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Banking institutions and business of insurance- study of Indian approach

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Abstract
Economy of any country is widely dependent on confluence of two important financial sectors which are banking and Insurance companies. Banks aim at providing credit and saving services whereas the main purpose of Insurance companies is to indemnify the losses to individuals. Thus, there prevails significant differences in functions pertaining to both the financial intermediaries.
Despite of prevent difference, there are some confluence factor which can help in bridging the functions of banks and insurance companies. Few example of connecting factors are the mutual capital dependence of the two, commonality of features in the products of the two like life insurance products and investment products offered by banks. Also, general insurance can help banks by securing mortgage loss.
Bancassurance is the process whereby the functioning of both the sectors can be linked on cooperative as well as competitive levels. Banks having larger customer base and wide outreach amongst the public can help in the sensitization and sale of insurance products.
The paper shall discuss the concept of bancassurance and its possible models of implementation. Also the paper shall talk about the regulatory aspects of bancassurance wherein it shall focus on the guidelines issued by Reserve Bank of India and Insurance Regulatory and Development Authority for Banks and Insurance Companies respectively with special focus on Bancassurance. Last, the paper shall focus on the merits and demerits of the concept both from the viewpoint of customers as well as banks and insurance companies.

Keywords: Banks, insurance, economy, finance, investment, capital, regulations, etc

1. Introduction
"The bancassurance channel has potential to reach out to the last mile and serve untapped markets thereby promoting the insurance penetration in India. With the alignments of our brands, people and processes, we hope to better serve our customers."
- Anmol Ambani, Executive Director, Reliance Capital [1].

Banking sector in India has one of the most stable and the largest financial sectors in the world. Strengthening of the Indian banking sector can be attributed to series of regulatory and financial reforms lately in the nature of increased flexibility in the rate of lending, steady reduction of government control and holding in the public sector banks and the dilution of restrictions on international and private sector banking institutions. The fast growth rate of Indian economy can be accredited to its financial regime which is composed of banking and insurance companies which look lucrative for long term investment. Both the sectors can take advantages from such a remarkable growth rate along with aiming to perform well at global competitive level [2].
There is no doubt that the banking institutions and the insurance businesses are two main parts of an economies financial industry but still there prevails significant differences. At fundamental level banking institutions aim at providing settlement and credit services, whereas, insurance industry primarily aims at indemnifying losses. However lately at different phases the common linkages between both the sectors have become prominent. For instance, there is an increase in the mutual holdings of the banks and insurance companies which shows increasing mutual dependence on the capital level. At the business front, because of the foundation of the concept of bancassurance there has been an increase in cross selling amongst insurance groups. Furthermore, there are common features between life insurance products and investment products of banking business which lead to formation of relationship in the nature of competition substitution, on the other hand general insurance can help banks by securing mortgage loss. Therefore, the cooperation and competition between

both the institutions leads to the formation of a complex relation [3]. Because of the complex relationship that both the sectors share there are noteworthy changes in the financial market front in India. Numerous agreements have been formulated between banking and insurance companies and many more are still in the initial planning stage. Bancassurance basically aims at integrating both the financial institutions for the purpose of mutual gain. Banks have wide consumer outreach because of large geographical area coverage.

Therefore, banks are the best platforms to sell insurance products as they already have consumers who have blind faith in these institutions due to long term relations they have shared. Thus, bancassurance has emanated as a new platform for dissemination of insurance products and services to different sections of the society through banks. In this highly competitive market, this bancassurance model is capable of helping both banks and insurance sectors to build up their market share and distribution networks [4].

2. What is bancassurance?

The term "Bancassurance" has been taken from French dictionary back in 1980. The term refers to process whereby the distribution channels established through banks are used for the purpose of insurance business. Bancassurance is synonymous to terms like Allfinanz which is a German terminology, Assure Banking and Integrated Financial Services. Basically in a common layman language the term "Bancassurance" means selling of insurance services through banks who act as distributive channel for variety of products and services related to investment and banking. Thus bancassurance is nothing but a system whereby synthesis is created between banking and insurance services. Besides France where the concept originated this model has proved to be a great success in Greece and Portugal. Whereas, in United Kingdom the success of the model has been limited the fact that there are stringent limitations on which banks can get into the business of insurance. In some countries the concept has been prohibited but in USA it has been lately legalized after the passage of Gramm Leach Bliley Act, 1999, which was passed after the Glass Steagall Act, 1933 was repealed.

2.1 various models in the concept of bancassurance

1. **Strategic alliance model:** As per this model, banks and insurance company tie- up with each other for the purpose of business. The main feature of this model is that the banks in this case only market the products and services of insurance company. Banks do not carry out any other insurance function except for marketing.

   Banks cannot act as brokers to the insurance companies as the regulation related to the same requires brokers to be solely engaged in insurance broking. Reserve Bank of India also does not promote banks to engage in insurance broking as a whole sole activity.
2. **Full Integration Model:** This model basically talks about full integration of insurance and banking services. The banks may have fully owned subsidiary for carrying out insurance activities which may be with or without any foreign participation. Main advantages of this model are benefit of synergy and economies of scope. Therefore, here insurance becomes the core activity of the banks.

   Many private sector banks in India like HDFC and ICICI Bank and SBI in private sector have set up joint ventures after adopting this model of bancassurance.
3. **Mixed Model:** This model is also known as Referral Model. In this form of arrangement, banks only provide their client databases to the agents or sales staff insurance companies for generating referral fee or commission. This model is feasible for the banks who do not intend to take up risk involved in the business of insurance. Moreover, most of the banks in India have resorted to this model of bancassurance [5]. This model is regulated by Insurance Regulatory and Development Authority (Sharing of Database for Distribution of Insurance Products) Regulations, 2010.

   Earlier Referral Arrangement guidelines [6] were issued by the IRDA wherein it stated that a bank cannot enter into referral arrangement with more than one Insurer Company. Furthermore, participation of a bank's customer will be a total voluntary activity and there will not be any link between banking services and insurance services on the customer front.

   There is no need of any prior approval of RBI for banks to engage in insurance business as agents but it is subject to certain criteria:

   First, such banking institutions should act in compliance with the IRDA rules and regulation to act in a referral arrangement or as composite corporate agents.

   Second, the customers of such banks should be allowed freedom of choice to choose any insurance scheme of any company they wish to. Banks should not force its customers to avail insurance scheme of companies whose assets such banking institution has financed.

   Third, the banks willing to* enter into such an arrangement should also enter into an arrangement with the insurance company to allow the use of its premises and infrastructure.

   Fourth, such an agreement should not exceed 3 years period in the first instance and banks should be free to renegotiate the terms and conditions of the agreement after the initial period of 3 years end.

   Fifth, since this arrangement gives freedom to of voluntary participation to its customers, it should also be stated in a publically distributed material.

   Furthermore, there should not be any linkage or overlapping in the banking services and the insurance products and services provided by such a banking institution.

3. Regulatory mechanism of bancassurance in India

The complexity of this model arises from the fact that in Indian Financial Sector, banking institutions and the insurance sector are regulated by two different entities altogether. Reserve Bank of India regulates the banking sector, whereas, Insurance Regulatory and Development Authority (IRDA) regulates and controls the Insurance sector. Bancassurance model basically gives rise to the mixture of two institutions therefore regulation has to be handled by both the sectors together. Each sector have their elaborate descriptive rules, regulations and guidelines.

Mr. P Chidambaram former Finance Minister has gave push to the idea of banks enacting the role of brokers so that insurance products may penetrate into the Indian economy. The fact that banks have to apply for licenses to disseminate insurance services or they act as mere agents has to be seen.

3.1 Reserve bank of India guidelines

In India, term gained popularity when Central Government issued notification dated 3rd August, 2000 under Banking Regulation Act, 1949 whereby it gave permission to Banks in India to act distributors of insurance services under Section 6 (1) (o) of The Banking Regulation Act, 1949. The notification issued by RBI gave three ways to banking institutions to enter into insurance business i.e.

1. Financially strong banks can enter into joint venture agreements with banking institutions whereby, they will have to participate in the risk also. The criteria for such a venture are that the net worth of such institution should be at least 500 crore rupees, Capital to Risk (Weighted) Assets Ratio should be at least 10%, there should be some net profit for at least 3 years consecutively, such bank should possess reasonable Non-Performing Assets (NPA's) and there should be satisfactory performance on part of its subsidiary.
2. Participation in the insurance activities without risk participation. On fee basis any scheduled commercial bank can be permitted to act as insurance agent. The participatory bank can work without any fear of participation risk. Even such bank's subsidiaries are also allowed to indulge in the business of insurance as agents.
3. Referral model as explained above.
   The banks who enter the business of insurance shall have to take permission and approval of Reserve Bank of India. The central bank shall grant approval only after scrutinizing various factors such as the level of Non- Performing Assets of the bank who makes an application so that the guardian bank may ensure that the non- performing asset level will not pose any threat in future to the banks proposed plans of entering into insurance business. Arm's length relation between the business of banking and insurance has to be made.

Although this notification issued in the year 2000 by the Central Government became functional and active after Insurance Regulatory and Development Authority i.e. IRDA passed "Corporate Agency" regulation in 2002, October. This notification allowed all commercial scheduled banks to participate in the business of insurance as agents of the insurance corporations, this participation was rewarded by way of fee and zero risk participation

3.2 Corporate agency regulations

The banks have permission to sell products and services of one life insurance Company and one non- life insurance Company as broker or agents as per current regulations of IRDA. Such banks shall not be eligible for any other kind of pay except for commission. The mandate also says that the banks who enter into such ventures must observe the code of conduct that is prescribed in favor of customers and the insurer principal [7].

3.3 Guidelines issued by Irda to regulate bancassurance

Insurance Regulatory and Development Authority (IRDA) has given permission to the banking institutions to act as agents and brokers for the purpose of selling insurance products of more than one insurer to increase the deepening the reach of this sector in the economy.

As per the Reserve Bank of India there may arise conflict of interest if banks act as agents for insurance companies. Although there is a prior requirement of RBI's approval in case a bank is willing to act as insurance broker but as per IRDA its jurisdiction should prevail in case any conflict arises. IRDA also makes it amply clear that in case of any conflict enforcement of laws applicable in the contract itself shall be done and RBI shall be furnished with the information related to the same.

The Insurance and Development Authority Act of 1999 prescribes certain conditions for new entrant banking institution who wants to operate in the insurance sector. Such an institution must comply with the following set criteria's:

a) Rupees 100 crore should be the minimum paid up capital of such an institution.
b) Restriction of investment of policy holders only to India.
c) Minority equity holdings only up to 26% for foreign companies.

Following models of Bancassurance have been approved by IRDA for business:

1. **Banks carrying out Insurance Business:**
   IRDA allows only scheduled banking institutions to take up life as well as non- life insurance activities for a fee without any risk participation in the same.
2. **Banks to enter into Joint Venture**
   After satisfying the required criteria's banks are allowed to enter into Joint venture to get into the insurance business but it is subjected to certain safeguards. Such banks have to participate in the risk also. Banks can hold up to maximum of 52% equity in the paid up capital of the joint venture on selective basis. But banking institutions with the permission of Reserve Bank of India can invest more than 52% in the initial investment but at the statutory level there must be a reduction in the equity. For example: ICICI Prudential life Insurance uses bancassurance for nearly 20% of its life insurance sale. Various banking institutions are linking to RRB's (Regional Rural Bank's) to make benefit out of rural and semi- rural market. In the same manner, AVIVA Insurance has tied up with more than 21 private, public and foreign sector banking institutions.
3. **Restrictions imposed on Subsidiaries**
   Subsidiaries of banking companies are restricted to join the insurance business with risk participation. In this context, subsidiaries means and includes subsidiaries of banks engaged in mutual funds, merchant banking securities etc.
4. **By way of investment in Insurance Company**
   Without any sort of risk participation banks which are ineligible to enter into joint venture shall be allowed to invest in Insurance companies. As per current norms, 10% of total net worth or Rupees 50 crores whichever figure is lower can be invested by the banking institutions.
5. **Mergers and Acquisition**
   There are various national laws that prohibit mergers between banks and insurance companies because of which this model is not very popular in India. In this particular model, either banking institution acquires the insurance company and merges with it or vice versa.
6. **Organic Start Up**
   This model is a perfect way to reduce the cultural differences between banking institutions and insurance

companies. This model believes in building skills organically without entering into any merger or acquisition arrangement [8].

3.4 Irda norms for insurance companies

Certain guidelines for Insurance companies given by the Insurance Regulatory Development & Authority are as follows:

1. Each banking institution which wishes to enter insurance business must appoint Chief Insurance Executive who is capable of handling all insurance related matters and activities.
2. The people who are involved in selling of insurance products and services in the banks must be provided with training which shall be mandatory in nature and such training shall be conducted at an institute which shall be determined by IRDA. Such people will also have to qualify the examination which shall be conducted by IRDA.
3. Cooperative Banks and Regional Rural Bank shall be allowed to become agents of one insurance company.
4. Banks are only allowed to act as insurance agents and not brokers.

Numerous rules and regulations have slowed down the growth of the concept of Bancassurance in India Earlier implementation of the concept was an unachievable dream but with the passage of Insurance (Amendment) Act, 2002 such regulatory barriers have been cleared. For instance providing mandatory training to the people who were engaged in the insurance activities of the bank was a barrier, but now only specific people have to be trained and examined as per the requirements of insurance agents.

3.5 Recommendations of committee constituted by Irda on bancassurance

As discussed earlier banking institutions are not allowed to engage in selling products of more than one insurance company. But various life and general insurance companies persistently requested IRDA to look into the matter, which led to formation of a 7 member committee in 2009. The committee examined the scope of differential treatment of insurance intermediation by the banks under Bancassurance consistent with intermediation best practices. The recommendations were submitted by the committee on 26th May, 2011. The committee although came to consensus with the term that there is widespread ambiguity in the organization and practices of Bancassurance. Some of the recommendations that committee made are stated below and main one of it included enactment of comprehensive legislative with regard to the channelizing of Bancassurance activities.

First, the banking institutions should be allowed to link up with any of the two sets of insurers i.e. either banks should be allowed to link up with two life insurance companies or two non- life insurance companies which will exclude health sector or with health sector insurance companies.

Second, Genuine efforts should be put to incorporation of Information Technology use so that there is reduction in the labor requirement and moreover, digitization would help in efficient, transparent and more structured organization.

Third, the agreement between the Insurer Company and banks at present usually ranges between 1 year- 3 years but such a short tenure makes the relationship between the two entities unstable and therefore, the agreement should be made for a minimum period of 5 years. Herein, the committee made a very vital point that the policies which shall be issues by the banks, its subsidiaries or special purpose vehicle shall stay with the bancassurance partner before and after the agreement period ends. Such bancassurance partner shall have to renew the policy and he shall be paid commission for every such renewal. But for such an arrangement to work out there is a need of memorandum of understanding between the insurer company and banking institution with minimum requirements.

Fourth, for the purposes of supervision and inspection the rules and regulations that are proposed must contain specific provisions which shall empower the RBI and IRDA to scrutinize Bancassurance partner.

Fifth, Maintenance of accounts and certification which shall be provided as periodical returns to the concerned authority must be incorporated as a specific provision in the regulation. If bancassurance is treated as an integral part of the business by the banking company than there must be corporate governance norms including CSR activity which should be compiled in form of regulation.

Sixth, mandatory training should be part of the regulation because it will facilitate in providing trained bank staff who can handle insurance activities i.e. sale of insurance products and services in a transparent manner and the customers can avail benefit of full and complete disclosure of the product features.

Seventh, the committee gave approval nod to multiple insurer principal but only if banking institutions are willing to diligently follow the recommendations given by the committee.

Eighth, the referral model of bancassurance concept which is not economical as it is costlier if compared to the corporate agent model was recommended to be abolished by the committee. The reason behind expensive nature of this model is that the insurer has to pay a high amount of premium in the first year as a referral fee and in addition he also has to the deploy infrastructure and staff in the premises of bank for this purpose.

4. Merits/ demerits of bancassurance

4.1 From the perspective of banks and insurance companies

a) The insurance company sees a widened scope of business when it gets linked to a banking institution from both old and new policy holders because of the fact that after merging with the banking institution, it can offer wide range of products and services to its customers related to both insurance and banking products. The insurance company can incentivize and encourage the customers of the bank to purchase the insurance services and thereby it can foster the relationship shared by the two institutions.
b) Bancassurance operations for an insurance company may allow the company to sell some products and services which may not be practically possible through traditional insurance channels. For instance, products may not get sold because the sale cost incurred in the process might force premium rates to go up which may not prove healthy for the competition. On the other by way of following bancassurance channels products may get sold feasibly as the cost is low.

c) Administration activity of the banks may be carried out by the insurance company if, bancassurer is a distinct corporate. Benefit of the economies of the scale in terms of administration cost which may include capital expenditure may be taken if both the business can be combined. This approach can help insurer to gain more profitability and pricing of future products may be done with narrow margins which in turn will help increased competitiveness in insurer products.
d) There is an increased scope of greater chances to learn and improvise the operation practices for both banking institution as well as insurance company. Both the institutions can benefit from each other's style of management, objectives and the measures to be taken along with appropriate exertion of pressure. The process of benefit to either company shall start when they learn from each other's working style and implement it in their own business operations.

4.2 From the perspective of the customers
a) The customers of banks can purchase insurance products and services due to their long association with the bank and brand loyalty which in turn help them build stronger relations with their banks as they get the benefit of diversified services.
b) Wide distribution of banking network and services throughout the country and better and improved marketing channels of the banking institutions can help those people benefit who are unaware of insurance policies and its advantages.
c) As compared to traditional insurance companies, the new bancassurance model has increased the competition in the market and therefore large number of people can benefit through better rates of premium and services.

4.3 Demerits of bancassurance
a) Data security may get compromised, as the personal identifiable data's and contact details of numerous amount of customers which banks manage are sold and given to insurance companies which in turn utilize the data for marketing of their own products.
b) Some products of banking institutions and insurance companies may be similar in nature which may result in conflict of interest between both the institutions. Such a conflict may confuse customers with regard to which is the better option of investment.

It is still a hope that bancassurance will lead to better products and services by the banking institutions. It's because numerous banking institutions in India are renowned for their poor customer serviced and the fact that they gain an additional responsibility to sell insurance products can further worsen the situation. The reason for above speculation is that the dissemination of insurance services requires submissiveness in the attitude and many banking institutions lack at this juncture [9].

5. Problems in bancassurance
If a bank decides to get into the business of insurance it must be kept in great conscience that a casual approach cannot be adopted. If the existing staff of the bank is used for the purpose of selling of insurance products and services they will have to be trained in the minutiae of the insurance activities and the intricacies of salesmanship. There is a difference in the skills required for the banking operations and the insurance activities. Persons with external orientation will be required. Dependency on personal skill is important because the magnitude of business that can be acquired will depend completely on personal skills of the banks and insurance executive staff. Problem herein comes from the fact that a skilled person who is effective in his salesmanship will want to function independently as an insurance agent rather than being attached to a bank. In such a circumstance banks need to come up attractive packages and policies related to compensations to prevent such disassociation by the skilled persons.
Other relevant area of problem can be the restrictions that Insurance Act imposes and the pressure created by the unions of employees within the banks. Herein, the commitment of senior level management is very crucial in determining the success of staff who are appointed for the insurance works.

6. Future of bancassurance
With the growth of the economy, strong vivacious financial sector is the demand of the public but it does not negate the importance and necessity of variety and sophistication in the banking and financial products and services. There is a positive outlook on the bancassurance front. Country's regulatory regime and business environment will no doubt effect the development of individual markets in the economy, but at the same time bancassurers can avail benefit from the government efforts and tendency to privatize pension liabilities and health care.
India as a country has almost around more than 200 million population in the middle class and the infinite banking network with wide depositor base provides great incentive for bancassurance to foster. Already the new entrants in the market are taking benefit of the bancassurance model of banking to compete with the established companies.
To promise a fruitful future it is very important for bancassurance to make sure that banking institutions stay fully committed promotion and distribution of insurance products and services. This commitment is expected from all levels of management wherein senior level management must commit to provide strategic inputs and the operation level management must commit at the product supply. Despite bancassurance being a completely new phenomenon, we can see great signs of initial success. Thus there remains no doubt in the fact that banking institutions will become vital distributors of products and services related to insurance in near future.

7. Recommendations and Conclusion
The Banking and Insurance industries have changed rapidly in the changing and challenging economic environment throughout the world. In this competitive and liberalized environment, everyone is trying to do better than others do and consequently survival of the fittest has come into effect.
In the past financial years India has seen large amount of growth in the business of life insurance. It has seen substantial amount of growth in the premium rates over the financial years. One of the main leading reasons which can be attributed to this growth is the contribution of banking industry in the insurance sector. The bancassurance model has motivated private insurance companies to develop strong relationships with the banking institutions. Besides

the fact that banks can reach out to the customers in the remotest of the places in the country it can now benefit them form giving wide range of advices related to financial sector under one umbrella.

European countries have shown high success rates when we talk about bancassurance model, which has contributed almost 35% to the premium income in the life insurance market of Europe. Whereas Spain, France, Belgium and Italy have respectively seen contribution of 65%, 60% and 50% to the life insurance premium.

Indian market has great potential for insurance companies when it comes to the rural front of the country. For setting u infrastructure and network to expand the business Insurance companies require great investment. In such a case bancassurance is better option available wherein insurance companies can without any investment in the infrastructure, market channels and advertisement do business. Insurance companies can directly target the potential customers by taking help of the customer database that banks share under the Bancassurance model.

In addition one of the issues which need clarification is that the interference and jurisdiction of authorities like RBI and IRDA. It would be much feasible and better to have a distinct regulatory authority which shall regulate the Bancassurance activities and deliver remedy in case of any grievance.

The bancassurance model is still in the budding stage in India, but the tremendous amount of growth and acceptance among the public within the short span of time reflects healthy future. After the insurance sector has been deregulated in India the phases of innovation in the distribution channels have started. In such a phase bancassurance is just one of those that has outshined others.

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