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PROSPECTS AND CHALLENGES OF BANCASSURANCE: A CONCEPTUAL STUDY

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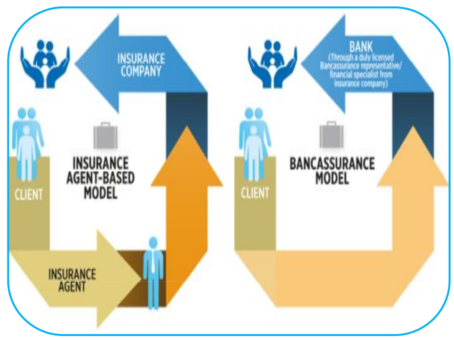
ABSTRACT

Bancassurance, a French term, simply denotes using banking channels to sell insurance products. Bancassurance is yet another manifestation of the convergence process in the financial services industry. Bancassurance benefits all the three key parties, i.e., the insurer, the bank and the customer. The insurer can access a client base, which is normally not available to it through other means or without cost. By allying with a bank of good repute, the insurer can improve its own public image. Bancassurance enables the insurer to establish a relationship early in a customer's life, as individuals open bank accounts at a much earlier age than they buy insurance. The insurer gains business at a lower acquisition cost than usual due to the bank's easy access to its client base and strong relationships with its clients. This paper is a modest attempt to study the prospects and challenges of Bancassrance to sell insurance products.



KEY WORDS: *Bancassurance, Bank Client Relationship, Consumer Eagerness.*

INTRODUCTION

Bancassurance helps increase the overall productivity of the bank's client relationships. It helps increase profitability, or return on asset or equity of the bank by virtue of generating extra income, particularly fee-based income. It can help banks increase their branch productivity. In addition to benefits that a bank can derive from its branch network, bancassurers can have a competitive advantage over traditional insurers (non-bancassurers) through their ATMs. Bancassurance helps the customer to pay a lower price for insurance products because of lower acquisition costs. The customer gets the convenience of one-stop shopping for financial services products and easier way to make payments (through the bank). The customer also enjoys better client service because of the bank's expanded relationship with the customer.

Reasons for Banks' Eagerness to Collaborate with Insurance Companies

- Attraction of fee income
- Diversion of surplus workforce
- Development of product range

Reasons for Insurance Companies' Eagerness to Collaborate with Banks

- Reliance on wide network
- Attraction of strong clientele base
- Aggressive marketing strategies

Reasons for Consumers' Eagerness to Welcome Bancassurance

Consumer perception is itself a very dynamic phenomenon. Today's customer is very demanding and sensitive too. Customer expectations in respect of service quality are quite high. Consumers insist on respectable behaviour from their banker. Now, when there are so many operators, they can always switch over their loyalty at any moment. Thus, there is a challenge before service providers that their clientele base is retained. In regard to quality of service, our public sector banks are certainly required to redefine their priorities and strategies because very often they are labeled as poor. The competitive state of market suits the consumer as customer care is always better. The customer will be benefited the most if the market is developed and competition is aroused to a greater extent.

Prospects in Bancassurance in India

1) The first and foremost objective indicators of insurance potential in a country are (a) insurance penetration, i.e., premium as percentage of GDP and (b) insurance density, i.e., premium per capita. India, with an insurance penetration of 2.3 percent and insurance density of $8 belongs to one of the lower rungs. These indicate that a lot of potential does exist in both life and non-life areas for the insurance industry as a whole and bancassurers too.

2) Today, life in general, has become more uncertain and risky. Not only are man-made dangers (burglary, accidents, terrorist activities, hijacking, etc.) on the rise but natural catastrophes (earthquake, flood, cyclone, etc.) are also becoming more frequent. One certainly does not welcome such uncertain times, but these uncertain times create opportunities for insurance business.

3) The financial environment has become equally uncertain due to liberalization measures and financial scams. Interest rate deregulation, combined with pursuance of bringing in a soft interest rate regime, has resulted in rates of interest on all financial instruments coming down substantially. In India, where no good old age pension scheme, public healthcare system or unemployment welfare scheme exists, where will the public, particularly the middle class, which no doubt wants return but safety and liquidity first and foremost, save money? The stock markets have become highly unreliable and are tainted with scams, and mutual funds have moved in tandem with stock markets. Money market instruments are still undeveloped. Many urban banks in various parts of the country have failed or become fragile. Against this backdrop, life products, at least, give tax benefits and future security. In fact, taking tax benefits into account, the return on certain life products are more than than on bank savings products, as interest earned on the latter, beyond a certain stipulated sum, is taxed at source, like dividends earned on shares. Thus, the moral of the story is that life products still have a bright future even though there are several competing products from banks and other financial intermediaries. Further, the gap between bank savings products and certain life products is fast narrowing.

4) The joint family system, which functioned like an insurance system, is gradually collapsing due to several reasons. More and more nuclear families are coming up, and with this, the demand for life-cover for the head of the family and family members is also rising.

5) An outcome of the above-mentioned phenomenon is that the elderly members in families are being gradually required to manage themselves either out of their own volition of not becoming dependent on their children or being compelled in one way or the other by their children. Thus, the future older generation has to plan for their financial safety and security in their old age, and the awareness is also increasing in this regard. This speaks well for life insurance products

6) With economic growth, per capita disposable income is also rising. The biggest force to reckon with here is the middle class population, which, according to various objective and subjective estimates, varies between 250 million and 500 million.

7) Improving economic conditions, coupled with higher education and small family concept, has resulted in savings orientation in the economy. The process has been catalyzed by higher awareness about savings culture being spread through various media by financial institutions.
8) Today, as bank branches are the origins for financial needs of any productive venture, these branches can simultaneously sell insurance products to borrowers, particularly non-life products, instead of obtaining the same non-life cover from other insurers. Such a one-stop mechanism may also save the borrower many headaches
9) Bancassurance provides a good opportunity for Indian banks to increase their fee-based income. The Indian banks' net interest margin or spread has come down substantially, whereas their operating cost has been increasing. The trend is expected to continue in the near future. Increased fee-based income through distribution of insurance products will compensate for the loss in spread. Moreover, in cases where insurance business is carried out as a subsidiary, the dividend income from the subsidiary will also add to the parent bank's profitability and return on assets.
10) Recently, the Central Government has approved a voluntary retirement scheme for the insurance sector. This would provide an opportunity to bancassurers to hire such retired insurance employees, i.e., readymade talent, into their business.
11) During the last couple of years, banks have been flush with deposits, whereas credit deployment has been slow - both due to several socio-economic reasons. Banks are investing in government and approved securities, overshooting the SLR ceiling. Therefore, banks now get an opportunity to focus on selling insurance products instead.
12) Some areas with good potential for bancassurers are health insurance, credit insurance, deposit insurance, travel insurance, capital market-related insurance and pension.
13) It is one of the basic ways to increase return on assets because they can increase their fee income through sale of insurance products. Banks that effectively cross-sell financial products can leverage their distribution and processing capabilities for profitable operating expense ratio.
14) Banks with their wide branch network spread all over the country (66,700 branches) can have a very good opportunity to enter the insurance business. India’s 27 public sector banks account for close to 92 per cent of total network. The network has among other things 33,000 rural branches and 14,000 semi-urban branches, where insurance penetration remains largely untapped. Huge manpower (8,74,170 staff) of all public sector banks will help in effective distribution of Insurance products.
15) In today's competitive environment offering more and more services under one roof would also help banks to improve their market share.
16) Huge customer database containing the names, profiles and contact numbers of banks can be of great use to insurance companies, since minimum average conversion from the bank database into sales will mean a higher productivity than their agencies. They also have access to multiple communication channels such as direct mail, ATMs, telemarketing, Internet banking etc.
17) This new venture would also help banks in better Asset Liability Management. Banks convert liquid short-term liabilities into long-term assets. It exposes them to default rate risk, liquidity risk and interest rate risk.

Challenges in Bancassurance in India

1) Bancassurance products, being "push" products, require a totally different mindset and work culture. Whether the existing staff of banks can achieve this is a big question. Have the Indian banks, which have Mutual Fund subsidiaries, succeeded in selling mutual fund products through their bank branches? Certainly not. The issue of cultural incompatibility can impede bancassurance business to a great extent. Alternatively, if the insurance subsidiary of the bank has to maintain the entire paraphernalia, comprising research, administrative, distribution and other staff, it would be too costly, and in some cases, the cost restrictions would not permit it to indulge in this.
2) Further, since life products and banking products are similar, efforts to market the former will be less cumbersome for the bancassurance company. However, non-life products are entirely different from life or banking products and are far too complex, with high counter-party and reinsurance risks,

and hence, it would be difficult for bancassurance companies to enter into general insurance business immediately, until and unless they develop and retain the required skill.

3) The manner in which insurance profits develop poses a threat to successful operation of bancassurance. An analysis of profit signatures, i.e., the time pattern over which profits of the insurance sector develop, shows that worldwide, the breakeven period of time before profits ranges between 6 and 8 years (unless the company is captive). For life insurance business, this works out to 8-10 years. This is because initial procurement costs are high. In some countries, commissions and expenses required to earn first year's premium are much higher than 100 percent. In India, these stand at 90 percent for the first year's premium. On the other hand, distribution of profits is tightly regulated. In India, only 5 percent of the actuarial surpluses can be distributed as dividend. Does this bode well for bancassurance?

4) LIC and the four subsidiaries of GIC are well established in their respective lines of businesses. Opening up the insurance sector has also awakened them, and being old players, they would like to take their competitors, who are new, by the horns. Thus, they will strive to become more competitive, and will be buttressed by their financial and non-financial strength, including the lobbying power. This would pose a threat to the new bancassurers. Too much of competition may lead to accentuation of the adverse selection and moral hazard problems, which may ultimately prove detrimental to the insurance industry as a whole.

5) Success of bancassurance would also depend on the extent to which and how fast the technology being used for banking operations can be used for meeting the technology requirements for insurance business. Otherwise, banks will have to incur large investments for putting in place the technological infrastructure for bancassurance operations.

6) In case of failure of the bancassurance operation, the bank runs the threat of image risk and cannibalizing deposits (i.e. there may be a fear among the staff that investment oriented life insurance products may eat into the deposit base of the branches).

7) Insurance sales being commission/incentive driven, banks selling insurance products may be required to provide incentive packages in addition to the regular remuneration to drive the sales.

8) Maintaining the same service levels for insurance business as that for the banking services may be one of the biggest challenge.

9) Private players in the insurance industry being new entrants are technology-savvy. Banks, especially PSBs, have to rise up to the challenge and be willing to invest in technology.

CONCLUSION

Traditionally banks transform short-term liabilities into long-term assets. This generates credit risk on asset side and liquidity risk on the liabilities side. The maturity mismatch between assets and liabilities exposes banks to interest rate risk and makes them more vulnerable. The bank can address this specific issue by entering into insurance business. An insurance activity accumulates substantial amount as premium receipt. With the long-term fund, banks can decrease the possibility of liquidity and solvency problems. Even if banking and insurance are carried out as separate entity, through a holding arrangement, the insurance outfit can afford a potential source of liquidity for the parent.

All over the world, governments are known to intervene in the insurance business through regulations to make insurance a catalyst of social development. The Indian government has also issued detailed guidelines regarding this. IRDA has made it mandatory for every insurer who started business after the commencement of IRDA Act, 1999 to ensure the prescribed levels of business from rural and social sectors. The guidelines in this connection indicate that the life insurer must cover a minimum rural business of five per cent in the first financial year; seven per cent in the second financial year, ten per cent in third financial year; twelve per cent in the fourth financial year and fifteen per cent in the fifth year of total policies written during that year. In respect of a general insurer, the prescribed limit is - two per cent in first financial year, three per cent in second financial year and five per cent thereafter of total gross premium income of that year. In respect of social sector all insurers are suppose to cover five thousand lives in the first financial year, seven thousand five hundred lives in second financial year, ten thousand lives in third financial year; fifteen thousand lives in fourth financial year and twenty thousand lives in the fifth financial year.

These rural and socially disadvantaged sectors are very difficult to service. They are scattered geographically in small indigenous social groups. It is very difficult to identify their need and design products that are viable as well as acceptable to these segments. In fact, the real issue is cost effectiveness. These target clienteles can be addressed by spending substantial amount of money by way of marketing research to identify their needs and promotional measures to reach them. The coming together of banks and insurance can provide substantial synergy here. The banks already have a massive infrastructure spread across the width and breadth of the country. Banks possess a vast array of market intelligence including rural and disadvantaged section of the society. This information can be leveraged to design appropriate products for the specific requirements of target population. The widespread branch network can be used as a marketing channel without incurring significant amount of money. Definitely collaboration between banks and insurance companies can be of great benefit to service this target group in a cost-effective and financially viable manner. In fact, it may be noted in this connection that generally insurance company suffer from substantial amount of losses in the early years of their operation. One of the contributory factors in this regard is social obligations mandated by the government. International experience shows that even in relatively developed countries it takes a long period of time to reach out to less privileged regions and segments of population. Obviously, in India the problem is much larger and more complex. Bancassurance is an appropriate strategy in this connection.

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