



The global bancassurance market

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With the notable exception of the US domestic market, 'bancassurance' represents a significant channel for the sale and distribution of insurance products in much of the world. Given the prominence of bancassurance as a distribution channel in the insurance industry, in recent years, bancassurance has been a key component of insurance sector M&A transactions. Bancassurance can be central to an insurance M&A transaction in a number of respects, from due diligence of key bancassurance relationships of the target insurance company to the negotiation of a new bancassurance relationship as part of the overall M&A transaction. This article reviews what has been driving bancassurance activity; the key commercial, legal and regulatory issues that arise on bancassurance transactions; and what the future may hold for this market.

The term 'bancassurance' encompasses a wide range of distribution structures including: banks owning insurance companies outright; banks and insurance companies in corporate joint ventures; and insurers selling their products to customers of banks under distribution agreements. The most significant proportion of the global bancassurance market relates to contractual and corporate joint ventures between banks and

insurers involving the sale of products to the bank's customers. The key distinction between the two is that, in a corporate joint venture, the bank is in effect a risk carrier through its joint ownership of the insurance vehicle and therefore participates in the underwriting result. In contractual joint ventures, the bank usually acts as an introducer or intermediary, for which it receives a commission (and sometimes a profit share), with the insurer taking 100% of the underwriting risk on the business.

Development of the bancassurance model

Bancassurance first developed as an insurance distribution model in Europe, with the most mature markets today including France, Italy, Spain and the UK. It is also now well established in Latin America and Asia. Although the first Asian transactions were entered into around 15 years ago, bancassurance is now the leading distribution channel (particularly for life products) in many Asian markets. There remains, however, significant growth potential in these markets, including China, India, Japan and South Korea. It is this huge potential for growth that has been driving bancassurance transactions and related M&A activity.

In high level terms, the key commercial and legal issues that

arise in the negotiation of bancassurance transactions are much the same regardless of jurisdiction and stem from what it is that makes this distribution model so attractive to banks and insurers. For banks, the ability to generate a significant new revenue stream by facilitating the sale of insurance products to the bank's existing customer base is of course the primary driver. Insurers are equally attracted by the ability to generate new revenue by selling products to a bank's extensive customer base, often utilising the bank's existing distribution network of branches and sales agents. Equally, even those insurers with the most prominent brands recognise that in certain jurisdictions a greater level of penetration of the market can be achieved by 'white labelling' a product in the name of the bank rather than selling through their own brands.



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Bancassurance issues in insurance M&A transactions

Bancassurance related issues can arise in insurance M&A transactions in a number of respects. Where bancassurance is an important distribution channel for a target insurance company, due diligence of this key relationship is paramount. Review of the bancassurance arrangement needs to be performed, not only to evaluate the contractual terms of the relationship, but also to assess legal and regulatory risk to which the target insurance company may be exposed as a result of this relationship. The diligence of the bancassurance relationship also will need to include consideration of any rights or changes to the terms of the bancassurance agreement that may be triggered as a result of the sale of the insurance company. Bancassurance issues also can be central to an insurance M&A transaction where the transaction involves the purchase of a target insurance company from a banking group which has been selling insurance products through its affiliate banking distribution channel (many times, the purchase of the bancassurance relationship is a driving motivation for the acquisition of the insurance company). In such cases, terms of the existing bancassurance relationship often will not be adequate, since the agreement was not entered into between third parties. As a result, the transaction will not only involve negotiation of the terms for the sale of the insurance company, but also the terms of a new bancassurance relationship between the buyer (on behalf of the target insurance company) and the seller, which will involve the consideration of a myriad of issues, as discussed below.

Key contract/diligence issues

When negotiating a new bancassurance distribution deal (or in conducting due diligence on existing arrangements that may be relevant in a M&A context), the key issues that need to be addressed in order to ensure that the bank and the insurer realise their commercial objectives include the following:

- *Minimum deal term/exclusivity.* Key to the overall commercial deal is whether the bank is willing to offer a fully exclusive relationship to an insurer or some lesser preferred supplier or panel arrangement. Typically, insurers will only materially invest in a bancassurance arrangement that is exclusive and, in order to recoup upfront investment costs, will seek to negotiate a minimum deal term of at least 5 years. The actual term negotiated will clearly depend upon a range of factors, including the extent to which competition law in the jurisdiction

concerned might render agreements beyond a certain minimum period unenforceable. In the UK, for example, exclusive insurance distribution agreements beyond 5 years in term are potentially unenforceable and, for this reason, contracts beyond 5 years will often move to a minimum volumes commitment rather than outright exclusivity. Across Asia, by contrast, the trend is for longer periods of exclusivity, as reflected in the recently announced 15-year deals across multiple Asian jurisdictions between Prudential plc and Standard Chartered, and AIA and Citigroup.

- *Customer ownership and privacy.* From the bank's perspective, this is usually the single most important element of a bancassurance transaction. Of course, the principal value the bank is bringing to the transaction is the ability to access its customer database. Banks will usually therefore insist on contractual provisions reinforcing that it is they who own the customers and limiting the insurer's contact with the customer to the minimum extent required in order to service the business written through the bancassurance arrangement. Insurers are often expressly precluded from cross-selling other product lines or seeking to renew policies with the bank's customers on termination of the bancassurance agreement. Insurers will be equally concerned to ensure that the bank has complied with appropriate data protection and privacy laws in order to share its customer data with the insurer on a legitimate basis.
- *Authorisation.* Although the precise analysis varies by jurisdiction and according to the role performed by the bank, whether the bank is required to be authorised as an insurance intermediary and the extent to which the insurer will take regulatory responsibility for the bank is a key structural question.
- *Mis-selling exposure.* From an insurer's perspective, ensuring that it has proper systems and controls in place in relation to the distribution of its product via the bank is usually the single most important factor as failures in this respect can materially erode any financial benefit from the bancassurance transaction as well as giving rise to regulatory intervention and brand damage. The recent spate of insurance mis-selling cases around the world has reinforced the need for there to be a clear allocation of responsibility for any mis-sales. Typically, in those deals where the bank is doing more than simply introducing the customer to the insurer, and is therefore acting more in the role of intermediary, it will be the bank that is primarily responsible for mis-selling, and insurers will sometimes require specific indemnity protection in this respect. In addition, and sometimes overlooked, is the need to be clear as to the impact

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on the deal financials in the event of premium in respect of mis-sold policies needing to be returned to customers. Insurers should seek to negotiate the right to clawback commission earned by the bank in respect of mis-sold policies as this will not always follow as a matter of law unless it is specified in the contract.

- *Risk free and profit-related income.* There are of course numerous possible ways of structuring the financial aspects of bancassurance transactions. The key driver will be whether the bank is only looking for so-called ‘risk free’ income in the form of commission, or whether in addition it requires a return based on the underwriting profit of the business. This can be achieved through a profit-sharing formula in the distribution agreement which would typically provide for a split of residual profit after the insurer has taken an agreed underwriting return and the bank its commission. Alternatively, for corporate joint ventures, the bank may participate in the underwriting return through its part-ownership of the insurance entity itself.
- *Pricing, product and underwriting flexibility.* Often heavily negotiated will be the extent to which the bank has the ability to dictate the pricing of the insurance product, its contractual terms and the extent to which there should be joint intellectual property in the customer proposition. Insurers will typically seek to retain as much control as possible over product design and pricing. From the pricing perspective, there is a tension in ‘risk free’ bancassurance deals between banks seeking lower selling prices in order to increase volumes (and therefore commission) at the expense of underwriting profit.
- *Investment in infrastructure.* Particularly for banks which are new to insurance distribution, a key issue in assessing prospective insurer partners is the extent to which the insurer will be willing to share expertise and know-how as well as investing in the venture by contributing towards the costs of sales and marketing, integration of IT access as between the bank and the insurer to facilitate policy sales and administration and the deployment of staff into bank branches to assist with sales and training. As indicated above, insurers will usually only be willing to make a significant investment in those areas where there is a commitment to an exclusive relationship for a minimum deal term that is sufficient to enable the insurer to recoup the upfront cost and still make an underwriting profit.
- *Contractual flexibility.* Given the often long-term duration of bancassurance arrangements, the circumstances in which the contract may be terminated prior to its natural expiry are clearly important. This has proved to be an issue for some insurers who were keen to secure watertight long-term exclusive arrangements with a bank, only to find that they effectively locked themselves into what turned out to be highly unprofitable business. This in turn has led to a number of market disputes. This risk can be minimised by anticipating at the outset of the contract the circumstances in which the parties may wish to renegotiate the terms (for example, in the

event of profitability targets not being met), failing which early termination could be a contractual option.

- *Corporate joint venture provisions.* In transactions where the bancassurance relationship is in the form of a corporate joint venture, a number of customary joint venture provisions also will need to be negotiated by the parties, such as provisions addressing corporate governance and management, early termination and exit rights (which will need to be considered together with any exclusivity rights), transfer restrictions, change of control provisions, branding, shared services arrangements and intellectual property.

The future of the bancassurance market

Looking at the bancassurance market from the perspective of a bank, insurer or reinsurer contemplating the renewal of an existing arrangement or new entry into the market, in addition to the specific contract and diligence issues outlined above, there are also wider trends in the market which are worthy of note.

- *Increased regulatory intervention.* Insurance regulatory developments can have a significant impact on the financial returns and viability of bancassurance arrangements, as has become apparent in Europe and Asia in recent years. In the UK, for example, the point of sale ban on payment protection insurance effectively destroyed the market for creditor insurance bancassurance deals. Although this is perhaps an extreme example of what can follow regulatory intervention in response to concerns about mis-selling, the trend is firmly in the direction of tighter regulatory control over the way in which bancassurance products are sold and this is likely to become an area of increasing focus. In China, for instance, the banking and insurance regulators have jointly issued rules that will increase regulation of the conduct of bancassurance business. The new requirements came into force on 1 April 2014 and are designed to reduce the likelihood of mis-selling. They include requirements that banks be restricted to offering the products of a maximum of three insurance companies and will need to ensure that at least 20% of premium generated by insurance sales relates to lower risk policies.
- *An increase in non-bank distribution.* Intense competition between insurers to secure bancassurance distribution has led to a significant increase in non-bank bancassurance deals involving other strong brands with a network of retail customers. This market is now relatively mature in some European jurisdictions, such as the UK, where arrangements of this type for the distribution of insurance via motor manufacturers and retailers have become commonplace. This channel is also developing in Asia, with deals between insurers and telecoms companies and post offices by way of example, although the market is much less mature and there remains strong growth potential.
- *Continuing high-levels of M&A related to bancassurance.* Although the post-financial crisis divestment of insurance subsidiaries by a number of banking groups will not continue indefinitely, the likelihood is that overall levels of M&A related to bancassurance will continue at a relatively high-level, particularly in Asian markets. This is partly because there are greater growth prospects in Asian markets than is the case in Europe, but also because restrictions on international insurance companies from operating in a number of Asian jurisdictions, other than in conjunction with a local joint venture partner, means that corporate transactions may be the only means of establishing an underwriting platform to access the vibrant bancassurance market. ●

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