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Future of Bancassurance in Australia

Is Bancassurance really the ‘perennial underperformer’ that many believe?

pwc

Executive summary

Traditional universal banking is genuinely in a state of flux. While the societal purpose of banks may have strengthened, they are being subjected to increasing scrutiny by government. Consumer expectations are escalating while at the same time their ability to demonstrate competitive differentiation is abating. Digital is the next industrial revolution and banks are trying to determine how they unchain themselves from operating legacies that go back many, many years. The formula that has proved successful in the past – relatively stable ROA with asset accretion – is no longer viable.

In response, we have seen some banks making bold choices. At a global level, a number of large universal banks (those most exposed) have radically pruned their portfolios. Locally, a more forensic focus on core services has led some banks to question whether they should be in product manufacturing at all, as they seek to retreat from certain sectors or reduce costs in other ways. Productivity is again a primary concern, but this will be different – the focus will be service of the customer.

Multichannel and digitally connected experiences across channels will be the norm. We believe that the term 'bancassurance' in this context is outdated, but the notion of providing customers with easily accessible solutions that combine wealth management, banking and insurance is not. In today's open markets, customers expect to be able to readily access products that meet their needs. Increasingly this doesn't involve face-to-face transactions (as the traditional bancassurance models would suggest), but is more digitally enabled and omnichannel in design.

There remain significant customer needs that are not being met by current business models. These models must evolve to be better networked within a broader ecosystem as banks more actively focus on servicing their customers. They will need to use bank channels to deliver better customer solutions (encompassing banking, wealth management and insurance componentry) using insights that reflect a deeper connection to their customers.

In future, bancassurance will no longer be a business model, but rather a channel model. Wealth managers, banks and insurers will harness their data and analytical and digital capabilities to better address customer needs by effectively managing a multichannel distribution model.

1 Market context

The changing channel environment for wealth and insurance products is challenging existing strategic beliefs regarding the potential of bancassurance models in Australia. What is the bancassurance model of the future? Can bancassurance genuinely be an effective distribution channel and source of growth given its history? While there are a number of lessons to be learned from the chequered past of bancassurance models in Australia and internationally, it's also necessary to assess how the future landscape of financial services in Australia is likely to evolve, and the merit of this channel in growth agendas. We believe that the bancassurance channel does have merit as part of a multichannel strategy – particularly as it evolves to better meet customer needs.

Historically 'bancassurance' has been understood to mostly mean the sale of simple risk products (general and/or life) through bank distribution channels. In this paper, we have applied a more expansive definition that includes not only risk products, but also the distribution of wealth management products through bank channels.

Challenging times for financial services in Australia

We are witnessing big shifts in Australia across banking, life insurance and wealth management sectors.

Growth prospects are atrophying as traditional sources of value rapidly abate or disappear altogether due to macroeconomic, regulatory and customer pressures. Australian financial services offerings have become increasingly commoditised, with cost savings continuously passed on to the customer (a phenomenon we call the 'commodity trap').

Australian banks are now all looking to differentiate from their competitors by increasing their customer relevance to protect revenues and enhance growth prospects. Wealth management players continue to rely on asset accumulation to benefit from regulated system growth, while ignoring the rapidly approaching structural shift to asset decumulation (as high-value customer cohorts enter retirement) and margin compression (resulting from a migration from mature to contemporary products and fierce competition from low-cost providers, most notably the industry funds). Life insurance is growing at the headline level >8% CAGR making it an attractive growth vector, but factors such as volatility in sector profitability, the difficulties faced by large players in modernising their systems and improving customer experience, and ongoing reputational challenges are effecting the overall attractiveness of the sector.

Finding new sources of growth

Pressure on ROE will continue as industry players seek sources of growth beyond traditional integrated models

The market is increasingly viewing financial services companies as 'yield' stocks without a compelling growth story. Globally, many universal banks are refocusing on their core business by divesting themselves of other parts of their portfolio (e.g. investment banking, private banking). Capital requirements remain high. Additionally, more life insurers are turning to reinsurance as a solution and this is likely to take participation levels beyond global averages (currently 8% in Australia and 10–12% globally).

ROC expectations for life risk will need to be revised (from above 10% down to something in single digits) as offshore players with longer term investment horizons and ROC expectations increase their market participation. Businesses will look to refine their portfolios to refocus on sectors with stronger capital returns and less volatility (e.g. asset management, wealth management). Existing boundaries around portfolios will be stretched in an attempt to improve ROC – either by adjusting risk appetites or the ways in which markets, channels, customers and products are accessed.

Developing meaningful customer relationships

Majors will sharpen their focus on customer strategies

Customer capability maturity will only accelerate as customer plays become more differentiated. All banks have been actively employing customer-centric strategies for quite some time (rather than just talking about it), for example, implementing structural changes to enable customer functions to take on a stronger leadership role in the business. Industry players are now evolving their approach when it comes to understanding customer types and offering products tailored accordingly. Now they are starting to offer propositions relevant to certain life triggers or events.

Meaningful customer relationships are central to developing a competitive advantage. However, there remains a significant risk that compliance requirements will force organisations to redirect resources to addressing problems stemming from advice provided in the past, rather than transforming the way advice is delivered in the future.

Reimagining distribution

The face of distribution will be multichannel and network-driven

Access to distribution is key, but traditional participation models are being challenged. One possible source of value is to align manufacturing activities with differentiated customer solutions to create multiple margin opportunities, provided these activities add value to customers throughout the value chain. As wealth management players grapple with the cost of delivering advice, product manufacturing importance depends on basis for differentiation and how they want to deliver sustained value-add to customers. The pressure is on to either move up the customer value curve, or else increase automation of service delivery to reduce costs while alleviating compliance issues.

The more the regulator focuses on compliance (e.g. misspelling, quality of advice), the harder it will become for businesses to rely on traditional channels, resulting in additional pressure on channel performance. In order to compete, financial services players will need to make significant choices as to how project capital is allocated to channels to either increase or decrease the development of meaningful customer relationships. Some leading retail banks are majoring in digital, which may be smart in terms of a simplification agenda, but questionable from the perspective of developing meaningful relationships. Another bank is taking an approach that is far more biased towards relationship building by accelerating the development of an assisted/remote advice model while still backing face-to-face advice and a branch footprint.

The great unknown: political risk

The political risks in financial services are growing

While recent events in Canberra may have reduced the likelihood of a royal commission in the foreseeable future, we still may well see a significant step-up in political pressure on banking models – including vertical integration. It is entirely possible that regulatory and political changes will have a bigger impact on the future of banking in this country than any other factor.

2 *Learning from the past*

The bancassurance model has had a very chequered past. Around the globe, the participation model has been characterised by cycles of expansion and contraction for the last 40 years. Figure 1 outlines some of the more notable deals.

Figure 1 – Timeline of notable bancassurance deals

NOT EXHAUSTIVE

1970–1990	1990–2008	2008–2010	2010–2016
Organic growth as retail banks invest in insurance subsidiaries	**Inorganic growth as insurance conglomerates expand**	**Banks divest insurance divisions post GFC**	**Banks increasingly looking to partnership as part of their bancassurance model**
For example, BNP Paribas pioneers bancassurance, Banco Bradesco implements bancassurance for life and pension products under Bradesco Seguros, Credit Agricole creates Predica introducing bancassurance model, now France's 2nd largest life insurer.	For example, Credit Agricole Group acquires CA Vita, Citicorp and Travellers merge, Lloyds acquires Scottish Widows, Aviva acquires 50% RBS insurance arm in a bancassurance JV, but 2002–2005 Citigroup divests insurance arm citing inability to leverage bancassurance successfully in the US.	For example, ING divests international arms, including Latin American Assets; RBS opts out of Aviva JV but BNP expands with acquisition of Fortis.	For example, 2011 Zurich acquires 51% Santander's LatAM Insurance arm in JV. 2011–2014 Lloyds announces plans to double bancassurance profits, however abandons strategy in 2014. 2015 Manulife and DBS forms a 15-year distribution partnership. 2016 Aviva and RBC GI form 15-year distribution agreement.

The failures have been many and some have been big. In 2009, ING received a €10bn bailout conditional on the divestment of assets including its European banking and insurance arms. Jan Hommen, the outgoing CEO remarked: "Banking and insurance are two different dynamics. Banks are much quicker. Insurance is much slower. Insurance runs on a fifty-year life cycle. Banking runs on a five-year life-cycle." In 2011, Lloyds announced an aggressive bancassurance plan to double sales and profits within three years. In 2014, Lloyds ceased the sale of standalone life insurance products due to poor consumer uptake, opting to retain protection only as a bolt-on to mortgage applications.

In contrast, BNP Paribas Cardif has been actively pursuing a bancassurance strategy for over 40 years. BNP Paribas Cardif has a presence in 37 countries across Europe, Latin America and Asia, with a GWP figure of €24.3 billion in 2012 and approximately 10,000 employees. Aviva, a global insurer with the largest share of bancassurance partnerships (8.5% in 2013), is driving its continued growth through partnership agreements selected on the back of a rigorous capital allocation framework. Bradesco Seguros, Brazil's largest insurer and widely considered one of the most profitable bancassurers, has contributed around 30% of the group's earnings since 2010 from bancassurance.

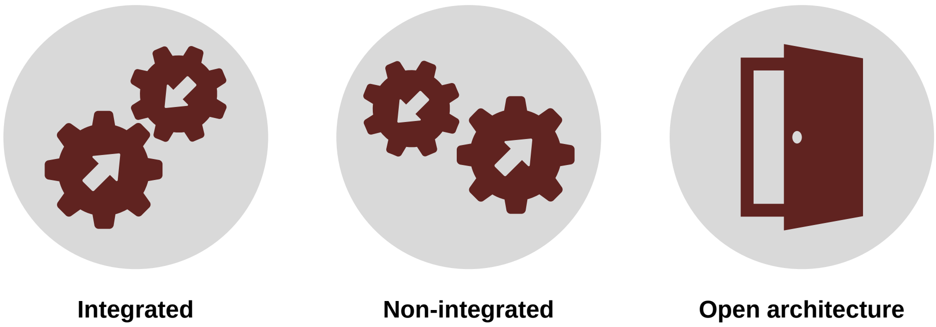
The past 10 or so years have shown that if the bancassurance channel is to provide growth:

- products should be simple and complementary to bank offerings – simple products gain more traction as they require less expertise to manufacture and distribute
- successful players need to serve their customer's financial services needs and avoid a product-centric sales approach
- investment in digital analytics is required to understand customer preferences to design campaigns and provide information in real-time during the sales conversation
- clear and pragmatic roles and responsibilities are required in partnerships to minimise conflict and friction as captive ownership is less common
- strong alignment is required at the senior level to leverage the capabilities of specialist providers, while a shared vision and strategy is required to deliver
- alignment of KPIs is critical to the long-term success of bancassurance partnerships.

The three levels of bancassurance integration

In preparing this paper we considered the bancassurance position of the largest banks in the world and other relevant case examples. Figure 2 (overleaf) provides a list of the cases considered.

Bancassurance models around the world have three distinct levels of integration:



Integrated models are characterised by deep integration of insurance and wealth management activity with the bank's processes (either through fully owned share purchases or joint ventures) and involve cooperative product manufacturing and distribution. Financial products are distributed by bank employees and a premium is usually collected by the bank directly from customers' bank accounts. Such models are often seen in Europe, as well as Brazil and Hong Kong.

Semi-integrated models are those that involve integration with some but not all channels. A growing number of partnerships are looking for ways to provide customers with seamless transitions between providers – using an expanding digital backbone underpinning customer experience and multichannel environments – while still enabling each party to maintain operational freedom.

Non-integrated models involve separation of distribution and manufacturing functions and are often used in regulatory environments that do not allow integrated models. Products are typically exclusively distributed through a network of financial advisers set up by the bank. Non-integrated bancassurance models are typical for northern Europe and the UK.

Open-architecture models are used when banks hold minor equity stakes in insurers and limit their role to distribution, but are not bound by exclusive distribution agreements, allowing them to offer multiple products from a range of providers. Such bancassurance models are common in Asia.

Figure 2 – Largest banks by region and largest global bancassurers 2014

US & Canada

1. JPMorgan Chase
2. Bank of America
3. Citigroup
4. Wells Fargo
5. Goldman Sachs

Spain[1]

1. Banco Santander
2. BBVA
3. La Caixa
4. Bankia
5. Banco Popular

France[1]

1. Credit Agricole
2. BNP Paribas
3. Group BPCE
4. Societe Generale
5. Credit Mutuel

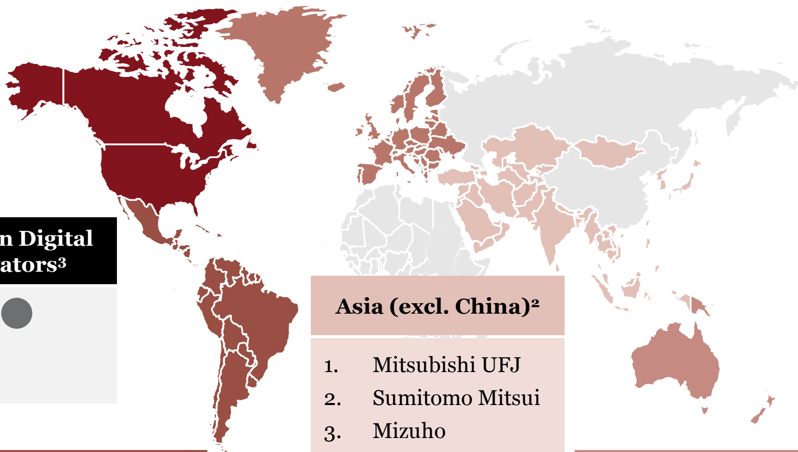
Rest of Europe

1. HSBC
2. Barclays
3. Deutsche Bank
4. RBS
5. Lloyds

Largest Global Bancassurers

1. Aviva
2. Zurich
3. Allianz
4. Prudential
5. Ageas
6. AXA
7. Mapfre
8. CNP Assurances

>10. Nippon



Additional Known Digital Banking Innovators[3]

1. Charles Schwab
2. USAA
3. Nordea

Asia (excl. China)[2]

1. Mitsubishi UFJ
2. Sumitomo Mitsui
3. Mizuho
4. Norinchukin Bank
5. DBS

Latin America

1. Itau Unibanco
2. Banco de Brasil
3. Banco Bradesco
4. Caixa
5. Banco BTG Pactual

Given distinct Japanese operating environment and materiality of Nippon & NAB partnership, additional Japanese players deprioritised

Australasia

1. CBA
2. NAB
3. ANZ
4. Westpac
5. Macquarie

Legend

A bancassurance implementation from corporate used as case study

A partnership implementation from corporate used in case study

Notes: Banks as measured by Tier 1 capital. Bancassurers as measured by % share of bancassurance partnerships.

[1] *Spain and France separated from the rest of Europe due to the significant influence of their banking groups globally and high bancassurance penetration.*

[2] *China excluded due to prevalence of disparate commoditised partnership models; transaction-oriented and commoditised collaborations lead to price competition.*

[3] *List of known digital banking innovators based on past Strategy& client work on customer-centric strategies.*

Source: The Banker, Finaccord, Strategy& analysis.

There are key lessons to be learned from similar regulatory and operating environments:

- Bancassurance is no longer only face-to-face, as online and mobile banking growth enables greater customer access (Credit Agricole, BBVA).
- Banks often own the customer relationship given the frequency of their interactions with customers, however non-traditional partners are entering new alliances where the customer ownership model varies (Ageas, BNP Paribas and bpost).
- Often the degree of partner integration is positively correlated with the level of success (ASB, Nordea, USAA), but comes with the peril of managing for shared interests across stakeholders to create shared value.
- More recently at Zurich, the commercial mid-market segment has shifted from relationship-driven decisions towards data-driven decisions, leading brokers and competitors to invest heavily in predicative analytics. In retail, new technology and customer experiences are changing customer expectations.

- In the Zurich-Santander partnership, the Zurich product set has an integrated front-end with Santander's online bank account, while Mapfre and Bankia are investing in the same front-end capability to enhance the user experience.

Greater digital integration leads to better partnerships

The evolution of digital technology and data analytics has created a new operating model for the delivery of bancassurance.

Partnerships are more likely to be joint ventures or strategic alliances (similar to the approach used by NAB, Zurich and Manulife), rather than captive. They are also generally one-to-many rather than exclusive. The go-to-market plan no longer relies on face-to-face delivery. Companies are recognising the criticality of investment in digital technology and innovation to enable seamless front-end and back-end integration, omnichannel experiences and organisational flexibility. For example, Manulife and DBS are investing $100 million over 15 years in digital and technology innovation on a $1.2 billion transaction, while NAB is investing a significant share of the $300 million from the sale of MLC in its digital capability build.

Growing customer demand for digital capabilities has allowed more tech-savvy players to bring out increasingly compelling customer value propositions. Sophisticated data capture and use creates opportunities for greater customer understanding and customised service provision.

Greater integration of IT capabilities between partners leads to a more successful partnership. Greater front-end and back-end integration means customer data can be better leveraged to provide a more tailored and timely experience. Data analytics capabilities, including shared customer data and agile product architectures, allow for the sale of increasingly complex offers by providing more targeted and timely insights into an individual customer's needs and customer relationships, while also contributing to the personalisation of customer experiences. Importantly, organisations need to understand how they can work within privacy constraints on data sharing.

Sharing assets increases capabilities

Partners are increasingly sharing assets (distribution networks, platforms, CRM systems) and, in some cases, are even co-designing assets to leverage complementary capabilities.

Using shared assets has enabled partners to maintain a focus on core business while gaining access to distribution channels or capabilities. Exemplars are sharing assets on both an exclusive and non-exclusive basis. Customer analytics is considered a valuable asset as its own capability. Increasingly, the use of data providers, data specialists and data aggregators is broadening access to quality information sources and leading to enhanced data analytics capabilities. Technology advancements are now providing access to channels and customer segments previously considered unprofitable.

Working efficiently in a multichannel environment

Channel integration and a multichannel approach are central to improving success.

Companies should consider opportunities to leverage external partner capabilities to build distribution channel capabilities. Channels must be integrated and conflicts between channels avoided.

It is important to establish product economics and commercial arrangements between distribution and manufacturing that support a multichannel environment. Reward structures for sales staff should be consistent between channels and the organisational culture should support shared gain.

The role of the branch

We have seen a significant change to the role of the physical branch in recent years, as online and mobile banking options have greatly decreased the number of branch-initiated transactions. Although the current trend in Australia may be flat – between 2001 and 2014 the total number of branches decreased by less than 100 – there is substantial potential to reinvent the role of the branch in a multichannel strategy.

As day-to-day transactions continue to migrate online, and the amount of cash in circulation in the Australian economy decreases, customers are primarily using branches for more complex, sales-related transactions (e.g. home loan applications, requests for investment advice) that typically require face-to-face interaction and the credibility of a branded retail location. For example, according to one major Australian mortgage broker, 80% of its top-performing franchisees operate from a branded retail shopfront.

This trend can be viewed by bancassurers as either a threat or an opportunity. On one hand, a reduction in branch numbers creates revenue risks, as players will continue to rely on access to branches as their primary distribution channel and seek to grow them in their networks. On the other hand, a shift to sales-related in-branch activities could result in a greater uptake in insurance and wealth product sales, while the increased digitalisation of transactions will create opportunities for offering insurance and wealth management products as a convenient add-on to other products and services offered online. Globally, bancassurers are already working with banks to migrate their offers online. For example, Allianz is bringing proprietary digital sales platforms into its partnership with Maybank to drive online product sales, while Zurich is integrating its products into Santander's online platform.

Capital One in the US is another example of a radical change to branch strategies. Between 2012 and 2015, in a response to its customers becoming increasingly used to a digital experience, Capital One decreased the number of branches from 920 to 800. Branches were assessed on a case-by-case basis, as it was found that in some geographies the bank's customers preferred regular visits to their local branch over a more predominantly digital experience, resulting in fewer closures than originally intended. The bank's overall goal is to adapt its retail distribution strategy to a new customer demographic that is less dependent on cash and more interested in digital offerings. To achieve this, Capital One has been decreasing the number of branch personnel (e.g. tellers) in favour of new, advanced function ATMs. It is also retraining staff to resolve customer issues by steering them to the bank's website, and is even opening café-style branches where customers can buy coffee while getting help from bank employees.

Capital One is not the only bank reinventing the branch space. A number of banks globally are executing similar strategies – JPMorgan Chase in the US, Barclays Bank in the UK, and Citibank in multiple geographies including Europe and Asia. All these players have reduced their existing branch networks and revamped the ones they choose to retain with a goal of decreasing the average branch size, employing fewer personnel and using technology to enable customers to resolve most of their requests via advanced ATMs and kiosks.

3 'Good growth' in the more integrated models

The more integrated bancassurance models are often viewed as having both advantages and disadvantages for the industry. On the one hand, players applying such models could develop and apply 'good growth' strategies more seamlessly than their counterparts. These strategies should see them being able to leverage their extensive data and analytics capabilities to execute a more integrated, needs-based and coherent customer experience. As a result, they have the potential to improve consumer trust and confidence, contributing to overall efficiency of the financial services sector and the wider economy.

On the other hand, these more integrated models might be seen to be misaligned with customer and national interests, by decreasing the number of independent players in industry and reducing competition – resulting in less incentive to respond to customer needs and possibly delivering outcomes that are not in customers' interests.

Achieving 'good growth' in integrated models requires executing strategies that align capability development with leadership and behaviours. In doing so, companies are maximising value for all stakeholders, including customers, employees and society in general. Companies that respond equitably to customer needs while staying within today's social norms and regulatory expectations significantly outperform their counterparts over the long term – both in terms of share performance and accounting results – while creating valuable social capital.

Increased digitalisation for bancassurance

If the regulator decides to be more aggressive in challenging the role of banks, their business models will be brought further into question. The banks themselves are trying to reinvent the role of the branch as they redefine their model. Some see the branch as a destination for sophisticated selling as distinct from a location for basic customer banking transitions.

As banks challenge their models, the potential to open up networks and redefine how distribution is managed will cause businesses to question once more where margins are going to accrue along the value chain.

The key question: Which players in the Australian marketplace have the differentiated capabilities to overcome the execution challenges of the bancassurance model of the future to drive growth?

The winners in Australia will be those able to take delivery of customer needs to the next level. They will achieve a successful integration of banking, wealth management and insurance, while continuing to innovate in potentially higher margin retirement income products by refining their life insurance capabilities. We expect the industry super funds to increase the vertical integration of their model. We also expect all major players to more effectively leverage their differentiated capabilities (e.g. solution design, pricing, customer analytics), although this will potentially involve different forms of participation across the value chain.

Bancassurance has a genuine role to play in meeting customer needs. Provided financial services companies clearly understand how this channel fits within their broader, multichannel strategy, then bancassurance can be a valuable part of their growth strategies. However, if bancassurance is to move on from its past reputation as the model that constantly underperforms, then the model for the future will need to be different. It will need to be more digital, more intuitive, and more seamlessly integrated into the banking relationships and experiences of the customer. And finally, it will need to be truly demand driven.

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