
Winning in Bank Insurance

By David Ascher, Neal Aton, Linda Cohen, Michael White

Uncertainty reigns in bank insurance today, as both current and potential participants in the marketplace seek to parse mixed signals. On the one hand, high profile divestitures of bank agency operations – driven by regulatory fear, the need to shore up capital ratios, and the promise of high exit multiples paid by private equity-backed buyers – cast light on some banks’ indifference toward their insurance operations. On the other hand, some banks are redoubling their efforts to use insurance sales to boost noninterest income in a stubbornly low interest rate environment.

Our perspective, based on decades of collective experience in this market, is that bank insurance is simply too attractive for banks or carriers to ignore. But there is a right way and a wrong way to pursue it.

This article examines the appeal of bank insurance, explores the nuances behind the market’s recent retreat, and outlines the key success factors that make the difference between winning and losing in bank insurance. The bank insurance alliance can be a highly profitable one when both strategy and execution are properly calibrated. Experience demonstrates this, as numerous banks have significantly prospered with well-calibrated execution while others have failed without it.



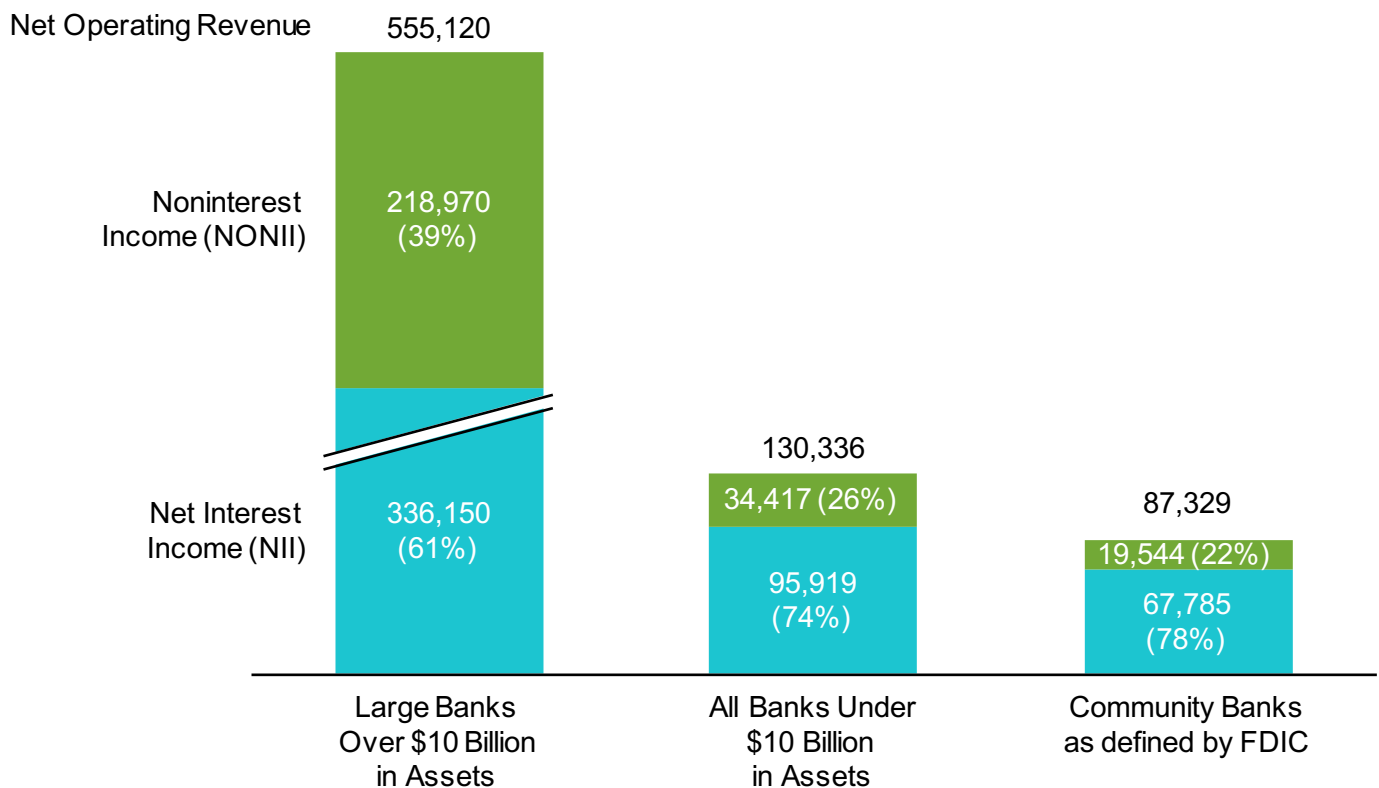
What's so interesting about bank insurance?

Bank executives should be seeking a minimum of 40% noninterest income to net operating revenue (NOR) to shield banks from economic swings and changes in the housing or energy markets. This has been a goal for years. And, while on the surface it appears that the industry achieved a 37% ratio in 2015, it was really the big banks driving this number with 39% of NOR; mid-size and community banks remain more heavily reliant on interest income. (See Figure 1.)

Insurance can be a particularly attractive noninterest revenue source because it offers significant recurring cash flows through renewal commission streams. Over the last decade, bank insurance as a percentage of noninterest income has hovered in the single digits with a mean of 5% in 2015. Among the top performers – the top 50 in terms of insurance brokerage concentration (i.e., insurance brokerage income as a percent of noninterest income) – the mean insurance brokerage concentration ratio was 79%. (See Figure 2.)

Smaller banks tend to benefit more from insurance than do large banks in terms of having higher concentration ratios. In 2015, among the top 50 small banks in insurance brokerage concentration (i.e., those under \$1 billion in assets), the median insurance brokerage concentration ratio was 68%.

Figure 1: Ratio of noninterest income to net operating revenue by bank size/type
\$ thousands ¹

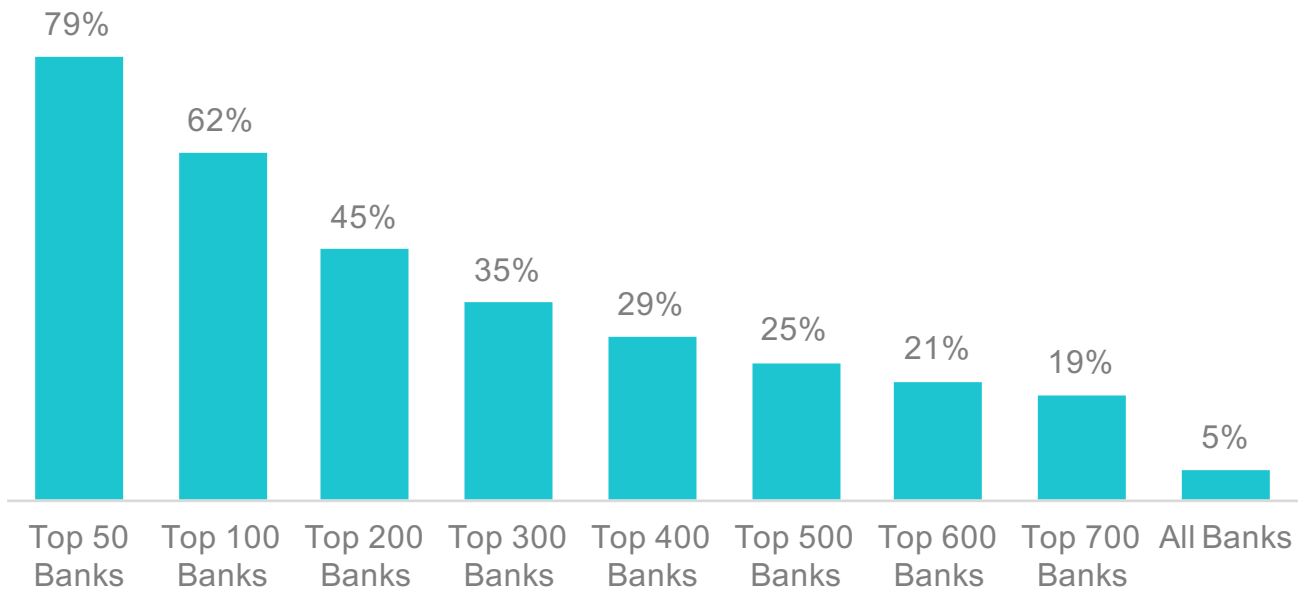


¹ Source: Michael White Associates, LLC

Further analysis shows that, while the percentage of noninterest income derived from bank insurance is lower for larger banks, the absolute dollar contribution of bank insurance at these large institutions is still quite significant. Consider, for example, that Wells Fargo generates over \$1.25 billion in annual bank insurance revenues and that the top 10 bank insurance revenue generators brought in \$4.04 billion in insurance revenues in 2015¹.

Figure 2: 2015 Mean concentration: insurance brokerage as a % of noninterest income Based on the leading banks in insurance brokerage concentration

(How to read: Among the top 50 banks in insurance as a percentage of noninterest income, the mean percentage of insurance brokerage to noninterest income was 79%)



Notes: Only banks participating in the sale of bank insurance in 2015, all bank size categories included

Source: Michael White Associates, LLC

Of course, bank insurance is also an opportunity to deepen the bonds between the bank and its clients, driving additional lifetime value (LTV). Our experience suggests that cross-selling a second line of business to a customer results, on average, in a 25-30% boost in LTV. Customers are “stickier” as relationships deepen.

¹ Source: Michael White Associates, LLC

The bottom line is that banks that “do it right” can create a growing, profitable business with insurance.

Looking at bank insurance from the carrier perspective, the bank channel holds extensive appeal in terms of size, scalability, and strategic flexibility. Today, insurers count on banks for about 5% of their P&C premiums and 16% of their annuity sales. Carriers with a compelling product, track record of successful partnership, and wholesaling competency can rapidly expand distribution points, at a rate that is unrealistic in the captive and independent agent channels. Through strategic partner selection, carriers can also advance enterprise objectives such as geographic diversification or the capture of underpenetrated segments. They may also benefit from the rich data repository and analytics power of banks, which typically exceeds their own.

Though bank insurance in the U.S. has never approached the prevalence of bank insurance in Europe, Asia and the Pacific Rim, consumer perceptions seem to support the notion that it could be much bigger than it is today. Despite all the negative press and the hangover from the Great Recession, 82% of surveyed respondents state that they trust their banks, and 43% indicate they would consider buying insurance from their bank. (See Figures 3 and 4.)

Figure 3: % of respondents stating they trust their various institutions ¹

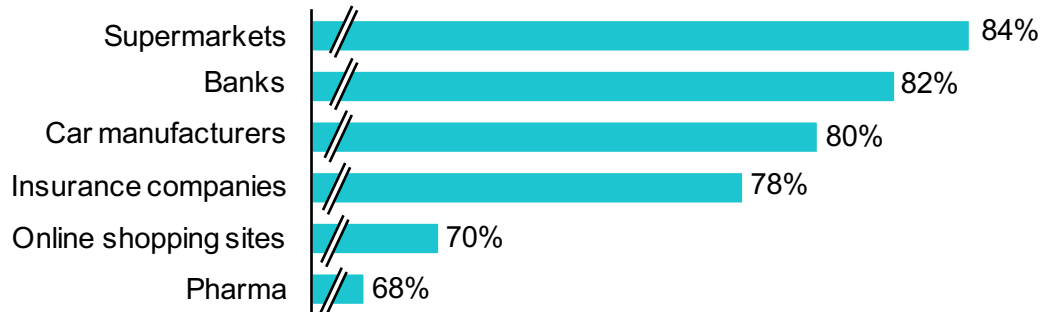


Figure 4: Percent of customers who would consider buying insurance from various providers ²



¹ Source: 2013 Ernst & Young Insurance Survey ;

² Source: 2013 Accenture Customer Driven Innovation Survey

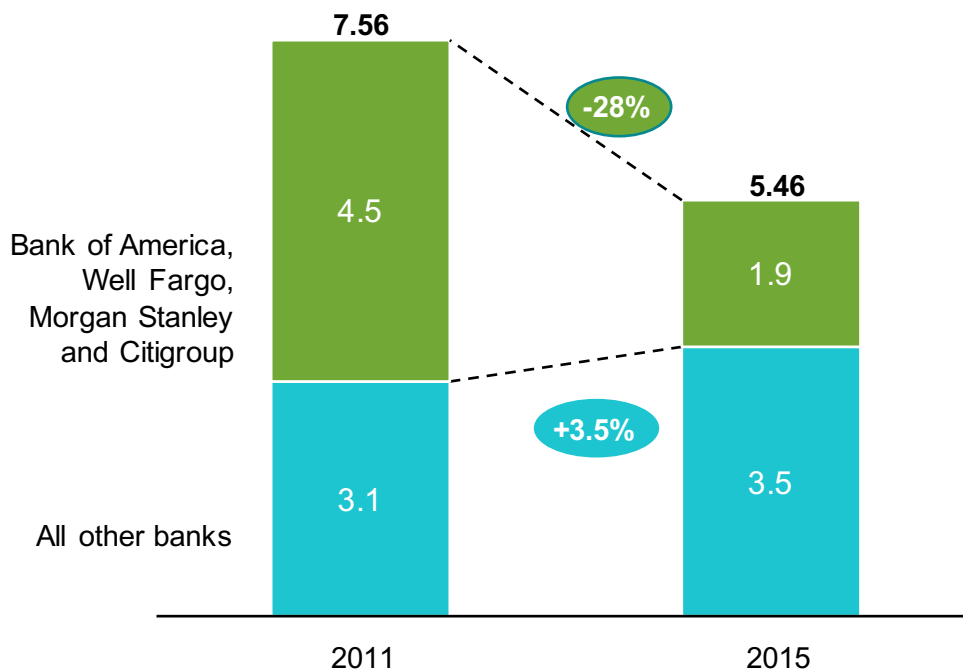
Why does it look like bank insurance is declining?

It takes some digging to understand the dynamics of this industry, so executives investigating the opportunity should be sure to look beneath the surface of broad trends. For example, an analysis of large bank holding company-level data reveals that bank insurance revenues declined 27.8% from 2011 to 2015. However, delving a little deeper into the data reveals that Citigroup, Morgan Stanley, Bank of America and Wells Fargo collectively accounted for the bank insurance industry's reverse. From 2011 to 2015 these four BHCs experienced a combined decline of \$2.55 billion in insurance brokerage income, well in excess of the overall decline in the BHC insurance brokerage market (\$2.1 billion) during the same period. Had those four large BHCs not suffered that aggregate decline and simply maintained their 2011 production at the same level in 2015, BHC insurance brokerage income would have increased to \$8.01 billion, or 47% more than the \$5.46 billion actually achieved in 2015.¹ (See Figure 5.)

Wells Fargo's revenue contraction is attributable to office sales and broker attrition in commercial operations, discontinuation of some products and channels, expense cutting, and reduced referrals from retail bankers. The declines at Bank of America and Citigroup were driven primarily by fines and reverses in the UK. Without these declines, the industry would have grown, driven by large gains at BB&T and smaller gains among other bank players.

Figure 5: Change in bank insurance revenues 2011 to 2015²

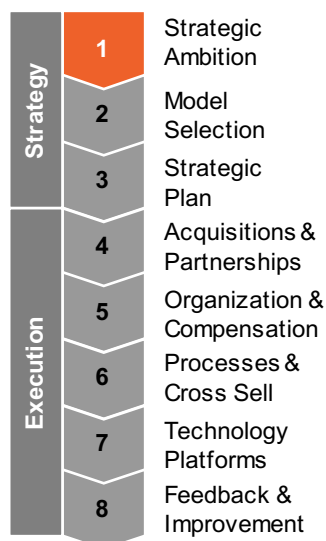
\$ billions



^{1, 2} Source: Michael White Associates, LLC

What does it take to succeed in bank insurance?

Banks



So, what do we mean by “doing it right”? While it might sound easy to set up an insurance operation in a bank given consumer interest in buying insurance at a bank, the truth is, success requires hard work on the part of both banks and their carrier partners.

Based on our experience, we believe that success for banks starts with a well-articulated strategy including a succinct strategic ambition, a properly selected model for participation and a strategic plan for implementing that model. That’s not enough, though. They need to follow with operational excellence in five areas: acquisitions & partnerships, organization design & incentives, processes & cross-selling, technology platforms, and metrics & improvement. We will discuss each of these factors in detail.

1. Clearly defined strategic ambition

In every industry and company, solid strategy starts with clear thinking. We recommend that banks interested in insurance engage key stakeholders in a vision-setting exercise. This requires answering the “big” questions:

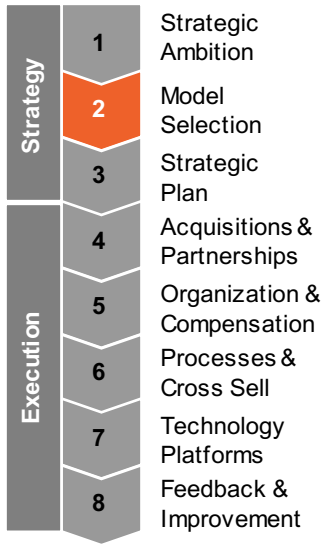
- What will we do?
- For whom will we do it?
- Where will we do it?
- How will we do it?
- Why will we do it?

This exercise should be both qualitative and quantitative. Decision makers should formulate their thinking based on careful analysis of past performance – their own and that of their competitors – to ensure a deep understanding of the business they are entering and to allow for an accurate assessment of feasibility.

At the end of this exercise, all stakeholders should be able to articulate what “success” will look like. Will it be a certain amount of insurance revenue, a certain level of and return on capital investment, a new level of relationship with the banks’ current customers, or some other aim? We’ve seen companies define success in many ways, including:

- Revenue/profit goals
- Investment hurdles
- Concentration ratio (% of noninterest income)
- Contribution ratio (% of net operating revenue)
- Risk/reward profiles
- Marketing objectives

Banks



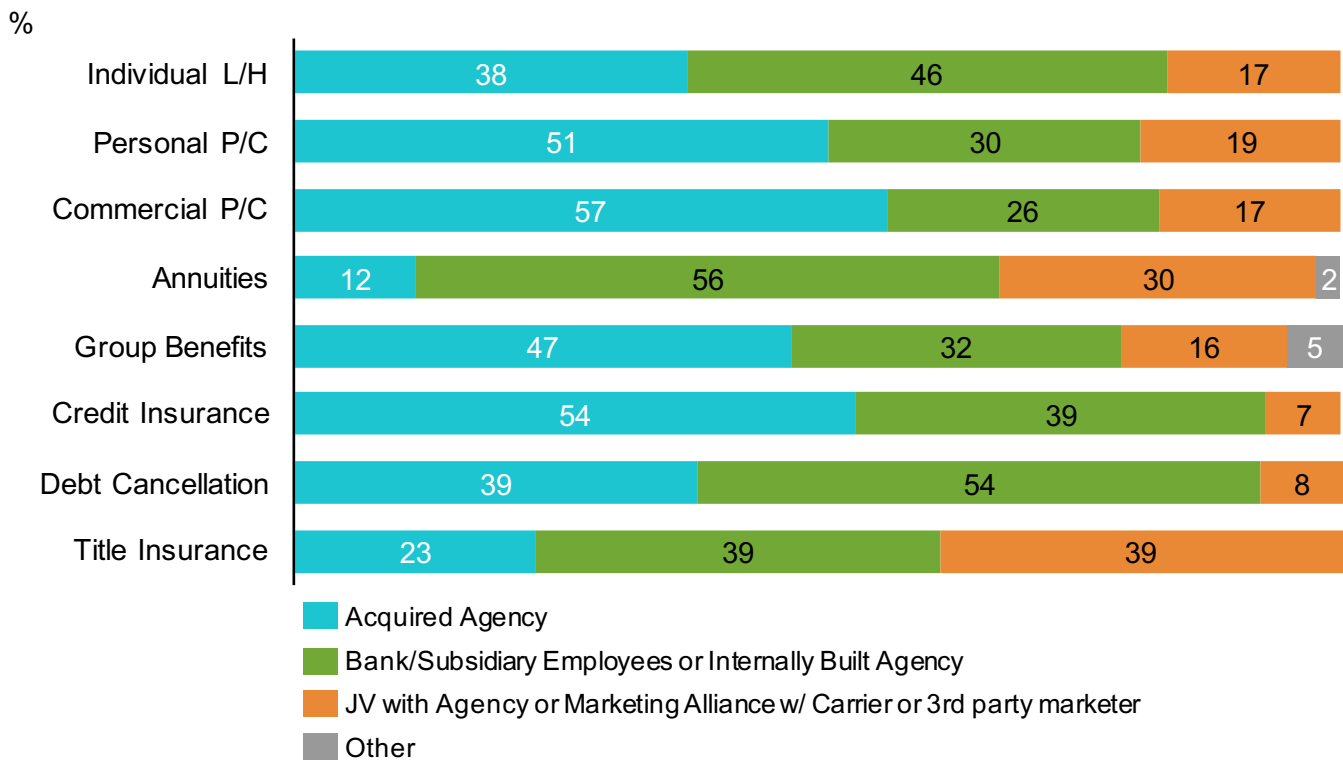
2. Model selection to fit strategic ambition

Banks have basically three options or models to choose from when deciding how to participate in insurance:

- Acquiring an agency or agencies
- Partnering with agencies or third party marketing organizations (TPMs)
- Building the capabilities internally

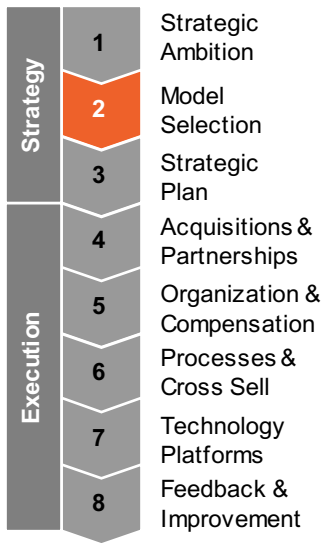
For P&C, acquisition dominates as a strategy, but partnering and building are prevalent in life and annuities. (See Figure 6.) However, line of business is not the only deciding factor in model selection: executives should also make sure to link their decision about operating model directly to their strategic ambition.

Figure 6: Primary bank insurance distribution strategies by line of business



Source: American Bankers Insurance Association, 2014

Banks

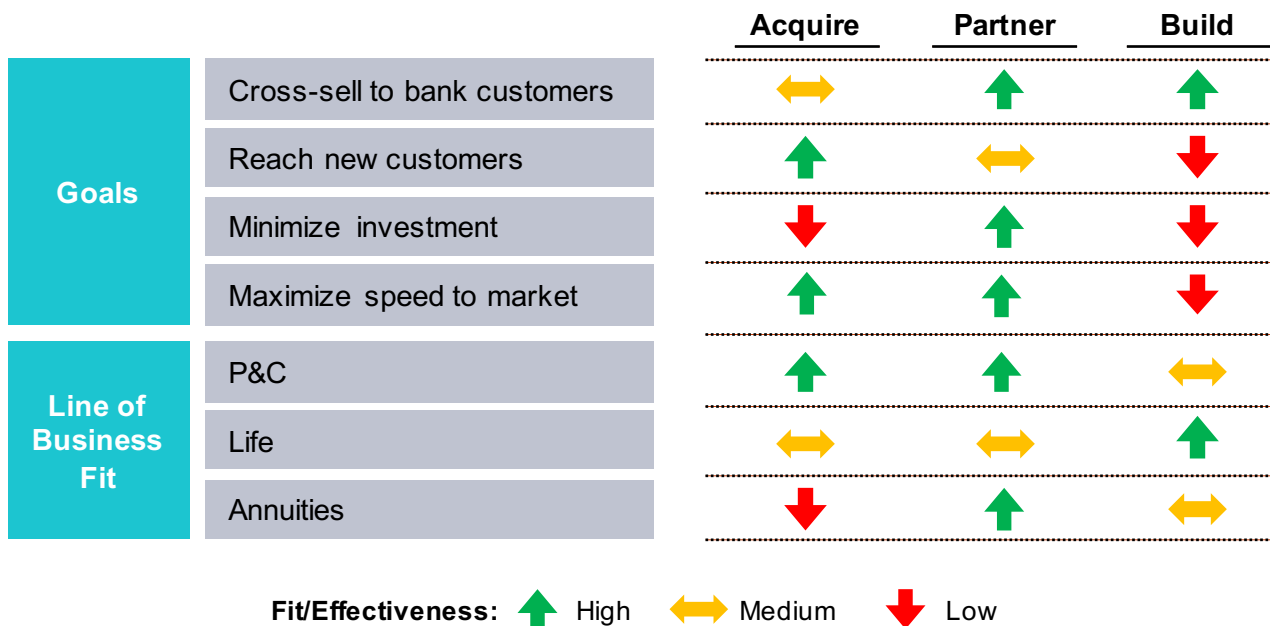


For example, if cross-selling to existing bank customers is a key ambition, then a bank might want to strongly consider the partner or build models. These arrangements allow banks to build offerings around their current clients' needs, then leverage and deepen these relationships. On the other hand, if expanding the customer base is more important, acquisition may be the answer. An acquired agency can sell to both existing bank customers and bring its own book of business to the relationship.

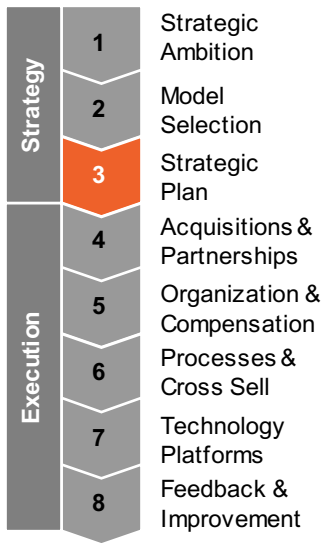
For the purposes of this article we will not delve into the build approach, as it is a high investment, long term approach that requires more in depth treatment due to the challenges. This model results in low or even negative cash flows and income in early years due to upfront investments in technology and marketing.

The decision regarding which model to employ is critical because it will drive the basic economics of the business and can mean the difference between achieving or falling short of the strategic objectives. Architects of the strategy should evaluate the models along multiple dimensions. (See Figure 7.) The example below is hypothetical as the actual evaluation will vary based on specific company strengths and opportunities. It is often the case that different models are selected for different lines of business or desired outcomes.

Figure 7: Hypothetical model evaluation



Banks

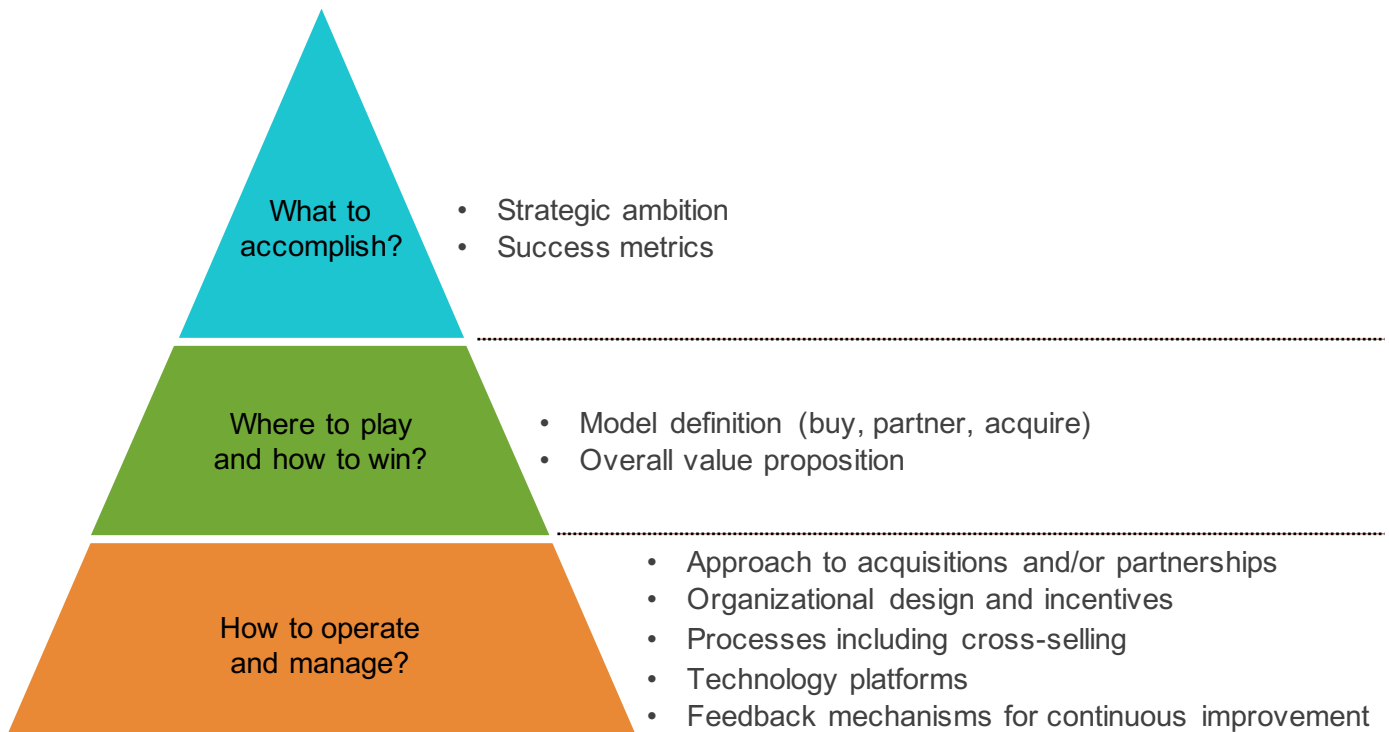


3. Codifying and communicating the strategic plan

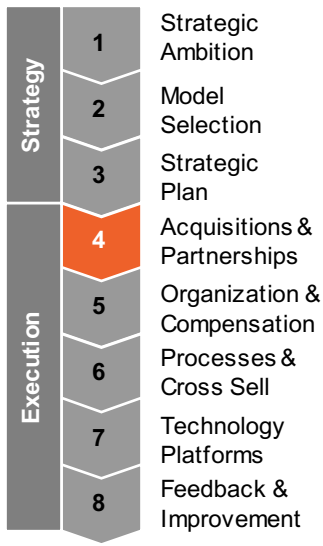
Before moving on to execution, a well-architected strategic plan is essential to ensure the planning process is complete and to use as a vehicle to communicate with bank executives to maintain their focus on and commitment to the effort. In the case of bank insurance, once the model has been defined and the value proposition articulated, our experience suggests there are five areas that are critical to operational success:

- A systematic approach to selecting the right acquisitions and/or partners
- An organizational design and compensation scheme that keeps the appropriate level of focus on insurance (and annuity) sales
- Processes that encourage cross-selling and minimize bureaucratic barriers
- Technology platforms that provide a seamless user experience
- Feedback mechanisms with a closed loop process to ensure customer service levels are optimal and program objectives are being met. (See Figure 8.)

Figure 8: Elements of a strategic plan for entering bank insurance



Banks



4. Making strategic acquisitions and building advantaged partnerships

For banks that decide to go down the path of acquiring insurance capabilities, we typically look at the following factors in evaluating acquisition candidates:

- Size (e.g., commissions, fees, profits, employee base)
- Geography (e.g., footprint relative to target markets)
- Target customers (i.e., consumer, vs. commercial, demographic or psychographic skews)
- Line of business mix (e.g., P&C, life, annuities, etc.)
- Carrier relationships (assignments, underwriting capabilities, commission and profit sharing levels)

Of course, typical acquisition due diligence and financial modeling are critical to ensure that the original objectives of the program are met (e.g., investment levels, ROE, IRR). As with any acquisition, triangulation is critical – values should be derived via multiple approaches (e.g., DCF, comparables analysis, etc.)

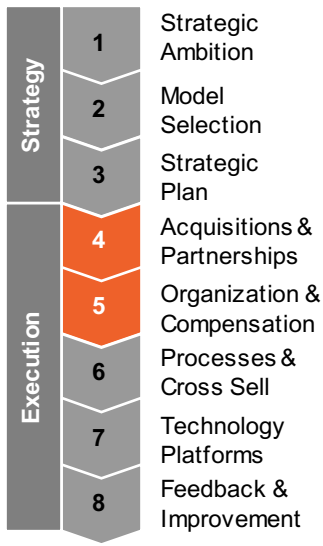
Once the acquisition activity evolves to the negotiation phase, we've found that successful buyers will pursue protections and commitments related to:

- Customer ownership
- Quality control parameters related to customer relationships and servicing
- Cross selling economics and mechanics
- Continuation of key agency personnel

If a partnership – either with an agency or TPM – is the path a bank pursues, similar due diligence and negotiations will set the foundation for success. In selecting agency partners the criteria above apply. In selecting TPM partners a few unique considerations come into play, including:

- Cultural match of the partner with the bank
- Ability to integrate systems across entity lines to provide a seamless customer experience

Banks



As with acquisitions, contractual factors can make or break the program. For partnerships, banks need protections and commitments in these areas:

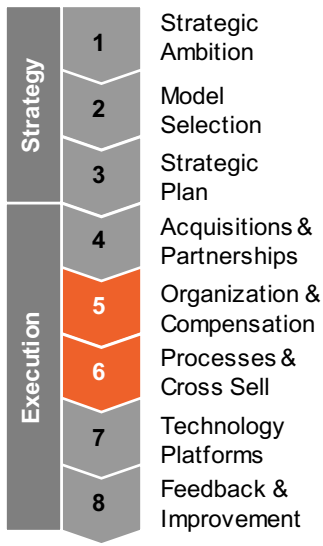
- Compensation mechanisms: for example, it is usually smart for banks to insist on share of revenue rather than share of profits since expenses and profits are subject to more adjustments
- Customer ownership and privacy: this is more critical here than it is for acquisitions since a third party will have access to customer information
- Proper resourcing by both the bank and the agency, including dedicating sales and servicing resources. Specific issues to address include who will sell, how the referrals and their outcomes will be transmitted and tracked, and who is responsible for servicing claims and other client issues
- Quality control parameters related to customer relationships and servicing: again, this is more critical for partnerships and banks should insist on a closed-loop system to monitor and correct any deficiencies
- Product pricing and product flexibility
- Regulatory and audit agreements
- Mis-selling exposure / handling
- Infrastructure investment

5. Creating alignment with the right organization and compensation structures

Focus should be the driving factor in considering how a bank should be structured for insurance operations. Experience suggests that, if it's not "the main event," it won't happen. For example, consider a bank with insurance operations embedded in the wealth management structure. This bank is potentially missing the opportunity to offer insurance to a broad swath of its customers that may not feel wealthy or qualify for wealth management services. And, there is an additional misalignment in this case since some insurance needs can be lower for the wealthy.

Compensation may be the most challenging issue for banks to address related to insurance operations. While bankers are historically working with razor thin margins, the more generous insurance margins allow for insurance producers to be more revenue focused. In the case of an agency acquisition or internally built capabilities, there is generally considerable tension in allowing for the type of compensation that motivates insurance producers.

Banks



For example, banks often find it difficult to provide incentive compensation such as stock options, restricted shares or other “upside” opportunities that competing brokers frequently offer to top sales performers.

The bottom line is that banks, to the extent possible, should model their compensation systems and key performance indicators (KPIs) on the insurance industry standards rather than banking standards to attract and retain high producers. This is not to say that profitability can’t be an element in compensation. Some banks link credits and compensation to the profitability of specific products. So, a banker that refers two different products may receive different compensation for each one.

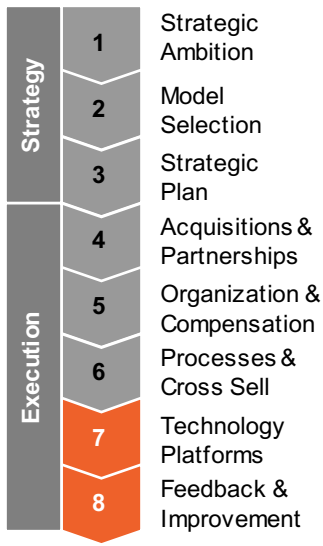
Another structural consideration, a financial concern, relates to how the insurance operations are held accountable and allocated overhead. We’ve seen cases where insurance operations were crippled by overhead allocations in the early years and even more so as revenue grew. During the investment period, it’s important for agency operations to be evaluated based on incremental cash flow and marginal profit rather than on a P&L stacked with corporate allocations.

6. Putting the right processes in place for cross-selling and other business functions

When we think of optimal processes for bank insurance operations, the first thing that comes to mind is making sure the organization has fully optimized cross-selling procedures. It’s at the intersection of current bank relationships and new product opportunities that bank insurance really pays off. So, how can a bank get bankers to cross sell insurance products? The answer is, it can’t just be a “strategy.” The banks that are most effective at cross-selling have focused policies, training, supervision, and tracking. They have also aligned compensation systems across businesses to reward cross-selling behaviors and/or results.

Aside from cross-selling, it’s important that business processes are streamlined to deliver a positive customer experience and the best possible returns on insurance investments. This means mitigating compliance/bureaucracy burdens by ensuring that, while risk is prudently managed, reporting requirements are held to a minimum and operating managers have real influence. To create this kind of productive environment requires the senior management team to be aligned with the objectives, a foundation that should be set when the strategic ambition is addressed.

Banks



7. Creating synergies through technology platforms

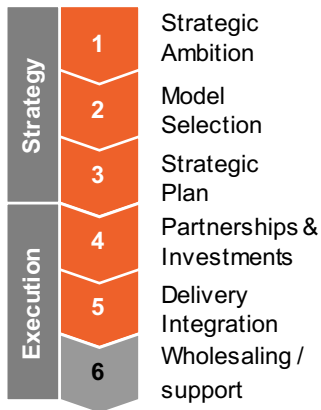
Systems integration with carriers is critical, but that is frankly behind the scenes. Banks that really do well with insurance ensure that technology drives a unified customer experience. The gold standard is an insurance experience embedded in the online banking experience. Ideally, bank customers can log onto their bank accounts and check their insurance premium due dates at the same time they check their savings balance. It should really be that simple. Unfortunately, the reality is that insurance website development efforts fall in line after nearly everything else. One of the upfront investment commitments banks should make if they decide to invest in insurance is to ensure that resources are allocated to ensure sufficient technical platform support.

8. Ensuring feedback is built into the system and linked to continuous improvement efforts

To safeguard valued customer relationships, banks that develop insurance capabilities must ensure that insurance interactions strengthen rather than degrade client affinity. Customer satisfaction surveys, audits of call center conversations and close supervision and coaching of frontline employees are examples of tactics that yield important and timely information about the quality of interactions. However, early detection isn't enough. Service recovery procedures must be tightly linked and immediately activated when something goes wrong. Giving frontline employees the training, resources and authority to resolve issues on the spot is a good first step. In the spirit of continuous improvement, though, the organization must have processes in place to identify and react to the root causes of inefficiencies and customer pain points.

Creating such a closed-loop system can be more challenging when dealing with external partners, but is even more critical since customer interactions are often offsite and less visible. Establishing these quality control procedures should be part of the negotiation process.

Carriers



Key success factors for carriers

Switching gears very briefly now and looking at bank insurance from a carrier perspective, a similar set of success factors emerge. We've observed that, to some degree, U.S. carriers remain a bit wary of banks as channel partners. Concerns surround the level of commitment and staying power of banks as channel partners as well as questions about expertise and quality of business. We believe that carriers can address these issues and strengthen bank channel revenues with their own commitment to strategy and execution.

1. Clearly defined strategic ambition,
2. Careful model selection, and
3. Well-articulated strategy as the foundation for success

Carriers, like banks, can't shortcut the strategy phase. Again, getting broad commitment to the strategic ambition, making thoughtful decisions around the best marketplace approach and articulating the go-to-market strategy all set the foundation for success.

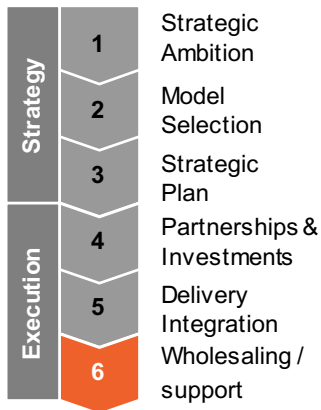
Carriers have two primary options for selling products through bank partners. They can directly appoint banks and their agencies or they can support bank-TPM relationships. In deciding which path is best, they need to consider which model will allow them to meet their goals, including investment levels and returns. As already discussed, product fit is another consideration.

4. Selecting the right partners and making smart investments, and
5. Ensuring integrated delivery platforms

Carriers, like banks, need to choose partners wisely, ensuring that prospective bank partners are committed and have or will acquire the right expertise. They also need to look for partners that have the technology or are willing to invest in technology that will create seamless integration and secure transactions. Carriers too will have to invest resources to support this tight integration. Finally, carriers need to commit to resourcing the wholesaling effort. Levers in the design of wholesaling efforts include:

- Degree of centralization of wholesalers (home office vs. field)
- Span of responsibility (single bank vs. multiple banks)
- Use of employees vs. contractors
- Deployment of generalists vs. product specialists

Carriers



6. Enlisting the right support

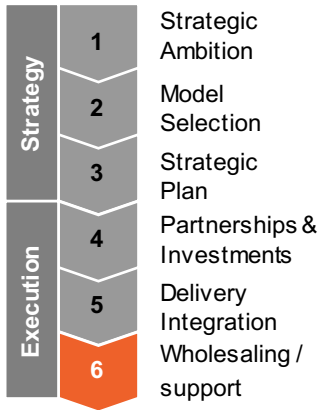
A strong wholesaling program can maximize a bank's return on its insurance strategy. Wholesalers (internal or external) should be viewed as trusted experts that participate in the consultation and sale process. There are also a number of other ways banks can optimize their operations by leveraging partner expertise.

In the P&C area, banks, particularly smaller ones that start or buy their own commercial agency, should assemble a cadre of trusted wholesalers to enable the successful placement of a broad range of risks. This breadth of service is particularly critical for large commercial clients. Smaller bank P&C agencies might also find support and markets by brokering business through a larger local agency. Small agencies can also often find markets and secure better compensation arrangements by joining an insurance network/cluster, an organization in which many agencies join together to leverage their combined "purchasing" and "productivity" powers. These clusters are arranged in any number of ways, such as equity shareholding and membership. MGAs (managing general agents) and specialist providers can sometimes be found for special or esoteric coverage that many carriers and most small agencies may not be equipped to handle on their own.

From the P&C carrier perspective, to set up relationships for success, building the wholesaling program must start with an understanding of the banks' client base (e.g., do they serve agricultural clients or other industries in their region?). This perspective will help carriers decide whether they will use a wholesaler to place their business with the bank agencies, and/or partner with a wholesaler who can help place the risks they don't want. Either way, they can address the banks' need to increase placement depth and capabilities, and serve a broad swath of their customers' needs.

In the life insurance and annuity area, wholesalers also have an important role, particularly since these products are sold through the wealth or advisory channels by individuals who may not be familiar with life insurance products and concepts. These wealth advisors need a reliable source of expertise for training and assistance in complex sales. It is often the case that if retail wealth advisors don't have this support, they won't try to sell life or annuity products out of a fear of appearing uninformed.

Carriers



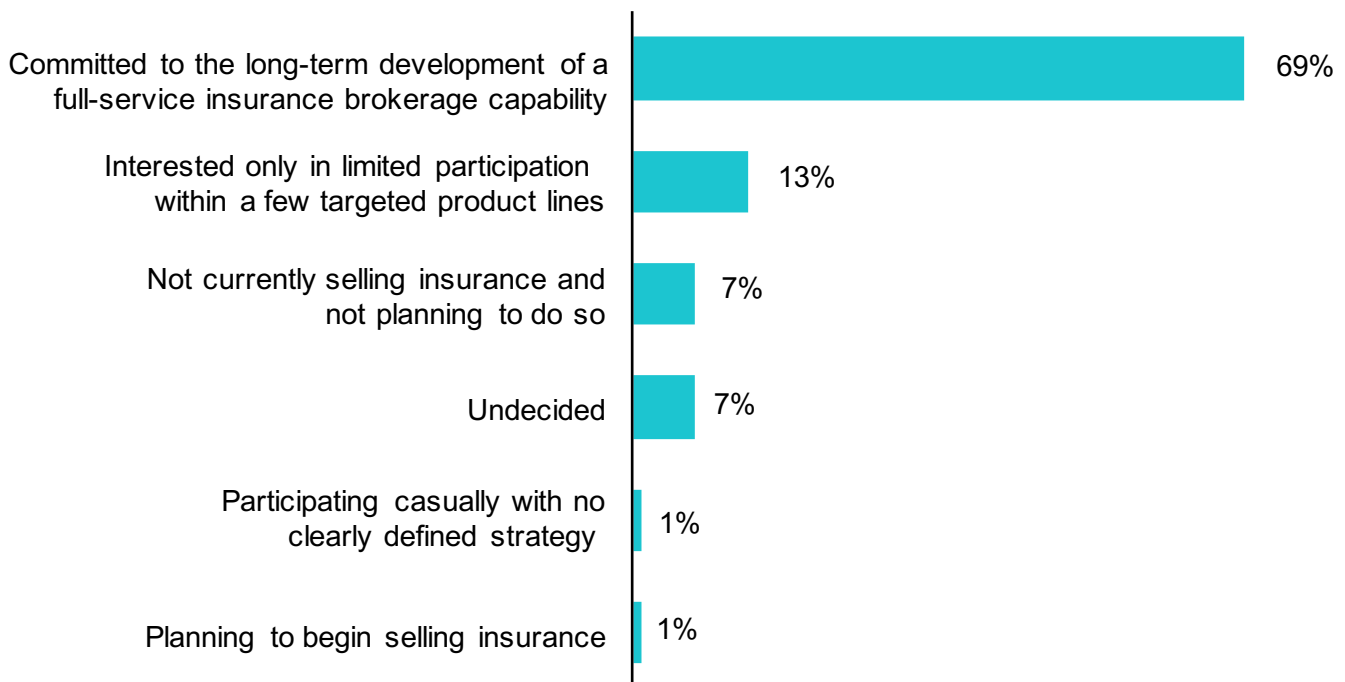
There are a number of options for wholesaling these products. The retail distributor could have in-house wholesalers and support staff, or the carrier could have internal/external, unaffiliated wholesalers. Another option is to use MGAs or BGAs (brokerage general agents) who can provide coverage/product knowledge and planning expertise in complex financial, business and estate situations. BGAs can also often provide important field technologies and handle business processing.

Taking the next step

We think 2016 is a good time for banks and carriers to reassess their bank insurance efforts and take advantage of the opportunities to bolster their top and bottom lines.

We see evidence of commitment to building capabilities among banks already engaged in insurance sales. (See Figure 9.)

Figure 9: Outlook toward insurance brokerage by % of survey respondents



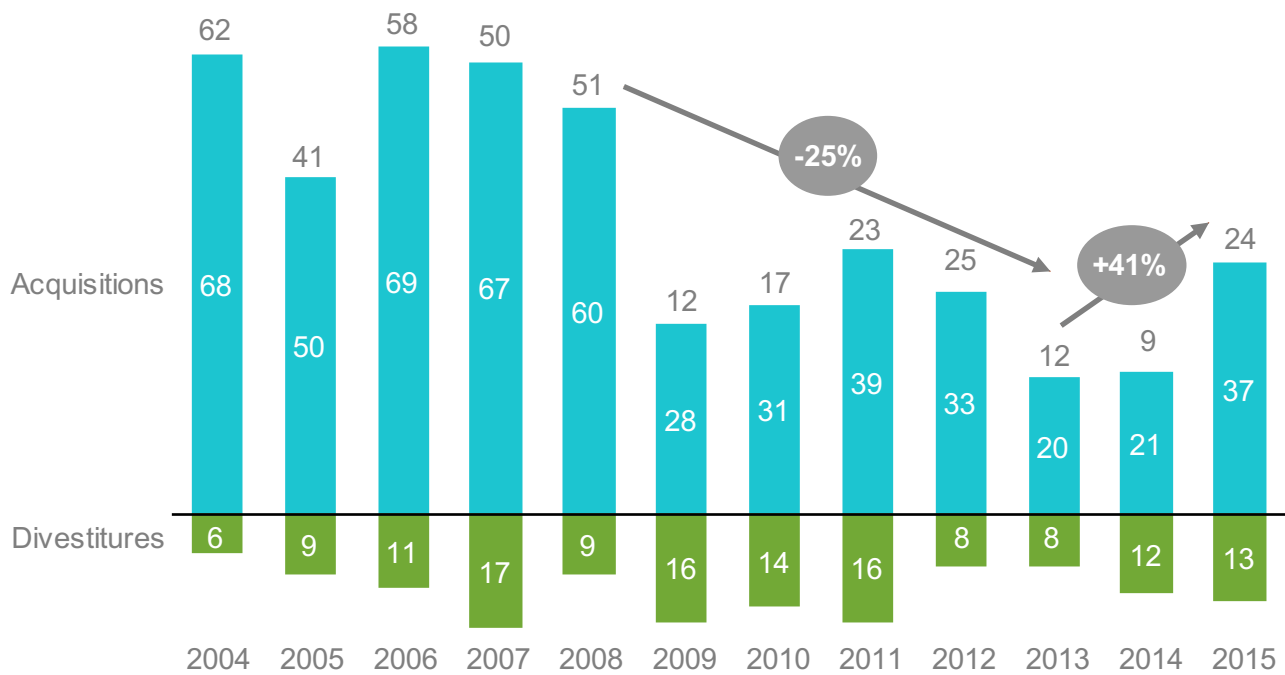
Source: American Bankers Insurance Association, 2014

In addition, acquisition activity is picking up after years of decline, reflecting some optimism about the bank insurance opportunity. (See Figure 10.)

Ultimately, we believe that banks and carriers that are willing to focus and commit can benefit from the bank insurance opportunity.

Figure 10: Acquisitions and divestitures of insurance entities by banks

Number of transactions



Source: SNL Financial



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