# Bancassurance in India:
# Who is tying the knot and why

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**Abstract**
Why do banks and insurance companies get into bancassurance? Little has been studied of this phenomenon in emerging markets. Bancassurance in India has taken a flying start. Economies of scale and scope make such an alliance attractive for both parties. We examine the factors behind bancassurance by examining the developments and performing quantitative tests.

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## 1. Introduction

Bancassurance commonly means selling insurance products under the same roof of a bank. Though bancassurance had roots in France in the 1980s, and spread across different parts of Continental Europe since, it has spread its wings in Asia – in particular, in India.

In India, there are a number of reasons why bancassurance could play a natural role in the insurance market. First, banks have a huge network across the country. Second, banks can offer fee-based income for the employees for insurance sales. Third, banks are culturally more acceptable than insurance companies. Dealing with (life) insurance, in many parts of India, conjure up an image of a bad omen.[1]

Some bank products have natural complementary insurance products. For example, if a bank gives out a home loan, it might insist on a life insurance cover so that in case of death of the borrower, there is no problem in paying off the home loan. Similarly, a car loan could only be given if comprehensive auto insurance is taken out on that particular car.

This paper is organized as follows. In section 2, we trace some of the salient developments of banks in India. Section 3 discusses how the lack of coordination between bank regulation and insurance regulation created confusion in the development of bancassurance. Section 4 details two main problems facing banks in India: bad loans and overstaffing. Section 5 describes some of the long term drivers of bancassurance in

[1] This has been a long tradition in India. Insurance salesmen (and they are mostly men) are seen to be bearers of bad omen. The superstition revolves around the belief that if you buy life insurance, the probability of your death increases. This is not just in India. It is true in many other parts of the world as well (e.g., Mexico). Even in English, we use the term "life" insurance that really means "death" insurance.

general. We discuss some salient issues of entry of banks into the insurance industry in section 6. The entry of the State Bank of India created special problems in the insurance industry. Sections 7 and 8 discuss bancassurance experience in other countries – in particular, two experiences in Asia are highlighted. In section 9, we discuss American versus European modalities and their relevance for India. In section 10, we assess the success of bancassurance model in India. Section 11 details some salient reasons why banks are getting into insurance business. In section 12, we develop a model of entry of banks in insurance business. In the following section, we discuss the results. Final section concludes.

## 2. Expansion of banks in India

Penetration of commercial banks in India has been quite extensive. There are around 66,000 branches of scheduled commercial banks. Each branch serves an average of 15,000 people. The only other national institution with a bigger reach is the postal service.[2] Banks have not only been successful in the urban areas. It has also grown tremendously in the rural areas. Of the total number of branches of commercial banks, there are 32,600 branches in rural areas, and 14,400 semi-urban branches. In addition, there are 196 exclusive regional rural banks in deep hinterland. There is research evidence to show that the deliberate expansion policy of banks in rural areas has contributed to poverty reduction in India (see, Burgess and Pandey, forthcoming).

Instead of simple headcounts, if we take other bank penetration measure like total value of deposits as a percent of GDP, it is also exhibiting an upward trend. This means bank deposits are growing at a rate much faster than the gross domestic product (Figure

[2] The Department of Posts (DoP) has 155,600 branches all across the country. Oriental Insurance has set up ties with the post offices to distribute their products on a pilot basis (see below).

1). Banks have become the main saving vehicle in the economy. Between 1985 and 1995, the growth of deposits in banks stalled at under 35% of the GDP (that itself is a high number by the standard of the developing economies). From 1995, the banking sector started growing again. The deposits in banks grew another 10% of GDP by 2000. This level of growth in bank deposit has been totally unprecedented in India since independence. Why did the bank deposits take a leap? One simple (but partial) reason is a substitution from the stock market. In 1994, Indian stock market was hit by the worst scandal of manipulation of stock prices in its long history. The stocks fell sharply driving many investors into safer investment options. Rising saving *rate* during the late 1990s led to sustained growth of bank deposits (that is, additional investment in the stock market came in the form of fresh money and not a flow of money out bank saving. The rising saving came as a result of rising income across the board.

With this background, it is therefore not surprising that banks have become a vehicle for selling insurance products.

**3. Financial Institutions in Insurance Business: RBI Rules**

Banks are regulated by the Indian central bank, the Reserve Bank of India (RBI). Therefore, the RBI has set down the rules for the entry of banks in the field of insurance. In 1999, the Governor of the Reserve Bank of India declared: "Presently, there is no provision in the Banking Regulation Act whereby a bank could undertake the insurance business. The Act may have to be amended before banks could undertake insurance business. Alternatively, there is a provision in the Banking Regulation Act whereby banks could take any other form of business which the central government may notify. Thus, if the central government notifies insurance business as a lawful activity for a

banking company, perhaps banks would be able to undertake insurance business. It may, of course, be necessary to specify what type of insurance business they could undertake".

However, the following year, in a set of draft guidelines issued to all scheduled commercial banks and select financial institutions, the RBI laid out a set of parameters that need to be met. (1) The net worth of the bank/financial institution should not be less than Rs.5 billon. (2) The capital adequacy ratio of the bank/financial institution should be not be less than 10%. (3) The bank/financial institution should have track record of at least three continuous years of profits. (4) The level of net Nonperforming Assets should be 1% below the industry average. (5) The track record of performance of existing subsidiaries of banks/financial institutions should be “satisfactory”.[3]

Some confusion arose from the circular. Therefore, the RBI proposed a series of amendments in March 2000. In addition to the entry of banks, the RBI also laid down a set of guidelines for the entry of Non-Bank Financial Companies (NBFC) into insurance business (June 30, 2000)[4]. There were two critical differences in the requirements proposed for the NBFCs.

First, the capital adequacy ratio of the NBFC (applicable only to those holding public deposits) should not be less than 12 percent if engaged in equipment leasing/hire purchase finance activities and 15 percent if it is a loan or investment company.

Second, the level of nonperforming assets should be no more than 5 percent of total outstanding leased/hire purchase assets and advances.

[3] Draft Guidelines for diversification into Insurance business by banks/financial institutions, Reserve Bank of India, Circular, January 10, 2000.
[4] Circular Number DNBS.(PD).CC.No. 13 /02.01/99-2000, Reserve Bank of India.

On November 28, 2001, the same rules were extended to cover "All India" Financial Institutions.[5] Specifically the rules for these institutions were set at the same level as the NBFCs noted above.

Some confusion still remained whether it was possible for the financial institutions to accept fees for their services directly or not. The RBI cleared their position in two separate circulars: one for the scheduled commercial banks and the other for the other institutions. It also stated that financial institutions "should not adopt any restrictive practice of forcing its customers to go in only for a particular insurance company".

In the 2001 *Report on Currency and Finance,* the RBI laid down its views in more concrete term. "The Reserve Bank, in recognition of the symbiotic relationship between banking and the insurance industries, has identified three routes of banks' participation in the insurance business, viz., (i) providing fee-based insurance services without risk participation, (ii) investing in an insurance company for providing infrastructure and services support and (iii) setting up of a separate joint-venture insurance company with risk participation. The third route, due to its risk aspects, involves compliance to stringent entry norms. Further, the bank has to maintain an 'arms length' relationship between its banking business and its insurance outfit. For banks entering into insurance business with risk participation, the prescribed entity (viz., separate joint-venture company) also enables to avoid possible regulatory overlaps between the Reserve Bank and the Government/IRDA. The joint-venture insurance company would be subjected entirely to the IRDA/Government regulations." (Chapter IV, Financial Market Structure, page IV-31).

[5] Circular Number DBS.FID No. C-8 /01.02.00/2001-02, Reserve Bank of India.

## 4. Problems of Bad Loans and Overstaffing

There are two serious problems that banks suffer from. First, banks have been saddled with bad loans in the early 1990s. Second, banks are overstaffed. We discuss them in turn. *Even though it sounds paradoxical, both of these developments are relevant for bancassurance. However, neither development will be a long term driver of bancassurance.*

First, let us take a look at the problem of bad loans. In India, the crisis of 1991-92 left a number of banks undercapitalized. The government started the long and slow process of infusing more money to these public sector banks (see Table 1). The total amount of money exceeded eight percent of the GDP.[6] But, since, they were undertaken over a long period of time, the problems of banks in India never came under the "crisis" category. Recent economic boom has also helped India to bring the proportion of nonperforming assets down. Since the *definition* of nonperforming assets vary across countries, it is difficult to compare India with other countries. At any rate, if India continues to grow as rapidly (as seems to be the consensus among forecasters) as in the recent past, the proportion of nonperforming assets will continue to come down for the banks. Thus, banks will feel more comfortable to get into life insurance business more directly like the State Bank of India has. The RBI is probably going to take an accommodative position if it sees a continuously falling proportion of nonperforming debt. Thus, *on this count, there is a greater likelihood of other banks entering the fray.*

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[6] No recapitalization support was provided to banks for the years 1999-2000 and 2000-01. Subsequently, the Union Budget 2000-01 announced that the Government would consider recapitalization of the weak banks to achieve the prescribed capital adequacy norms, provided a viable restructuring program acceptable to the Government as the owner and the Reserve Bank as the regulator is made available by the concerned banks. Accordingly, during the year 2001-02, a sum of Rs.1,300 crore (or 0.31% of the GDP) was disbursed.

As noted earlier, this is a one-time only factor for banks entering insurance markets in India. This reason is not going to be repeated. This cycle of upswing of business conditions will come to an end sooner or later.[7]

Second, let us examine the problem of overstaffing in banks. There have been numerous committees set up in India and by international organizations like the World Bank and the IMF pointing out the problem of overstaffing in the banks in India (especially the government owned banks). The general consensus among experts is that banks need to shed at least 10% of their workforce. Unfortunately, banks also have one of the most militant and politically powerful unions in the country. To manage this problem, banks have taken some steps. They have, so far, reduced the cost of operation from around 3% of total deposits in the early 1990s to around 2.5% by 2000 (Figure 2). The cost of operation is not uniform across types of banks. The reduction of cost of operation has not been uniform either.[8] Neither has it been smooth. In the past two years, banks have taken additional steps.

One of the much vaunted efforts in banks in India in recent months has been the so-called voluntary retirement schemes (VRS). Typically, workers over 40 who have served the banks for ten years or more become eligible to take voluntary retirement. Since VRS does not involve coercion, it has the blessings of the relevant unions. However, the problem has been this: whenever such offers are made, the most productive and most employable workers take up the offer. This is a manifestation of a well-known problem first articulated by the Nobel Prize winning economist George Akerlof under the problem of "lemons" in used car market. In the case of VRS, the problem may be termed

[7] This will probably happen when the rainfall becomes unfavorable in one or more consecutive seasons.
[8] CII Bank Background Paper, 2002, Chart F.

as a “dead wood” problem. Only the workers who cannot be employed elsewhere are more likely to stay. This has the problem of lowering productivity of the banks. Banks have responded by refusing to grant VRS to persons it deems necessary.[9]

VRS has been an expensive exercise for banks. All told, they have spent some sixty billion rupees (USD 1.2 billion) during 2000-2003. The number of employees amount to some 100,000 employees or 11% of total number of employees in the banking sector. This exercise has produced the desired reduction in employment if we simply look at the headcount. Banks manage to shed 11% through this process where 10% was the initial target. Although the hope of the banks was to ease out “non-officer” category employees in the process, 34% of the takers turned out to be officers.

Some banks, especially the State Bank of India have been espousing another solution. If they could redeploy some of their existing staff for selling insurance, they will be able to reallocate resources without resorting to VRS or any other scheme that have adverse effects on the bank productivity. *Thus, the excess staffing problem may turn out to be a boon for bancassurance business. Once again, this development is going to be a one-time only effect and not a future driver of bancassurance.*

**5. Long Term Drivers of Bancassurance in India**

The staffing problem has redirected some banks to bancassurance and so has the reduction of bad loan problem. But, they are not the long term drivers of bancassurance in India. The long term drivers in India are going to be the following. (1) The culturally more acceptable banking transactions. Banking does not have the same stigma that (life) insurance carries (see footnote 1). This factor will diminish in importance over time as people become more educated. (2) Banks can offer fee-based income for insurance sales.

[9] As might be expected, this action has been challenged in the courts by the workers who want to leave.

This can be attractive under current rigid structure of wage benefits. At present, banks are prohibited from offering commission to the bank employees for selling insurance products. Banks have found ways to circumvent the problem. For example, they offer "car allowance" for the employees selling insurance. (3) Narrowing bank margins are another key driver. (4) Banks have complementary products with insurance products such as the auto insurance, home insurance or annuities. (5) When the pension reform is undertaken (and it is in the works), banks can become natural institutional vehicles for private pension products. In some countries, banks are explicitly prohibited from selling pension products (e.g., Australia). In some other countries, banks are the leading private pension providers (e.g., Mexico). (6) Healthcare insurance sector can also benefit from bancassurance. In India, only 2.5 million people have access to healthcare facilities. On the other hand, 5% of personal income is spent on healthcare. Banks can distribute and facilitate administration of healthcare insurance. (7) In many countries, the absence of banks from selling insurance seems to stem from regulatory reasons. In India, privatization of the insurance sector signaled an accommodating approach from both the insurance regulator and the banking regulator for banks entertaining the thoughts of selling insurance (see below).

**6. Entry of Banks in Insurance Business**

On December 28, 2000, the State Bank of India (SBI) announced a joint venture partnership with Cardif SA (the insurance arm of BNP Paribas Bank). This partnership won over several others (with Fortis and with GE Capital). Many experts in the industry have awaited the entry of the SBI. It was well known that the SBI has long harbored plans to become a universal bank (a universal bank has business in banking, insurance

and in security). For a bank with more than 13,000 branches all over India, this would be a natural expansion.

In the first round of license issue, the SBI was absent. There were several reasons for this delay. First, the SBI was seeking a foreign partner to help with new product design. Second, it did not want the partner to become dominant in the long run (when the 26% foreign investment cap is eventually lifted). It wanted to retain its own brand name. Third, it wanted a partner that is well versed in the universal banking business. This criterion ruled out an American partner where underwriting insurance business by banks has been strictly forbidden by law (although with the passage of the Gramm-Leach-Blily Act, this is not quite as drastic as before). Cardif is the third largest insurance company in France. More than 60% of life insurance policies in France are sold through the banks. Fourth, the Reserve Bank of India (RBI) needed to clear participation by the SBI because in India banks are allowed to enter other businesses on a "case by case" basis.

The SBI entry is groundbreaking for several reasons. This was the first for an Indian bank to enter the insurance market.[10] Second, even though the regulators have said that banks would not (generally) be allowed to hold more than 50% of an insurance company, the SBI was allowed to do so (with a promise that its share would be eventually diluted).

Ever since the entry of the SBI, a number of other insurance companies have declared their desired banking partners. In this process, both life and nonlife companies have tied up with banks. The list of partnerships is in Table 2. Note that some of the partnerships listed here are simply at the Memorandum of Understanding (MoU) stage.

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[10] This kind of synergy between a bank and an insurance company is not so rare in other parts of the world, but in India, it was.

They are yet to take any concrete form. These alliances are listed in Table 2. A number of interesting facts emerge from the table.

The first obvious feature of Table 2 is the "natural partnerships" in the list. Specifically, HDFC Life Insurance is tied with HDFC Bank, ICICI Prudential with ICICI Bank and so on.

The second striking feature of the table is the proliferation of banks partnering with single insurance companies. Given that there are only two dozen insurance companies and hundreds of banks, this outcome is to be expected. Moreover, insurance companies are targeting different market segments by affiliating with banks that do niche banking. Take the example of Aviva. Aviva has evolved a three-layered strategy. The first layer is a tie-up with ABN Amro and American Express. It caters to high net worth urban customers. The second layer is a tie up with Canara Bank. Through this nationalized bank with 2,400 branches, it reaches customers across the length and breadth of the country. The third layer, at a regional level, a tie-up with Lakshmi Vilas bank focuses on the region specific customers. This tie-up helps them reach customers in rural and semi-urban centers in Tamil Nadu and Andhra Pradesh.

The third feature is best illustrated by an example. Allianz Bajaj does not have the same banking partners for the life sector as in the non-life sector. These two lists do not match. The same is true for several other companies.

Fourth, some banks appear to have tied up with several insurance companies. For example, Citibank appears in the list of a number of life as well as in the non-life insurance company lists. This fact will become important as the warning of the RBI that

banks “should not adopt any restrictive practice of forcing its customers to go in only for a particular insurance company” become an issue in the future.

Fifth, the most recent addition to the list is the Oriental Insurance Company. In January 2004, it declared that it would distribute insurance policies through the post offices after it announced a joint venture with the Department of Posts. Given that the post offices have unprecedented reach around the country with 155,600 branches, it could distribute policies to the customers even in very remote areas. The Department of Posts is the *only institution* with a reach bigger than the banks in India.

There are several other banks in the pipeline for the approval of the IRDA. They include the Punjab National Bank, the Principal Group and Vijaya Bank. Two of them are well-established banks in India. The Principal Group, an international financial institution, is mainly in pension business around the globe. In India, it is likely to enter in a partnership with a bank with national distribution network in order to ramp up pension products once pension becomes deregulated in India.

The latest group to receive an outright charter for operating insurance operation is Sahara Group (on March 5, 2004). Sahara's entry is notable for two important reasons. First, Sahara is the only company to enter the Indian market without any foreign partner. It thus becomes the only purely domestic company to be granted a license to operate in the insurance sector. Second, it operates the largest Non-Bank Financial Company in India. It has over 50 million depositors. To put it differently, one in every 20 Indians has an account with Sahara. It serves the country through 1,700 establishments. Since the

company is diversified,[11] it can use multiple channels for distribution of its product – not the least through its NBFC capacity.

**7. Experience from other countries and their relevance for India**

In this section, we draw on important general points about bancassurance experience in other countries (Crooke, 1997).

*Banking habits:* Bancassurance tends to have greater influence where banking habits are well entrenched. In Continental Europe, good examples can be found in countries like France, Belgium, and the Netherlands. Customers there visit their banks more frequently than in other countries. In other markets, where securities markets dominate, bancassurance developments have been relatively mute. These also happen to be countries with English Law origin: Australia, Canada, United Kingdom and United States.[12] However, it is not just those countries where bancassurance has not taken large market share in Continental Europe. This is probably driven by restrictive regulatory regime.

In India, banking is well spread both geographically and across different socio-economic groups. In this respect, India is similar to Continental Europe. India also owes its legal origin to the English system. Thus, it shares some of the characteristics of the other Commonwealth countries mentioned above. In addition, ownership of equity is relatively high compared with the level of economic development. So far, regulation both by the IRDA and the RBI has been accommodating.

[11] It has large bases in housing, depository institutions, infrastructure, housing construction, aviation, media and entertainment (television channels, movie production etc.).

[12] Perhaps the development of securities market and the English Law origin have some relationship with each other.

*Extent of development of insurance:* Where insurance is underdeveloped with low penetration, but there is a strong banking branch network, insurers often use the banking reach as a cheaper alternative to building from scratch. This has been the experience in southern Europe (e.g., Spain, Italy).

On this count, India comes out as a mixed bag. There are over 1,000,000 insurance agents in India. Therefore, it does not appear that India *has to* have an alternative distribution system. However, the average number of transactions conducted by these agents is very low (by international standards). A large proportion of them do not have access to telephones or electricity, let alone computers. For some companies, turnover of agents has become a disaster.[13] Banks have more resources in these regards. Thus, banks could provide cheaper service (especially for simple products). In other words, large market like India can sustain serving different market segments through different channels of distribution.

*Role of distribution system:* In some countries (e.g. Germany & Japan), companies have cross sharing holding arrangements which assign separate roles to the branch network and the tied agency network.

In India, cross-holding is practically non-existent for regulatory reasons. Thus, this element is not very important.

*Tax and pension structure:* Regulatory advantage - creation of products classed as life insurance. For example, endowment type life policies have been sold extensively in France. But they are closer to long term bank deposits rather than "true" insurance products. Tax structure in the country may encourage this type of products as well.

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[13] Business World reported in December 2003 that MetLife has been asked by the IRDA to resubmit its business plan after it lost huge amounts of money (http://www.businessworldindia.com/dec1503/news15.asp).

To some extent, this is also true in India. On maturity, payments are tax-exempt. There is also a small tax relief for premiums paid in certain kinds of policies (see Table 4). However, we have to keep this point in perspective. The proportion of workers who pay taxes is very small (in the single digit). Therefore, the tax advantage does not apply to a vast proportion of the population. Similarly, pension is virtually non-existent in India (with the exception of workers in the government sector). Thus, this discussion is academic in India. However, in future, as the economy grows and becomes formalized, this point will assume greater importance.

**8. Bancassurance in Asia: Two examples**

*Malaysia:* Mayban Life Insurance, incorporated in 1992, was established as a dedicated bancassurance arm of Maybank of Malaysia. Mayban decided to employ bancassurance and leverage on the bank's brand name and branch network to break the tight grip of a handful of large life insurers in the Malaysian market. The highly integrated model employed (i.e., Maybank Life Insurance as a subsidiary of Maybank bank) allowed the life insurers exploit the customer base of its parent company (about five million customers) through some 265 Maybank and 100 Mayban Finance branches. The company was able to pass on some of the cost saving to customers. It has also succeeded in using bank's other capabilities like payment services. In a similar fashion, Mayban General Assurance (Berhad) was established later in a partnership with Fortis to distribute non-life insurance products (This example is taken from Sigma 7/2002).

*Japan:* The first phase of deregulation of bancassurance in Japan began on April 1, 2001.[14] The range of products that banks are allowed to distribute was expanded from October 1, 2002. One of the first products that banks were allowed to sell was credit life

[14] The deregulation of insurance started much earlier in 1996. It became known as the "Big Bang".

insurance. Banks are now allowed to distribute personal pension insurance, asset formation insurance, individual life annuity and accident insurance, and personal accident insurance. All of this is expected to translate into a bancassurance boom in Japan.

In many Asian countries, bancassurance has become an important channel but, unlike in some countries in Continental Europe (e.g., Portugal, France, Spain, Belgium), it has *not* become the main channel of distribution of insurance. Countries with relatively high bancassurance share of life insurance distribution are Hong Kong (25%), Singapore (15%), Thailand (12%) and Malaysia (11%) in 2001 (data taken from Leo Puri's presentation at the Swiss Re CEO Summit). In other countries in the region, such as China, Indonesia and the Philippines, the share of bancassurance was rather small (5% or less in 2001).

Key driver of bancassurance elsewhere in Asia has been the following. Banks are seeking ways to raise additional earnings without commitment of additional capital in a low interest rate environment; increased competition; reducing margin. Insurance Companies are seeking new customers using new distribution activities to reach such segment. As noted above, the biggest driver in India is different at present: banks are seeking an alternative method of redeploying their surplus workers. Of course, this is a one time only phenomenon. Therefore, over time, we will see other factors that have played important roles in other countries will also play out in India.

**9. India: American versus European Modalities**

Looking forward towards 2020, with a more developed middle income economy, India will have a bigger insurance market both in life and in non-life.[15] There are two

[15] Estimates vary how large the insurance market will be in 2020. It could be somewhere between USD 120 billion to USD 160 billion assuming no sudden policy reversals by Indian government.

developed country modalities that India might move to: the Continental European Model and the American Model. This contrast is presented in Table 5. Where is India headed? The short answer: India is moving towards the Continental European model. Why? The peculiar structure of the American model is an outcome of longstanding firewall between banks and insurance companies and a prohibition of expansion of business for both insurance and banks across state lines. This overhang is absent in India. Take the example of insurance business. There is no state by state limit of insurance business. There are minimum business requirements for rural areas. The fragmentation of both insurance and banking businesses in the United States is a direct result of the Glass Steagall Act of 1933.

Nevertheless, it might be instructive to examine what succeeded in America for the expansion of bancassurance business. A survey by LIMRA identified the following ten elements for success of bancassurance: (1) Strength of the Brand. (2) Sales Staff Management/Training. (3) The Branch Network/Geographical Coverage. (4) Bank and Insurance products form a complementary range. (5) Single view of the customer. (6) Focus on Customer Service/satisfaction. (8) Use of Customer Relation Management Tools and Techniques. (9) Integration of the bank and insurance organizations producing a single culture. (10) Providing advice/solutions, not selling products (taken from the presentation of Marielle Theron at the SwissRe India CEO Summit, 2003).

**10. How successful has the bancassurance model been in India?**

There have been two broad classes of agreements between banks and insurance companies. (1) Pure Distribution Agreements. Under this class, there are two sub-classes of arrangements: (1a) Referral Arrangement and (1b) Corporate Agency Arrangement.

(2) Joint Venture Agreements. There has been a range of such arrangements from loose to integrated form of distribution partnerships.

There has been a substantial growth of bancassurance in India. Within two years, the share of bancassurance in the insurance distribution business has gone from zero to 20% of new business in the private sector. Table 3 provides us a sense of how rapidly bancassurance is growing in India. Some experts are predicting that within a decade, this proportion could rise to 35% to 40%. There is evidence that policies sold through bancassurance add more value. In the July 2003 issue of the Asia Insurance Post, the Mr. P. Nandagopal of Birla Sun Life was quoted as saying, "The average size of the policy for the agency channel is Rs 19,500 per policy and for the bancassurance channel it is Rs 39,000 per policy." Although such concrete numbers are not available industry-wide, there is general consensus that bancassurance is indeed bringing in customers of higher value.[16]

**11. Why Banks are Highly Motivated to Enter Insurance Business Now**

Why banks have an incentive to promote bancassurance in India? We summarize the arguments we have elaborated upon in this article. (1) Overstaffing problem can mitigated without resorting to drastic and politically unacceptable solutions like large scale firing. (2) Banks seek to retain customer loyalty by offering them an expanded and more sophisticated range of products (than simple bank deposits of few varieties). (3) Insurance distribution will increase the fee-based earnings of banks. (4) Fee-based selling helps to enhance the levels of staff productivity in banks. This is a key driver for raising motivation among bank workers.

[16] Evidence from China shows that the profit margin for the insurance companies from products sold through banks is much lower than agent-distributed products. Most benefits go to the banks.

Banks have some in-built advantages in some of these areas. (1) Banks can put their energies into the small-commission customers that insurance agents would tend to avoid. (2) Banks' entry in distribution helps to enlarge the insurance customer base rapidly. This helps to popularize insurance as an important financial protection product. (3) Bancassurance helps to lower the distribution costs of insurers. A study by Tillinghast, Towers and Perrin in the UK shows that the cost of selling insurance through direct sales force is approximately twice as high as the cost of selling through bancassurance. However, the cost of selling the products through independent financial advisers is approximately the same as bancassurance (quoted in *Sigma* 7/2002). Acquisition cost of insurance customer through banks is low. Selling insurance to existing mass market banking customers is far less expensive than selling to a group of unknown customers. Experience in Europe has shown that bancassurance firms have a lower expense ratio. This benefit could go to the insured in the form of lower premiums. Banks could have an important role to play in the pension sector when deregulated. Banks can provide collection and payments of pension contributions. Banks can also play a major role in developing a viable healthcare program in India.

**12. Hypotheses Development**

Given the discussions above, we develop the following hypotheses.

*Hypothesis 1:* For banks, if the business per employee is low, it is likely to be attracted to improve productivity by adding bancassurance in their portfolios.

*Hypothesis 2:* For insurance companies, non-performing assets of a bank will act as a brake on the bank/insurance company tie-up for insurance distribution.

*Hypothesis 3:* If a bank profitable (by the standard of banking industry), it could be less likely to get away from core business. On the other hand, a more profitable bank might be willing to gamble some of its profits to a new line of business.

*Hypothesis 4:* For insurance companies, the larger the network of bank branches (for banks with national presence), the more the likelihood of a bank/insurance company tie-up for insurance distribution.

Now we need some instruments to measure various factors discussed in the hypotheses listed above. For hypothesis 1, we take the variable “business per employee” as the measure for business activities of a bank. For hypothesis 2, we take the independent variable “net non-performing assets/net advances” as our variable to measure non-performing assets of the bank. For hypothesis 3, we take the “return on assets” (“ROA”) as our independent variable. For hypothesis 4, we take the volume of business as the size variable. All of these variables are available in the 2001-02 Banking Report of the Reserve Bank of India for each of the 95 banks operating at the time (some of them have since merged with others).

## 13. Results

Results are reported in Table 6. First, we note that the It shows that the variable "business per employee" is negatively correlated with bancassurance variable at a significance level of 5%. This confirms our Hypothesis 1. Asset performance is also negatively correlated with the non-performing assets. However, the association is weaker (only significant at 10%). Thus, we find qualified support for our Hypothesis 2. Hypothesis 3 did not have any support from our results. Hypothesis 4 is also marginally supported (at 10%).

We also investigated a range of sub-variables. For example, we had investigated if branches in different geographical areas make a difference. The only variable that shows marginal significance (not shown in Table 6) is the number of branches in the semi-urban areas.

The data for our analysis is only for a given time window. Thus, it was impossible to test short run versus long run effects (Kaminsky and Schmukler, 2002). As more data become available over time, it will become possible to examine such effects.

**14. Conclusions**

There are natural synergies between banks and insurance companies. In India, with the deliberate expansion policies of banks in remote areas, a large number of bank branches indeed reach even the remote areas. Banks also a huge "Trusted Brand" advantage. In December 2003, the Annual Survey of trust in different brands of companies in India shows one clear picture (see Table 7). There is *only one* financial institution in the top 50 list: the Life Insurance Corporation of India (LIC) at 39. There are a number of banks in the list of 150 trusted brands (with the State Bank of India heading the list at the fifty first place (with no other bank cracking even the top 100). There is *no other insurance company* in that list.

In April 2004, we sent out a questionnaire to all the insurance companies asking the following question: "What proportion of your distribution would be through bancassurance in five years from now?" With one exception (of a small private insurance company), all others responded to the question.

For private life insurance companies, the average response was that they expect 35% of their products to be sold through banks within five years. As might be expected,

there is a wide variation among insurance companies. It varied from a low of 20% to as high as 75%.

For general insurance companies (both private and public), the average response was that they expect 25% of their products to be sold through banks within five years. The variation in this case was very low. It varied between 20% and 30%.

It is possible that such development could accelerate. For example, at present, it is not possible for bank employees to directly accept commission for selling insurance policies. In the future, it might become possible to do so.

Regulatory changes made by the Reserve Bank of India and the Insurance Regulatory and Development Authority have been favorable to bancassurance development.[17] Restrictions on foreign share ownership limit the choice of bancassurance. But, it is widely expected that by the end of the calendar year of 2004 we shall see a move towards loosening up this barrier.

This has become a focal point for many foreign insurers. They would like to see the bank branches as their main distribution channel. Of course, this can only be done if there is smooth flow of information between the customer database of the banks and their insurance partners. Unless computerization becomes universal, this development will take a number of years.

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[17] The term "favorable" is relative. For example, in comparison with other countries in the region, Sigma (7/2002, Table 6) has termed the posture of the IRDA as "neutral" only regulatory bodies of two City States of Hong Kong and Singapore get "favorable" qualifications.

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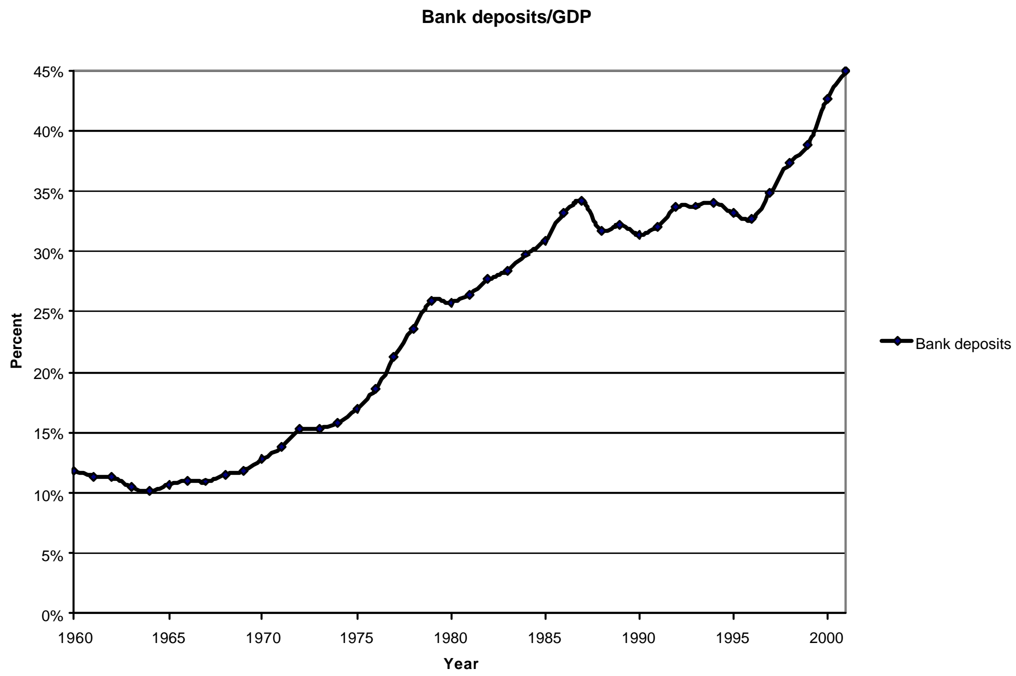
Figure 1: Banking activity relative to the economy




Source: World Bank Data on Financial Penetration (www.worldbank.org)

Table 1: Cost of re-capitalization of banks in India

| | 1993 | 1994 | 1995 | 1996 | 1997 | *1998* |
|---|---|---|---|---|---|---|
| *Capital cost as a percent of GDP* | *0.73* | *1.31* | *1.32* | *1.38* | *1.58* | *1.52* |

Source: Raje (2000).

Table 2: Existing relationships between insurance companies and banks

| **Life Insurance Company** | **Banking Partner** |
|---|---|
| HDFC | Standard Union Bank of India, Indian Bank, HDFC Bank |
| ICICI Prudential | Federal Bank, ICICI Bank, Bank of India, Punjab & Maharashtra Cooperative Bank, Allahabad Bank, South Indian Bank, Citibank, Lord Krishna Bank, Goa State Co-operative Bank, Indore Paraspar Sahakari Bank, Manipal State Co-operative Bank and Jalgaon People's Co-operative Bank, Shamrao Vithal Co-operative Bank. |
| Birla SunLife | Citibank, Deutsche Bank, IDBI Bank, Development Credit Bank, Bank of Rajasthan, Bank Muscat, Catholic Syrian Bank Ltd, Andhra Bank, Karur Vysya Bank Ltd |
| Tata AIG | HSBC, Citibank, IDBI Bank, Union Bank of India |
| Old Mutual KM | None |
| SBI Life | SBI , BNP Paribas |
| ING Vysya | Vysya Bank, Bharat Overseas Bank |
| Allianz Bajaj | Standard Chartered Bank, Syndicate Bank |
| MetLife | Dhanalakshmi Bank , J&K Bank, Karnataka Bank |
| AMP Sanmar | Manjeri Cooperative, Perunthalmanna Bank , Nilambur Bank (all Kerala based). |
| Aviva | ABN Amro, American Express, Canara Bank, Lakshmi Vilas Bank |
| LIC | Corporation Bank, Oriental Bank of Commerce, recently signed MoU with Nedungadi Bank, Central Bank of India, Indian Overseas Bank, and Bank of Punjab, Vijaya Bank, Centurian Bank, The City Union Bank Ltd, Repco Bank |

| **Nonlife Insurance Company** | **Banking Partner** |
|---|---|
| Bajaj Allianz | Bank of Punjab, Bank of Rajasthan, Jammu & Kashmir Bank, Karur Vysya Bank, Lord Krishna Bank, Punjab & Sind Bank, Shamrao Vithal Co-operative Bank, Karnataka Bank. |
| Royal Sun Alliance | Citibank, ABN Amro, Standard Chartered, American Express, Repco Bank, SBI-GE, Karur-based Lakshmi Vilas Bank |

| Tata AIG | HSBC, IDBI, Development Credit Bank, Union Bank of India |
|---|---|
| IFFCO Tokio | Not formally tied up with any banks as yet. |
| ICICI Lombard | ICICI Bank and others in the pipeline. |
| Reliance | Not formally tied up with any banks as yet. |
| United India | Punjab National Bank; Andhra Bank, Dhanalakshmi Bank Indian Bank, South India Bank, Federal Bank, |
| New India | Union Bank of India ,SBI, Corporation Bank, and United Western Bank. |
| Oriental | Department of Posts, Oriental Bank of Commerce, State Bank of Saurashtra |

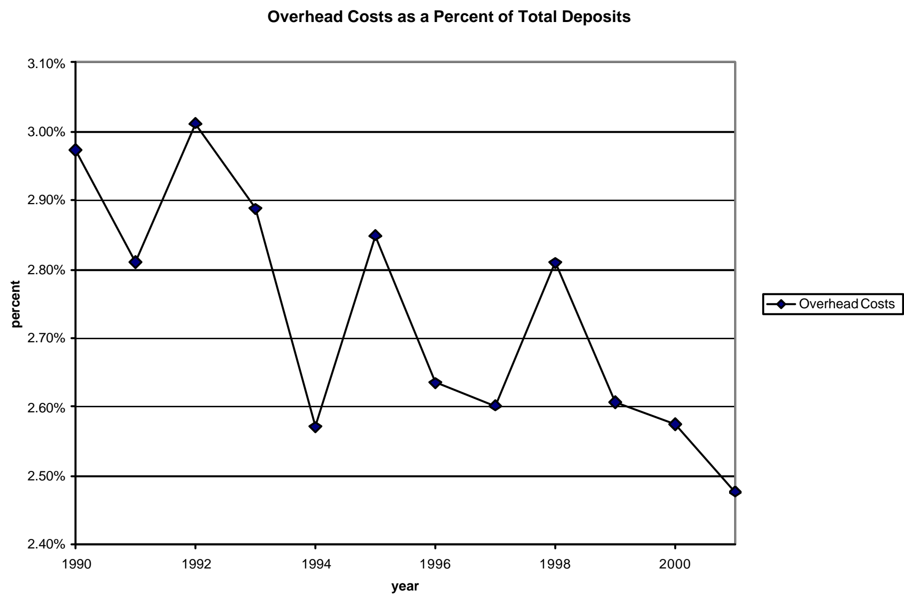
Information updated from newspaper sources and websites of the respective banks and insurance companies (March 11, 2005).

Table 3: Bancassurance business conducted by companies

| Company | % of policies |
|---|---|
| ICICI Prudential | 15% in 2002, 30% in 2004 |
| SBI Life | 15% in 2002, 50% in 2004 |
| Birla Sun Life | 25% in 2002, 40% in 2004 |
| ING Vyasa Life | 10% in 2002 |
| Aviva Life | 50% in 2002, 70% in 2004 |
| Allianz Bajaj Life | 25% in 2003 |
| Royal Sundaram Allianz | 40% in 2002 |
| HDFC Standard Life | 10% in 2002, 40% in 2004 |
| MetLife | 25% in 2002 |

Source: Newspaper reports, various dates.

Figure 2: Overhead costs of banks (1990-2001)




Source: World Bank Data on Financial Penetration (www.worldbank.org)

Table 4: The Atlantic Divide of Bancassurance

| | Continental Europe | United States |
|---|---|---|
| Products | Simple | Extended bank |
| Brand | Extended bank brand | Co-brand |
| Channel | Bank branch | Direct to customer |
| Sales | Bank generalists | TPM/Specialists |
| Organization | Integrated | Silos |
| Insurance Carrier | Few | Many |
| Challenges | Adapting to change | Integration |
| Penetration | 30%+ | 10% |

Source: Marielle Theron's presentation at the SwissRe India CEO Summit, 2003.

Table 5: **Comparing bancassurance in Europe, Asia and India**

| | Europe | Asia (general) | India |
|---|---|---|---|
| Regulation | Liberalized | Ranging from liberalized to forbidden | Supportive |
| Market growth | Mature markets but pension reforms can spur growth in the life insurance sector | High growth potential | High growth |
| Bancassurance model | Highly integrated models | Mostly distribution alliances and joint ventures | Distributive |
| Major drivers | Tax concessions for life insurance premium paid<br>Squeeze on bank margins | Squeeze on bank margins<br>Insurers' growing cost pressure and desire to expand distribution capability<br>Financial deregulation<br>Foreign companies use bancassurance to enter Asian market | Tax free status on maturity<br>Small tax relief on premium<br>Narrowing bank margin |
| Products | Mainly life insurance products to maximize tax benefits<br>Mostly single premium | Mainly life insurance products linked to bank services and increasingly, products geared towards managed savings | Mainly non-unitized<br>Regular premium |
| Distribution | Multi-bank branches | Mainly bank branches | Bank branches |
| Major players | Domestic banks and insurers | Foreign companies are playing an important role. | |
| Sophistication | High | Varied | Low |

This table is adapted from a presentation by Swiss Re CEO Summit and another presentation by Krishnamurthy.

Table 6: Results of binary regression for the determinants of bancassurance
Dependent Variable: Bancassurance (binary)

| *Independent Variable* | *Coefficient* | *z-Statistic* | *Probability* |
|---|---|---|---|
| Business per employee | -0.001451 | -2.367214 | 0.0179 |
| NPA/Advances | -0.044439 | -1.866148 | 0.0620 |
| Return on Assets | -0.060288 | -0.632505 | 0.5271 |
| Log (size) | 0.081921 | 1.932505 | 0.0521 |
| Constant | 0.848935 | 2.037997 | 0.0416 |

Notes: Method used is Maximum Likelihood - Binary Logit. (The results are very similar for Probit and extreme value methods). Convergence achieved after 4 iterations. Covariance matrix computed using second derivatives. Total number of observations is 95. The number of observations where "bancassurance" = 1 is 42 and the number of observations where "bancassurance" = 0 is 53.

Table 7 Trusted Brands in India (Economic Times Survey, December 2003)

| Rank | Brand | Rank | Brand | Rank | Brand |
|---|---|---|---|---|---|
| 1 | Colgate | **51** | **SBI** | 101 | Bombay Dyeing |
| 2 | Dettol | 52 | Liril | 102 | Reliance IndiaMobile |
| 3 | Pond's | 53 | Band-Aid | 103 | BOI |
| 4 | Lux | 54 | Fanta | 104 | BSNL |
| 5 | Pepsodent | 55 | Cinthol | 105 | Tide |
| 6 | Tata Salt | 56 | Cadbury | 106 | Sundrop |
| 7 | Britannia | 57 | Onida | 107 | TVS Victor |
| 8 | Rin | 58 | Nescafe | 108 | Sprite |
| 9 | Surf | 59 | BPL | 109 | Maruti Zen |
| 10 | Close-up | 60 | Hamam | 110 | Hero Honda Ambition |
| 11 | Lifebuoy | 61 | Taj Mahal Tea | 111 | 7 Up |
| 12 | Fair &lovely | 62 | Ariel | 112 | Maruti Esteem |
| 13 | Vicks | 63 | Head & Shoulder | 113 | ICICI Bank |
| 14 | Titan | 64 | Vimal | 114 | Borosoft |
| 15 | Rasna | 65 | Kit Kat | 115 | Tata Indica |
| 16 | Phillips | 66 | Mortein | 116 | Gillette |
| 17 | Bata | 67 | Pears | 117 | Fair Glow |
| 18 | Pepsi | 68 | 5 Star | 118 | Nivea |
| 19 | Clinic plus | 69 | Raymond | 119 | Indian Airlines |
| 20 | Horlicks | 70 | Dalda | 120 | Fairever |
| 21 | Wheel | 71 | Hero Honda Splendor | **121** | **Central Bank of India** |
| 22 | Ujala | 72 | LG | 122 | Anchor Tooth paste |
| 23 | Iodex | 73 | Lakme | 123 | Baygon |
| 24 | Goodknight | 74 | Red Label | **124** | **Punjab National Bank** |
| 25 | Coca Cola | 75 | All Out | 125 | Stayfree |
| 26 | Limca | 76 | Pantene | 126 | Kendriya Vidyalaya |
| 27 | Fevicol | 77 | Whirlpool | **127** | **Union Bank of India** |
| 28 | Godrej | 78 | Bisleri | 128 | Bajaj Pulsor |
| 29 | Thums up | 79 | Samsung | 129 | Taj Hotels |
| 30 | Parchute | 80 | Saffola | **130** | **Indian Bank** |
| 31 | Vim | 81 | Burnol | **131** | **Canara Bank** |
| 32 | Nirma | 82 | Asian paints | 132 | Bajaj Boxer |
| 33 | Moov | 83 | Vicco | 133 | Kotex |
| 34 | Sunsilk | 84 | Timex | 134 | Wills |
| 35 | Complan | 85 | Disprin | 135 | Kinley |
| 36 | HMT | 86 | Eveready | 136 | Bajaj Caliber |
| 37 | Johnson & Johnson | 87 | Boroline | 137 | Reebok |
| 38 | Rexona | 88 | Dhara | 138 | Airtel |
| **39** | **LIC** | 89 | Perk | 139 | Toyota Qualis |
| 40 | Tata Salt | 90 | Maruti 800 | **140** | **UTI bank** |
| 41 | Mirinda | 91 | Bajaj Chetak | 141 | Nike |
| 42 | Maggi | 92 | Palmolive | 142 | BPL Mobile |
| 43 | Videocon | 93 | Lijjat | 143 | Nomarks Cream |
| 44 | Dabur | 94 | Boost | 144 | Pizza Hut |

| | | | | | |
|---|---|---|---|---|---|
| 45 | Parle | 95 | Liberty shoes | 145 | Ayush |
| 46 | Frooti | 96 | Whisper | 146 | BOB |
| 47 | Amul | 97 | D'Cold | 147 | Tata Indicom |
| 48 | Bournvita | 98 | Haldirams | 148 | Nature Fresh Atta/Salt |
| 49 | Sony | 99 | Hero Honda Passion | 149 | Hit |
| 50 | Crocin | 100 | Action Shoes | 150 | McDonalds |

Source: www.economictimes.com