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Prospects for Bancassurance: Trends towards Integration of Banking Services and Insurance Sales

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We have now entered the fourth year since April 2001 when insurance sales by banks started. During the initial stage, these sales activities were limited to credit life insurance and long-term fire insurance, which are closely related to banking operations. However, as is seen in the individual financial markets in Europe and the United States, "bancassurance" that combines banking services and insurance sales services also started in Japan. In October 2002, individual annuity insurance and asset-building insurance were added to the products handled as over-the-counter (OTC) sales at banks. Plans call for the start of OTC sales of all insurance products at banks in April 2007. Current trends in the OTC sales of annuity insurance at banks indicate good sales of single premium payment annuity insurance, in particular, foreign currency-denominated fixed annuity insurance with a relatively high guaranteed yield. This is considered to be due to its similarity to time deposits.

One of major characteristics of OTC sales in banks is their stability and reliability as sales channels. From the perspective of OTC sales performance of investment trusts, this characteristic is represented in stable sales strength without the influence of market conditions such as the stock market and extremely few mid-term cancellations before maturity.

In the United States as well, insurance sales by banks have grown rapidly since 2000, reaching the stage where the bank share among total sales of fixed annuity insurance was 35 percent in 2002. Bank OTC sales activities in the United States are characterized by their channel strategies, focusing on consulting functions by principally using registered salespersons specialized in insurance sales, financial consultants, etc., rather than bank employees.

In preparation for the full-scale evolution of bancassurance in April 2007, there are many issues that both banks and insurance companies must overcome. In addition to the efficient sales of insurance products that are life-design-proposal-type products, what is essential for banks is the enhancement of consulting functions that help create good, long-term relationships with customers. The pressing need for insurance companies is to rebuild the sales commission structure to fully use diversified sales channels and to develop products that make the best use of bank OTC sales channels.

I Start of OTC Sales of Annuities at Banks

1 Past Trends of OTC Sales at Banks

We are now in the fourth year since April 2001 when banks and securities firms started selling insurance as permitted by an amendment to the Insurance Business Law in 2000. While the amended law permitted securities firms to engage in the sales of an extensive range of insurance products, the products that banks could provide were initially limited to those that were closely related to banking services. These included credit and life insurance and long-term fire insurance related to housing loans. Although the basis was restricted, this represented the start of "bancassurance" in Japan, in which banking and insurance sales services are integrated in much the same way as in the individual financial markets of Europe and the United States. Incidentally, the term "bancassurance" was coined in France by combining "bank" and "insurance."

Although bancassurance started with handling limited products, the sales of fire insurance moved forward smoothly because of factors such as the strengthened sales of housing loans as core products under the banks' retail strategies at the time and that the product is easy to understand. Sales of this product (based on revenues from insurance premiums) in the first complete fiscal year during April 2001 to March 2002 after sales began were only slightly less than 80 billion yen. However, it appears that the sales for fiscal 2003 exceeded 100 billion yen.[1] According to observers in this field, the handling of fire insurance for newly constructed houses using housing loans is now almost monopolized by sales at banks.

In October 2002, the Financial Services Agency officially issued the cabinet order amending the Insurance Business Law Enforcement Regulations and the Bank Law Enforcement Regulations. This order permitted the inclusion of personal annuity insurance (fixed and variable annuities) and asset-building insurance as life insurance products handled at banks. In the field of non-life insurance, personal accident insurance products that provide pension benefits by using accumulated funds and asset-building non-life insurance were added.

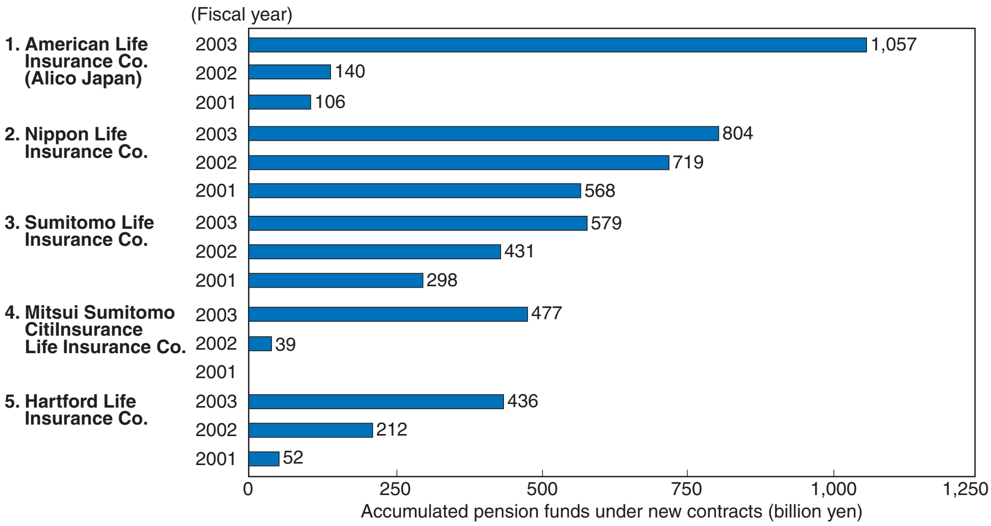
According to the initial plan decided by the Cabinet (the "Three-Year Program for the Promotion of Deregulation" in 2000), a complete lifting of the ban on insurance sales by banks, etc., was scheduled for April 2004. However, various forms of resistance prevented implementation of this plan. At present, the Financial System Council decided to implement the total lifting of bans on the sales of insurance products by banks by April 2007.

While off to a somewhat rough start, it appears that sales of annuity insurance at banks for the 18-month period from October 2002 to March 2004 exceeded 3.5 trillion yen (based on paid-in accumulated pension funds). Looking at the life insurance industry overall, which is facing the issue of negative interest rate margins, a slack season has continued over the past several years where the trend of declining amounts of insurance contracts could not be stopped because of an increasing number of cancellations caused by prolonged deflation and job reductions. Under such circumstances, it seems that the start of bank sales of annuities has served as one piece of bright news.

In particular, as we entered fiscal 2003, fixed annuity insurance in US dollars and euros centered on the products of foreign-capital insurance companies and sold through banks has gained popularity. These products accounted for 20 percent or more of the sales of personal annuities at banks.[2]

This phenomenon is confirmed by the five top-ranked companies in terms of the amounts of new annuity insurance contracts, as shown in Figure 1. The rapid advance of Alico Japan was prominent in that it positioned its

Figure 1. Sales of Annuity Insurance (Top Five Companies in Fiscal 2003)



Source: Compiled based on the account closing (draft) for fiscal 2003 of each company.

foreign currency-denominated fixed annuity insurance as a major product and established affiliations with 67 financial institutions principally consisting of banks (as of March 2004). Alico surpassed the previous leader, Nippon Life Insurance Co., and recorded a surprising amount of new annual contracts exceeding one trillion yen, which is 7.5 times that of the previous fiscal year. According to Alico, the total revenue from insurance premiums sold by banks reached approximately 790 billion yen.

Similarly, Hartford Life Insurance, which entered the Japanese market with investment-type variable annuity insurance that guarantees the same death benefit amount as the principal, increased its sales through 46 sales channels consisting of major banks and securities firms (as of March 2004). Hartford's sales have doubled each year.

When we look at the performance of banks during these 18 months, variable annuity insurance and foreign currency-denominated fixed annuity insurance have accounted for the majority of sales. Yen-denominated fixed annuity insurance with its low anticipated rate of interest has seen little or no gain in popularity.

2 Product Lineups of Major Banks

In our preliminary forecast, it was thought that *keiretsu* bank affiliations and the fact that an insurance company is a major shareholder of a financial institution might influence a bank's product lineup. Actually, however, each bank has offered a wide variety of products, with such cases seen only in a few major banks. This result indicates the strong posture of banks that is aimed at the expansion of sales as quickly as possible, rather than focusing on relationships among financial institutions.

Table 1 outlines the product lineups offered by major banks. All of these banks cover variable annuity insurance and fixed annuity insurance, and offer currency options, such as foreign currency-denominated products in US dollars and euros, in addition to yen-denominated products.

With respect to variable annuity insurance, two types are available. In one, paid-in insurance premiums are managed under a "special account" of the insurance company for the relevant product. In the other, called "investment-type annuity insurance," the insurance purchaser selects an affiliated investment trust to invest the funds. Both types are known as variable annuity insurance because the accumulated pension funds vary according to investment performance. In addition, other types are offered that provide a death benefit guarantee (usually, the same amount as that of a single premium payment) or paid-in accumulated pension funds (premiums) at the minimum, regardless of the investment performance of the premiums. It is easy to see that these product lineups take full consideration of bank customers who are generally concerned about the safety of the principal.

What is noticeable is that all major banks are developing sales activities focused on annuity insurance with a single premium payment.

In view of these product lineups, some characteristics can be identified as background factors behind good annuity insurance sales.

The first characteristic concerns the handling of products mainly consisting of annuity insurance with a single premium payment. Annuity insurance essentially resembles a time deposit that has, so far, been a major savings product of banks targeted at individuals. Almost all annuity insurance products sold in banks guarantee the principal (accumulated pension funds or a death benefit) and refund the yield in the form of either a lump sum or the payment of pension benefits after maturity. It may safely be said that these products are a variation of maturity-designated time deposits (where maturity of more than one year after deposit can be freely designated and semi-annual compound interest can be received as a lump sum at the time of maturity). In other words, these products could be thought of as "time deposits providing a death benefit and pension benefits."

The second characteristic relates to foreign currency-denominated fixed annuity insurance. This product can also be positioned as an insurance version of foreign-currency deposits already exceeding 5 trillion yen. These products could be thought of as "time deposits providing a death benefit and pension benefits in a foreign currency."

Table 1. Annuity Insurance Product Lineup of Major Banks

	Alico Japan	Nippon Life Insurance Co.	Sumitomo Life Insurance Co.	Hartford Life Insurance Co.	Mitsui Sumitomo CitiInsurance Life Insurance Co.
Mizuho Bank	Fixed annuity (in foreign currencies)	Variable annuity		Variable annuity (principal guaranteed)	
The Bank of Tokyo-Mitsubishi	Fixed annuity (in foreign currencies)	Variable annuity		Variable annuity (principal guaranteed)	
Sumitomo Mitsui Banking Corp.	Fixed annuity (in foreign currencies) Variable annuity	Variable annuity	Variable annuity		Variable annuity
UFJ Bank	Fixed annuity (in foreign currencies)	Variable annuity			

Among small and mid-sized banks, quite a few hesitate to strengthen and promote sales of deposit products in foreign currencies. They are hesitant because of their own risks involved in the investment of foreign-currency assets even though they are aware of the high popularity of such deposits when the popularity of yen-denominated deposit products has been low. For such banks, the sales of annuity insurance in foreign currencies can not only avoid fund investment risks but can also meet the needs of individual customers. It appears that annuity insurance is a most opportune product for these banks.

In any event, it can be assumed that insurance products have gained popularity because they are being sold at bank branches that are familiar to people's everyday lives as supported by various background factors. These include the effect of tax deferral, in which taxes are not levied on fund investment yields until actually paid, and increasing uncertainties as to the future of public pensions.

II Life Insurance Market and Sales at Banks

1 Rapid Increase in the Number of Registered Insurance Salespersons

With the start of insurance sales by banks, etc., the number of employees of financial institutions including banks taking a qualifying examination and registering to become insurance salespersons has naturally increased at a rather quick pace.

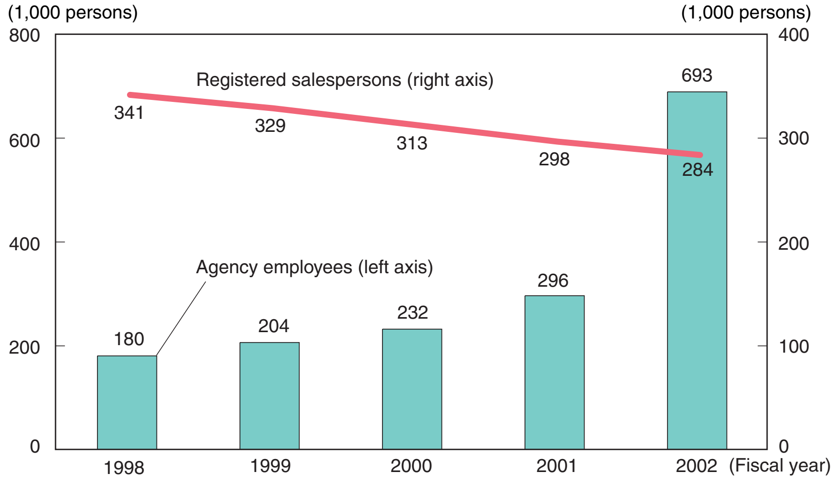
Figure 2 shows the change in the number of registered life insurance salespersons who work on a full-time basis for a life insurance company and in the number of employees of agencies, such as financial institutions and independent insurance sales companies that have become sales agencies under contracts with life insurance companies. With respect to the number of registered full-time salespersons at life insurance companies, a declining trend began to accelerate after the collapse of the bubble economy. The figure fell below 300,000 persons at the end of fiscal 2001 (the end of March 2002).

In contrast, the number of registered salespersons at agencies (agency employees) has rapidly increased in parallel with the acquisition of qualifications by salespersons at agencies such as banks and securities firms as accelerated by the lifting of the ban on bank sales of life insurance. Many banks required all employees to become qualified salespersons. Consequently, the overall number of registered life insurance salespersons jumped to 690,000 at the end of fiscal 2002 (the end of March 2003). Employees of financial institutions are considered to constitute about 400,000 registered salespersons. This means that the number of agency employees surpassed the number of existing registered life insurance salespersons at life insurance companies in less than a single year.

Figures 3 and 4 show the change in the number of sales agencies and in the number of salespersons, respectively, relative to non-life insurance companies. Due to the background factors of management consolidation and restructuring involving non-life insurance companies in the past several years, the number of agencies has been decreasing. However, since 2001, the number of salespersons started to rapidly increase in response to the lifting of the ban on sales of non-life insurance products at banks and securities firms. In 2001 and 2002 alone, the number of salespersons sharply increased by about 500,000, thereby creating a major sales force of more than 1.6 million, which is 1.5 times the figure at the end of 1993.

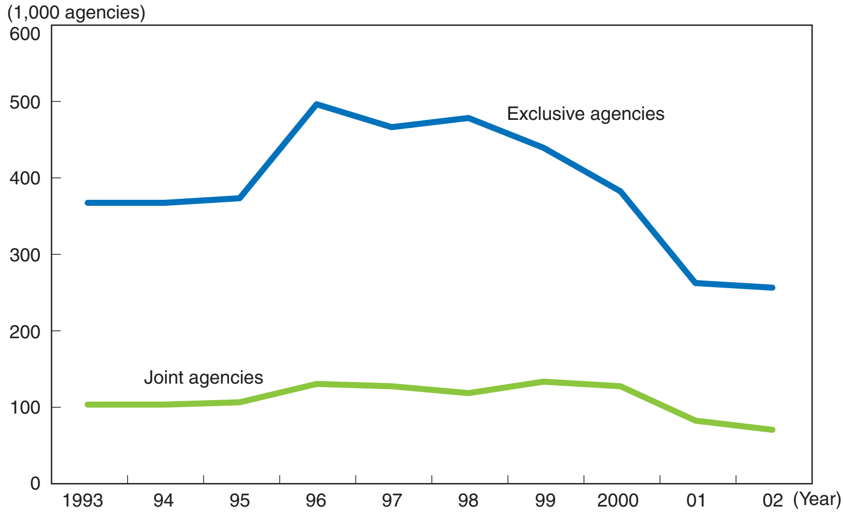
It seems that the focused efforts of banks and other financial institutions have provided momentum to their sales of annuity insurance policies. While sales employees of life and non-life insurance companies conduct sales activities principally outside their offices by visiting

Figure 2. Change in Number of Registered Life Insurance Salespersons and Agency Employees



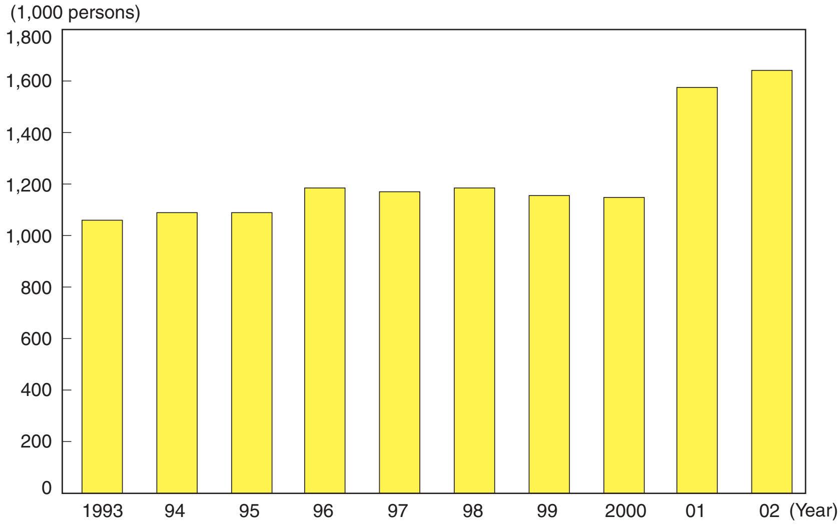
Source: Japan Institute of Life Insurance.

Figure 3. Change in Number of Sales Agencies of Non-Life Insurance Companies



Source: The General Insurance Association of Japan.

Figure 4. Change in Number of Non-Life Insurance Salespersons (Total Number of Domestic and Foreign Companies)



Source: The General Insurance Association of Japan.

their customers, it is considered that the expanse of bank branch networks consisting of some 14,000 branches nationwide has demonstrated a strength that cannot be ignored.

However, there is a difference in the sales venues of major banks and those of small and medium-sized financial institutions such as regional banks. Major banks, which have already significantly reduced the number of traveling salespersons mostly engaged in deposit collections, have naturally focused on branch sales.

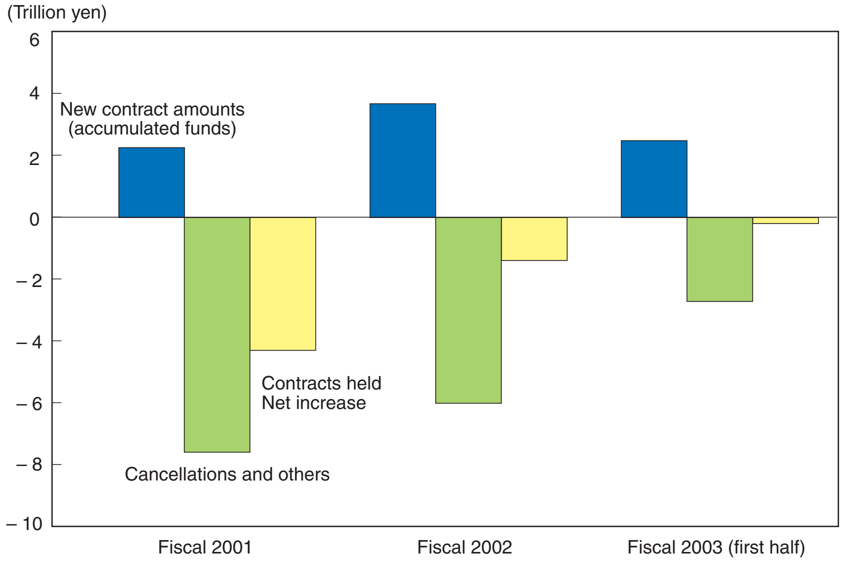
In contrast, it is said that liaison salespersons at regional banks account for about 70 percent of sales. According to a number of sources, some regional banks encouraged branch general managers and highly experienced salespersons who had already reached retirement age to stay in the office to engage in the sales of insurance products. If the fact that these employees have served as symbols of the relationships between banks and their local areas or served as faces of local areas is considered, such sales forces should be evaluated as one of the means of building extremely efficient and strong sales channels.

2 Impact on Life Insurance Sales Channels

The sales of annuity insurance in banks have had a significant impact on the insurance market, as discussed above. However, when we look at new contract amounts and cancelled/lapsed amounts with respect to overall annuity insurance contracts, it appears that complications have arisen for life insurance companies (Figure 5).

Even in fiscal 2002, when bank sales began, amounts due to cancellations exceeded amounts due to new contracts. A similar trend continued when we entered the first half of fiscal 2003 during which bank sales developed on a full-scale basis, although the amounts resulting

Figure 5. Trends in New Contracts and Cancellations of Annuity Insurance



Notes: Contracts before the start of the payment of pension benefits. "Cancellations and others" represents the contract decrease amount due to lapse, conversion, etc.
Source: Insurance Research Institute of Japan, *Insurance* (issue of life insurance statistics), 2004.

from cancellations were reduced somewhat. Because financial institutions that entered the market for the first time must have exerted their utmost efforts on the sales of insurance products, it is natural to assume that products that were sold through the channels of existing registered salespersons were primarily subject to such cancellation.

In the future, the ban on the sales of various insurance products by banks and other financial institutions will be lifted as appropriate, and the total lifting of the ban is scheduled for April 2007. In addition to taking the measures necessary to use these new sales channels effectively, life insurance companies must also develop measures to mutually utilize their sales channels of existing salespersons and to build a strategy of multiple sales channels. Moreover, it is obvious that urgent matters include the reorganization of the existing sales force and the introduction of new sales support measures.

3 Characteristics of Bank Sales

If the characteristics of the banking business are expressed in one phrase, it is often "control of an account's due date." Undoubtedly there are many bank products that require the control of an account's due date, such as the management of time deposit maturity and the management of loan principal and interest repayment dates. Proficient bank employees are said to be good at persuading customers not to cancel a time deposit immediately before its maturity.

In contrast, securities business and insurance sales activities are expressed as "control during a period (monitoring)." This means that because product maturity is very long or there is no maturity (e.g., shares in the case of securities and whole life insurance in the case of insurance products), relationships with customers begin with the sales of a product. In the case of the securities business, advice to customers on daily price movements constitutes a source of revenue. In the case of the insurance business as well, necessary work over a long period includes the management of customer information (address changes, changes in beneficiaries, etc.) and advice to customers concerning insurance premiums in relation to job switching, business restructuring, etc.

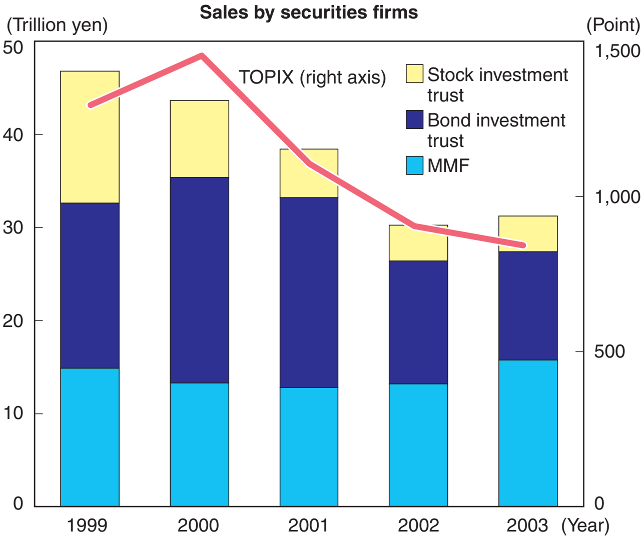
These characteristics of the banking business have been clearly reflected in the sales of securities investment trusts that started in banks prior to the sales of insurance products. With respect to the sales of investment trusts, which started in December 1998, Figure 6 compares the net asset balance involving sales by banks with that involving sales by securities firms. Figure 7 shows the volume of investment trust offerings and trading volume at banks, etc. There are three characteristic factors in bank sales.

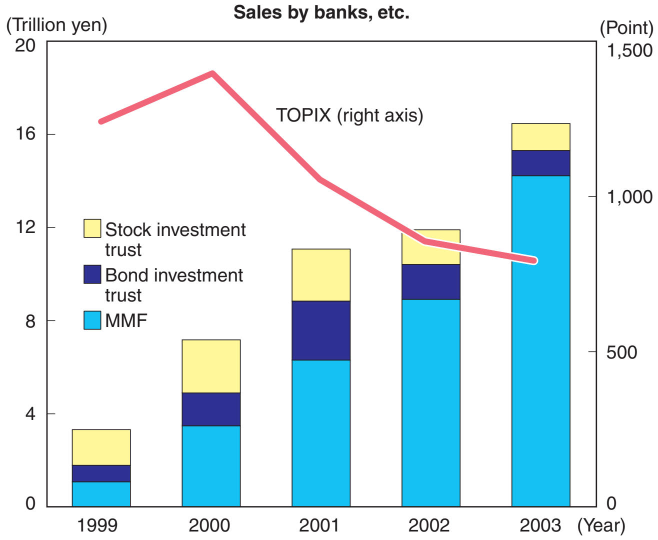
The first characteristic relates to the sound sales channel that a bank has that is hardly influenced by the market (price fluctuations). In fiscal 2002, during which the stock market was sluggish, the net asset balance of investment trusts sold through securities firms decreased. However, the asset balance of investment trusts sold through banks increased; the investment trust offering volume by banks for that year exceeded 4 trillion yen.

The second characteristic is that the trading volume of investment trusts is very small. This is considered to indicate that most investment trust products sold through banks are held and not sold before maturity.

While this constitutes the third characteristic, most investment trusts sold at banks are stock investment trusts with no maturity or with a long maturity. Accordingly, these stock investment trusts are not under due-date management by bank salespersons, and have become

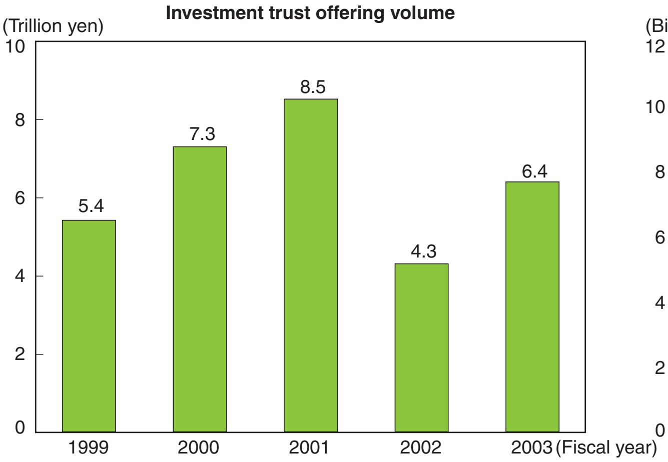
Figure 6. Net Asset Balance of Investment Trusts by Sales Channel

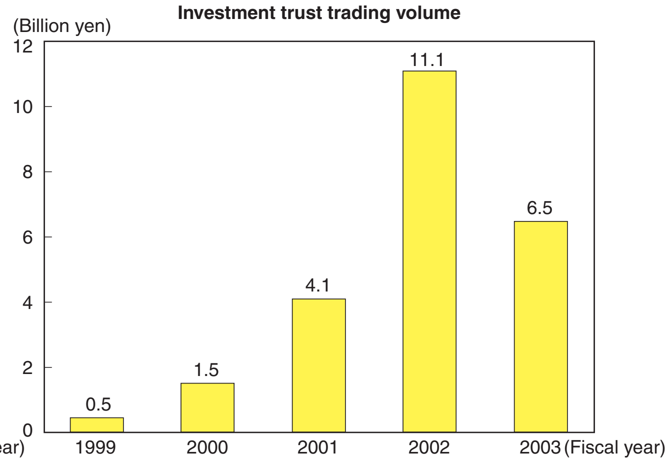




Notes: MMF = money market fund; TOPIX = Tokyo stock price index.
Source: The Investment Trusts Association, Japan.

Figure 7. Investment Trust Offering Volume and Trading Volume at Banks





Note: Total of publicly offered domestic investment trusts.
Source: Japan Securities Dealers Association, "Securities Industry Report."

ideal buy-and-hold, long-term securities investment products for investors. From the bank's standpoint, this is not a reason for focusing on the sales of stock investment trusts. The chief reason for their focus on the sales of stock investment trusts, rather than bond investment trusts and MMFs (money market funds) is, of course, high sales commission fees.

In many cases, a prerequisite for investing in securities is long-term investment. It seems that the sales channels at banks have become suitable for persons who have small amounts of savings. Similarly, in the case of life insurance, except for the products in the third field (e.g., products with a death benefit, guarantee of medical expenses, cancer insurance, etc.), there are many products for which relationships with customers continue for long periods. Accordingly, life insurance companies undoubtedly consider banks that offer solid sales channels important sales routes that cannot be ignored.

III Insurance Sales by Banks in the United States

1 Trends in Insurance Sales

In the United States, insurance sales by banks have evolved on a full-scale basis after the passage of the Financial Modernization Act of 1999, also known as the Gramm-Leach-Bliley Act, or GLB Act, (comprehensive financial structure reform act), which went into effect in 2000. In anticipation of the passage of this act, a mega-merger of Travelers Group (insurance company) and Citicorp occurred in 1998, heralding the start of full-scale bancassurance in the United States.

While all insurance products have already been covered by banks, the sales of credit insurance that is closely related to loan products are most popular, as shown in Figure 8, followed by fixed annuity insurance and term insurance. Annuity insurance, especially fixed annuity insurance, already accounts for a large sales share and has recently increased to around 35 percent (Figure 9). This is because banks in the United States offer incentives to bank employees for the sales of annuity insurance that is similar to time deposits.[3]

2 Diversified Sales Channels of Banks

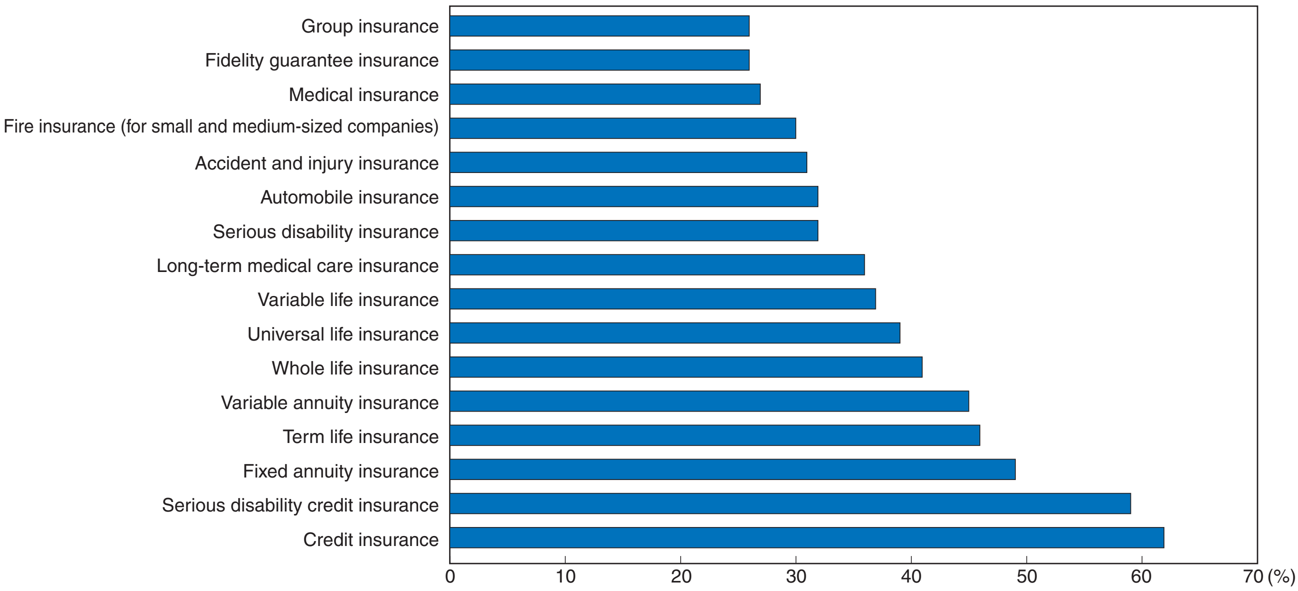
US banks adopted the following two strategies at the time of inaugurating bancassurance.

The first strategy concerned the acquisition of insurance sales agencies in order to start the bancassurance framework as early as possible. In 1998 and 1999, around the time when the law lifting a ban on insurance sales by banks went into effect, the annual number of acquisitions of insurance agencies by banks was about 50. However, in 2000, this figure reached about 170.[4] That many insurance agencies were managed with relatively small amounts of capital was considered to be to the reason for these accelerated acquisitions.

In May 2003, a large-scale transaction occurred in which Bank One purchased the national annuity and life insurance sales network for $285 billion from Zurich Financial Services, which surprised the industry.[5] The Bank One sales force of about 3,000 registered insurance salespersons was significantly augmented by the addition of about 40,000 salespersons through this deal, at one stroke creating a sales network that compares favorably with those of major insurance companies.

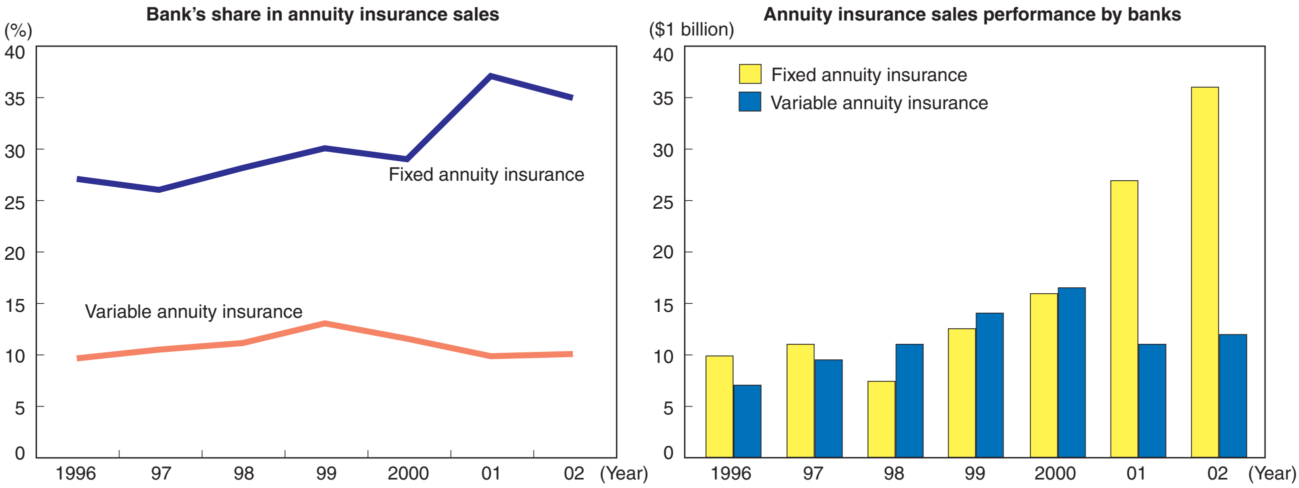
The second strategy concerned the efforts of banks to build their own sales channels. At the initial stage, target customers were narrowed down to members of the mass

Figure 8. Ratio of Insurance Products Handled at Banks in the United States (2003)



Note: This survey covered 447 banks (deposit financial institutions).
Source: American Bankers Insurance Association.

Figure 9. Annuity Insurance Sales by Banks in the United States



Source: Kenneth Kehrer Associates.

market having low levels of life insurance coverage although they have checking accounts. This strategy appears quite natural in light of the dense branch network that a bank has and the sales abilities of tellers who were hired after graduation from high school.

To supplement such a sales force and in addition to their own employees who have insurance sales licenses, many banks recruited financial consultants, senior registered insurance agents and registered insurance agents, and assigned them to counters in bank branches. Table 2 indicates the results of a questionnaire concerning the deployment of salespersons for life insurance products. While the use of financial consultants accounts for the largest share, many banks also conduct direct sales by the Internet and telephone. Because senior registered insurance agents and registered insurance agents who have extensive experience in the sales of insurance products require a high commission rate, the number of banks employing them is less than half the total number.

However, this situation changes completely in terms of contribution to bank revenues by insurance sales. According to the contribution to revenues by sales channels, which was also covered by the same questionnaire, senior registered insurance salespersons requiring the highest payback ratio (commission) ranked at the top, followed by registered insurance salespersons (Table 3). Financial consultants ranked third, and bank employees with sales licenses ranked fourth. On balance, "life-design-proposal-oriented" insurance agents demonstrated more strength in life insurance sales than did "transaction-oriented" bank employees.

Moreover, many of the customers approached by insurance agents fall under the so-called mass affluent stratum with financial assets of $100,000 to $500,000. This stratum has now become the target market of banks. If it is considered that securities products opened the door of the highly wealthy market for banks, life insurance is positioned as an important product to approach the mass affluent market. The fact that mail-order and Internet sales have already become the popular sales channels for such products as term insurance with low insurance premiums has also spurred the shift to the mass affluent market.

Additionally, in pursuit of the improved profitability of these sales channels and the banks themselves in insurance sales, bancassurance generated several important management issues. Specifically, negotiations and management of the payback ratio to salespersons, the formulation of rules concerning customer referrals and compliance management have become extremely important matters requiring management decisions for banks that provide sales platforms and customers.

Accordingly, the selection of management personnel who are responsible for employees involved in insurance sales, related structures and revenue management has become one of the most difficult executive decisions for banks. Figure 10 indicates the results of the questionnaire concerning personnel appointed as insurance sales managers. This survey revealed that, in most cases, outside people, in particular, persons who were managers at insurance companies and who are experienced in insurance sales, are appointed as managers. Here again, the use of specialists is evident among banks in the United States.

In contrast, when we look at the sales (based on insurance premiums received during the initial year) of

Table 2. Life Insurance Sales Channels of Banks in the United States

Distribution channel	Share (%)
Financial consultants	82
Direct sales	38
Bank employees registered for insurance sales	36
Senior registered insurance agents	21
Registered insurance agents	18
Referral to outside insurance agents	7

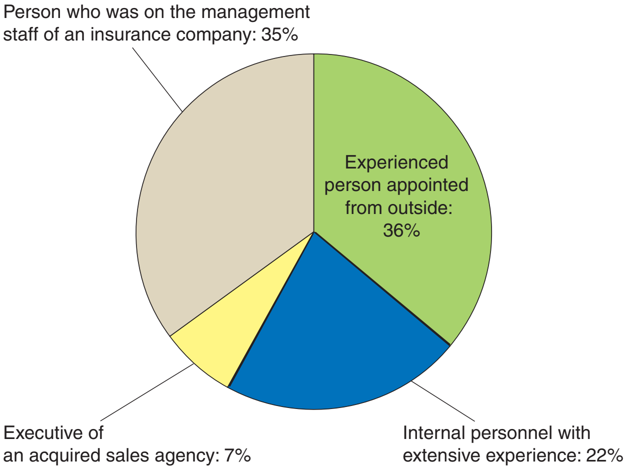
Note: The above table indicates the results of a survey of 56 banks.
Source: Kenneth Kehrer Associates, LIMRA International, *Banking Strategies*, March/April 2004.

Table 3. Contribution to Revenues by Life Insurance Sales Channels of Banks in the United States

Distribution channel	Contribution to revenues
Senior registered insurance agents	100
Registered insurance agents	73
Financial consultants	66
Bank employees registered for insurance sales	64
Referral to outside insurance agents	51
Direct sales	44

Notes: (1) Contribution to revenues is expressed in terms of an index value by treating contributions by senior registered insurance agents as 100.
(2) The above table indicates the results of a survey of 56 banks.
Source: Kenneth Kehrer Associates, LIMRA International, *Banking Strategies*, March/April 2004.

Figure 10. Most Appropriate Person for Insurance Sales Management



Note: The above values indicate the results of an Internet-based survey of banks.
Source: *American Banker*, January 30, 2004.

mortality-related life insurance, excluding annuity insurance, the bank share is only around 3 percent, even in the United States.[6] This figure is extremely low and cannot stand comparison with the sales share of annuity insurance. Probably for this reason, the target customers for cross-selling life insurance are mostly borrowers and investment product purchasers because these products are closely related to transactions with banks, as shown in Figure 11.

Table 4 lists the amounts of insurance sales of major life insurance companies whose sales share derived via banks (OTC sales) is high. The figure that is most noticeable is the large amount of sales of single premium payment life insurance. According to the results of the sales of all banks, sales of single premium payment insurance were $760 million in 2003, while those of installment payment insurance were only about one-fifth, or $170 million.

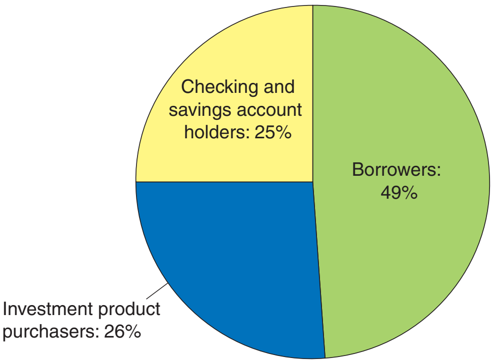
While similar rates are also applied in Japan, the commission rate is around 40 percent to 100 percent of the insurance premium for the initial year for installment payment insurance, while that for single premium payment insurance is around 7 percent to 10 percent. If this is taken into account, it appears that the fewer sales of installment payment insurance do not reflect logic. Nevertheless, these sales trends are influenced by the fact that single premium payment insurance can be sold under the concept of being an annuity with life insurance and provide a larger amount of immediate income. Specifically, for bank salespersons who are highly transaction-oriented, as explained previously, the eight-percent commission ($4,000) they can obtain from the sales of single premium payment insurance of $50,000 is greater than the 40-percent commission ($240) from installment payment insurance with an initial yearly premium of $600 even for the same amount of insurance.

In actuality, however, considering profitability from the perspective of product design, installment payment insurance offers greater profitability than does single premium payment insurance in terms of both commissions to salespersons and revenues to the insurance company. Accordingly, in calculating the performance of life insurance sales, an insurance company applies weighted averages to the results. This means that while 100 percent of the initial-year insurance premium is used for calculating installment payment insurance, 10 percent of the insurance premium is applied for single premium payment insurance. The fact that single premium payment insurance imposes a higher fund management risk such as interest rate fluctuations also constitutes one of the reasons for such performance calculations.

If we take a careful view of Table 4, differences in the strategies of each company can be seen. While companies such as Aegon have rapidly been expanding the OTC sales of single premium payment insurance at banks, Hartford Life Insurance and Massachusetts Mutual Life Insurance have been focusing on the sales of installment payment life insurance.

According to Hartford Life Insurance, banks are positioned as important sales channels in insurance sales for the future in view of the banks' dense networks of regional branches and their sales style highlighted by close community relationships. It is also said that

Figure 11. Bank Customers for Whom Cross-Selling of Insurance Products Is Effective



Note: The above values indicate the results of an Internet-based survey of banks.
Source: *American Banker*, April 20, 2004.

Table 4. Life Insurance Sales via Banks at Insurance Companies in the United States (Based on Initial-Year Insurance Premiums)

(Unit: $10 million)

Single premium payment life insurance	2003	2002	Change (%)
(1) Aegon USA	220.1	99.4	121
(2) Liberty Life Insurance Co.	164.1	112.4	46
(3) Allstate Insurance Co.	117.6	61.1	92
(4) First Penn-Pacific Life Insurance Co.	59.8	30.0	100
(5) Aviva Life Insurance Co.	43.5	40.1	8
(6) Golden Rule Insurance Co.	33.9	30.6	11
(7) Hartford Life Insurance Co.	4.4	8.0	– 45
(8) General Electric Co.	2.2	0.3	633
(9) Massachusetts Mutual Life Insurance Co.	0.5	5.7	– 91
(10) John Hancock Financial Services	0.0	3.7	– 100

Installment payment life insurance	2003	2002	Change (%)
(1) Hartford Life Insurance Co.	33.1	17.0	95
(2) Nationwide Mutual Insurance Co.	21.0	38.1	– 45
(3) Massachusetts Mutual Life Insurance Co.	11.9	2.5	377
(4) Great-West Life & Annuity Insurance Co.	11.0	7.8	42
(5) American International Group	10.9	9.7	12
(6) AXA Financial	8.5	11.3	– 25
(7) CUNA Mutual Life Insurance Co.	6.3	15.2	– 59
(8) John Hancock Financial Services	5.9	4.2	40
(9) Sun Life Assurance Company of Canada	5.7	5.2	10
(10) Aegon USA	4.3	0.0	–

Source: Kenneth Kehrer Associates, *American Banker*, June 24, 2004.

Hartford has been providing support for installment payment life insurance in order to enable bank employees to learn life-design-proposal-type sales methods to eliminate the need to rely on insurance agents.

In fact, Hartford recently developed a life insurance product exclusively for OTC sales at banks. This universal life insurance, called "Quantum Life," guarantees the lower limit of a death benefit and permits a policyholder to change the insurance cash value and insurance premiums paid on term to various investment accounts (e.g., investment trusts) at any time. In other words, this product enables the policyholder to freely design the saving plans without having to worry about the guaranteed death benefit. Without a doubt, this product was developed under a design concept with significant focus on the conservative customers of banks.

As shown in Table 5, these efforts by insurance companies and banks have contributed to increased revenues from insurance sales commissions at major banks to a significantly high level. In particular, small and medium-sized banks have emerged where the ratio of insurance sales commissions in non-interest revenues has reached an extremely high level (Table 6). Accordingly, it is considered that life insurance sales at banks will be strengthened as an increasingly important revenue source in the future.

Table 5. Ranking of Banks in the United States Based on Insurance Sales Commissions (2003)

(Unit: $1 million)

	Insurance sales commissions
(1) Wells Fargo & Co.	1,071
(2) Countrywide Bank	784
(3) Bank One Corp.	501
(4) BB&T Corp.	396
(5) Wachovia Corp.	306
(6) JP Morgan Chase & Co.	269
(7) MBNA Corp.	232
(8) Bank of America Corp.	151
(9) National City Corp.	121
(10) Greater Bay Bank	117

Source: *American Banker*, May 7, 2004.

IV Prospects for Bancassurance in Japan

1 Characteristics of Insurance Products

While banking operations are characterized by "due date control," securities business and insurance sales activities are expressed as "control during the period (monitoring)," as stated previously. This is because a product has a long maturity, or has no maturity (e.g., shares and perpetual insurance). With the sale of a product as the start, a long relationship with a customer begins. In the securities business, advice to a customer about daily price movements and trading fees that are generated based on such advice constitute a source of operating revenues.

In the insurance business, in order to ensure that insurance premiums are regularly paid until maturity, sound sales operations and management are predicated on the management of customer information (address changes, changes of beneficiaries, etc.), advice about the payment of insurance premiums (for example, in case the premium is increased due to company restructuring, etc.), and related activities over a long time.

As explained before, OTC sales at banks as sales channels of annuity insurance have had an extremely large impact on the life insurance market. In anticipation of the total lifting of the ban on OTC sales, scheduled for April 2007, banks are expected to further increase the types of insurance products they will offer. The following section outlines the issues to be dealt with by banks and insurance companies towards the building of a full-scale bancassurance market in the future.

2 Three Issues Facing Banks

(1) Establishing channel strategy considering the use of specialists

There are several differences with respect to profitability in selling insurance products compared to selling the bank products as so far discussed. Specifically, contribution to substantial bank revenues depends on premium

Table 6. Ranking of Banks in the United States Based on Ratio of Insurance Sales Commissions in Non-Interest Revenues (2003)

(Unit: $1 million)

	Insurance sales commissions	Non-interest revenues	Ratio (%)
(1) BNC National Bank	14.6	19.6	74.5
(2) Greater Bay Bank	116.7	163.9	71.2
(3) President's Choice Financial	1.7	2.7	63.0
(4) Shore Bancshares	6.1	9.5	64.2
(5) MountainOne	4.8	7.8	61.5

Source: *American Banker*, May 7, 2004.

payment methods, sales channels (payback rate), and the type of insurance.

Accordingly, the first issue to be dealt with would be the establishment of a channel strategy. In the past, the conventional method of OTC sales of non-bank products was to build a sales channel that gave priority to the acquisition of sales capabilities by the bank's own employees. Further, the management of the profitability of OTC sales was simple, and it could be managed in a format linked to the product sales amount. In the case of investment trusts, for example, profitability management of OTC sales was possible through simply separating the sales amounts of stock investment trusts and other investment trusts in accordance with differences in sales commissions. Similarly, in the case of annuity insurance, because the products sold at banks primarily consist of single premium payment annuity insurance, and part of the new insurance premiums becomes sales commissions, management of profitability is easy.

However, as seen in OTC insurance sales by banks in the United States, if OTC sales of life insurance products in a third field (such as death benefit guarantee products, medical expense guarantee and cancer insurance) and automobile insurance, which is the representative non-life insurance product, are started in the future, it is unlikely that a similar sales channel strategy can be maintained as in the past. To enable bank employees to sell such diversified insurance products in addition to bank products, substantial expenses would undoubtedly be required for training, compliance management, etc.

In preparation for the removal of the ban on the securities brokerage agency business in December 2004, there have already been some banks that have changed their strategies to employ salespersons of securities firms for OTC sales of investment trusts. It would be necessary to build a channel strategy that considers the use of specialists as is seen in banks in the United States. In such a case, as explained previously, the implementation of profitability analysis for each channel with a different payback rate and the establishment of mixed products and channels will be the key to success.

At the same time, in order to manage the personnel involved in insurance sales, related structure and revenues, it is natural to expect that developing and using specialists as managers will become increasingly important.

(2) Selecting and handling products that are consistent with channel strategy

The second issue relates to the selection and handling of products that are consistent with the channel strategy. It would be expected that financial institutions would pursue the sales of products offering high degrees of profitability (with a commission rate that is high compared to the workload required). However, if the characteristics of a sales channel are not appealing to customers, sales efficiency will not increase.

In the case of OTC sales at banks, as is seen from the results of the sales of annuity insurance, it seems that the degree of efficiency is high in the sales of single premium payment insurance at banks both in the United States and Japan. Moreover, as far as banks in the United States are concerned, it appears that the sales of guarantee products other than annuity insurance are not as straightforward. The decision of each bank on what types of insurance products it will handle in the future is a management decision largely dependent on the sales channel strategy of the bank.

(3) Developing comprehensive asset management services

The third issue concerns the development of comprehensive services related to asset management. In addition to joint bank and securities branches that started in September 2002 and securities brokerage agency businesses to be started in December 2004, bancassurance will evolve to a full-scale operation by April 2007. According to a concerned industrial source, although OTC sales of such products as investment trusts and annuity insurance at banks started with great expectations, many purchasers of such products are existing customers who already have deposit accounts in the same way as in the United States. It appears that all that has happened is that money that was in deposit accounts has simply been transferred to investment trusts and annuity insurance.

If this is the case, it is believed that banks face a growing need to provide customers with products and services that manage deposits, securities and insurance products on a comprehensive basis. The offering of such a comprehensive asset management menu and the evolution of consulting services based on such a menu will lead to a further strengthening of depositor loyalty as well as to an increase in the number of potential customers.

At some major banks, OTC consulting services that were started with the intent of strengthening housing loan sales have been transformed to consulting services for comprehensive asset management after the start of the sales of investment trusts and annuity insurance. In addition, the hours of operation for providing these services have been expanded beyond ordinary banking hours as well as during weekends, indicating banks' efforts to capture more customers.

Thus far, however, these financial consulting services have appeared to be focused on static face-to-face solicitations at bank counters by providing information in the form of pamphlets, etc. It seems that such activities have not yet reached the stage of providing dynamic consulting services such as through asset management simulations that consider actual interest rate and foreign exchange rate fluctuations. This is because the development of computer systems enabling the evaluation and analysis of an integrated bank, securities and insurance product portfolio cannot keep pace with the speed of structural reforms.

In other words, banks now face an urgent need to develop an asset management system that is suitable for an era of retail financing sales. Currently, this field is largely an unknown area in which both financial institutions and system developers lack experience and expertise. As how to develop such a new system and what companies (e.g., financial institutions, system vendors, or software firms) develop such a system merits great attention because the result will undoubtedly affect the future of financial retail sales.

In Japan, where bank account transfers are the common means of paying wages, banks play the role of wallets for consumers. Because of such characteristics, banks have given priority to investments that are aimed at offering consumer convenience, such as the deployment of branches and the installation of automatic teller machines (ATMs).

However, in addition to seeing bank participation in the securities brokerage agency business, we will see the arrival of full-scale bancassurance services. What appears to be needed under such circumstances includes not only investment as in the past to simply provide convenience, but also investment to provide asset-forming consulting services by competent consultants by means of effectively utilizing computer systems. If such investment schemes can evolve in the next three years on a systematic and dynamic basis, new banks will emerge that can transform the retail financial service market into Japan's new era of bancassurance.

3 Four Issues Facing Insurance Companies

(1) Managing and generating profits from orphan contracts

With respect to annuity insurance sold at banks, insurance companies now conduct all after-sales procedures including customer management and processing of changes in policyholder information. This means that insurance purchasers receive a variety of post-purchase, insurance-related services directly from insurance companies, rather than from banks. For insurance companies, these customers are classified under contracts (so-called "orphan contracts") for which neither insurance salespersons nor agencies actively provide follow-up services.

Assuming that OTC insurance sales at banks increase in the future, the first and largest issue for insurance companies to deal with is how to manage these orphan contracts and how to generate additional profits from these contracts as a new customer base.

(2) Building a new commission structure

The second issue concerns the development of a commission structure for insurance products for which restrictions will be removed as has happened for annuity insurance and fire insurance. As noted before, from the perspective of both insurance companies and customers, bank OTC sales channels function only as sales counters. Unlike existing sales channels (in the case of life insurance companies, sales channels mostly consist of full-time tied (direct) salespersons; in the case of non-life insurance companies, they are comprised of agency salespersons), bank sales channels neither provide after-sales consulting or services nor do they handle claims processing. For these reasons, it is said that insurance sales commissions for OTC sales at banks with respect to annuity insurance have been reduced to about 50 percent of those applied to sales by tied salespersons.

In the future, banks are expected to handle a wide variety of insurance products as OTC sales. In such cases, the complex issue facing insurance companies would be how to build a commission structure for OTC sales at banks for each product, while maintaining compatibility with sales commissions paid to existing sales channels as well as preserving efficiency. It is common for consumers to automatically ask for additional services from a company where a product is purchased. Accordingly, there is a possibility that banks may expand their policyholder services without limiting their activities to OTC sales, making the issue more complex.

(3) Emergence of "niche" insurance companies and the start of cost competition

For OTC sales of annuity insurance that started recently, new types of insurance companies emphasizing OTC sales at banks and securities company sales channels have been achieving good results. Hartford, focusing on investment-type annuity insurance, has evolved a unique sales strategy of giving priority to the use of securities company sales channels. Mitsui Sumitomo CitiInsurance adopted a similar strategy of making use of the OTC sales channel of a *keiretsu* (affiliated) bank, and rapidly made inroads into a higher rank in terms of sales performance of annuity insurance after the start of OTC sales. These activities highlight the emergence of specialized insurance companies that reduce insurance costs by specializing in the development of insurance products and underwriting without having their tied sales staff.

Considering the future expansion of products handled through OTC sales channels, the number of insurance companies that specialize in the development of insurance products and underwriting is expected to increase. If the sales situation continues to favor "niche" insurance companies as supported by their cost predominance, a new type of competition, i.e., cost competition, might intensify in the life insurance industry as well.

After World War II, the insurance industry has had nothing to say with respect to competition in terms of product costs or cost competition. The start of OTC sales of annuity insurance at banks should be considered as an ultimate sign urging insurance companies to review their comprehensive cost strategies including products and sales channels.

(4) Developing products that make the best use of bank OTC sales channels

In September 2004, Millea Holdings, the largest non-life insurance holding company in Japan, and Mitsubishi Tokyo Financial Group announced the establishment of a business partnership in the field of individual annuity insurance. Concurrently, they started a new, unprecedented type of annuity insurance. The new annuity insurance that is investment-type annuity insurance consists of three types. These include a basic plan, a type in which a prescribed addition is made to the accumulated annuity funds at maturity regardless of the fund management performance, and a type that guarantees the accumulated annuity funds. Except for the basic plan, the two other types of products are designed under the concept of full consideration of the safety-oriented thinking of bank customers.

In the future, accelerated movement is expected in the development of products that make the best use of bank OTC sales channels. Whether sales channels can be used wisely or poorly depends entirely on whether the characteristics of the products handled and their sales channels match. It should be noted that customers expect banks to provide convenient and easy saving and settlement functions in addition to a guaranteed death benefit. In keeping pace with the development of bancassurance on a full-scale basis, insurance companies must further strengthen their efforts to develop products that offer both convenient and advantageous saving functions and guarantee functions as is evidenced by the products offered in the United States.

Data so far available on the performance of OTC sales at banks indicate good sales of annuity insurance products with guarantee of principal (accumulated annuity funds) and fixed annuities. This favorable trend may be attributed to the fact that the greatest expectation bank customers have is the safety of principal as seen in the case of deposits. To fully use bank OTC sales channels, it is essential for insurance companies to develop new products by thoroughly using their expertise and ideas not to again invoke the issue of negative interest rates in the management of funds.

The establishment of a business partnership between Millea Holdings and Mitsubishi Tokyo Financial Group is considered one of the moves aimed at the development of such products. It would be natural to consider that similar business partnerships between members of the insurance industry and the bank industry will be seen extensively in the future.

(1) "Kasai hoken no ginko madohan kyuzo" (Rapid Increase in OTC Sales of Fire Insurance at Banks), *The Nikkei Financial Daily*, April 23, 2004.
(2) *Weekly Toyo Keizai* (extra edition), July 28, 2004.
(3) Based on the materials of Career Resources, and is part of the education program for employees of PNC Financial Services (former PNC Bank).
(4) "So You Want to Buy an Insurance Agency," *ABA Banking Journal*, November 2000.
(5) *American Banker*, June 17, 2003. (Bank One announced its merger with JP Morgan Chase in January 2004. Its name was changed to JP Morgan Chase & Co., after the merger in June.)
(6) *Life Insurers Fact Book*, American Council of Life Insurers, 2003, and *American Banker*, June 24, 2004.

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