On the banks of Insurance

Banking industry worldwide is experiencing sweeping changes. Technology is transforming the way banking products and services are delivered thereby helping newer and diverse financial services to be extended through the portals of a bank

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Mention insurance and a picture of an unrelenting LIC agent chasing a hapless prospect appears before you. For decades, insurance has been synonymous with Life Insurance Corporation of India (LIC) and a handful of other government controlled non-life insurance firms in India. And people's impression about these firms is no better than any government organization – erratic and not quality conscious. All that is set to change with Government of India's new wave of liberalization initiatives. Recently, the government threw open the insurance sector to private companies and MNCs thus ushering in an era of better insurance. But the best part about this new development is the keen interest shown by banks to enter this service sector. Getting into insurance is no diviation for banks as it would only add to their already wide spectrum of financial services. With the banks already identifying themselves with greater degree of proactive customer servicing, insurance comes in as a natural extension of this changing stance.

Insurance privatisation

Government's issuance of registration certificates for life insurance to the HDFC-Standard Life combine and for general insurance to Reliance General Insurance Company and Royal-Sundaram Insurance is a significant step in India's acceptance of growing market competitiveness. With this, Indians soon can hope to get not only their life and other insurance done from private sector companies but also a host of other products and services. Some of the different products offered by foreign insurance include insurance policies to guard directors of companies against possible lawsuits and prosecution of their firms and insurance policies linked with pension plans.

With almost 95 per cent of India's population uninsured, private insurance firms have a huge fertile market to capture. Opening up of the insurance sector provides a big opportunity for US firms to work with co-ordination with Indian firms to access the market as that is the only way to enter the insurance market for foreign companies at the present. Government has set the foreign equity at only 26% in the insurance segment. The HDFC insurance firm is expected to have a formal launch of its products in January 2001. HDFC's insurance venture will have a paid up capital of Rs 168 crore, 81.6 per cent of which will be owned by HDFC and the rest by Standard Life.

Insurance through banks

So far, ten companies have applied for insurance licences. The interesting part is the Public sector banks, including SBI, Punjab National Bank, Bank of Baroda, Canara Bank, Bank of India and Corporation Bank are also preparing to enter the insurance market. Why are banks intruding into the space of traditional insurance companies? How are banks positioned to handle insurance products? What are the advantages banks have in getting into insurance?

For one, banks have the advantage of their existing customer base and a huge branch network as to start off with. Banking for long meant collecting deposits and lending money to companies at a profit. Now the area of activity of a bank has broadened. There are products like demat services and mutual funds. In a couple of months from now, banks would sell insurance products as well. Such banking-cum-insurance services are known by the term bancassurance in France, where this model has been well accepted. Besides France, bancassurance has succeeded in Portugal and Greece and bancassurance is only about 10 years old in the US.

The interest shown by various banks suggest that bancassurance (banking-cum-insurnace) is here to stay. So far, regulations did not permit any corporate entity to become an insurance agent. As a result, the Indian consumer had access to only individual insurance agents. But with the prospect of banks turning out to be insurance providers this is bound to change. The mode of entry differs from bank to bank; a few banks are sticking to the strict definition of the term by actually setting up insurance joint ventures themselves. Centurion Bank has tied up with Canada Life, a Canadian life insurance company and SBI, Corporation Bank and BoB are negotiating with life insurance companies for joint ventures. Many others are toying with the idea of third-party arrangements for distributing life and general insurance retail products.

The government funded insurance companies in India are so well trenched and well spread that it may take quite a while for some private companies to match that kind of reach. That's where banks emerge as ready avenues for distribution. They can use their available channels and customer base to direct insurance products at a larger audience whose financial positions are known. Having total control over every aspect of the insurance product range would be preferable for banks that enter into insurance segment. But Indian insurance regulations allow only banks with a capital adequacy ratio of over 9% to set up their own insurance operations. So, many public sector Indian banks will have to be content with being just distributors of insurance products. Clearly, only the better-run Indian banks have the capability to sustain a 74% equity partnership in this capital-intensive business.

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New insurance companies that'll enter India

Foreign company	In tie-up with
Prudential Life Insurance	ICICI
New York Life Insurance	Max
Tokyo Marine General Insurance Company	IFFCO
Standard Life	HDFC
Royal Insurance	Sundaram

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Do banks really need to enter insurance segment? Isn't it prudent to leave it to those who know it best and concentrate on its own core competencies? These are necessitated by the pressures of competitive market. The best companies have drastically cut their working capital requirements and whatever they need can be raised directly from the market at rates which the banking system cannot match. The entry of private banks and other financial intermediaries has made the fight even stiffer. The marketshare of government-owned banks has dropped from 97% in the early 1980s to about 90% in 2000. Lending margins too have fallen as giving plain-vanilla loans has become something of a commodity business. Therefore, banks have been getting into high-margin retail businesses like housing loans to ramp up profits. Besides, it's also a great way to make expensive branch networks more cost-effective, since off-the-shelf products will in all probability be sold out of bank lobbies.

Models Of Distribution

So far no bank has entered into insurance nor has there been finalisation of tie-up between banks and insurance companies. Still banks are expected to be distribution channels even where non-banking companies even where non-banking companies have ventured into, HDFC Bank will distribute HDFC's insurance products. There are two ways in which a bank can get into insurance segment: as a corporate agent or go in for the broker model.

Broker regulations limit foreign ownership to 49%. The brokerage model allows tie-ups but will have to be set up as a separate company since regulations do not allow banks to be brokers. The difference between a broker and an agent is that the agent acts as a representative of the company and a broker a representative of the customer and as such a broker has to be service oriented. Also the bank's advice as a broker has to be impartial regardless of the commissions that the broker gets from the insurance firm. The banks may also have to adopt innovative approaches to sell insurance products like cross- selling, off the lobby selling, bundled offerings along with other loans and cards.

Banking on insurance products

Banks can offer a host of services that a traditional insurance cannot offer. Here are some examples of it.

Synergetic insurance

The consumer takes a housing or an auto loan, or even a credit card, he could also take an insurance cover on that. In the case of death or disability, the insurance company picks up the rest of the loan payments, so that the surviving members of the family are not burdened with the loan. Similarly, a housing loan could be entwined with a life insurance policy. Here again, in the case of death or disability, the insurance company picks up the life insurance amount and takes care of the loan payment.

Remote Banking Insurance

This is available to financial institutions that offer customers on-line remote banking services. SafeWeb (an insurance service provider) provides insurance for individual bank customers that are utilizing bank-from-home computer services, commonly known as PC, Internet, home or remote banking services. The SafeWeb policy insures such customers against unauthorized transactions in their accounts that occur through remote banking systems. Under applicable banking regulations, home-banking customers can be personally liable in certain circumstances for loss arising from unauthorized transactions in

Bank-assurance: where does it fit?

Banking	Insurance	Banking-insurance
Accepting, for the purpose of lending or investment of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheques, draft, order or otherwise.	The business risks attached to any activity over time (including life) and sharing the risks between various entitiies, both persons and operations.	Effectively leverages the strengths of banking infrastructure to offer insurance thus helping banks to offer all financial products under one roof

Advantages of Bank-insurance

- Expansive branch networks
- Established customer base
- Insurance becomes a part of the banks' product portfolio
- Requires extension of the existing financial expertise
- Can act as one-stop shop for all financial products

Banks into insurance

Indian Banks

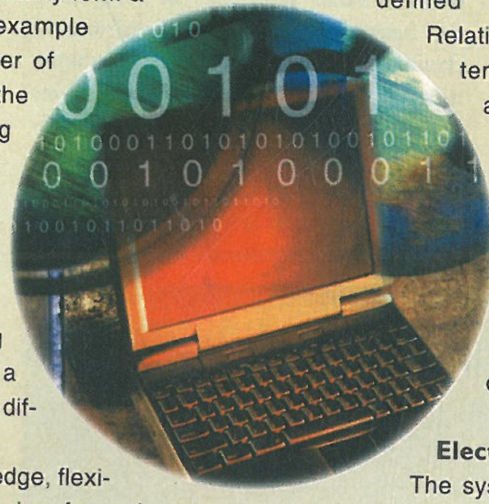
- State Bank of India
- Punjab National Bank
- Bank of Baroda
- Canara Bank
- Bank of India
- Corporation Bank

Foreign Banks

- Stanchart – Grindlays bank
- ABN-Amro Bank
- Citibank
- Hongkong Shanghai Bank (HSBC)

Profile, Anywhere!

From technology point of view insurance offering doesn't alter a bank's service efficiency at all nor is it necessary for the bank to drastically change its technology systems to suit the insurance needs. Several solutions companies today are offering integrated solutions for banking products, insurance would only form a new dimension to it. Take for example Sanchez, one of the leading provider of integrated banking solutions in the world. Sanchez has a core banking system called Profile/Anyware that can be modelled to suit the different needs be it typical banking services or insurance offerings. Says Rajiv, Kolhatkar, Vice President, Sanchez India operations, "The core processing system remains the same. It is only a matter of modifying the system to suit different offerings".



Profile is the cost-effective, cutting-edge, flexible core processing solution of choice for a large number of leading banks worldwide. It has an in-built flexibility that enables it to adapt dynamically to the diverse and changing demands of financial marketplace. The solution is an integrated core processing system that supports all consumer and corporate loan and deposit processing functions. The system will provide financial institutions with the flexibility to quickly take advantage of new opportunities. Profile has an electronic manufacturing model - an innovative architecture that lets new products to be quickly created and allowing limitless possibilities while dramatically reducing product development costs.

There are different components to profile:

- *Profile/Anyware* - is a multi-currency, multi-language, multi-bank core processing system.
- *Profile for Windows* - a native Windows client application for Profile/Anyware's customer service and teller functions
- *Profile/FMS* (Financial Management System) - a multi-company, multi-currency, cost center-based accounting systems
- *Profile/ODBC* - the open connectivity database driver for the Profile system.

Data management

PROFILE/Anyware uses an extendable database to hold customer information. This includes demographic data, common customer data, affinity linkages, information from other systems and other customisable data, as defined by your financial institution. Relationship codes are used within the system to relate customer records to account data. For example, using relationship codes, the system ties the data for an account to the appropriate customer or customers. For a loan account with multiple borrowers, relationship codes can indicate if the borrowers are joint borrowers or if one is a cosigner.

Electronic manufacturing

The system uses an electronic manufacturing model to create and assemble new banking products. From the system's single electronic factory, a business analyst can access business processes, defined as banking as banking objects, to create new products – without the need for programming. In assembling new products, it draws from an inventory of tried and tested banking objects. This inventory is maintained with an extendable data dictionary of over 1,500 tables and 20,000 data items. Using this inventory, the number and type of banking products you can create are nearly limitless.

Real-time/24x7 information system

The system operates in real time. When a transaction is received by Profile/Anyware, the system updates the appropriate customer and account information immediately. Real-time processing prohibits users from inadvertently posting a transaction against an unavailable.

Certain banking activities, such as interest accruals, service fees and interest processing are associated with end-of-day processing. But Profile/Anyware will provide full online, real-time access to the database, even during end-of-day processing, through a mechanism that will make the end-of-day invisible to system users. This will support true 24 x 7 access for all activity.

their accounts. The SafeWeb policy can be written on a master policyholder basis with coverage applying to the home banking customers of a specified financial institution. This insurance product promotes the medium of PC banking by specifically addressing the main roadblock to widespread use of e-commerce: security concerns. It calculates the insurance on a per-loss limit of liability applying separately to each insured PC banking customer. It also offers worldwide coverage (important because a hacker can be anywhere). The term "Loss" under this includes not only loss of the customer's money via hacker intrusion, but also these other expenses that may result from a covered unauthorized transaction like overdraft and merchant-assessed returned check fees incurred by the customer as a result of insufficient funds, and loss of interest income in the customer's account.

Banks v/s insurers

Banks, with their vast capital resources dominate the convergence of banking and insurance. But the convergence of banks and insurers probably has more to do with life and household insurance than complex commercial or macroeconomic risk.

Banks deal in risk, as do insurers. Banks receive money for assuming different types of exposures. Most frequently, they receive interest in return for risking the return of their capital when making a loan. At other times they receive payment for giving a guarantee. In both cases, they accept the risk of default. Like insurers, bank frequently seek to offload this risk or to minimise it. Conversely, banks and insurers both deal in risk, but the nature of that risk and the compensation available for its assumption differs greatly. Banking risk is much more expensive than insurance risk. This may be because of the level of capacity available in the insurance markets, the manner in which they accept risk, the level of risk insurers will tolerate. The derivative, a product developed by banks, could present an alternative to traditional insurance.

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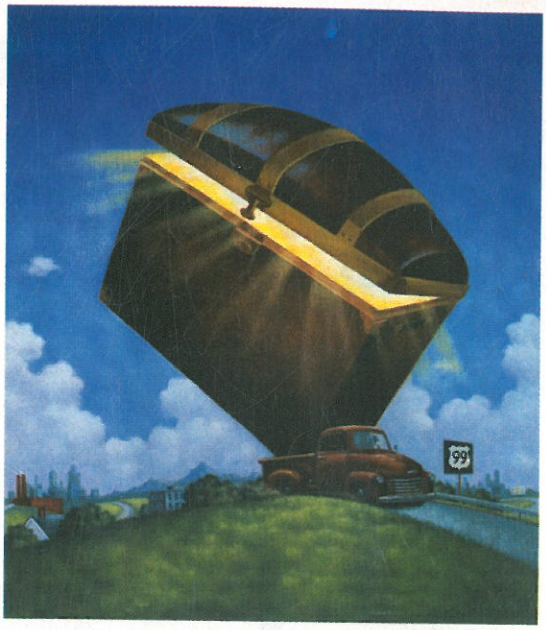
However, weather derivatives have found markets. Ice-cream manufacturers and cold drinks sellers in England, for example, have purchased weather derivatives to protect themselves against the threat of poor summers and the consequential loss of sales. In these cases, derivatives have a distinct advantage over insurance products. Payment is automatic and immediate, and there is no need to prove an actual loss. Banks sell derivative products with significant margins for themselves, pricing products at profit levels of up to 50%. This rate of return is far beyond that anticipated from insurance. Some insurers desire to compete with banks to share these profits, but cannot do so alone – they need banks that are willing to trade with them and obtain insurance on the products they underwrite. Banks can insure against their liability as they can assume risk under derivatives and establish a legal liability to pay in the event of sums becoming due under those products.

Many derivative products or similar banking risks are available to insure. Credit derivatives, film finance covers, weather derivatives, aircraft finance and project finance guarantees have all been insured. Banks accept an enormous amount of risk from derivatives. The amount of risk generated is infinite, and banks can profit from the margins of accepting additional risk and passing it on to insurers. The only limitation is the availability of people to purchase derivatives. Banks that accept risk through derivatives often pass it on by purchasing other derivatives. Derivatives require no insurable interest, but their trade is not restricted by the amount of risk one holds.



Multiple services

People are social beings and cannot be tied down to just one thing however technologically innovative it maybe. Internet may help as an intelligent resource base and you can shop around, but you can't actually say things like 'can you please tell me about this?' And 'what does this mean?' and so on. The fact is people want to interact and they don't stick to just one service, they want to access services in various ways and forms. So, we have ATMs, branches, telephone trading and Internet banking.

Similarly people want to obtain different services and products from various sources. This is where insurance makes its presence in the banking product range. The difference between banks and insurance companies are getting blurred. We are going to see more and more consolidation within the industry. We would have large financial conglomerates that have the whole range of products and a whole range of expertise. And future would see vertical expertise organisations that offer anything from savings account to advanced financial services under one roof.All these augur well for the average consumer in the future.