Making the Leap

Starting in insurance requires forethought and unvarnished analysis

by Michael D. White

At one time or another, most of us have heard a horror story about a bank that entered the insurance business and fell flat on its face in a pile of failure. The bank may have bought an agency, built one from scratch, or "rented" its insurance program (i.e., outsourced or partnered with an unaffiliated agency).

Like success, failure appears in many forms, and its midwife is often the particular strategy and mode a bank selects for entering the insurance market. Failure doesn't always result from poor execution of a strategy. Often, the strategy itself is poor and inappropriate.

Sometime, somewhere, there is the story of a bank that decided to buy an agency, despite not knowing how to evaluate whether the agency was a strategic fit and how to financially value the agency's worth. Filled with unbounded eagerness to sell insurance (and naiveté), the bank accepted the agency owner's declaration that agencies were selling for "two times revenue, or more." Only a couple years after buying the agency, did the bank realize it would endure a 13-year payback period before earning back the agency's purchase price.

Sometime, somewhere, there is the story of the bank that built a personal lines property-casualty agency, because nearly all its customers owned homes and drove cars. Bank management thought selling auto and homeowners insurance would be an easy layup. Little thought was given to the commoditized, price-sensitive nature of these products, their premium-size or gross commissions, or the information and timing required to approach these prospects at the right point in the buying cycle.

Three years later, and a lot of systems used and money spent, the bank discovered it would be many more years before this de novo agency returned a profit. In this case, Will Rogers' quip comes to mind: "I'm more concerned with the return of my money than the return on my money."

And, then, somewhere is the story of the bank that negotiated a sales agreement with a local independent insurance agency, whereby the agency would sell insurance to the bank's customers. Initially, expectations were high, but after more than a year sales were disappointing. There just weren't enough prospects among the bank's customer base for the types of insurance products the agency sold.

This discovery should have been made before the bank and agency reached an agreement and launched an insurance program. Instead, it was made after both firms had attached considerable time, effort, money and hopes to the insurance program.

Why Failures Occur

Why do these kinds of failures occur? After all the focus on the potential of bank insurance sales, why do they persist? What do these horror stories tell us about how banks should approach their opportunities for selling insurance?

Because there are many ways to sell insurance, some bankers who consider getting into the business sometimes begin and end at the wrong place. These bankers start by asking whether they should "buy, build or rent." While mode of entry into the insurance business is an important decision, it is not the appropriate starting point for formulating a bank insurance strategy.

Knowledge of what insurance your bank should sell and how to sell it is best attained after you have evaluated its particular circumstances and ranked its opportunities for serving its customers, generating revenue and producing a profit.

Understand the Circumstances

With uncommon common sense, General George Patton stated this most fundamental principle of strategic planning succinctly: "One does not plan and then try to make circumstances fit those plans. One tries to make plans fit the circumstances…. [The] difference between success and failure in high command depends upon the ability, or lack of it, to do just that."

So, the appropriate initial focal points for evaluating bank insurance opportunities must be the circumstances of each bank and its customer bases. Bankers need to ask "who" their banks are. They must consider, "Who

are our customers, and what business do they do with the bank? What insurance needs do they likely have? What insurance products neatly dovetail with their banking transactions, their business relationships with the bank, and their known or likely needs?"

Making an economic assessment is the essential first step to a bank insurance strategy, which involves answering the questions above by calculating their dollar values. This is the only way a bank can rationally determine whether it can effectively and efficiently deliver appropriate products to target customers at a sufficient profit.

A proper economic assessment measures the financial value of a bank's likely insurance sales-by products, means of distribution (such as direct marketing or a retail sales force), retail and commercial customer bases, prospect appointments, closing ratios, premiums, commission rates, policy retention rates and direct expenses.

This logical methodology forms the necessary foundation of a bank's strategic evaluation process. Emerson called this sort of thing "genius dressed in its working clothes," because it is so basic. It is basic to project a bank's realistic potential for generating insurance premiums, revenue and incremental income from its customer bases.

In this way, each bank's retail and commercial customer bases are examined to determine which insurance products and delivery systems have the greatest likelihood of serving customers and generating fee income for a particular bank.

These findings are critical to determining whether to buy, build or rent. When a bank understands its circumstances and knows what products it should sell, it can then focus on the most significant sources of insurance income, maximize its profits, and minimize its risk and chances of failure.

Assess the Economics

A thorough economic assessment measures a bank's insurance potential against its statistical profile of assets, deposits, net interest income, noninterest income, net operating revenue and noninterest income as a percent of net operating revenue. It should also measure that potential against its returns on assets and equity, number of bank employees and banking locations, and Tier 1 and Total Risk-Based Capital ratios, which can be indicators of capital that can be a key source of investment in an insurance program.

Insurance sales potential must also be measured against a bank's customer bases, including its retail deposit customers; new and existing direct auto loans; new home loan originations and those held in portfolio or serviced; nondeposit investment and trust customers, if any; retail householders aged 55 or older; and commercial customers.

When doing an assessment, it is important to not get lost in analyzing the sales potential of every possible insurance product available. Focus on the traditional product lines that most people and businesses are likely to need and buy. This includes personal lines auto and homeowners insurance and personal life insurance and annuities for retail customers. It also includes the bank's own corporate covers, commercial property and casualty insurance, group life and health insurance, and business life insurance sold to commercial banking customers.

Generally speaking, these mainstream protection products hold the likeliest potential for sufficient volume and adequate profitability.

A precise economic assessment should calculate the premiums, revenues and profits your bank can realistically generate by each line of insurance and total results over a five-year period. And, be sure to evaluate the impact of sales of these products on your bank's financial position.

Do so by measuring insurance fee income as a percent of your bank's total noninterest fee income. Examine the impact of insurance on the growth of noninterest income as a percent of your bank's net operating revenue and of net insurance income as a percent of your bank's net income.

Plan Accordingly

These economic findings identify the product mix that serves your bank's customer bases and best suits its corporate profile, strategic positioning and objectives. And they help determine the most effective, productive and profitable modes of market entry (buy, build or rent) for producing meaningful profits and a desirable rate of return.

In this way, an economic assessment guides your bank's long-term strategy as you plan and launch successful insurance operations.

From these findings, you can conclude whether your particular bank can derive meaningful results selling property-casualty or life insurance-annuity lines. You can deduce whether your bank should enter a particular insurance business. And you can determine how your bank can most effectively enter those markets.

More specifically, you will have a logical basis for deciding whether you should build a start-up agency, enter the property-casualty or life markets via acquisition, or use an unaffiliated insurance provider. Only in this way will you know what your bank can, and should, do in selling insurance.

Michael D. White, Ph.D., CLU, ChFC, is Chairman and CEO of Michael White Associates, LLC, a bank insurance consulting firm. MWA is headquartered in Radnor, PA. You may email Dr. White at mwa@BankInsurance.com.

A version of this article first appeared in ***Independent Banker*** *,*
May 2001, V.51 N.5, pp. 80-81
*"**Making the Leap**"*
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