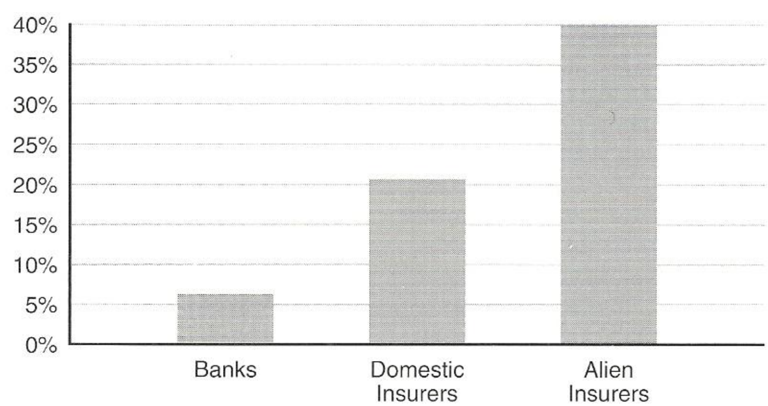
Convenience. Banks contend their entrance would increase both customer convenience and access to insurance services. The issue of convenience is of special importance being that most customers prefer "one-stop" shopping.[22] Access to the financial services marketplace is already available to the lowest income levels of society through local bank branches.[23] Therefore, the most underinsured Americans will, enjoy substantially more opportunities to buy necessary insurance coverage.[24] The fact that banks have existing relationships with the largest number of people, serving both the wealthy and the poor, bolsters their contention of greater convenience and access.

Increased Efficiencies. Banks argue that their entrance would increase efficiencies and thereby enhance product value. European bancassurance results prove this to be true, as illustrated in Figure 1.[25]

While a 7 percent commission seems unrealistically low, banks rely on cross-selling ratios between 10 to 15 percent to enhance profitability within their "core banking services."[26] Banks also experience higher productivity than do traditional distribution channels, which has been primarily attributed to a more efficient lead generation system (the aforementioned direct mail, telemarketing, and branch referrals). Additionally, banks can harness potential economies of scale (related to technological advances and the branch banking system) as well as economies of scope (through diversification of products and services). British bancassurers, for example, have enjoyed four times the selling effectiveness vis-à-vis traditional agency distribution methods.[27] The present life insurance distribution system in the United States costs insurers approximately 70 percent of their gross overhead, the largest majority of which represents agent commissions.[28]

Life insurers cite these "excessive costs of distribution and low sales force productivity" as the number one threat to the industry.[29] Some experts believe that bancassurance will ultimately enhance product value through compensation competition, as U.S. savings bank life insurance (SBLI) has already illustrated.[30] This tends to corroborate, therefore, that the efficiencies experienced by a bank-based distribution system would create substantial production surpluses, and through the free market mechanism, increase value to the consumer.

FIGURE 1
Life Commissions of European Distribution Channels



Regulatory Constraints

If the consumer benefits are viewed as a given, why have regulators resisted change? The answer may lie in the capture theory of regulation, which holds that regulation is influenced by special interests from within the regulated industry. These special interests groups have remained in control, because consumers have not historically had the financing or organization necessary to have their collective voices heard on a specific issue. Characteristics of capture theory regulation include:

- thwarting new entries into the industry, and
- restricting free market competition for firms both inside and outside the industry.

Clearly, intermediaries seek to maintain their oligopoly as the primary distribution source within the insurance industry. In doing so, they restrict free market competition where the benefits (surpluses) inure to themselves instead of consumers.

Conclusion

In summary, the inadequacy of the traditional distribution system (e.g., 40 percent of Americans without indi-

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vidual insurance, $5 trillion need, and the abandonment of the lower and middle markets) warrants bank involvement as distributors of insurance. No evidence verifies the majority of the intermediaries' concerns, and where valid points are made (quality of advice and service, coercion), regulations either already exist or can be put in place to curb such behavior. Banks' assertions, however, are fully supported by empirical evidence as well as current European bancassurance activities. From both an objective and subjective perspective, lower- and middle-income consumers would benefit from heightened competition, increased access, and enhanced value. Moreover, with exponential growth in the opportunities to buy insurance, the underserved will finally be served.[31] To be sure, the United States has been left behind in the global bancassurance race,[32] but the industry should take action to ameliorate the current life insurance distribution crisis, thereby benefiting lower- and middle-income consumers nationwide. **J**

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(1) *See*, John Scully, *How Are You Doing? Industrywide, Recruiting is Down*, Managers Mag., May 1993, at 2.

(2) *See*, Carol King, *U.S. New Career Agent Recruiting Still Weak....*, Nat'l Underwriter, Dec. 12, 1994, at 7.

(3) LIMRA, Market Trends 28 (1994).

(4) *See*, Stephen Shaw, *Embracing a Multicultural World*, Life Ass'n News, Mar. 1993, at 23.

(5) *See*, Dennis Pilsbury, *Target: The Affluent Market*, Life & Health Ins. Sales, Sept. 1993, at 14 - 15.

(6) LIMRA, *New Study of Life Ownership Covering 1984-1993 Decade Reveals Continuing Decline; Entire Blame Put on Dramatic Drop In Individual Ownership*, Ins. Advoc., Feb. 26, 1994, at 27.

(7) *See*, Bob Stein, *Financial Forecast*, Ins. Exec. Rep.: The State of the Industry, Winter 1994/1995, at 2.

(8) Prudential Insurance introduced a no-load term life product to consumers, but quickly pulled the program after an unprecedented agent backlash. See *Pru's No-Load Insurance Program Threatens Industry Upheaval*, Fin. Planning, Dec. 1994, at 12,16.

(9) Banks already account for one-third of aggregate annuity volume. *See*, Michael White, *Banks Have Won a Third of Individual Annuity Market*, Am. Banker, Jan. 9, 1995, at 19. Nearly one-third of the largest 50 insurers distribute life insurance products via banks. *See*, David Jones, *Biggest Life Companies Selling Through Financial Institutions*, Nat'l Underwriter, July 16, 1990, at 1,4.

(10) *See*, Goran Bergendahl, *The Profitability of Bancassurance for European Banks*, 13 Int'l J. of Bank Marketing, 19 (1995).

(11) Off. Econ. Coop. & Dev., Financial Conglomerates 39 (1993).

(12) U.S. Gen. Acct. Off., GGD-90-113, Banking Powers: Issues Related to Banks Selling Insurance 5 (1990).

(13) *Bancassurers Show Lack of Integration*, Ins. Sys. Bull. 4 (Feb. 1995).

(14) *See*, Lisa Howard, *Bancassurers Nibbling Share of Traditional Life*, Nat'l Underwriter: Life & Health, July 10, 1995, at 17.

(15) This section draws from Off. Econ. Coop. & Dev., Insurance and Other Financial Services: Structural Trends 20 (1992).

(16) "Ninety percent of credit insurance buyers in 1985 thought credit insurance was a good product and would purchase it again." U.S. Gen. Acct. Off., *supra* note 12, at 3.

(17) Off. Econ. Coop. & Dev., *supra* note 15, at 26.

(18) *See*, Jerome Corsi, Marketing Life Insurance in a Bank or Thrift 1 (1986).

(19) Cons. Fed. Am., The Potential Costs and Benefits of Allowing Banks To Sell Insurance 7 (Feb. 10, 1987).

(20) *Insurance Rules Penalize Consumers*, Canadian Banker, Jan/Feb 1996, at 10 - 11.

(21) Howard, *supra* note 14.

(22) Bergendahl, *supra* note 10, at 18.

(23) "Nine out of ten households with annual incomes of less than $15,000" have relationships with banks. *See*, Michael White, *The Crisis in Life Insurance — How to Solve it with Freedom of Choice and Free-Market Competition*, The FIIA Banks Insurance White Paper 45 (1995).

(24) Many within the insurance industry purport that insurance is sold, not bought. This assumes intermediaries are indeed soliciting a specific market. In fact, one only has to review the data confirming the tremendous decline in individual life ownership for the lower- and middle-income classes to support creating more "buying" opportunities. Moreover, the number of independent agencies has declined during the period of 1987-1996 from 53,000 to 44,000, respectively. *See*, Victoria Pasher, *Agency Decline Slows*, Nat'l Underwriter, Aug. 12, 1996, at 1, 54.

(25) Predica (a French insurer) pays 3 percent commission to Credit Agricole according to their joint marketing agreement, and Allianz (a German insurer) pays 3.5 percent to Dresdner Bank. Motor vehicle insurance, however, has traditionally paid the writing bank 10-15 percent commission, with fire coverage offering 25 percent. Bergendahl, *supra* note 10, at 25.

(26) *See*, L.L. Bryan, *Core Banking*, 1 McKinsey Q. (1991). Additional research confirms insurance sales costs are substantially reduced when policies are cross-sold to existing bank clients. *See*, G. Nicholson, Competition Between Banks and Insurance Companies, (Centre for Eur. Pol. Studies, Brussels).

(27) Howard, *supra* note 14.

(28) *See*, Travis Pritchett and Benjamin Brewster, *Comparison of Ordinary Life Operating Expenses for Agency and Non Agency Insurers*, J. Risk and Ins., June 1973, at 206.

(29) *See*, Carole King, *CEOs Rank Distribution Management as Top Concern*, Marketfacts, May/June 1994, at 12.

(30) *See*, Robert Stein and Mark Olson, *Courting Customers: Will Banks Have the Edge?*, Nat'l Underwriter, Nov. 27, 1995, at 8 - 9.

(31) An independent survey of Canadian households revealed most would "switch their auto, home, and life insurance to a bank — especially if it meant savings... of as little as five per cent." *See*, Claudia Cattaneo, *Banks Mount Campaign To Sell Insurance in Branches*, Calgary Herald, Nov. 18, 1995, at C3.

(32) *See*, Steven Davis, *Who are the Leaders? The Delivery of Financial Services: Lessons from Europe*, Bank Mgmt., Nov/Dec 1995, at 60 - 64.