

U.S. BANCASSURANCE IN THE U.S. AND ABROAD

MICHAEL D. WHITE

***Vice President, International Insurance
Security Pacific Insurance Group
San Diego***

***CEO & Managing Director
Security Pacific Insurance Group (UK)
London***

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Around the World, Banks in Insurance

The 1980s witnessed a powerful acceleration towards global integration of financial services. In the 1990s that movement will continue, propelled along by the internationalization and diversification of industries and markets, facilitated by advancements in technology and communications and a new appreciation for the benefits of freedom.

The entry of financial institutions, particularly banks, into the insurance business marked a significant change in the financial services industry. Bank entry into the insurance business as agent and/or underwriter is an accomplished fact in Australia, Britain, Denmark, France, Germany, Ireland, the Netherlands, Spain and other European countries. In other nations with developed financial markets, regulators, legislators and financial service competitors debate how, when and in what way banks may enter insurance markets. But the trend toward “universal banking” is unmistakable ... and it is global.

Financial Services Integration in the United States

The United States has not taken the lead in this aspect of the global movement toward financial integration. In the early and mid-1980s U.S. brokerage firms and insurers ventured into other financial services. Financial integration was dominated by acquisitions which involved primarily insurers, institutional investment managers, broker-dealers and mutual funds. Many of these acquisitions met with mixed results. The most notable U.S. success in the 1980s was that of E.F. Hutton. Hutton had a very successful life insurance operation of its own that sold a considerable amount of product through its stock broker sales force, benefiting greatly from its innovation in

creating universal life insurance. I was fortunate to be Hutton's National Director of Insurance Sales at that time.

Many American nonbanking firms – including industrial and commercial companies – offer both insurance and traditional banking products, such as time deposits, credit cards and mortgages. Numbered among them are General Motors, USAA, Sears, J.C. Penney, American Express, Prudential Insurance (U.S.), and John Hancock. Other financial services companies include the names Xerox, Ford, Chrysler, General Electric and Florida Light and Power.

For 30 to 40 years some deposit-taking and lending institutions, primarily thrifts or savings and loans (S&Ls), have been in the insurance business one way or another. Now, over 1,000 of about 3,000 S&Ls are selling annuities and other insurance. Although their numbers are growing, only about 100 of the nation's 14,000 banks are selling annuities. Some institutions offer personal property-casualty policies, single premium life, universal life, term and whole life. A few are selling long-term care. In addition, a handful of banks – like Signet Bank of Virginia and First Security Bank in Salt Lake City – are operating commercial lines agencies.

The U.S. Regulatory Environment

The obstacle to bank insurance activity in the U.S. is the result of complex regulatory prohibitions carefully guarded by the insurance agents' once almighty lobby, which works to maintain these anti-competitive strictures. At the Federal level the Bank Holding Company Act (BHCA) empowers the Federal Reserve Board (The Fed or FRB) to regulate bank holding

companies (BHCs). Regulation Y of the BHCA also limits domestic insurance underwriting and agency by BHCs to creditor-related products for affiliated extensions of credit.

Passage of the Garn-St. Germain Act in 1982 was viewed by the agents as a major victory that would completely close what was then known as the South Dakota loophole. It didn't. Instead, the FRB argued that it doesn't have authority over state-chartered subsidiaries of BHCs. Therefore, it concluded that the Act permits state-chartered subsidiaries to engage in insurance activities permitted under state law.

The agents went to court to contest this interpretation made by the FRB in the case of Merchants National Corporation, a BHC engaging in insurance activities through its Indiana state-chartered subsidiaries. Last November 29, the U.S. Court of Appeals for the Second Circuit (New York) with no dissenting votes (3 to 0) affirmed the FRB's ruling. This was the fourth consecutive judicial defeat for the agents' lobby; we are hopeful that the U.S. Supreme Court will not review the Appellate Court's unanimous decision.

In addition, the insurance agents recently lost one of their key allies in the struggle to prevent expanded bank powers when, in late 1989, the Securities Industry Association (SIA) reversed its long-standing opposition to repeal of the Glass-Steagall Act which prohibits banks from entering the securities business. By no longer standing firm behind Glass-Steagall, the SIA acknowledged the value of allowing banks greater freedom in offering a full range of financial services.

In keeping with this progressive trend, in December, the FRB approved Citicorp's application to retain ownership of two state-chartered insurance subsidiaries in Arizona and to resume sales in which they were involved in 1982.

The arguments of insurance agents are less and less convincing, and the barriers against bank agency activities are beginning to crumble. With varying regulations and restrictions, 24 states now permit state-chartered banks to engage in insurance distribution activities. California Proposition 103 permits state bank agency activities. It was a precursor to the proposed bill which was defeated by one vote in the Delaware State Senate in January. Before too long, another vote will be taken there, because the bill has the support of the state's governor and House. Moreover, the Merchants National decision is expected to increase pressure on State legislatures. The next great political battleground will probably be in Florida, where the financial laws are due to be reviewed. In a February editorial entitled "Banks and Insurance: Time for a New Policy," Florida's influential newspaper, The Miami Herald, called for repeal of the 1974 prohibition against banks selling insurance.

In states where banking organizations cannot field their own agency sales force or license bank employees, banks have been creative and utilized third-party marketers to derive fee income via a number of arrangements: space lease/rental or franchise contracts; trust fees; marketing service or list rental agreements, and so forth.

“Bancassurance” in the United States

Despite the relatively slow pace of product and service desegregation within the U.S. financial services industry, the process of domestic bank insurance activity is in motion.

The best-selling insurance products at banks and thrifts are annuities, primarily single premium deferred annuities. These sales have gone through the roof. In 1988 they rose 50% to \$6 billion. By 1989 they reached approximately \$10 billion, accounting for one-eighth of the national annuity market and \$500 to \$600 million in commissions and fees.

- The insurance agency profits of Carteret Savings Bank went from \$500,000 in 1985 to \$5.5 million in 1988, annuity sales from \$12 million to \$92 million. The retail sales network generated \$13 million in fee income, second only to the mortgage corporation.
- Bank of America’s program with GNA is reputed to have produced \$500 million in annuities and mutual funds in its first 20 months.
- CalFed Bank converted platform personnel into licensed salespeople and in 12 months generated \$250 million in annuity premiums in approximately 125 branches.
- First Insurance, one of the “sweet-sixteen” bank agencies grandfathered under the BHCA, did \$225 million in brokerage premium. Introduction of annuities is expected to raise premium to over \$300 million.

- Security Pacific did approximately \$150 million in annuity premium through its affiliated banks in Arizona, Oregon and Washington states. That number doesn't approach what Security Pacific will do through its California branch system once its Proposition 103 annuity distribution plans are finalized.

Bank insurance activity presents opportunities for insurers, too. Mutual of New York (MONY) Financial Services and SunAmerica Corp. wrote some \$400 million in 1989 through banking institutions. United Pacific Life wrote \$650 million in annuities through 130 banks and S&Ls. The list of U.S. insurers who are providing product, marketing and sales support to financial institutions is growing.

The number of foreign-owned American-based insurers who seek to penetrate the bank market is also rising. Pacific Fidelity, owned by Aegon, wrote \$630 million in annuities in 1988 through depository institutions. Its 1989 premium budget was \$1.5 billion. Integrity Life, now owned by Australia's National Mutual, aggressively works the bank market. And Skandia America has come to play with the banks and S&Ls, too. Already foreign insurers write an estimated 10% of U.S. life insurance premiums.

The sale of insurance products by banks, like the financial services integration movement, is growing significantly. Security Pacific Insurance Group (SPIG) is a leader in the U.S. "bancassurance" movement.

Security Pacific Insurance Group – At Home

SPIG are the insurance subsidiaries of Security Pacific Corporation (SPC), the second largest bank holding company in California and the fourth largest in the United States with over \$84 billion in assets as of December 31, 1989.

Since 1982 when SPIG was established as a functional business unit and independent profit center, SPC's insurance activities, programs and revenues have expanded rapidly. We function as underwriter, reinsurer, agent, administrator and consultant. In 1988, the most recent year for which figures are available, SPIG ranked 9th among all U.S. insurers in creditor life insurance issued, and 1st among all direct writers owned by financial institutions – ahead of ITT Credit, AVCO, Associated, Commercial Credit, Beneficial, Norwest and HFC. Citicorp's direct writer, Family Guardian, is not even in the top 100 issuers of creditor life. SPIG not only issues more coverage than Citicorp. We write more premiums at our California bank alone than our three major California bank competitors combined, and our income is a multiple of the combined income of all other California-based BHC insurance operations. In the last three years SPIG has generated for the Corporation approximately \$155 million in income benefits in the form of net-after-tax earnings, claims paid and compensation to affiliates.

Security Pacific Insurance Group – Proposition 103

Security Pacific Insurance Group continues to be thoughtful and deliberate in laying its plans to take advantage of the opportunities Proposition 103 has created. Security Pacific now offers a 10% agent rebate on homeowners insurance premiums for mortgage loans. We are targeting 30% to 40% penetration of new loans and also expect good results on a separate project targeted

at existing mortgages and home equity loans. Additionally, term life, tax-favored annuities, disability, long-term care, marine and auto insurance are available. Distribution of all types of insurance products is being tested through agentless insurance kiosks. Some kiosks have telephones which link customers directly to the telemarketing unit; some also have “continuous-play” informational videos. Customers are able to pick up brochures on available products and call agents on a toll-free number to obtain further information and buy any products. A Ready Quote service, available through the toll-free number, gives immediate estimates on insurance policy premiums.

SPIG is examining the possibility of marketing performance bonds for developers, playing on the strengths of Security Pacific’s portfolio wherein SPC is a leader among developers’ financing sources. We are considering a test in a cooperative venture with an unaffiliated broker to distribute commercial insurance to SPC corporate clients. SPIG is also moving ahead with a program to provide professional liability self-insurance services, a program which will incorporate the use of life insurance.

Security Pacific Insurance Group – Overseas

Three years before Proposition 103 was drafted as a referendum, Security Pacific recognized that it needed to grow and diversify its earnings. I mentioned earlier that Regulation Y of the BHCA basically limits BHC underwriting and agency activity to creditor products on affiliated business. Therefore, domestic earnings growth in creditor products ultimately is limited to maximum penetration ratios or new bank acquisitions. However, Regulation K permits – offshore – full agency and brokerage activities as well as creditor underwriting on unaffiliated lending. It also

allows BHCs to apply on a country-by-country basis for authority to underwrite non-creditor products such as annuities, cash value savings or retirement-oriented insurance, and other non-creditor insurance products.

Admittedly, U.S. “bancassurance” activities abroad are few and far between. While a few U.S. insurers are testing the waters on the far sides of the Atlantic and Pacific, to my knowledge, only two major U.S. bank holding companies are making any effort to market or underwrite insurance overseas. They are Citicorp and Security Pacific.

In 1985 Security Pacific entered the EC market by obtaining creditor and certain non-creditor insurance underwriting authorities in the United Kingdom. FRB and the U.K. Department of Trade and Industry (DTI) approvals were obtained, respectively, in late 1985 and mid-1986. The companies have been operational for a little more than 3 years; more importantly, we have established a very important franchise that gives us access to the post-1992 Single European Market. We now underwrite or reinsure business in the U.K., Ireland and Germany. We are quoting on business in other EC and EFTA countries. We are also proud to be the only boutique creditor insurer on the approved underwriter lists of several major Lloyds brokers.

In three years time, we have achieved generally excellent results. In the fourth quarter of 1989, our new overseas insurers generated over 23% of the Group’s consolidated gross premiums. Net written premiums more than quadrupled in 1989 and exceeded Plan by 114%. Despite new business strain, 1989 insurance earnings more than doubled and contributed almost 8% to SPIG’s

consolidated insurance earnings. The number of new institutional clients exceeded Plan by 17% and sales penetration rates averaged 40%, more than three times market norms.

We look forward to expanding our international activities in other ways, in Europe and elsewhere. For instance, in late 1989 we received approval to establish an agency in the Caribbean which will serve as a beachhead for our Hispanic markets strategy. I have been asked to accept an appointment by the U.S. Department of Commerce to serve as the U.S. life insurance industry's representative in bilateral insurance trade talks with Mexico to open that country's insurance markets. We are looking at selective opportunities in the Pacific Rim.

We are also learning a great deal from the experiences of the European bancassurance movement. As noted earlier, European banks have greater latitude from a regulatory perspective to engage in insurance activities than do U.S. banks. We believe there is much to be learned from comparative studies of various EC Member country markets. One need only look at BNP and then Predica in France, or at KKB Leben and then Deutsche Bank Lebensversicherungs in Germany, or at NatWest and then TSB in England, to judge how management, marketing and operational decisions are the key to performance, despite widely varying regulatory controls and sociocultural differences in each market.

On Freedom of Services and Making the World Big

Reregulation in the United States that inculcates greater freedom of services for all financial institutions and that specifically permits bank distribution of insurance products will afford tremendous opportunities for banks and insurers alike. Both will profit by widening their

sources of income. More importantly, expanded insurance powers and services for banks will more amply benefit and satisfy the consumer.

As the world in general and Europe in particular is learning, freedom of services bestows the benefit of opportunity and generates a more lasting social, political and economic security. This is a most important reality. When American banking and insurance regulations reflect this reality, U.S. banks and insurers will be free to compete, unfettered, in domestic and global markets.

However, Security Pacific will not idly wait for that day to arrive. We will compete in insurance in every reasonable way we can. When it comes to insurance markets at home or abroad, we remember the observation of the American novelist, F. Scott Fitzgerald, who wrote: “The world only exists in your eyes – your conception of it. You can make it as big or as small as you want to.” Security Pacific Insurance Group believes we should make the world big, and thereby savor the opportunities it offers.